THE COALITION FOR 21ST CENTURY PATENT REFORM

Protecting Innovation to Enhance American Competitiveness

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Prepared Statement of Philip S. Johnson,
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On Behalf of the
Coalition for 21st Century Patent Reform

Before the

Committee on the Judiciary
United States Senate

On

"Protecting Small Businesses and Promoting Innovation by Limiting Patent Troll Abuse"

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Executive Summary

Mr. Chairman and distinguished Members of the Judiciary Committee: Thank you for the opportunity to testify on the subject of "Protecting Small Businesses and Promoting Innovation by Limiting Patent Troll Abuse."

Although I am active in a number of professional organizations with interests in patent law reform, including the American Intellectual Property Law Association, PhRMA, BIO and the Intellectual Property Owners Association, I am testifying today as a representative of the Coalition for 21st Century Patent Reform ("21C").

In the view of our Coalition, patent troll abuse involves the use of court proceedings, or threats of them, to press specious patent claims or defenses for the purpose of coercing settlements driven solely by the desire to avoid litigation costs. Such practices can be perpetrated by any litigant who is so inclined, and while the effectiveness of the tactic will vary based upon the parties' circumstances and means, the identification of the abuser turns not on who the party is, but rather how they behave.

The problem of patent litigation abuse is not new to the patent system, or to this Committee. You devoted a great deal of attention to the problem while developing the Leahy-Smith America Invents Act ("AIA"), and have already gone a long way towards giving the courts and the USPTO the tools they need to address the problem. Open and transparent patentability criteria, enhanced USPTO funding, the establishment of new post grant and inter partes review proceedings, limitations of joinder in patent suits, elimination of non-competitor false marking suits, and the pilot patent courts bill have given the USPTO and the courts important new weapons that they are now just beginning to employ. Nor is Congress acting alone, as the courts themselves have handed down a series of constructive decisions starting with the elimination of automatic injunctions in patent cases, rulings addressing overbroad patents, especially in the software and business method fields; and new precedents that reign in speculative damages awards, particularly when the infringing component is part of a much larger system. In addition, the Federal Judicial Conference is now very active proposing reforms to procedural rules relating to pleadings and discovery in patent cases, particularly to address cases where discovery burdens are asymmetrical.

This is not to say that everything that can be done to stop abusive patent litigation practices has been done. One promising proposal in S. 1720 (the Leahy-Lee Bill) would automatically stay patent suits against off-the-shelf distributors, retailers and end users who are doing no more than using purchased products in the manners instructed by the manufacturers, in favor of suits joined or separately brought by manufacturers or suppliers to resolve the issues. The Leahy-Lee Bill would also improve transparency of patent ownership, correct an error in the AIA relating to the estoppel to be applied in post grant reviews, direct the USPTO to follow the same claim construction rules as applied in the courts and ITC, and codify the rule of double patenting for first-inventor-to-file patents, all of which should improve the effectiveness of our patent system. In addition, the Leahy-Lee Bill proposes to stem the use of bad faith demand letters by authorizing the FTC to treat them as unfair and deceptive trade practices. With further development to address preemption, free speech and safe harbor issues, we see this as a promising approach for dealing with this aspect of the patent abuse problem.

Until recently I would have added to this list of remedies the modified attorney fees shifting proposal by Senator Cornyn in S. 1013 or Senator Hatch in S. 1612, but because the Supreme Court has recently granted *cert* in two cases to address patent fee shifting, Congress should probably wait for the Supreme Court to decide these cases before revisiting this subject. But whatever the Supreme Court decides, problems will remain when plaintiffs are structured as shell corporations so that they can bring specious suits knowing that they have insufficient assets to satisfy any fee awards they might incur. Of the three approaches suggested to address this aspect of the problem – joinder, bonding or legal recourse against persons with a financial interest in the proceeds of the suit -- our Coalition favors the third. Treating this aspect of the problem as the collection issue it is will preserve free access to the courts, not disrupt good faith patent assertions, and be the most difficult for abusers to avoid.

Other proposals relating to heightened pleading standards, mandatory stays of discovery pending *Markman* rulings, and the specifics of managing discovery in patent cases, while well intended, are unworkable in their present forms, and should be referred to the Federal Judicial Conference for further development. While there is clearly room to improve pleading practices in patent cases, to depart from the general principles of notice pleading by requiring plaintiffs to plead both their contentions and their supporting evidence will bog these cases down at their outsets. Nor does 21C favor imposing mandatory discovery stays pending *Markman* rulings, leaving little or no discretion to the courts as to what is right for each particular case. Such an approach would serve as an open invitation to copyists to enter the U.S. market safe in the knowledge that patent actions brought against them will come to a virtual standstill for an extra year or more while the parties wrangle over the meanings of patent claim terms. In the meantime, manufacturers' market shares, and the jobs they support, will shrink as the as the infringement continues.

Finally, especially now that the Supreme Court has agreed to hear an overall challenge to the patentability of computer-implemented inventions, 21C believes it would be best to table Senator Schumer's proposals in S. 866 to expand and extend the transitional program for financial sector business method patents.

The innovation ecosystem in the country is extremely sensitive to changes in our patent system. While troll abuse is a problem that should be addressed, it is critical that Congress not do so at the expense of the vast majority of innovation stakeholders for whom the patent system is working. Proposals that deprive patent owners of free access to the courts and/or delay or make less certain the availability of relief from the harms caused them by infringers should be avoided even, if necessary, at the expense of accepting less than a complete solution for troll abuse. With the help of this Committee, our country has come a long way by enacting the AIA and the pilot patent courts bill, which are only now being fully implemented. Let's move forward with remedies that are sharply focused on abusive behaviors, while exercising restraint as to those which may have broader ramifications on the innovator community, and our economy as a whole.

Prepared Statement of Philip S. Johnson

I. Background

The issue of litigation abuse in patent cases is not a new one. During the public debate that followed the 2004 recommendations of the National Academy of Sciences, both the Supreme Court and the Federal Circuit handed down important decisions that addressed the criticism that the system favored the assertion of vague or overly-broad patents by non-practicing patentees (or non-practicing entities, referred to as "NPEs"). These decisions restricted the availability of patent injunctions to NPEs[1], mandated transfer of patent cases to more convenient and potentially less NPE- friendly jurisdictions[2], clarified that damages may be awarded based only on the value of an invention rather than on an entire system in which the invention is only a small component[3], strengthened the written description and enablement requirements to ensure that overly vague and ambiguous patents will not be upheld[4], and clarified that innocent infringers should not be subjected to treble damages[5].

In January of 2011, Congress also addressed patent litigation concerns by passing the pilot patent courts bill to establish a ten year program to test the concept that patent cases can be better and more efficiently managed, and abuses deterred, if they are handled by district court judges who preside over a large number of them. This initiative is now being implemented, and is already yielding fruit in the form of a number of proposals for courts to limit the amount and cost of discovery in patent cases and to actively manage them to deter and/or punish litigation abuse.[6]

Perhaps most significantly, Congress acted again in September of 2011 by passing the Leahy-Smith America Invents Act ("AIA")[7], which included further provisions, some now just going into effect, that are designed to lessen the opportunity for abusive patent litigation conduct. This act made the criteria for patentability more transparent in a first-inventor-to-file system, authorized the public to participate in the patent examination process and increased funding for the United States Patent and Trademark Office (USPTO), all to improve the quality of future issued patents. As importantly, this Act created several new procedures that allow members of the public, including those who are being sued for infringement, to quickly and inexpensively challenge a patent's validity before a panel of administrative law judges in the USPTO. This act also effectively eliminated opportunistic false marking suits, mandated that patent

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[1] *eBay, Inc. v. MercExchange*, LLC, 547 U.S. 388 (2006).
[2] *In re TS Tech Corp*., 551 F.3d 1315 (Fed. Cir. 2008).
[3] *Lucent Technologies, Inc. v. Gateway, Inc.*, 580 F. 3d 1301 (Fed. Cir. 2009).
[4] *Ariad Pharmaceuticals, Inc. v. Eli Lilly and Co*., 598 F.3d 1336 (Fed. Cir. 2010) (*en banc*).
[5] *In re Seagate Tech.*, LLC, 497 F.3d 1360, 1371 (Fed. Cir. 2007), *cert. denied*, 2008 U.S. LEXIS 2153 (2008).
[6] *See* Patent Cases Pilot Program, Pub. L. No. 111-349, 124 Stat. 3674; District Courts Selected for Patent Pilot Program, Admin. Office of the U.S. Courts (June 7, 2011) (available at: http://www.uscourts.gov/News/NewsView/11-06-07/District_Courts_Selected_for_Patent_Pilot_Program.aspx).
[7] Pub. L. No. 112–29.
[8] 35 U.S.C. 285.
[9] See *Marctec LLP v. Johnson & Johnson and Cordis Corporation*, 664 F.3d 907, (Fed. Cir. 2012) (awarding $4.7 million in attorney and expert witness fees against an NPE). For 2011, *see also* the cases listed at items 38 & 39 at www.patstats.org/2011_Full_Year_Report.html.

plaintiffs could no longer indiscriminately join unrelated parties in a single law suit, and provided for a further study by the GAO of issues relating to NPE patent assertions.

As Congress recognized in authorizing a study into the litigation conduct of NPEs, little empirical evidence existed confirming or refuting the complaints that NPEs bring a disproportionate percentage of specious patent suits. Unfortunately, the advancement of specious claims or defenses has always been a part of patent litigation, and can be perpetrated by any party, if so inclined. Fortunately, courts already have the power to award attorney fees in exceptional patent cases[8], but, in our experience, they are unwilling to do so unless a party engages in clearly reprehensible litigation conduct[9].

On March 14, 2013, our Coalition testified before the Subcommittee on Courts, Intellectual Property and the Internet, of the House Judiciary Committee at a hearing entitled "Abusive Patent Litigation: The Impact on American Innovation & Jobs, and Potential Solutions." At that time we agreed that more could be done to address abusive patent assertion tactics, and suggested that two of the additional remedies that had been considered but not adopted during the consideration of the AIA --- lowering the standard for fee shifting so it is easier for judges to award fees to a prevailing party and automatically staying suits against customers and users where the original provider of the product or service accused of infringement elects to bring suit to resolve the issue with the patentee --- could be developed further to address the problem.[10] At the same time, our Coalition warned that any provisions directed at entire classes of patent litigants would be neither fair nor effective, and would run the risk of chilling activities, such as the investment in research and development, which are important to our economy and to the creation of jobs. Accordingly, we urged that such remedies be targeted only at the offending conduct, and that they not impinge upon legitimate patent licensing and enforcement activities.

Our Coalition also recommended legislative restraint, as most of the provisions of the patent pilot courts bill and the AIA were still in the process of being implemented, the impacts of several important judicial decisions addressing the issues had yet to be fully appreciated, and the AIA commissioned GAO study had not yet been issued[11]. Our Coalition warned that Congress has already gone a long way toward fixing the problem of patent litigation abuse, and that to improvidently modify the system at this time would run the risk of chilling innovation, and the jobs that flow from it, by making reliable patent enforcement substantially less certain.

On March 15, 2013, the USPTO fee increases authorized by the AIA went into effect. At that time, the IP community, which had supported these increases, understood that, as promised, the additional funds generated from these increases would be available for use by the USPTO to implement the AIA and to improve the quality of patent examination.[12] However on April 11, 2013 the IP community learned that the OMB had determined that, even though copyright fees would be qualified as exempt from sequestration as voluntary payments, patent fees would not be. The result was that the USPTO would be denied the use of about $148 million in fiscal year 2013, causing the cancellation of a number of important initiatives, and delaying many others.

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[10] At that time, we also suggested several technical corrections to the AIA to correct certain estoppel and claims construction issues to improve the fairness of the AIA's post-grant proceedings.
[11] The GAO Report subsequently issued on August 22, 2013; *see* n. 17 infra.
[12] It was then widely thought that USPTO fees would be exempt under Section 255 of the Budget Control Act ("Paygo") as funding activities supported by the voluntary payments of the public for goods or services, and that the funding provisions of the AIA would ensure that fee revenues would be spent by the USPTO to improve the quality of patent examination.

In June of 2013, Price Waterhouse Coopers ("PWC") released its annual study of patent litigation activity, covering 1995 through 2012. This empirical study reports that the rate of patent litigation remains closely correlated to the number of patents issued by the USPTO[13], and that the recent sharp increase in case filings is due to the temporary rash of false marking cases (since abolished by the AIA) and to the AIA's requirement that unrelated defendants cannot be joined in a single action.[14] Over the past five year period, practicing entity patent holder success rates in litigation are reported by PWC to be 38% vs. 24% for NPEs, due largely to the fact that courts grant summary judgment against NPEs more often than against practicing entities.[15] Since PwC categorized universities and non-profits as NPEs in this study, their 45% success rate in court means that for-profit NPEs and individuals collectively experienced an even lower success rate.[16]

In August of 2013, the GAO issued its long-awaited study entitled, "Assessing Factors That Affect Patent Infringement Litigation Could Help Improve Patent Quality," in which it reported that between 2007 and 2011, about 80% of all patent suits are brought by manufacturers, individual inventors and universities, and that NPEs and "likely PMEs" accounted for about 19% of these suits.[17] The GAO noted that while there was a steep rise in the number of PAE suits brought in 2011, the increase in that year was likely the result of anticipating the enactment of the AIA, which contained provisions requiring that fewer defendants be joined in a single suit, thus requiring that more suits be brought.[18]

On October 29, 2013, the House Judiciary Committee held a hearing to receive testimony on H.R. 3309, and other proposed bills that were then pending in the House. At that hearing, former USPTO Director David Kappos summarized the effect on the patent system of withholding access to the user fees paid to the USPTO:

> Before turning to H.R. 3309, the most important point I will make today – the most important by some wide margin – is that Congress simply *must* ensure full funding of the USPTO. Less than 2 years after passage of the AIA and all the accompanying focus on USPTO user fee diversion, we found ourselves again looking at an Agency having its lifeblood, the user fees that come with all the work asked of USPTO by American innovators, drained away. I simply cannot overstate the destruction this is causing, as the work remains without the funding to handle it, creating an innovation deficit that will require future generations of innovators to pay into the Agency again in hopes their fees can actually be used to undertake the work for which those fees are paid. Nor will it be possible for the USPTO to accomplish the mandates of the AIA, much less the added responsibilities contemplated by parts of H.R. 3309, without access to the user fees calculated to meet those challenges. The USPTO is making progress in improving examination rigor, patent quality, and reduction of its backlogs. But none of this will continue, and backsliding is inevitable, unless full user fee access is provided to the Agency. Full fee access must be job one.[19]

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[13] 2013 PWC 2013 Patent Litigation Study, at Chart 1, pg. 6, noting a 96% correlation since 1991, available at http://www.pwc.com/en_US/us/forensic-services/publications/assets/2013-patent-litigation-study.pdf
[14] *Id.*
[15] *Id.* at 13 and Chart 5d.
[16] *Id.* at 26 and Chart 10b.
[17] "Intellectual Property: Assessing Factors that Affect Patent Infringement Litigation Could Help Improve Patent Quality" (GAO-13-465 Patent Litigation), August 22, 2013, at page 17. See http://www.patentdocs.org/2013/08/the-gao-issues-a-report-on-patent-litigation-trends-it-turns-out-that-the-sky-is-not-falling.html.
[18] *Id* at page 14.
[19] Testimony of David J. Kappos, House Judiciary Committee of October 29, 2013, at pg. 2, available at https://judiciary.house.gov/hearings/113th/10292013/Kappos%20Testimony.pdf; *see also* testimony of Robert

Although not currently addressed in any legislative proposals pending in the Senate,[20] our Coalition, and likely all of the stakeholders testifying today, wholeheartedly agree with Mr. Kappos.

Between March and December of this year, a number of discussion drafts and bills were introduced in the House that eventually led to the passage of the Innovation Act (H.R. 3309), on December 5, 2013. The provisions of this bill fall into seven main categories: (1) attorney fees shifting to prevailing parties and related provisions to ensure their collections, (2) stays of patent suits against customers and end-users in favor of those against manufacturers and suppliers, (3) disclosure requirements of real-party-in-interest information by patent asserters, (4) heightened pleading requirements for complaints in patent cases; (5) discovery management requirements for patent cases, (6) recommendations of procedural proposals for consideration by the Federal Judicial Conference, (7) technical fixes to the AIA, and (8) miscellaneous provisions.

Within this period, the Senate was also active, with a number of bills being introduced by Senators Schumer (S. 866), Cornyn (S. 1013), Hatch (S. 1612), and Leahy-Lee (S. 1720) to address different aspects of the perceived problem. Our Coalition is pleased to have been part of the process leading towards the development of this legislation, and appreciates the opportunity to present this testimony on the various provisions now under consideration in the Senate.

II. Personal/Corporate/Coalition Introduction

By way of personal introduction, I am a registered patent attorney with 40 years of experience in all aspects of patent law. In addition to drafting and prosecuting patent applications, I have tried patent cases to both judges and juries, and have advised a wide variety of clients, both plaintiffs and defendants, in many industries ranging from semi-conductor fabrication to biotechnology. Over the course of my career, I have represented individual inventors, universities, start-ups, and companies of all sizes. In January of 2000, I left private practice to join Johnson & Johnson as its Chief Patent Counsel, where I now serve as Senior Vice-President and Chief Intellectual Property Counsel in its law department.

Johnson & Johnson is a family of about 275 companies, and is the largest broad-based manufacturer of health and personal care products in the world. Collectively, Johnson & Johnson companies represent this country's largest medical device business, its sixth largest consumer, nutritional and personal care business, and one of its largest pharmaceutical and biotechnology businesses. Johnson & Johnson companies employ approximately 128,000 people. Johnson & Johnson's companies are research-based businesses that rely heavily on the U.S. patent system and its counterpart systems around the world.

The 21C is a broad and diverse group of nearly 50 corporations, the Steering Committee of which includes 3M, Caterpillar, Eli Lilly, General Electric, Procter & Gamble and Johnson & Johnson. For more than 100 years, our Coalition's companies have played a critical role in fostering innovation. We invest billions of dollars annually on research and development to create American jobs and improve lives. Representing 18 different industry sectors including manufacturing, information technology, consumer products, energy, financial services, medical device, pharmaceutical, and biotechnology, our Coalition advocates for patent reforms that will foster investment in innovation and job creation and promote vigorous competition in bringing new products and services to American consumers.

Armitage, House Judiciary Committee hearing of October 29, 2013 at pg. 3, available at https://judiciary.house.gov/hearings/113th/10292013/Armitage%20Testimony.pdf.

[20] *But see* H.R. 3347, the "Innovation Protection Act," (Conyers), available at http://www.gpo.gov/fdsys/pkg/BILLS-113hr3349ih/pdf/BILLS-113hr3349ih.pdf.

As the manufacturers and marketers of thousands of products, the freedom to make and sell products in view of the patents of others is always a concern to our Coalition's members. And even though we routinely review thousands of patents during our product development processes, make appropriate design changes to avoid the patents of others and/or obtain appropriate licenses or legal opinions prior to launching our products, we nonetheless must defend our companies against charges of patent infringement. Most of these litigations involve competitors or would-be competitors, although many involve non-manufacturing patentees. Overall, Johnson & Johnson's companies find themselves to be defendants about as often as plaintiffs.

The 21C's interest in patent law reform is to ensure that the patent system fairly rewards those who contribute to our society through the invention and development of new and useful products and processes. A fair, efficient and reliable patent system will continue to stimulate the investment in innovation that is necessary in today's technologically complex world to create the new products and processes that will lead to better lives for Americans and the rest of the world. In addition, the best promise for preserving and enhancing our place in an increasingly competitive global marketplace will be to stimulate U.S. investment in research by universities and small and large companies.

III. The Relationship Between Patent Litigation, Innovation and Jobs

A. The Relationship Between Patent Protection, R&D Investment and Patent Enforcement

To enhance the objective of maximizing R&D investment and its attendant creation of jobs, it is incumbent on the courts to effectively enforce meritorious patents against those who are infringing them, while weeding out specious claims that act as drags on the system. For those wishing to deter the assertion of specious claims, the challenge is how to deter only those claims that are specious without deterring those worthy of serious consideration by the courts.

As reflected by the recent passage of the AIA, there is bipartisan agreement that a strong and efficient American patent system will stimulate investment in R&D, and lead to the preservation and/or creation of millions of jobs. As Senator Leahy has explained:

> High quality patents are the key to our economic growth. They benefit both patent owners and users, who can be more confident in the validity of issued patents. Patents of low quality and dubious validity, by contrast, enable patent trolls and constitute a drag on innovation. Too many dubious patents also unjustly cast doubt on truly high quality patents.
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> Innovation and economic development are not uniquely Democrat or Republican objectives, so we worked together to find the proper balance for America--for our economy, for our inventors, for our consumers.
>
> Thomas Freidman wrote not too long ago in The New York Times that the country which "endows its people with more tools and basic research to invent new goods and services [] is the one that will not just survive but thrive down the road. . . . We might be able to stimulate our way back to stability, but we can only invent our way back to prosperity."

10 Cong. Rec. S131 (January 25, 2011) (statement of Senator Patrick Leahy)

This focus on economic growth is the correct one. If done right, patent reforms will stimulate the private sector to invest in economic development and job growth. All other considerations should be secondary.

Johnson & Johnson's companies are good examples of the relationship of the patent system, and patents, to jobs and job growth. Johnson & Johnson conservatively estimates that at least 65,000 of its full time jobs depend on the patent portfolios of its companies' ten thousand U.S. patents (and their foreign counterparts). Stated differently, we now estimate that, on average, each U.S. patent results in, preserves and protects the jobs of 7.2 employees per year, or, over its 20-year life, 144 job-years. This estimate does not take into account the jobs of countless others at suppliers, distributors and retailers involved in the research, manufacture, distribution and sale of our products that indirectly depend in whole or in part on our patent rights.

Johnson & Johnson companies invest about $8 billion on research and development ("R&D") yearly, and are awarded about 1,000 U.S. patents yearly protecting the inventions that result from these investments. Our operating companies therefore spend about $8 million on R&D for each patent obtained. Needless to say, these research and development expenditures result in the direct employment of thousands of people throughout the United States in very good jobs with excellent benefits. Without the promise of reliable patent protection, only a small fraction of this expenditure would be made.

As these numbers would suggest, the costs directly associated with the enforcement of patents and the defense of patent suits brought by others against our companies represents a very small fraction of the cost of R&D we conduct. Nonetheless, the amount of R&D investment itself is very sensitive to changes in the patent enforcement climate; a primary consideration in deciding whether patent laws should be changed is what effect they may have on R&D investment, and thus jobs and job growth. Proposed changes that increase the likelihood that meritorious inventions may be reliably enforced against infringers should be favored, as these changes will have the greatest impact on stimulating R&D investment and job growth. Those that might discourage inventors from bringing meritorious claims of patent infringement should be viewed with a critical eye.

Research based companies are rational decision makers when it comes to deciding whether and how much to invest in R&D. When deciding whether or not to make, or to continue making, an investment in any given project, many factors are taken into account, including the cost of the project, the technical risk and likelihood of success of the project, the expected cost saving or product enhancement to be achieved, and the expected return on investment. In determining the expected return on investment, a critical element is the likelihood that meaningful patent protection will be accorded to deserving inventions resulting from the project, the degree and duration of exclusivity that resulting products or processes will enjoy, and the likelihood that the involved patents will either be respected by competitors, or can be promptly and successfully enforced in the event of infringement. When such projections indicate that the return on investment exceeds a threshold commensurate with the risk involved, the investment is, or continues to be, made. When it does not, the project is not begun, or is cancelled.

It is a common misconception that a patent for an invention confers a right on the patent owner to make, use or sell products embodying the invention. This is not true. A patent confers only the right to exclude others from doing so for the limited term of the patent. If patents in a given field are seen to be too expensive to enforce in relation to the value of market exclusivity they protect, they lose their value, and investment in inventions in that field is chilled. Accordingly, there is a delicate balance between the cost of patent enforcement and the impact of the patent system on R&D investment.

Another important factor that impacts R&D investment is the perception of the business community of the reliability of patent enforcement. Patents will not stimulate R&D investment and job growth unless they are perceived to be readily enforceable. If the courts and/or USPTO post grant review procedures are perceived as hostile to patent rights, our patent system will suffer. A patent that cannot be enforced is a hollow right.

As important as patent enforceability is to inventors and developers, it is the ability to ultimately profit from their inventions that induces and rewards R&D investment. For manufacturers, the ability to commercialize their inventions free from specious legal claims and the legal expenses needed to successfully defend against them is a significant consideration. For non-manufacturing patentees, the consideration is similar, as the values of their patents depend upon their existing or future licensee's ability to market their inventions.

As previously noted, most manufacturers mitigate the risk of being sued for patent infringement by searching the patent literature during product development, and either designing around existing patents of others, or acquiring rights to them by purchase or license. Nonetheless, even the most diligent of these "freedom to operate" studies cannot identify every possible future patent claim. This is especially true for specious claims that are based upon patents that are asserted against products or processes that cannot be argued reasonably to be within the scope of the invention claimed in the patent.

B. <u>Non-Practicing Entities and the Importance of Freely Transferrable Patent Rights</u>

Some of our best and most productive inventors do not manufacture or market their own inventions. Among these are America's independent inventors, university and government based inventors, and many small businesses and startups. NPEs, especially universities, startups and other research organizations serve as important sources of technology that are, or become components of, innovations that are developed and brought to market by others, including many of the members of our Coalition. Johnson & Johnson's companies, for example, pay hundreds of millions of dollars a year to NPEs, including their R&D partners, universities, independent inventors and small businesses, for licenses under valuable technologies that are, or that we hope will be, incorporated in our products.

For some NPE's, the decision not to pursue manufacturing and marketing is a matter of choice. They may, for example, prefer to concentrate their energies on originating inventions rather than in developing them, leaving the commercialization to licensees who are better positioned to manufacture and market them. Or they may sell or license their patents to venture capitalists who will attend to raising the capital needed for commercialization.

For others, superseding circumstances may effectively prevent or limit inventors from commercializing their inventions. For example, if the invention is an improvement on existing patented technology, the owner of the original patent rights on that technology may be the only licensee for the improvement, at least until the original patents expire. Or should an existing unlicensed competitor copy and begin marketing the inventor's invention before the inventor is able to do so, the inventor's ability to later market that invention may be substantially impaired. In those circumstances, the only recourse available to the inventor may be to bring suit against the infringing company to abate the infringement and/or to recover fair compensation for the unlicensed use of the invention. By the same token, when an inventor's invention relates to an improvement useful in an industry with high barriers to initial entry and/or one in which the market is shared by just a few well entrenched competitors, the only practical way for an inventor to commercialize his invention may be to license, or if necessary sue, one or more of those competitors.

In all of these circumstances, freely transferrable patent rights are fundamental to the achievement of the Constitutional objective of "promoting the progress of science and the useful arts." Inventors who are not in a position to develop or market their own inventions would be deprived of the value of their patents were they not able to freely license or sell them. Similarly, those who wish to bring these inventions to the public either by developing and marketing them themselves or by licensing them to others should not be discouraged from doing so. Such free trade in patent rights is beneficial to our society as it allows technology developers to combine many different inventions to create products that would not otherwise have been possible.

IV. Abusive Patent Litigation Behaviors

Abusive litigation practices are not unique to the patent law, nor are they of recent vintage. As long as there has been an adversary system for resolving judicial disputes, there have been litigants who have looked for unfair ways to game the system for their own benefit. Nonetheless, the nature of patent cases is such that they may be prone to more abuse than is seen in other types of commercial litigation.

A. Assertions of Specious Claims and Defenses To Force Settlement

One common complaint about patent litigation is that too many specious claims or defenses are filed solely for the purpose of forcing an unjust settlement, typically at a cost that is less than the cost of successfully completing the litigation. While this type of abuse no doubt exists in other types of litigation, it may be more effective in patent litigation, where the subject matter is complex, extensive document discovery is available, a large number of potential witnesses may be deposed, and expert testimony is a practical necessity. Coupled with the difficulty in patent cases of distinguishing specious from meritorious claims and defenses, many parties choose to settle rather than litigate to a final conclusion.

While most commonly thought of in the context of plaintiffs' assertions of patent infringement, the problem may also manifest itself through specious attacks on the validity of a patent, and/or in the assertion of questionable defenses that drive up costs for the purpose of forcing settlement.

Without the benefit of a trial or other consideration of the merits of the particular claims and defenses, it is particularly difficult to distinguish whether patent claims brought, or validity or other defenses pressed, have substantial merit. While it is common to hear from both defendants and plaintiffs that the charges against them are without merit, the truth most often lies somewhere in the middle, making it difficult to craft an appropriate legislative response that targets only abusive litigation behavior.

While some critics point to estimates of how much manufacturers pay to NPEs, they seldom acknowledge that the majority of such payments are being made to gain commercial access to valuable technologies, not just to buy off frivolous suits. Indeed, in cases where a licensee fee is paid at settlement that substantially exceeds the cost of successfully defending the case, it is usually fair to conclude that the accused infringer has recognized some likelihood that the courts would find the asserted patent to be both valid and infringed. Such recognition is quite often warranted as evidenced by the 2013 Patent Litigation Study by Price Waterhouse Coopers ("PwC").[21] The empirical data indicates that, while litigation brought by NPEs is somewhat less successful overall than litigation brought by practicing entities, NPE's success rates are still significant.[22]

[21] 2013 PwC Patent Litigation Study http://www.pwc.com/en_US/us/forensic-services/publications/assets/2013-patent-litigation-study.pdf; *see also* 2012 Patent Litigation Study http://www.pwc.com/en_US/us/forensic-services/publications/assets/2012-patent-litigation-study.pdf.

[22] *Id*. chart 5b.

This is not to deny or minimize the problems in litigation caused by the over assertion of a patent claim, or the over assertion of a defense of invalidity, unenforceability or noninfringement. This practice is unfortunately quite common, but difficult to address, as there is a fine line between zealous representation of a client's interests, and pressing a position that is not reasonably based on the evidence or without substantial merit under existing law or a reasonable extension thereof.

An analysis of case statistics concerning the award of attorney fees to prevailing parties in patent cases deemed to be "exceptional"[23] fails to reveal any identifiable trend that would suggest that any more specious claims or defenses are being pressed through trial now than they have been over the past 12 years.[24] Nonetheless, since the overwhelming majority of all patent cases are settled without trial, statistics based on case dispositions are unlikely to reflect trends in specious claims that are extinguished by settlement. Moreover, collection of reliable data concerning those claims is nearly impossible, as almost all of settlements are confidential and entail sharply differing opinions of the merits of the matter settled.

B. Assertions Against Distributors, Retailers and End-Users Rather Than Manufacturers

Another patent litigation practice that has been sharply criticized is the institution of suits against large numbers of distributors, retailers or end-users rather than the original manufacturer or supplier of the component or product alleged to infringe. This tactic takes advantage of the fact that such suits threaten defendants with the disruption of aspects of their businesses that are at best tangentially related to the invention which is the subject of the patent, and that each individual defendant has less motivation to litigate the issue to final conclusion than the manufacturer of the product at issue. The result can be to collect enormous sums as the result of a very large number of small settlements whose cumulative value far exceeds the amount that could have been recovered from the original manufacturer.

While existing jurisprudence would normally favor a stay of such customer suits pending resolution of an action brought by the manufacturer to finally resolve the issue, some district courts decline to so exercise their discretion, thus attracting a disproportionate percentage of such filings.

C. Blanket Demand Letter Abuse

Another kind of abusive patent assertion activity that has drawn public attention is the blanket assertion of patent rights against vast numbers of end-users or others who are using purchased products in their intended manners. This type of abuse involves the sending of hundreds to thousands of demand letters to individuals or small businesses who are generally not sophisticated in patent matters. The recipients are advised that their activities infringe, and that they will be sued if they do not remit a license payment that is often less than the cost of hiring a patent attorney to assess the merits of the claim. If the recipients do not respond, some asserters follow up by reiterating the demand along with a document that purports to be a draft complaint. And even though litigation is threatened, in most cases it appears that, unbeknownst to the recipients, these threats are false, as the asserters have no intention of ever filing suit.

Fortunately, thus far it appears that no more than a handful of such assertion entities are pursuing this strategy[25], and that, to the extent discernible, the strategy has not been very successful. Nonetheless,

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[23] *See* 35 USC § 285, which states: "The court in exceptional cases may award reasonable attorney fees to the prevailing party."

[24] *See* www.patstats.org statistics for awards of attorney fees to plaintiffs and defendants from 2000-2012.

[25] Most cited are letters threatening coffee shops for providing internet and scanner owners for using their scanners as intended. See "Patent trolls want $1,000—for using scanners," ars technica, January 2, 2013 at

these behaviors smack of classic unfair and deceptive trade practices, so it is not surprising that they have drawn scrutiny from a number of state legislators and state attorneys general, leading to the passage of at least one state law to counter this abuse. *See* Vermont Consumer Protection Act at http://www.leg.state.vt.us/statutes/fullsection.cfm?Title=09&Chapter=063&Section=02453. In addition Nebraska has sent a law firm a civil investigative demand, as well as a cease-and-desist order that directed it to stop sending threatening demand letters to Nebraska consumers and businesses, citing concerns under both its Consumer Protection Act and the Uniform Deceptive Trade Practices Act.[26]

In recognition of the lack of information concerning the prevalence of bad faith demand letters, the Section 8(e) of the Innovation Act authorizes a one year study by the Director "of the prevalence of the practice of sending patent demand letters in bad faith and the extent to which that practice may, through fraudulent or deceptive practices, impose a negative impact on the marketplace."

Our Coalition supports this study, as more information is needed to assess the prevalence of this practice.

D. A Party's Identity Does Not Determine The Propriety Of Its Litigation Behavior

While the financial, legal and business circumstances of a patentee will affect the objectives in asserting a patent, none of these criteria are predictive of whether litigation brought by any particular patent owner is abusive. Indeed, the litigation practices discussed above may be employed by all classes of patentees, should they be so inclined.

The PwC Patent Litigation Study data indicates that litigation rates vary considerably from year to year and industry to industry. NPEs enjoy their highest levels of success, exceeding even those of practicing entities, in certain industries (biotechnology/pharma & medical devices) while having less success than practicing entities in other industries (business/consumer services, software, automotive/transportation, chemicals/synthetic materials and telecommunications).[27] Nonetheless, during the overall 18 year period covered by the NPE study, NPE's experienced a success rate of 24.3%, versus a non-NPE rate of 34.5%.[28] Of course, none of these statistics demonstrate that any of the unsuccessful enforcements were frivolous, rather than good faith assertions that were simply not proven.

These statistics do suggest that courts may be changing their approach to cases brought by certain NPEs. While non-practicing and practicing entity success rates were very close to each other in the 2001-2006 time period (28% vs. 33%), they diverged in the 2007-2012 time period (25% for NPE's vs. 38% for non-NPE's) due largely to an increase in the number of NPE cases disposed of by summary judgment. Collectively, this data suggests that in the last five years, judges have been closely scrutinizing NPE patent assertions, and have been terminating a higher percentage of them before trial.

http://arstechnica.com/tech-policy/2013/01/patent-trolls-want-1000-for-using-scanners/; *Stopping Patent Trolls*, Joshua Brustein, Businessweek at http://www.businessweek.com/articles/2013-12-12/a-bill-stopping-patent-trolls; TROLLING EFFECTS at https://trollingeffects.org/letters. Few other examples have often been cited, perhaps suggesting that the practice is not as widespread as might appear.

[26] *See* "Vermont and Nebraska Attorneys General Take Patent Trolls Head On," NAAGazette, available at http://www.naag.org/vermont-and-nebraska-attorneys-general-take-patent-trolls-head-on.php.

[27] *See* chart 6f, n.13 supra.

[28] *See* chart 9b, n.13supra.

These statistics also show that most NPE suits are brought in just a few districts, and that the NPE success rate in the most popular district, the Eastern District of Texas, at 57.5%, is substantially higher than in all other districts.[29]

V. Steps Already Underway To Counteract Abusive Patent Litigation

Our Coalition believes that it is important to take into account the recent steps that have been taken, or that are in the process of being taken, by the Courts, Congress and the USPTO to counteract abusive patent litigation. As early indications are that these steps will make a significant difference, our Coalition believes that a cautious approach should be taken towards additional reforms until better information becomes available concerning the reform measures that are now being implemented or that are already in place.

A. Issued and Impending Judicial Decisions

The judiciary has issued opinions in a number of areas relating to patent law which have significantly curbed abusive patent litigation. These include decisions that address the appropriateness of injunctive relief, overly broad patents, unfounded damage claims, and problematic venue issues. The judiciary now has turned its attention to other issues that are likely to have a profound impact on patent litigation and perceived abuses of the process. During its current term, the Supreme Court has granted *certiorari* in two cases regarding fee-shifting under 35 U.S.C § 285, and a case involving the patent eligibility of computer-implemented inventions under 35 U.S.C. § 101. By the end of June 2014, when decisions in these cases have been announced, the landscape of patent litigation may look significantly different than it does today.

i. Courts No Longer Automatically Grant Injunctive Relief

Concern had been expressed in the patent community that non-practicing patent holders who were litigating solely for the purpose of seeking monetary relief were nevertheless using the threat of an injunction to "hold up" defendants for higher settlements. It had been the general rule that upon a finding of infringement and validity, a permanent injunction should issue. As noted above, however, the Supreme Court in *eBay*[30] rejected the Federal Circuit's rule of a near automatic grant of injunctive relief in patent cases, instead calling for an assessment of the "principles of equity." After *eBay*, a patent holder must show, among other things, that ongoing infringement causes it to suffer an irreparable injury and that remedies available at law, such as monetary damages, are inadequate to compensate for that injury. Courts following *eBay* now deny requests for injunctive relief where patent holders, for example, can be fully compensated by monetary damages in the form of an ongoing license.[31] This has significantly removed the "hold up" threat in patent cases. At the same time, these decisions reflect a balance in that they leave open the prospect of injunctive relief on a case-by-case basis.

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[29] *See* chart 9a, n.13 supra.; This trend may not continue, however, as the AIA's limitations on joinder of parties in a single action coupled changes in venue law of venue have already resulted in more cases being transferred from the Eastern District of Texas to other jurisdictions.

[30] 547 U.S. 388

[31] *E.g., Bard Peripheral Vascular, Inc. v. W.L. Gore & Assocs., Inc.*, 670 F.3d.1171, 1192 (Fed. Cir. 2012); *VernetX, Inc. v. Apple Inc.*, No. 6:10-cv-417, 2013 WL 692652 (E.D. Tex. Feb. 26, 2013).

ii. The Law is Evolving to Address Overly Broad Patents

Concern has also been expressed that patents are being routinely asserted which contain overly broad, vague and ambiguous claims. The Supreme Court and the Federal Circuit have issued a number of recent decisions directly dealing with these concerns.

Method claims

The Supreme Court has recently taken up a series of cases that examine the validity of method claims in the context of patentable subject matter under 35 U.S.C. Section 101. In *Bilski v.Kappos*,[32] the Supreme Court affirmed the rejection of claims directed to a method of hedging losses in one segment of the energy industry by making investments in other segments of that industry on the basis that the claimed investment strategy was simply too abstract to warrant patent protection. Similarly, in *Mayo Collaborative Services v. Prometheus Labs., Inc.*,[33] the Court held that the claimed method of personalized medicine dosing was not eligible for patent protection because the process is effectively an unpatentable law of nature. In response, courts are more closely scrutinizing claims in patent cases to ascertain whether they are sufficiently concrete and non-abstract to qualify for patent protection under Section 101.

Software claims

On December 6, 2013 the Supreme Court announced that it has granted *certiorari* in *Alice Corp. v. CLS Bank.* This case involves several business method patents that claim software-implemented strategies for reducing the risks of certain types of financial transactions. In this case below, the Federal Circuit had addressed the following questions:

a. What test should the court adopt to determine whether a computer-implemented invention is a patent ineligible "abstract idea"; and when, if ever, does the presence of a computer in a claim lend patent eligibility to an otherwise patent-ineligible idea?

b. In assessing patent eligibility under 35 U.S.C. § 101 of a computer-implemented invention, should it matter whether the invention is claimed as a method, system, or storage medium; and should such claims at times be considered equivalent for § 101 purposes?

In a sharply divided decision, the Federal Circuit decided that the claimed business methods did not qualify as patentable subject matter.[34]

The issue now to be decided by the Supreme Court is

> Whether claims to computer-implemented inventions – including claims to systems and machines, processes, and items of manufacture – are directed to patent-eligible subject matter within the meaning of 35 U.S.C. § 101 as interpreted by this Court.[35]

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[32] 130 S.Ct. 3218 (2010)
[33] 132 S.Ct. 1289 (2012)
[34] 717 F.3d 1269 (Fed. Cir. 2013)
[35] *Alice Corp. Pty. Ltd v. CLS Bank Intern.*, Supreme Court Docket No. 13-298, *see* *http://www.supremecourt.gov/Search.aspx?FileName=/docketfiles/13-298.htm*.

Accordingly, this case is very likely to finally decide the extent of patent-eligibility for computer-implemented inventions, including computer-implemented business methods, and, regardless of which way it is decided, to have an enormous impact on the field of software patenting.

Written description requirement

The Federal Circuit has also addressed over-breadth of claims by reaffirming that the patent laws in fact require a written description of the invention.[36] According to the Federal Circuit, this requirement ensures that inventors have actually invented the subject matter claimed in their patents. In other words, each claim must have support in the written description for each element to show that the inventor actually invented that which he or she claims.

Specification disclosure requirement

Finally, the Federal Circuit has also addressed concerns about the over-breadth of claims, particularly in the software field, by ensuring that functional language in such patent claims finds adequate structure in the specification for performing the claimed function. In *Function Media, LLC v. Google, Inc.*,[37] for example, the asserted patents involved a computer system for facilitating advertising on multiple computer outlets. The Federal Circuit affirmed the district court's invalidation of the patents because they were indefinite, stating"[w]hen dealing with a 'special purpose computer-implemented means-plus-function limitation,' we require the specification to disclose the algorithm for performing the function."[38]

iii. Courts Have Reigned-In Speculative Damages Awards

The Federal Circuit has also been quite active in the damages area, issuing a number of recent important decisions directly addressing the proper measure of damages in cases of patent infringement. In *Lucent*,[39] the Federal Circuit addressed concern about large patent damages awards where the patented invention was merely a component of a much larger commercial product. The Court made clear that damages awarded for infringement in this situation cannot be based automatically on the market value of the entire product, but must be shown to be reasonably tied to the value of the patented feature as shown through consumer demand for that feature. In other words, in order for a damages award to be based on the value of the larger commercial product, the patent holder must prove that the patented feature drives the sales of the larger commercial product. In the wake of the *Lucent* case, district courts, through their important gate keeper function, are now rejecting damages expert testimony which attempts to base the value of patent damages on the larger commercial product where it cannot be shown that the smaller patented feature is the basis for the demand for the larger product.[40]

The Federal Circuit has further reigned in speculative damages expert testimony by abolishing the so-called "25% of profits rule" which had been used by damages experts over the years as a rough baseline for negotiating a reasonable royalty for patent damages. In *Uniloc v. Microsoft*,[41] the Federal

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[36] *Ariad Pharmaceuticals, Inc. v. Eli Lilly and Company*,598 F.3d. 1336 (Fed. Cir. 2010) (en banc).
[37] No. 2012-1020, slip op. at 9 (Fed. Cir. Feb. 13, 2013).
[38] *Id.*
[39] 580 F.3d 1301 (Fed. Cir. 2009).
[40] *See, e.g., MultiMedia Patent Trust v. Apple Inc.*. No. 10–CV–2618–H (KSC), 2012 WL 5873711 (S.D. Cal. Nov. 20, 2012); *Apple, Inc. v. Motorola, Inc.*, No. 1:11-cv-08540, 2012 WL 1959560 (N.D. Ill. May 22, 2012); *Inventio AG v. Otis Elevator Co.*, No. 06 Civ. 5377(CM), 2011 WL 3359705 (S.D.N.Y. June 23, 2011)*; IP Innovation LLC v. Red Hat, Inc.*, 705 F. Supp. 2d 687 (E.D. Tex. 2010).
[41] 632 F.3d 1292 (Fed. Cir. 2011).

Circuit made clear that any damages testimony must be carefully tied to the facts and circumstances of a particular case and not to abstract general rules.

The Federal Circuit also has cabined the types of licenses that are permissible to use in assessing a reasonable royalty. In *ResQNet.com v. Lansa,*[42] the Court made clear that if a plaintiff is relying on licenses as a measure of litigation damages, there must be an evidentiary basis linking the licenses to the claimed invention. This case thus limits the ability of a plaintiff to inflate its claimed measure of damages by picking and choosing economic terms of licenses that are not for the patents in suit or that are not "clearly linked to the economic demand of the claimed technology."[43]

These decisions have routinely been applied by the district courts to reign in speculative damages claims and awards in patent cases.

iv. Courts Have Addressed Venue Abuse

Another area of significant focus by the courts has been venue abuse. Specifically, it was argued that patent cases were being filed in districts, particularly the Eastern District of Texas, with no meaningful connection to the defendant other than the fact that the defendant may sell accused infringing products in that district. Defendants who have moved to have the cases transferred to a more convenient forum had those motions denied by some district courts which placed virtually dispositive weight on the plaintiff's choice of forum.

In a series of precedential rulings, the Federal Circuit employed the extraordinary remedy of issuing writs of mandamus to prevent litigants from abusing the permissive venue provisions for patent litigation by filing patent litigation in venues that have no reasonable connection to the parties and evidence. *See, e.g., In re Nintendo Corp.*[44] In addition, the Federal Circuit has also indicated that a district court must rule on a writ of mandamus when it is filed and not delay ruling on it until much later in the case, as delaying a ruling on such motions until substantial pre-trial proceedings have occurred has the effect of depriving litigants of their right to be transferred to a more convenient forum.[45]

v. The Supreme Court Is Addressing Fee Shifting in Patent Cases

On October 1, 2013, the Supreme Court granted petitions for writs of *certiorari* in two patent infringement cases raising the issue of when an award of attorney fees to a prevailing party is appropriate under 35 U.S.C. § 285. In *Octane Fitness, LLC v. ICON Health & Fitness, Inc.*, Docket No. 12-1184, the Court will consider the test used to determine whether a case is "exceptional" under Section 285, which is a requisite finding for the award of fees to the prevailing party. The petitioner challenged the "rigid and exclusive" test that the Federal Circuit uses to determine whether a case is "exceptional," presenting the following question that the Court accepted for review:

> *Whether the Federal Circuit's promulgation of a rigid and exclusive two-part test for determining whether a case is "exceptional" under 35 U.S.C. § 285 improperly appropriates a district court's discretionary authority to award attorney fees to*

[42] 594 F.3d. 810 (Fed. Cir. 2010).
[43] *Id*. at 872-873.
[44] *See, e.g., In re Microsoft Corp.*, 630 F.3d 1361 (Fed. Cir. 2011); *In re Acer America Corp.*, 626 F.3d 1252 (Fed. Cir. 2010); *In re Zimmer Holdings, Inc.*, 609 F.3d 1378 (Fed. Cir. 2010); *In re Nintendo Corp.*, 589 F.3d. 1194 (Fed. Cir. 2009); *In re Genentech*, 566 F.3d 1338 (Fed. Cir. 2009); *In re Hoffman-LaRoche Inc.*, 587 F.3d 1333 (Fed. Cir. 2009); *In re TS Tech USA Corp.*, 551 F.3d 1315 (Fed. Cir. 2008).
[45] *In re EMC Corp.*, No. 10-cv-0435, 2013 U.S. App. LEXIS 1985 at *5, 6 (Fed. Cir. Jan. 30, 2013).

> *prevailing accused infringers in contravention of statutory intent and this Court's precedent, thereby raising the standard for accused infringers (but not patentees) to recoup fees and encouraging patent plaintiffs to bring spurious patent cases to cause competitive harm or coerce unwarranted settlements from defendants.*

In *Highmark Inc. v. Allcare Health Management Sys.*, Docket No. 121163, the Court will consider the deference to be given, if any, to a district court's determination that a case is "exceptional" within the meaning of Section 285. The question presented to the Court is:

> *Whether a district court's exceptional-case finding under 35 U.S.C. § 285, based on its judgment that a suit is objectively baseless, is entitled to deference.*

The Solicitor General, as well as many *amicus curiae*, has argued that the Court should lower the standard needed to find a case to be "exceptional" under Section 285, thus permitting fee shifting in favor of prevailing parties more frequently in patent infringement cases.[46] In an *amicus* brief filed in the *Octane Fitness* case by Johnson & Johnson and other 21C Steering Committee member companies, we argued:

> *Amici* Companies believe that the Federal Circuit's test for what constitutes an "exceptional" case under Section 285 has set the bar too high. Fee shifting is invoked too rarely to serve as an effective deterrent against litigation misconduct. The Federal Circuit has interpreted Section 285 as permitting fee shifting only in cases where the culpable conduct of the non-prevailing party fits into one of the specific categories the court has defined as meeting the threshold for an exceptional case: objectively baseless litigation brought in subjective bad faith; willful infringement; inequitable conduct before the patent office; or Rule 11 abuses and similar material litigation misconduct. *See, e.g., Brooks Furniture Mfg., Inc. v. Dutailier Int'l, Inc.*, 393 F.3d 1378, 1381 (Fed. Cir. 2005). As a result, application of Section 285 has become mechanical and ineffective as a means for district courts to manage and deter litigation misconduct.
>
> The Federal Circuit's Section 285 jurisprudence misses the forest for the trees. By cabining the grounds for finding a case "exceptional" to narrow categories of egregious conduct, the court has lost sight of Section 285's purpose as an exception to the American Rule when, under the totality of the circumstances, equity requires that the prevailing party not bear some or all of the fees it incurred. To be clear, Section 285 plainly makes the awarding of fees the exception, not the rule. But "exceptional" is not synonymous with "almost never." Fee shifting under Section 285 should be available to district courts in practice, not merely on paper, when sound equitable discretion dictates that a non-prevailing party has acted in a manner beyond the bounds of acceptable litigation behavior and should therefore bear the consequences of its actions by paying some or all of its opponent's reasonable litigation expenses.
>
> *Amici* Companies thus urge the Court to realign the interpretation of Section 285 with traditional principles of equity, as applied in the context of the claims, defenses, and issues arising in patent litigation, and with acceptable norms of litigation conduct. The district courts should be empowered to determine which cases are "exceptional," and

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[46] *See* http://www.americanbar.org/publications/preview_home/12-1184.html (collecting *amicus* briefs in *Octane Fitness*); http://www.americanbar.org/publications/preview_home/12-1163.html (collecting *amicus* briefs in *Highmark*).

> whether and in what amount fees should be shifted upon such a finding, through exercise of their sound equitable discretion based on the totality of the record. By doing so, fee shifting in patent cases will serve the same purposes this Court has indicated it serves in other areas of litigation: a case management tool for courts to discourage certain types of claims or defenses and to sanction misconduct.

The Court will hear arguments in both *Octane Fitness* and *Highmark* on February 26, 2014. Decisions are expected by the end of the Court's current term in June.

vi. The Supreme Court Is Addressing the Patent Eligibility of Computer-Implemented Inventions

On December 6, 2013, the Supreme Court granted a petition for a writ of *certiorari* in *Alice Corp. Pty. Ltd v. CLS Bank Int'l*, Docket No. 13-298, to consider the patent eligibility of computer-implemented inventions. The question presented to the Court is:

> Whether claims to computer-implemented inventions – including claims to systems and machines, processes, and items of manufacture – are directed to patent-eligible subject matter within the meaning of 35 U.S.C. § 101 as interpreted by this Court?

In this case, the Supreme Court will revisit the issue of how to determine whether a software-related claim is directed to a patent-eligible invention or an ineligible abstract idea. The Alice Corp. patent is directed to software-implemented business methods for mitigating settlement risk in certain financial transactions. In a sharply-divided *en banc* decision issued in May, the Federal Circuit determined that some of Alice Corp's claims lacked patent eligibility. The Federal Circuit split down the middle, with five of the ten judges concluding that all of the claims were ineligible for patenting and the remaining five judges concluding that, at least, the system claims were patent eligible. Because none of the opinions in the decision carried a majority, however, the Federal Circuit did not add clarity to the question that has now been accepted for review by the Supreme Court.

The Supreme Court decision is likely to have a profound impact on many of the issues underlying calls for legislative action to combat patent infringement litigation abuse. The GAO report, for example, concluded that the recent increases in patent infringement litigation were not caused by non-practicing entity cases, but rather by the growth in litigation involving software patents:

> Public discussion surrounding patent infringement litigation often focuses on the increasing role of NPEs. However, our analysis indicates that regardless of the type of litigant, lawsuits involving software-related patents accounted for about 89 percent of the increase in defendants between 2007 and 2011, and most of the suits brought by PMEs involved software-related patents. This suggests that the focus on the identity of the litigant—rather than the type of patent—may be misplaced.

Likewise, calls for expansion of the transitional review program for covered business method patents have focused on the perceived need for additional review of software patents. Thus, the Supreme Court's opinion, expected by the end of the term in June 2014, may go a long way toward addressing some of the fundamental questions regarding the patent eligibility of the types of patents that have spurred calls for the changes reflected in several of the pending legislative proposals in both chambers of Congress.

B. Litigation Process Initiatives

In addition to judicial rulings addressing abusive patent litigation, a number of judicial jurisdictions as well as Congress have already implemented litigation process reforms that have had the effect of counteracting abusive litigation practices through more streamlined and consistent litigation practices.

i. Patent Court Pilot Program

One of the recent legislative initiatives to improve the process for patent litigation is the Patent Court Pilot Program. In January of 2011, Congress created the program whose stated purpose is "to establish a pilot program in certain United States district courts to encourage enhancement of expertise in patent cases among district judges."[47] The Administrative Office of the United States Courts selected 14 federal districts courts to participate in the 10-year pilot program, which was implemented in July of 2011. In each district, at least three judges have been designated to hear patent cases. The participating districts have adopted case assignment procedures allowing judges in those districts who do not want to hear patent cases to have their cases assigned to one of the designated judges. The effect of this program for the participating districts has been that patent cases are being heard by judges who have developed an interest and expertise in the area. The expectation is that this will lead to more expedient resolution of patent cases. Another goal of the program is that the patent lawsuit caseload will become more dispersed throughout the country and less concentrated in Delaware, Northern California, and Eastern Texas.

ii. Federal Judicial Conference and Other Initiatives

The Advisory Council of the Federal Judicial Conference is in the process of an extensive review of the Federal Rules of Civil Procedure, with special emphasis on discovery management issues such as those present in complex patent cases. Proposed rules were published on August 15, 2013, with the public comment period remaining open until February 15, 2014.[48] On November 5, 2013, the Committee's Subcommittee on Bankruptcy and the Courts held a hearing regarding the proposed new rules, and the Committee is in the process of holding a series of hearings to gather input from involved stakeholders. A number of the proposed new rules specifically address case management and discovery issues in all federal civil cases, including patent infringement actions. For example, Rule 26(b) would be amended to require that discovery be "proportional to the needs of the case considering the amount in controversy, the importance of the issues at stake in the action, the parties' resources, the importance of the discovery in resolving the issues, and whether the burden or expense of the proposed discovery outweighs its likely benefit." Other proposed changes to Rule 30 would reduce the presumptive numerical limits on depositions and their duration, and Rules 33 and 36 would be amended to place lower presumptive limits on the numbers of interrogatories, and to establish new presumptive limits on requests for admissions. In addition, Rule 37 would be amended to clarify the requirements for preservation of electronically stored information and the sanctions for failure to preserve such information.

Members of the judiciary have also been quite vocal in urging Congressional restraint in legislatively proposing litigation reforms, even asserting that the proposed legislation could violate the constitutional separation of powers, by encroaching on the authority of judges to manage their dockets.[49]

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[47] *See* n.6 *supra*.
[48] See http://www.uscourts.gov/uscourts/rules/preliminary-draft-proposed-amendments.pdf.
[49] *See* Letter to John Conyers from Committee on Rules of Practice and Procedure of the Judicial Conference of the United States, November 6, 2013 at http://legaltimes.typepad.com/files/letter-on-innovation-act.pdf .

In a February 27, 2013 speech at the Association of University Technology Managers, Chief Judge Rader advocated an additional step to deter abusive patent litigation: an award of fees when it is clear there has been litigation abuse, which would include those situations that Chief Judge Rader referred to as "litigation blackmail," *i.e.*, those in which there are only the most vague assertions of patent infringement coupled with a minuscule offer to settle the litigation.

iii. Managed Discovery

A number of district courts are also working on developing rules that mesh with their local procedures in order to mitigate disproportionally high discovery expenses.[50] Most of these involve promoting streamlined discovery in patent cases, often by requiring both parties to turnover certain categories of key documents within weeks of the initial status conference. In the Northern District of Illinois, for example, the patentee must disclose (i) documents related to the sale of the claimed invention prior to the date of the patent application; (ii) documents related to the conception and development of the claimed invention; (iii) communications with the United States Patent and Trademark Office regarding the invention; and (iv) documentation related to the ownership of the patent. The defendant must disclose documents sufficient to show all aspects of the accused "instrumentality" that was identified by the patentee and a copy of each item of prior art of which the party is aware that allegedly invalidates any claim of an asserted patent.[51] Using early disclosure procedures that focus on the core issues and quickly provide the appropriate information can avoid wasted discovery efforts and mitigate discovery disputes later on.

In support of such initiatives , the Advisory Council of the Federal Circuit drafted a Model E-Discovery Order for the district courts to use to manage the electronic discovery process, and in particular, the production of email. The Model Order begins with a discovery process whereby the parties exchange core documentation concerning the patent, the accused product, the prior art, and financial information before seeking email production. At the Judicial Conference for the Eastern District of Texas in September 2011, Chief Judge Rader promoted adoption of the Model Order for patent cases in the district courts, and the Eastern District of Texas, for example, has adopted a form of this order for all cases.[52]

Discovery reform has not been limited to patent litigation in the federal courts. In October 2012, the International Trade Commission proposed amending its rules for discovery of electronically stored information in Section 337 proceedings, which usually involve claims that imported goods infringe a U.S. patent. The proposed rules adopt many of the initiatives adopted in the Federal Circuit's Model Order and by some district courts to reduce the burden on patent litigants.

C. Provisions of the AIA That Stem Abusive Patent Litigation

Congress also acted in 2011 by passing the AIA which included many provisions designed to lessen the opportunity for abusive patent litigation conduct.[53] This Act made the criteria for patentability more objective and transparent, increased Patent Office funding and authorized the public's participation

[50] *See* Emery G. Lee III & Thomas E. Willging, *Litigation Costs in Civil Cases: Multivariate Analysis* 8 (Fed. Judicial Ctr. 2010) ("Intellectual Property cases had costs almost 62% higher, all else equal, than the baseline 'Other' category.").
[51] *See* N.D. Ill. Local Patent Rule 2.1. *See also* D. N.J. Local Patent Rules 3.2 & 3.4 (setting forth similar early disclosure and production requirements).
[52] *See* E.D. Tex. Local Rules, Appendix P.
[53] *See* n.7 *supra*.

in the patent examination process, all to raise the quality of patents to be issued in the future. The AIA created several new procedures that allow members of the public, including those who are being sued for infringement, to quickly and inexpensively challenge a patent's validity before a panel of administrative law judges in the Patent Office. The AIA also mandated that patent plaintiffs could no longer indiscriminately join unrelated parties in a single law suit, and provided for a further study of issues relating to non-practicing entity patent assertions, which is not yet completed.

i. Objective and Transparent Patentability Criteria

A major focus of the AIA patent reform effort was to improve the quality of patents. Much of the criticism of the patent system over recent years has been directed toward the quality of patents issued from the USPTO. The AIA includes a number of provisions to address this perennial complaint from users and the public. The new law begins by eliminating subjective and non-transparent tests for patentability in favor of a patent law in which the validity of a patent is assessed through information available to the public. The result, at the front end of the process, is greater transparency, objectivity, and simplicity in the criteria for determining when an invention is novel and non-obvious. The validity of patents granted using these criteria is more predictable and their enforceability more certain.

The initial examination process has been made more open and transparent, allowing the public to work with the USPTO to provide the most relevant information for patent examiners to use. By allowing the public to share their knowledge and information with examiners before patents are granted, the likelihood that an examiner will have all the relevant information to determine the patentability in any given case is enhanced.

ii. Adequate and Secure Funding for the USPTO

The AIA provided the basis for the USPTO to receive a major increase in its operating funds. With the authority to establish and retain the fees it charges for its services, until affected by the sequestration, the Office had been able to significantly increase the patent examining staff, embark on upgrading its antiquated IT systems, and prepare for the implementation of the many new programs and procedures created by the AIA. Coupled with the new rules for determining patentability, and assuming full funding is restored to the USPTO, the added resources made available to examine applications and reduce the backlog of applications should speed the processing of patent grants and enable investments to be made in new industries with accompanying job creation.

iii. Post-grant Proceedings

The AIA also established new proceedings before the USPTO allowing for the public to initiate a review of issued patents. The AIA creates three new tracks within the USPTO to challenge the validity of patents. These proceedings are *inter partes* review, post-grant review and the transitional program for covered business method patents. While the details of these various review proceedings are important to practitioners, their policy significance is that they provide a mechanism that is an alternative to litigation to challenge the validity of a patent in a special forum, with special procedures and proceedings designed to address the type of review being invoked. The procedures are generally designed to lead to a less expensive and speedier decision than is available in most federal courts, and to allow the challenger to make its arguments to a panel of administrative law judges experienced with the complicated subject matter of patentability.

New procedural rules allow for administrative trials to be completed within one year from initiation of the review. The rules provide for expedited discovery, and other pre-trial disclosures designed to reduce the costs of these validity proceedings as compared to tradition federal court litigation.

The transitional review program for covered business method patents is a special program designed to allow for post-grant review of patents directed to methods used in the administration or management of a financial product or service. Only a party that has been sued or otherwise charged with infringing the patent can seek review under this program. The program allows a party who is defending against such a patent in litigation to take an immediate appeal if the district court denies a stay of the lawsuit while the patent is being reviewed under this transitional program.

iv. AIA Joinder Limitations

The AIA also addressed the abusive practice of a plaintiff joining dozens of companies together in a single lawsuit when they had nothing in common other than the accusation of infringement. The AIA imposes new requirements that must be fulfilled before a patentee can join multiple accused infringers in one action.[54] Under Federal Rule of Civil Procedure 20(a)(2), multiple defendants can be joined in one action only if "(A) any right to relief is asserted against them jointly, severally, or in the alternative with respect to or arising out of the same transaction, occurrence, or series of transactions or occurrences; and (B) any question of law or fact common to all defendants will arise in the action."

The AIA codifies the standard in Federal Rule of Civil Procedure 20(a)(2) into patent law and adds that "accused infringers may not be joined in one action as defendants or counterclaim defendants, or have their actions consolidated for trial, based solely on allegations that they each have infringed the patent or patents in suit."[55] Plaintiffs unable to meet this new requirement now must file separate lawsuits alleging infringement of the same patents and, unless the cases are consolidated for pretrial purposes, will lose the economies of scale.

VI. Proposed Solutions To Curb Abusive Litigation Practices

Although it is far too early to assess the full impact of the changes to patent litigation brought about by judicial efforts to improve substantive and procedural aspects of patent infringement litigation, as well as legislative efforts to address patent litigation concerns, most notably by enactment of the AIA reforms, a number of new legislative proposals have been suggested to curb perceived abusive litigation practices. Among these are H.R. 3309 as passed by the House ("Innovation Act"), S. 866 (the "Schumer Bill"), S. 1013 (the "Cornyn Bill"), S. 1612 (the "Hatch Bill") and S. 1720 (the "Leahy-Lee Bill"[56]), the provisions of which are discussed below.

In the view of the 21C, some elements of these proposals have merit, while others run the risk of negatively impacting the value and enforceability of patent rights, and thus chilling investments in innovation and the creation of new jobs. Coming as they do so soon after enactment of the AIA and the other efforts to reform patent litigation, our Coalition urges Congress to exercise legislative restraint by adopting provisions carefully targeted at abusive conduct, while resisting those that carry with them the danger of over-correcting and/or creating collateral damage.

A. Transparency of Patent Ownership

Provisions relating to improving the transparency of patent ownership are found in both the Innovation Act and the Leahy-Lee Bill.

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[54] 35 U.S.C. § 299.
[55] 35 U.S.C. § 299(b).
[56] This bill is also co-sponsored by Senators Whitehouse and Klobuchar, who have also been very active in its development.

i. Innovation Act Transparency Provisions

Pursuant to Section 4, subsection 290(b) of the Innovation Act, disclosure of certain ownership and related information regarding the patents at issue upon the filing of the initial complaint for patent infringement is required. This includes the assignee of the patent(s) at issue, any entity with a right to sublicense or enforce the patent(s), any entity that the plaintiff knows to have a financial interest (further defined in proposed subsection 290(e)) in the patent(s) or the plaintiff, and the ultimate parent of any assignee. Proposed new subsection 290(d) would require this information be continually updated and sanction the failure to do so.

When a patent is being asserted against a potential infringer, it is natural that the defendant desires to know the owner or assignee of the patent being asserted. If this information is not already of record (as it routinely is in patent litigation), requiring it to be provided will generally not impose an undue burden on the patent owner nor disclose information that can fairly be deemed confidential. Nor would it be unduly burdensome on the owner of the patent asserted in court to update certain information relating to the ownership of that patent on a going forward basis, as the Innovation Act requires.

Depending upon the circumstances, however, some of the information required to be disclosed could pertain to competitively sensitive information that should not be required to be disclosed in a public document. Examples of information that may fall in this category include disclosure of the ultimate parent entity of the assignee or disclosure of entities with a right to sublicense the patent. Consequently, while the 21C has no objection to providing such information in a case filing made under seal (as provided in Section 3 for the information to be disclosed in an initial complaint), we do not believe it should be disclosed to the Patent and Trademark Office.

The "right to enforce" a patent is not nearly as straightforward as identifying the owner or assignee of a patent, and is more likely to require the disclosure of confidential business relationships. Whether a party has the right to enforce a patent, also referred to as a "real party in interest," is a legal determination that is frequently litigated and is often not resolved until a court has issued a final decision on the issue. Consequently, the 21C believes that initial disclosure requirements should focus on requiring disclosure of the underlying facts, if known, upon which such legal conclusions may depend, leaving to discovery inquiries into further information that may inform the issue.

21C views this section of Innovation Act as inferior to the transparency provision of the Leahy-Lee Bill, discussed below.

ii. Transparency Provisions of the Leahy-Lee Bill

Section 3 of the Leahy-Lee Bill requires disclosure of information to the court of certain information relating to parties having a financial interest the patents asserted in a court action, and those whose interests may be affected by the outcome of the litigation. Such disclosures, which may be filed under seal to protect confidential information, represent an existing best practice in court proceedings. For many reasons, including the ability of courts to screen for potential judicial conflicts, it is not unreasonable to require such disclosures.

Section 3 of the Leahy-Lee Bill further requires recordation of assignments of issued patents, made on or after the effective date of the act. In particular, this section requires that "an assignment of all substantial rights in an issued patent that results in a change to the ultimate parent entity shall be recorded in the Patent and Trademark Office within 3 months of the assignment." Failure to record an assignment subject to this obligation may result in a loss of the patent owner's right to collect enhanced damages or attorney fees in a subsequent litigation "with respect to infringing activities taking place during any period of noncompliance" and may result in an award "to the prevailing accused infringer [of] reasonable attorney fees and expenses incurred in discovering any previously undisclosed ultimate parent entities in the chain of title."

This provision is balanced, and does not place an unreasonable burden on owners of currently existing patents. It is fairly limited to assignments that would result in a change in the "ultimate parent entity" and provides both reasonable penalties for failures to comply and encouragement to patent owners to belatedly comply to minimize the effects of those penalties.

The 21C supports Section 3 of the Leahy-Lee Bill as it is currently written.

B. Stays of Patent Suits Brought Against Customers and End-Users

Section 5 of the Innovation Act and Section 4 of the Leahy-Lee Bill both contain provisions that, under certain circumstances, would require patent infringement suits brought against customers or end users to be stayed in favor of pending suits between manufacturers or suppliers.

i. Customer Stay Provisions of the Innovation Act and the Leahy-Lee Bill

Section 5 of the Innovation Act and Section 4 of the Leahy-Lee Bill both require that patent suits brought against covered customers to be stayed if (1) the covered manufacturer and covered customer agree to the stay, (2) the covered manufacturer is a party to the suit or is engaged with the plaintiff in another suit involving the same patent or patents and relating to the same covered product or process, (3) the covered customer agrees to be bound by any finally decided issues that the covered customer has in common with the covered manufacturer, and (4) the motion for a stay is timely filed. The bills further provide that the stay may be lifted if it is shown that a major issue between the plaintiff and the covered customer will not be resolved in the manufacturer suit or that the stay "unreasonably prejudices and would be manifestly unjust to the party seeking to lift the stay," and that, when there is a separate suit between the manufacturer and plaintiff, the judge in that suit determines these conditions have been met.

Stays under Section 4 would not be available in suits including causes of action under Section 271(e)(2), e.g., ANDA and biosimilar suits, and would provide some protection to customers from being bound by certain actions of covered manufacturers who agree to consent judgments, or who decline to prosecute the action, based on a showing "that such an outcome would unreasonably prejudices and be manifestly unjust to the covered customer in light of the circumstances of the case."

ii. Position of the 21C on These Customer Stay Provisions

The 21C supports the concept that a manufacturer or supplier should be able to intervene in patent infringement actions brought against its distributors, retailers or end users who are simply using the purchased products in the manner in which the manufacturer or supplier intends. The 21C also supports the concept that the manufacturer should alternatively be allowed to proceed in a separate action against the patent owner. Such distributors, retailers or end users who have been sued should have the option, if they agree to be bound by the outcome, to stay the actions against them pending the outcome of an infringement suit between the patent owner and the manufacturer or supplier. This right to stay distributor/retailer/end user suits would curtail the practice of filing such suits to coerce settlements and would promote resolution of patent disputes between the parties in the best position to litigate the merits of the case: the patent owner and the manufacturer or supplier of the products accused of infringement

The 21C notes that the proposed language in the Innovation Act and the Leahy-Lee Bill includes a number of important safeguards intended to ensure that stays do not unfairly prejudice manufacturers and their customers. First, both the customer and the manufacturer must consent in writing to the stay. This ensures that the stay is entirely voluntary as between the supplier and its customer, thus avoiding unintended consequences of impacting contractual obligations that may exist between suppliers and purchasers and that may allocate the risks of infringement or the costs of defending against infringement allegations. Second, the customer must agree to be bound by any judgment against the manufacturer to the same extent that the manufacturer may be bound with respect to issues that the manufacturer and the customer have in common. This safeguards the patent holder against duplicative litigation on the same issues against the manufacturer and the customer and ensures that the stay does not unduly delay the ultimate resolution of the action. Third, the motion to stay must be filed within 120 days after service of the first "pleading" – we would suggest the first "paper" -- in the action identifying the product or process alleged to infringe. This ensures the timely filing of motions to stay and protects against such motions being filed late in the litigation to delay resolution or for other improper tactical purposes. Fourth, the stay applies only to the patents, and products, systems or components accused of infringement, so it would not apply with respect to infringement allegations based on other patents or accused products, systems or components – actions involving such allegations would proceed. Finally, the stay may be lifted upon grant of a motion showing that the action involving the manufacturer will not resolve a major issue in suit against the customer, or a showing that the stay unreasonably prejudices and would be manifestly unjust to the party seeking to lift the stay.

However, the 21C believes that the language of these stay provisions has strayed beyond the original intent of the customer stay concept: to protect small businesses, retailers and end-users from defending patent infringement actions in the first instance, in favor of allowing the litigation to proceed first against their suppliers of the accused product or process, who are better-positioned to mount a defense. As the language has expanded beyond this core concept, unfortunately the provisions lack adequate protections for patent holders. In particular, more guidance is needed as to when entry of a stay may not be appropriate, even if a manufacturer and customer agree to the stay. We believe that courts should have the discretion to deny a stay even when such an agreement is reached, because a stay may nonetheless not advance ultimate resolution of the dispute or may be unfair to a patent holder.

As ongoing discussions between the stakeholders have highlighted, it is sometimes but not always clear when a named defendant located in the middle of a supply chain should qualify as a "covered customer" as opposed to a "covered manufacturer." At the retail end of the supply chain, there appears to be widespread agreement that "off-the-shelf" distributors and retailers, i.e., parties who do not modify products or services received from their suppliers, but merely resell them or use them for their intended purposes, should qualify as "covered customers," just as should end users who do nothing more than buy and use products or services in accordance with their manufacturer's or supplier's instructions. On the other hand, that consensus erodes as the position of the defendant moves up the supply chain. For example, opinions appear to differ between stakeholders whether a defendant who is an assembler that designs and/or first brings together the combination of components should be treated as a customer on account of its status a purchaser of components from other suppliers/manufacturers, or a supplier/manufacturer on the basis of its design and/or assembly operations.

Because of the difficulties that exist in drawing the line between who is a customer and who is a supplier for these purposes, 21C believes that mandatory stays should best be limited to the "off-the-shelf," small business, retailer and end-user circumstances discussed above. We would support language narrowing the definition of "covered customers" to such circumstances, which we believe would mitigate many of the disputes that stymied efforts to reach consensus among stakeholders.

Alternatively, if the language of the stay provisions continued to encompass "covered customers" further up the supply chain than retailers, small business resellers or end users, then 21C believes that the interests of all litigants – suppliers, customers and patent holders – should be adequately represented and balanced through the addition of language allowing courts to use their discretion to deny a stay under circumstances such as: 1) when the customer has designed or specified the design of the accused product or process; 2) when the customer has modified the accused product or process, or combined it with other components, products or processes, in a manner that gives rise to the charge of infringement; or 3) when the customer has used the accused product in a particular way, other than its off-the-shelf or intended use, that gives rise to the charge of infringement. In such circumstances, the original defendant is often in a position to fairly defend the case and a stay of the action against the original defendant would not advance the prompt or efficient resolution of the infringement dispute. In such cases, a stay should not be entered in the first place, even if the manufacturer/supplier and the customer/end user agree to its entry.

Accordingly, the 21C continues to support the concept of staying suits against customers and end users, but believes that the language in the bills should be improved, as discussed above, particularly with respect to either: limiting the scope of automatic stays to their original intent: to protect small businesses, retailers and end-users; or adding language to ensure that patent owners will not suffer stays of suits that in fairness should proceed.

C. Bad Faith Demand Letters

i. Bad Faith Demand Letter Provision in the Innovation Act

In addition to authorizing a study on the prevalence of bad faith demand letter practices, the Innovation Act includes a statement of the senses of Congress that "it is an abuse of the patent system and against public policy for a party to send out purposely evasive demand letter to end users alleging patent infringement."[57] This statement further advises that that demand letters sent should "at the least, include basic information about the patent in question, what is being infringed, and how it is being infringed."[58] Finally, the statement provides that "Any actions or litigation that stem from these types of purposely evasive demand letter to end users should be considered a fraudulent or deceptive practice and an exceptional circumstance when considering whether the litigation is abusive."[59]

The Innovation Act further provides that a claimant seeking willful infringement (and thus enhanced damages) "may not rely on evidence of pre-suit notification of infringement unless that notification identifies with particularity the assert patent, identifies the product or process accused, identifies the ultimate parent entity of the claimant, and explains with particularity, to the extent possible following a reasonable investigation or inquiry, how the product or process infringes one or more claims of the patent."[60]

ii. Bad Faith Demand Letter Provision in the Leahy-Lee Bill

Section 5 of the Leahy-Lee Bill would add a new §299B to the patent statute that would make the widespread sending of demand letters that assert, without a reasonable basis in fact or law, that the recipients are infringing a patent and owe compensation an unfair or deceptive act or practice within the meaning of section 5(a)(1) of the Federal Trade Commission Act (15 U.S.C. 45(a)(1)). The Coalition believes that narrowly-tailored legislation, providing the Federal Trade Commission ("FTC") with the authority to target those who send such bad-faith patent demand letters would further the FTC's consumer

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[57] SEC. 3(e), Innovation Act, H.R. 3309 as passed by the House of Representatives December 5, 2013, page 15, available at http://www.gpo.gov/fdsys/pkg/BILLS-113hr3309eh/pdf/BILLS-113hr3309eh.pdf.
[58] *Id.*
[59] *Id.*
[60] SEC. 3(f)(3), Innovation Act, H.R. 3309 as passed by the House of Representatives December 5, 2013, page 16, http://www.gpo.gov/fdsys/pkg/BILLS-113hr3309eh/pdf/BILLS-113hr3309eh.pdf.

protection mission and would curtail some of the egregious practices that unfortunately have developed whereby some patent owners send upward of hundreds – or even thousands – of letters to small businesses or individuals with false or misleading threats of litigation for alleged patent infringement and demand for payment.

Given the critical role that patent licensing plays in stimulating and protecting our nation's innovators, the 21C urges caution and balance to ensure that efforts to address what may be a small subset of egregious patent demand letter abuses do not inadvertently chill legitimate patent licensing and enforcement communications. The patent system is designed to encourage notice and communication of patent rights to foster licensing, technology dissemination and enforcement, and many provisions of our laws in fact require notifications concerning patent rights. For example, notification of infringement is, as a practical matter, a prerequisite for collecting enhanced damages under 35 U.S.C. 284, and often important to a determination that a case is "exceptional" under 35 USC 285. Also, in certain circumstances under 35 USC 287, patentees may not be entitled to recover damages on account of infringement "except on proof that the infringer was notified of the infringement and continued to infringe thereafter." Different, but important notification provisions are also found in other areas of patent law, including the patent provisions of the generic and biosimilar statutes, and in situations where the infringers' state of mind may be in issue, such as when they are accused of having induced infringement under 35 USC 271(b).

Free and open communication relating to patent rights is also fundamental to the efficiency of our economy. Routine patent licensing, patent sales, research collaborations, joint ventures, venture financings, and many other transactions involve issues of patent ownership, coverage, validity and enforcement. When disputes relating to patent rights arise, parties should feel that they can freely express their views, so that reporting obligations can be met, and amicable resolutions can be negotiated without resorting to litigation. Such communications also should be encouraged as a means for resolving patents disputes quickly and amicably. Over regulation in this area thus brings with it a clear and present danger of chilling free speech, and of forcing parties into court for fear that pre-litigation communications may otherwise spawn secondary liability issues.

Thus, efforts to regulate patent licensing communications should be narrowly-tailored and measured to avoid the risk of unintended consequences or collateral damage to legitimate patent licensing, settlement and enforcement communications. The 21C is concerned that some calls for FTC oversight of patent demand letters represent thinly-disguised efforts to devalue patent rights, to make patent infringement a less risky business decision, to make patent enforcement more difficult, or to use patent law to pick winners and losers among different industries. That is why the 21C urges that any legislation in this area be framed in terms of objectively defined and identifiable unfair or deceptive acts or practices, involving widespread communications targeting multiple recipients, to protect consumers while avoiding unintended consequences that may upset the balance of the patent ecosystem as a whole.

iii. Suggestions for a Balanced Approach

In the sections that follow, the 21C's specific suggestions are offered relating to legislative measures that can achieve the needed balance between the need for consumer protection against bad faith demand letters and the need to ensure that we do not weaken our patent system by making patent licensing or enforcement more difficult or less certain.

iv. The Need to Define Specific, Objective Acts or Practices as Unfair or Deceptive

It is important that any legislation clearly define what are considered to be unfair or deceptive acts of practices in a clear and objective fashion. Patent owners engaged in legitimate patent licensing communications have no desire to deceive or mislead any recipients of their communications. To the contrary, it is in their interest to provide sufficient information to make clear their ownership of the patent rights in question and their intentions to license or enforce those rights.

So as not to impede such communications, any legislation should clearly spell out those objectively-identifiable acts or practices that the FTC may deem to be unfair or deceptive. This may include false statements of patent ownership or the right to enforce or license patents, as well as misleading basic disclosures that would deceive recipients so that they would be unable to make informed decisions, leaving consumers vulnerable to abuse. But determinations of the merits or sufficiency of allegations of patent infringement included in demand letters are questions of substantive patent law, not consumer protection. The role of the FTC should be to protect the recipients of demand letters against false or materially misleading statements of fact, not to stray into substantive patent law by weighing in on the merits or sufficiency of patent disputes.

Thus, the appropriate role of legislation in this area should be to identify, and empower the FTC to address through its enforcement powers, only those demand letters that are truly intended to deceive or mislead their recipients. Demand letters may be considered to be objectively false or misleading if they:

- Falsely state that litigation has been filed against the recipient, or falsely threaten litigation if compensation is not paid;
- Originate from a person or entity that does not have the right to enforce or license the patent, and is not the representative of a person or entity with the right to enforce or license the patent;
- Seek compensation for a patent that has not been issued or that has been held to be invalid or unenforceable in a final, unappealable or unappealed decision; or
- Seek compensation for activities by the recipient undertaken after the patent has expired.

Likewise, demand letters may be materially misleading if they mislead the recipient concerning basic facts underlying the demand, namely:

- The identity of the person or entity with the right to enforce or license the patent;
- The patent or patents forming the basis of the demand; and
- The identity of at least one product, service or other activity of the recipient alleged to infringe the identified patent or patents.

Any legislation should clearly spell out and enumerate these and any other acts or practices that the FTC will be entitled to address as an unfair or deceptive trade practice. Patent owners pursuing legitimate licensing activities should have clear guidance as to prohibited communications and should not be left wondering about the rules they must follow.

Also, as further protection for legitimate licensing communications, the FTC's enforcement authority should be invoked only when the foregoing activities are numerous and widespread. The problem to be addressed, from a consumer protection standpoint, is caused by those patent owners who send hundreds – or even thousands – of letters to small businesses or individuals with false or misleading threats of litigation and demand for payment. Limiting the FTC's enforcement authority to these widespread practices furthers its consumer protection role while reducing the risk that the FTC will be drawn into individual disputes between patent owners and particular potential licensees or alleged infringers. Those one-off disputes should be decided by federal courts applying substantive patent law, not by the FTC under the guise of consumer protection.

v. The Need to Define a Safe Harbor for Legitimate Patent Communications

To mitigate the risk of chilling effects on legitimate patent licensing, sale, enforcement and settlement communications, the legislation should include "safe harbor" language that makes clear it is not intended to impinge on a patent owner's obligations under applicable laws and policies, his right to inform others of the existence of, need to license, infringement of, or right to put others on notice of its patent rights and/or the availability of, of need for, a license.[61] Such language will also help to ensure that the legislation is not vulnerable to challenge on Constitutional grounds as intruding upon protected rights of free speech in connection with legitimate patent licensing and enforcement activities.[62]

vi. The Need for Federal Preemption

The public and patent owners alike will benefit from the adoption of clear, balanced and uniform legislative guidance regarding the FTC's authority to target bad-faith patent demand letters that, when sent on a widespread basis to multiple recipients, may constitute unfair or deceptive trade practices within the meaning of Section 5(a)(1) of the Federal Trade Commission Act. These interests of balance, uniformity and clarity apply nationally and are furthered by the adoption of exclusive federal legislation. Just as substantive patent laws derive from the Constitution and are exclusively within the province of federal statutes and courts, so too should issues relating to patent demand letters be applied consistently and uniformly nationwide through federal legislation, regulation and judicial action. The FTC, rather than individual states, is in the best position to weigh the balance that federal legislation establishes between the need for consumer protection against bad faith demand letters and the need to ensure that we do not weaken our patent system by making patent licensing or enforcement more difficult or less certain. Thus, legislation in this area should expressly provide that it preempts state law or regulation directed to patent demand letters.

In view of the above, our Coalition is supportive of the approach of treating bad faith demand letters as false and deceptive trade practices, provided it is clear that the FTC will have jurisdiction only in instances where the bad faith assertions are widespread, i.e., to a very large number of unaffiliated recipients, where the statements made are clearly false and deceptive, where it is clear to patentees that they may continue to make good faith statements as required and/or encouraged under the patent laws and other statutes and/or current practice without concern of FTC scrutiny, and where the subject matter of the nature of the demand letters is within the exclusive jurisdiction of the FTC.

D. Improved Post-Grant Issuance Procedures

Section 7 of the Leahy-Lee Bill and Section 9 of the Innovation Act eliminate "could have raised" estoppel provisions from post grant and inter partes reviews, and require that the USPTO apply the same claim construction principles in conducting these proceedings as are applied in court proceedings.

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[61] *See, e.g.*, *Virtue v. Creamery Package Mfg. Co.*, 227 U.S. 8, 37-38 (1913) ("Patents would be of little value if infringers of them could not be notified of the consequences of infringement, or proceeded against in the courts. Such action, considered by itself, cannot be said to be illegal."); *Va. Panel Corp. v. MAC Panel Co.*, 133 F.3d 860, 869 (Fed. Cir. 1997) ("[A] patentee must be allowed to make its rights known to a potential infringer so that the latter can determine whether to cease its allegedly infringing activities, negotiate a license if one is offered, or decide to run the risk of liability and/or the imposition of an injunction.").

[62] Courts have held that patent demand letters fall within the First Amendment's guarantee of "the right of the people . . . to petition the Government for a redress of grievances," U.S. Const. amend. I, and thus are protected from liability by the *Noerr-Pennington* doctrine. *See, e.g.*, *In re Innovatio IP Ventures, LLC Patent Litig.*, 921 F. Supp.2d 903 (N.D. Ill. 2013) (collecting cases).

Our Coalition supports these changes as necessary to carry out the letter and intent of the AIA.[63] It was never intended that the estoppel standard for post grant reviews ("PGRs") be the same as that for inter partes reviews ("IPRs"). To the contrary, because PGRs must be brought immediately after the patent first issues when it is unlikely challengers would be willing to forego all possible grounds for challenge, it was never intended that PGRs would be subjected to a "could have raised" estoppel standard. And this was how the legislation was written until a scrivener's error resulted in it being erroneously conformed to the standard applicable to IPRs, where the estoppel standard is indeed one of "raised or could have been raised."[64]

21C similarly supports the requirement for the USPTO to use the same standards to assess patent validity in post grant and inter partes reviews as are used in the courts. In assessing the validity of already-granted patents in adjudicative proceedings, it makes no sense to judge their validities by one standard in the courts and the ITC, and by an entirely different one in the USPTO. While the USPTO's use of the "broadest reasonable interpretation" ("BRI") during patent examination proceedings makes sense when the USPTO is writing on a blank slate and applicants many freely amend their claims as often as needed in response to USPTO rejections of them, it makes no sense in judging the validities of the claims of issued patents where the prosecution histories of their previous examinations are available, and where the patent owners are given no opportunity to amend the claims of the patents[65] after learning the positions of the Patent Trial and Appeal Board ("PTAB") on their validities. The USPTO is already using the "ordinary and customary meaning" approach to interpreting claims in certain reexamination proceedings where amendments to patent claims are no longer allowed, and can easily do so in PGR and IPR proceedings, so that patent validity will be determined uniformly regardless of the forum in which the issues are raised.

As the comments of the three major IP associations – ABA-IPL Section, AIPLA and IPO -- pointed out during the rulemaking process to implement the AIA, Congressional intent was clear in enacting both the PGR and IPR procedures that the USPTO was being given a new authority to adjudicate the validity of issued patents in fully contested proceedings before the Office under the same legal precedents applicable in the courts.[66] The USPTO nonetheless opted to employ the procedural "BRI" protocol used by patent examiners, both during original examinations and in reexaminations, where the patentee has a right to amend the claims at issue in response to examiners' rejections.

Under the BRI protocol, the USPTO limits its consideration of claims in post-grant proceedings to the express language of the claims and the patent specification, ignoring the prosecution history of those claims, prior statements made by the applicant and the patent examiner about the scope of those claims, and evidence concerning the ordinary and customary meanings of the claim terms as understood by those of ordinary skill in the art, all of which are routinely used by the courts in reaching proper constructions of the claims.

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[63] *See A "REASONABLY COULD HAVE RAISED" ESTOPPEL IN LITIGATION FOLLOWING POST-GRANT REVIEW WILL PREVENT THE ENVISIONED BENEFITS OF THE NEW PROCEDURE FROM BEING ACHIEVED,* available at http://www.patentsmatter.com/issue/pdfs/WhyRCHRJudicialEstoppelShouldNotApplytoPGR6-19-2013.pdf .

[64] *"REASONABLY COULD HAVE RAISED" ESTOPPEL A Technical Error That Should Be Corrected*, available at http://www.patentsmatter.com/issue/pdfs/CorrectiontoJudicialEstoppelinPGRNeeded6-19-2013.pdf

[65] Pursuant to Sections 316(d) and 326(d) of the AIA, the only option available to patent owners in PGR and IPR proceedings is to cancel their patent claims. While the statute does allow patent owners to propose a "reasonable number of substitute claims," these new claims must be proposed early in the instituted proceeding, before any ruling by the PTAB, are subject to the application of intervening rights which causes the forfeiture of past damages collection, and still cannot be amended after finding out the PTAB's position on their validities.

[66] Available at http://www.uspto.gov/aia_implementation/comment-aba-aipla-ipo.pdf.

In doing so, the USPTO overlooked existing precedent that authorizes the use of BRI only in examinations where the applicant still enjoys the right to freely amend the claims at issue in response to USPTO rejections--- a right not provided under PGR or IPR. Since the purpose of PGR and IPR was to provide procedures for testing the validity of issued patents using the same principles applied in the courts or an invalidity challenge before the ITC, it is entirely appropriate that the same claim constructions be used in IPR and PGR and in the courts and ITC. Moreover, this change would bring uniformity to proceedings in the USPTO where it presently uses judicial claim constructions in reexaminations involving expired patents where, as in PGR and IPR, the claims can no longer be freely amended.[67]

While Section 7 appropriately specifies for both PGRs and IPRs that the Office may consider claim constructions previously rendered by the courts, it could be further improved by clarifying that petitioners who were parties to those court proceedings are collaterally estopped by those constructions in the USPTO, just as they would be in the ITC and in other court proceedings. This clarification would simplify the USPTO proceedings such cases, and would ensure that petitioners are not motivated to seek PGR or IPR review solely for the purpose of upsetting already litigated issues.

In addition, both the Innovation Act and the Leahy-Lee Bill should be further amended to ensure that these provisions apply equally to business method patent reviews.

E. Protection of Intellectual Property Licenses in Bankruptcy

Section 6(d) of the Innovation Act and Section 8 of the Leahy-Lee Bill contain provisions intended to protect patent and trademark licenses in foreign bankruptcies. Subsection 6 (d) of the Innovation Act would amend Chapter 15 of the bankruptcy code to make it clear that, in U.S. bankruptcy proceedings involving foreign bankruptcy administrators, U.S. courts will apply the protections of §365(n) of title 11 to prevent unilateral rejection of the debtor's existing intellectual property licenses.

The 21C continues to support these provisions as they will ensure that existing licensees of U.S. intellectual property owned by foreign entities will receive the same protection as licensees of U.S. intellectual property owned by domestic entities. This ensures that existing licenses will not lose their license rights if the foreign intellectual property owner files for bankruptcy under the laws of a foreign country that allow existing intellectual property licenses to be rejected by the bankruptcy administrator.

F. Standards for Awarding Attorney Fees To Prevailing Parties

i. Fee Shifting Provisions of the Cornyn Bill, the Hatch Bill and the Innovation Act

Section 3(b) of the Innovation Act and Section 5 of the Cornyn bill would revise 35 USC 285 to presume that attorney fees and expenses should be shifted to the prevailing party absent certain circumstances. The Innovation Act specifies that such awards are to be made "unless the court finds that the position and conduct of the nonprevailing party or parties were reasonably justified in law and fact or that special circumstance (such as severe economic hardship to a named inventor) make an award unjust. The Cornyn bill is similar, providing that fees and other expenses are to be awarded "unless the court

[67] As the PTO's MPEP § 2258 G explains, "In a reexamination proceeding involving claims of an expired patent, claim construction pursuant to the principle set forth by the court in Phillips v. AWH Corp., 415 F.3d 1303, 1316, 75 USPQ2d 1321, 1329 (Fed. Cir. 2005) (words of a claim "are generally given their ordinary and customary meaning as understood by a person of ordinary skill in the art in question at the time of the invention) should be applied since the expired claim are not subject to amendment."

finds that the position of the losing party was objectively reasonable and substantially justified" or "exceptional circumstances make such an award unjust." [68] The wording in the Hatch Bill is similar but not identical to that of the Cornyn bill, awarding fees, "unless the court finds that the position and conduct of the nonprevailing party or parties were substantially justified or that special circumstances make an award unjust." The 21C supports these provisions in concept because they are (a) bilateral, (b) fairly restricted to only those parties whose conduct is improper, (c) does not attach until after the merits of the case have been finally decided, (d) cannot be easily avoided and (e) encourage the bringing of meritorious suits while discouraging frivolous ones.

Both the Cornyn Bill and the Innovation Act further specify that if a losing party is unable to satisfy the award, the court is empowered to make the reasonable costs and other expenses recoverable against any interested party joined pursuant to proposed new section 299(d) (discussed below). The Innovation Act further adds a new subsection (c) to § 285, to provide that a party giving a unilateral covenant not to sue shall be deemed a "nonprevailing" party for purposes of fee shifting. This provision would not advance the interests of prompt and efficient resolution of patent disputes. This proposal is clearly unfair to parties asserting their patents, and represents poor public policy. First, the unilateral nature of the this provision is unfair to patent owners in that the same right to fees is not given in instances where the accused infringers give up on all or some of their defenses. Second, there are many reasons a patent plaintiff may wish to give up on the assertion of a patent that should not trigger fees liability. Included in these may be that the infringer has stopped the infringing activity, that market conditions or the expenses of the action itself no longer make the case worth pursuing, or that even though believed to be meritorious, the probability of success may no longer justify prosecution of the action. In such circumstances, parties should be encouraged to offer covenants not to sue rather than to continue the litigation to avoid the risk of an automatic application of this provision. Third, the effect of the provision will be to discourage defendants from settling actions in the hope of gaining attorney fees by prolonging and expanding the case to the point where the patent owner will abandon it and have to pay fees. Fourth, sound public policy strongly favors the early termination of cases, by settlement or otherwise, to conserve judicial resources. For these reasons, the 21C opposes this subsection.

Currently, 35 U.S.C. § 285 empowers district courts to award attorney fees to prevailing parties in "exceptional" cases. The 21C believes, however, that existing § 285 is invoked too rarely to serve as an effective deterrent against litigants who seek to assert specious positions – including questionable assertions of infringement or questionable infringement defenses. The 21C has long advocated for a relaxation of the "exceptional" case standard to permit fee shifting in more cases and thereby encourage both plaintiffs and defendants alike in patent infringement actions to assert only meritorious positions. As noted above, with the grant of *certiorari* in the *Highmark* and *Octane* cases, it now appears likely that the Supreme Court is about to do just that, perhaps mooting the need for any new fee shifting legislation.

In the absence of such judicial action, the 21C would continue to support fee shifting to address the litigation behavior sought to be discouraged – the assertion of unjustified claims or defenses in patent infringement cases – in a balanced fashion, seeking to curtail such behavior whether it comes from a plaintiff or a defendant. In other words, such abusive litigation behavior should be targeted regardless of the party that engages in it. Any litigant asserting non-meritorious litigation positions should face the prospect of "loser pays."

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[68] The 21C believes that this language should be amended slightly, to read: "unless the court finds that the position <u>and conduct</u> of the losing party was substantially justified or that special circumstances make an award unjust." Addition of the words "and conduct" will make clear that litigation misconduct can form the basis for an award of attorney fees, as is currently the case under Section 285. *See, e.g., MarcTec, LLC v. Johnson & Johnson,* 664 F.3d 907, 919 (Fed.Cir.2012) ("[I]t is well-established that litigation misconduct and unprofessional behavior may suffice, by themselves, to make a case exceptional under § 285.") (internal quotations omitted).

ii. Fee Shifting When The Losing Party Is Unable To Pay

A number of proposals have been introduced to address the situation where the losing party in an action is unable to satisfy a fee award. This is of particular concern due to the perception that NPEs are often created and structured to be shell entities with no assets other than the patents that are being enforced, and that any fee shifting provision will have no practical effect in deterring abusive litigation if its effect can be easily avoided.

The 21C also supports authorizing courts to order the recovery of reasonable fees and expenses in certain circumstances when the losing party is unable to pay and a related nonparty should be responsible for satisfying the fee award. Specifically, courts should be empowered to address the situation where an entity has transferred a patent to a shell company with assets inadequate to satisfy a fee award, who then asserts that patent in a way that violates Section 285.

For the reasons explained further below, however, the 21C questions whether joinder of parties with a direct financial interest in the case is the appropriate mechanism to ensure that an attorney fees award is collectable when the named party against whom the fees have been assessed is unable to pay such fees. As both the Cornyn Bill and the Innovation Act acknowledge, joinder is an impossibility in instances where the party to be joined is not subject to service of process, where the court would lose jurisdiction as a result of the joinder, or when venue would be improper. Since at least the last of these conditions can easily be created by NPEs who are so inclined, these joinder provisions will likely be easily avoided, rendering this approach not only one of limited utility, but one that will likely drive up the cost of litigation with little positive effect.

The Innovation Act would amend 35 U.S.C. § 299 to add new subsection 299(d), requiring courts in any civil action arising under the patent laws to grant a motion by a party defending an infringement action to join an "interested party" to the case if the party alleging infringement has no substantial interest in the patent(s)-in-suit other than litigation – *i.e.*, the patent owner is a so-called patent assertion entity. A joinder motion could be denied, however, if the party sought to be joined is not subject to service of process in the action or if joinder would deprive the court of subject matter jurisdiction or make venue improper. The joinder requirements in the Innovation Act are largely the same as those in the Cornyn bill.

The definition of an "interested party" who can be joined under this provision includes assignees of the patent at issue, persons who have a right to enforce or sublicense the patent, or a person who has a "direct financial interest" in the patent. However, a direct financial interest would not include i) an attorney or law firm providing legal representation in the action or ii) a person whose sole financial interest in the patent is ownership of an equity interest in the party alleging infringement, unless that person has the right or ability to influence, direct or control the civil action.

With respect to the impact of joinder under this provision, proposed subsection 285(b) would extend contingent liability to satisfy an attorney's fee award made pursuant to proposed subsection 285(a) to an interested party joined pursuant to section 299(d):

"If a nonprevailing party is unable to pay reasonable costs and other expenses awarded by the court pursuant to subsection (a) [35 U.S.C. § 285(a)], the court may make the reasonable costs and other expenses recoverable against any interested party joined pursuant to section 299(d)."

21C questions whether the joinder provision will function as intended. In particular, we question the scope of the third category of persons who may be joined, and whether the provision will achieve its objective of adding the parent companies of shell patent plaintiffs or litigation funders as parties to patent infringement cases. 21C believes that more effective mechanisms exist for achieving that purpose.

With respect to the categories of persons who may be joined, the first two categories – assignees and persons with the right to enforce or sublicense the patent – are relatively noncontroversial. For the most part, such persons must be joined as plaintiffs in patent infringement actions for standing purposes under existing law.

The third category of persons who may be joined – persons with a direct financial interest in a patent-in-suit – raises several concerns. First, the language "direct financial interest in the patent or patents at issue, including the right to any part of an award of damages or any part of licensing revenue" is ambiguous. For example, would this include persons or entities who might stand to benefit from a successful patent infringement action, but who are not so-called "third party litigation funders" who would receive a share of a damages award or who control the conduct of the litigation? The second exception (which would exclude from joinder "a person whose sole financial interest in the patent at issue is ownership of an equity interest in the party alleging infringement, unless such person has the right or ability to influence, direct or control the civil action") would alleviate some, but not all, of our concerns. We still question, however, whether this language would permit joinder of parent companies, or shareholders, of a named plaintiff, since it could be alleged that such persons have at least the ability to "influence" the civil action. The provision should be tightened to clarify that the joinder provision would only reach those persons who have the right to receive proceeds from an award of damages or settlement of the action. We believe that such tightening would better reflect the intent underlying the provision to join only those persons with a right to share in the proceeds of the litigation.

Another problem with joinder is that it is likely to engender collateral disputes over the question of whether joinder is proper at the outset of many patent cases, even those in which a fee award is ultimately not an issue. Such collateral disputes risk delaying and unduly complicating the resolution of patent disputes generally. Equally problematic are the questions of jurisdiction and venue over the parties sought to be joined. Proposed subsection 299(d)(2) provides that joinder may be denied where the interested party is not subject to service or process, or where joinder would deprive the court of personal jurisdiction over the parties or make venue improper. This exception creates a risk that nominal plaintiffs who are shell companies lacking the resources to satisfy fee awards will bring suits in courts where their nonparty owners or litigation funders are not subject to jurisdiction, thus defeating the intended purpose of the joinder provision.

An alternate approach to this collection problem is contained Title II of the Hatch Bill, which proposes that motions to require bonding be brought to force parties who may not be able to satisfy a fee award to post a bond to guarantee that payment. Unfortunately, this bonding provision suffers from a number of disadvantages. First, the proposal would be applied at the outset in all actions, regardless of the merits of the claim being advanced. Indeed, while the proposal lists a number of factors to be considered in deciding whether to require a bond, none of them goes to the merits or potential merits of the claim. As a result, a large class of plaintiffs with meritorious cases will be burdened by the bonding requirement even though there is no possibility that fees will ever be awarded against them. Second, for small businesses and independent inventors, the bonding requirement may foreclose their access to the courts. Given that attorney fees and costs can easily run into the millions of dollars in these cases, to meet a bonding requirement patent owners would need to pledge, i.e. freeze or post, assets at least equal to the amount of the bond, and pay a bonding agency or other service provider for the bond itself. This burden, unilaterally imposed on patent owners but not accused infringers, would be grossly unfair. Third, the proposed procedure in the Hatch Bill will increase the costs of and prolong the patent litigation in all cases where it is raised, even though only a small percentage of them will ever result in fees being awarded. Fourth, rather than being a simple procedure, the factors to be considered are complex, including such issues as the projected amount of fees to be incurred in the litigation, "whether the party alleging infringement can demonstrate that it has and will have the ability to pay the accused infringer's fees and other expenses if ordered to do so" and "whether any party will agree to pay the accused infringer's shifted fees and other expenses, provided that the person or entity can demonstrate that it has and will have the ability to pay the accused infringer's shifted fees and other expenses." Fifth, some of the factors specified to be considered in bonding are totally irrelevant to the issue of whether fees are likely to be awarded, or could be paid. These include whether the party alleging infringement is an institution of higher education or non-profit technology transfer organization, or a licensee thereof who conducts further research on or development of the subject matter to make the subject matter more licensable; "is a named inventor of or an original assignee to an asserted patent"; or is one who "makes or sells a product related to the subject matter described in an asserted patent." Yet the abilities of these exempted parties and organizations to bring frivolous suits or engage in abusive litigation conduct is no different than any other type of patent owner. Finally, the principal factor that will be litigated in most cases where other exemptions don't apply is "whether the bond will burden the ability of the party alleging infringement to pursue activities unrelated to the assertion, acquisition, litigation, or licensing of any patent." This provision is objectionable not only due to its vagueness, but because it plainly discriminates against assertion, acquisition, litigation or licensing activities, which themselves are perfectly legitimate pursuits. The unfairness of this provision is underscored by the fact that a plaintiff would not be able to avoid a bond in the action if its consequence would be to "burden the ability" of that party to continue the very litigation in which the bond is sought.

iii. Contingent Liability – An Alternative Approach to the Fee Collection Problem

The 21C acknowledges that a fee-shifting provision without the ability to assess fee awards against certain third parties may not be effective in deterring litigation misconduct, because litigation funders could bring suits in the name of shell corporations that lack adequate funds to satisfy a fee award. Thus, we recognize that fee-shifting needs to reach beyond the nominal plaintiff.

In our view, a better approach is to extend contingent liability for satisfaction of a fee award to certain non-parties related to a losing party against whom fees have been assessed – specifically, to any person with a direct financial right to share in damage awards or settlement proceeds from the action. Such contingent liability would be triggered when the named party against whom the fees have been assessed is unable to pay the awarded fees. Notice would be given to any third party with a financial interest in a patent when that patent has been asserted in litigation. The notice would inform the third party that the patent is being litigated and would allow the third party to protect itself against any liability by renouncing its right to receive proceeds from an award of damages or settlement of the action. This would ensure that such third parties would be fairly treated and be guaranteed due process.

This approach would extend contingent liability for fee awards to certain third parties without generating fights over bonding or joinder at the outset of patent cases. In addition, this approach would not be subject to circumvention by a plaintiff bringing suit in a court lacking personal jurisdiction over the third party. It might, in some cases, require collateral litigation to collect the fee award at the conclusion of the patent infringement action, but only in that subset of cases in which 1) fees are actually awarded following adjudication on the merits, 2) the nominal plaintiff is unable to pay, and 3) the third party refuses to pay voluntarily.

To ensure that the reach of this contingent fee liability proposal is properly limited, it could be made clear in the legislation or its legislative history that it would not reach to non-parties who are not the real-party-in interest, who are not in privity with a party to the action, and who would benefit only indirectly from a favorable litigation outcome. It would not encompass, for example, patent owners who have exclusively licensed their patents to the plaintiff, with the only interest in the litigation being the possibility of increased royalties if successful litigation allows the licensee to expand its revenue. Rather, it would extend only to those third-parties who own a stake in the proceeds from the litigation. The 21C believes that such an approach would directly address any concern that fee-shifting might be ineffective because patent owners would bring suits in the name of shell corporations that lack adequate funds to satisfy a fee award. It would be both more efficient, and more effective, than would the joinder of interested parties approach currently proposed in the Innovation Act (H.R. 3309), or bonding as proposed in the Hatch Bill (S. 1612).

G. Heightened Pleading Requirements Provisions in the Cornyn Bill & the Innovation Act

Section 2 of the Cornyn Bill and Section 3 of the Innovation Act both require substantially more information to be included in complaints, counter-claims and cross-claims of patent infringement.[69]

The Cornyn Bill would require any pleading alleging patent infringement to include the following: an identification of each patent and each claim allegedly infringed; and an identification of each accused instrumentality, including its name or model number; an explanation of all theories of infringement; an identification of the right of the party alleging infringement to assert the patent(s)-in-suit; a description of the principal business of the party alleging infringement; a list of prior litigation involving the patent(s)-in-suit; disclosure of whether the patent(s)-in-suit have been declared essential in a standard-setting body; disclosure of the identity of any person other than the party alleging infringement who owns, co-owns, or is an exclusive licensee of any asserted patent; disclosure of the identity of any other person that the party alleging infringement knows to have a legal right to enforce an asserted patent or to have a license under such patent; disclosure of the identity of any person with a direct financial interest in the outcome of the action; and a description of any legal basis for a financial interest of another in an asserted patent.

Unlike the Innovation Act, the Cornyn Bill does not 1) except allegations of infringement under cases including Section 271(e)(2) allegations, i.e., Hatch Waxman and biosimilar cases, from these requirements, 2) provide any flexibility where the required information is not readily accessible, or 3) provide for a court, for good cause shown, to allow information determined to be confidential to be filed under seal.

Currently, the content of complaints, counter-claims and cross claims is subject to the requirements established by a network of Federal Rules of Civil Procedure (“FRCP”), and substantial case law precedent that interprets what is needed to plead such a claim. FRCP Rule 8 requires of all claims for relief include (1) a short and plain statement of the grounds for the court’s jurisdiction, unless the court already has jurisdiction and the claim needs no new jurisdictional support; (2) a short and plain statement of the claim showing that the pleader is entitled to relief; and, (3) a demand for the relief sought, which may include relief in the alternative or different types of relief. FRCP Rule 9 of the Federal Rules addresses “Pleading Special Matters.” In general, Rule 9(a)(1) specifies that, unless required to show that the court has jurisdiction, a pleading need not allege (A) a party’s capacity to sue or be sued; (B) a party’s authority to sue or be sued in a representative capacity; or (C) the legal existence of an organized association of persons that is made a party. Rule 9(a)(2) requires that to raise any of those issues, a party must do so by a specific denial, which must state any supporting facts that are peculiarly with the party’s knowledge. Rule 9(b) requires that in alleging fraud or mistake, a party must state with particularity the circumstances constituting fraud or mistake. Malice, intent, knowledge, and other

[69] The Leahy-Lee Bill is silent with respect to pleading requirements, appropriately relying on the courts and Judicial Conference to react to and appropriately adjust pleading requirements to reign-in abusive litigation practices

conditions of a person's mind may be alleged generally. Rule 9(b) has generally been made applicable to the pleading of inequitable conduct defenses in patent infringement actions. Other matters that need to be pleaded specially include conditions precedent, official documents or acts, judgments, special damages and admiralty or maritime claims. Rule 9(f) further specifies that allegations of time or place are material when testing the sufficiency of a pleading.

The pleading of claims in the federal courts is a "notice pleading" system where only the nature of a claim, not the underlying evidence supporting it, is to be pled. Rule 11(b) of the Federal Rules, however, specifies that by presenting a pleading to the court, an attorney or unrepresented party certifies that to the best of the person's knowledge, information and belief, formed after an inquiry reasonable under the circumstances, that: (1) it is not being presented for any improper purpose, such as to harass, cause unnecessary delay or needlessly increase the cost of litigation; (2) the claim is warranted by existing law or by an nonfrivolous argument for extending, modifying, or reversing existing law or for establishing new law; (3) factual contentions have evidentiary support or, if specifically so identified, will likely have evidentiary support after a reasonable opportunity for further investigation or discovery; and (4) the denial of factual contentions are warranted on the evidence or, if specifically so identified, are reasonably based on belief or lack of information. Rule 11(c) authorizes the court, on motion or sua sponte, to impose sanctions on an attorney, law firm, or party who violates this rule.

Under the FRCP, several options are made available to defendants who do not think a claim has been sufficiently pleaded. FRCP Rule 12(b)(6) provides that a party served with a complaint may move to dismiss that complaint for failing to state a claim upon which relief can be granted. In addition, a party who does not believe that there is sufficient disclosure in a complaint may move under Rule 12(e) to compel a more definite statement. Pursuant to Rule 12(e), a more definite statement will be required if the complaint was "so vague or ambiguous that the party cannot reasonably prepare a response." Pursuant to Rule 12(e), once the court has required a more definite statement, if it is not obeyed within 14 days or such other time as the court may set, the court may strike the pleading or issue any other appropriate order. Since its inception in 1937, these rules have been reviewed and revised as needed to keep up with modern practice, and are now again under review by the Federal Judicial Conference. This general approach has served us well for more than 70 years, and has provided defendants ample protections against complaints that are insufficient, vague or ambiguous.

The Innovation Act and the Cornyn Bill would single out patent infringement cases as the only federal civil actions that are required to comply with substantially higher pleading requirements. While the idea of raising the requirements for pleading is patent cases is no doubt well intended, it is likely to lead to exactly the opposite of the results the drafters intend. With heightened, technical pleading requirements, the parties will be drawn into preliminary motion practice, e.g., fighting over whether the pleading is properly framed, rather than getting down to the merits of the case. This is precisely why the Federal Rules adopted a simplified notice pleading approach in the first place. Moreover, the result of such extended motion practice will not be to deter a motivated plaintiff from successfully instituting an action against a party, but will instead consume the parties' and court's time, while unnecessarily delaying the initial disclosure, case management, initial discovery and claims construction phases of the case. These provisions are therefore misdirected and if adopted, will be counterproductive.

Nonetheless, it is fair to say that some of what the Innovation Act and the Cornyn Bill would mandate is fairly necessary to a well pleaded complaint for patent infringement anyway. Included in this category is: (1) the identification of the asserted patent(s), and (2) a description of the product, process or other instrumentality that is the basis for the allegation of infringement. While an identification of the plaintiff's principal business may be relevant to the kind of relief sought, as for example when the defendant is a competitor, in many suits its disclosure in the complaint will be irrelevant. Beyond that, much of what is proposed to be included in a complaint is unnecessary to fairly place the defendant on notice of the nature of the claim, and is best left to the initial disclosure, discovery and case management processes. Other provisions, such as paragraphs (a)(2), (3) and (4) could be improved by limiting paragraph (a)(2) to the identification of at least one claim of each asserted patent, and by limiting (a)(3) and (a)(4) to the identification of each "accused instrumentality" alleged to be infringed under each patent.

Paragraphs (a)(5) and (a)(6) of the Cornyn Bill are inappropriate, as they go far beyond notice pleading, seeking the pleading of evidence and the details of infringement contentions that should not be required at the outset of the proceeding. First, the plaintiff will often not have enough information about the nature and operation of the accused instrumentalities to make such contentions, and in any event, as the claims will not yet have been construed by the court, any contentions that could be made would need to be revised after the *Markman* ruling. Paragraph (a)(7) could be made acceptable if amended to be limited only to the identification of the right to assert each patent, as that requirement would fall within the requirements of Rule 8 that the pleading should generally identify the basis for the court's jurisdiction. Since that jurisdiction is not determined on a claim by claim basis, further specification by claim would be inappropriate. Paragraphs (a)(9) and (a)(10) are also subjects that would be better left for initial disclosure and/or discovery, however if appropriately amended to conform to the Innovation Act's corresponding provisions, could be seen to provide information that might be helpful to a defendant in preparing the answer to the complaint.

The Cornyn Bill could also be improved by adopting the provisions of paragraphs (b) and (c) of the Innovation Act relating to information not accessible to the plaintiff, as these provide important safeguards relating to information not readily accessible to the plaintiff, or that is confidential. Arguably, even in the absence of paragraph (b), Federal Rule 11(b) would have authorized pleadings based on a party's best information and belief, however paragraph (b), as it appears in the Innovation Act, makes this specific for patent cases. Further, paragraph (c) as proposed gives the plaintiff the automatic right to file confidential information under seal, recognizing that the parties will routinely stipulate to a protective order to provide the defendant access to the information while protecting its confidentiality.

In the absence of the changes suggested, pleading requirements requiring this degree of specificity will simply engender disputes at the outset of cases about the sufficiency of the pleadings, even in cases where the parties fully understand the basis for the allegation of infringement. The new pleading requirements in the Cornyn Bill will add to the costs, burdens and time it takes to identify and narrow the issues in dispute and to resolve patent infringement actions.

Apart from pleading requirements, the 21C would support a more robust exchange of information underlying the allegations in initial pleadings at the outset of patent infringement actions. A more fulsome exchange of information at the outset of infringement actions by plaintiffs and defendants alike will advance their efficient resolution. As a practical matter, however, the 21C believes that the judiciary is in the best position to determine what additional pleading specificity will in fact best advance the efficient resolution of patent cases.

H. Discovery Management Requirements for Patent Cases

Both the Cornyn Bill and the Innovation Act would limit discovery in every civil action relating to patents where construction of the terms used in a patent claim is required until the court has rendered such decision. Discovery would only be permitted of information "necessary for the court to determine the meaning of the terms used in the patent claim, including any interpretation of those terms used to support the claim of infringement."[70]

Since judicial construction of claims is sooner or later required in almost every patent case, the effect of this provision would be to delay and bifurcate merits discovery. Even in courts where claims construction is routinely conducted early in the proceeding, it takes at least several months, and sometimes up to a year or more for the court to issue its order. In other jurisdictions, it can take up to 18 months or more before the final *Markman* ruling is issued. Under the proposals in the Cornyn Bill (S. 1013) and Innovation Act, discovery that might otherwise be undertaken concurrently during this period will be postponed, thus delaying consideration of potentially dispositive pre-trial motions until the necessary re-started discovery is completed, and delaying both trial and the ultimate resolution of the case.

Such a bifurcated approach would be less efficient and likely more costly. Discovery disputes over which documents must be produced in the first phase of discovery and which may be withheld would be likely, as would the necessity to recall witnesses for further depositions as the case progresses.

Under current practice, where discovery on all issues starts immediately, additional evidence will normally be adduced that may facilitate the early termination of the case by summary judgment ruling or settlement. If discovery is not allowed prior to claims construction, the court will often be required to delay or deny early disposition of the case pending its completion.

While some patent cases might be managed more efficiently by deferring some, or all, discovery pending the claims construction ruling, courts are already empowered to manage discovery in this manner and to tailor case management to the particular facts and circumstances of each case. District courts across the country with the most experience and skill in managing patent infringement cases have already adopted local rules that specify the timing and scope of discovery and, to our knowledge, none of those courts has put in place an automatic stay of discovery pending claim construction. To the contrary, most local patent rules provide for initial disclosures at the outset of cases mandating an early, robust exchange of documents and information related to the merits of the action, recognizing that such disclosures help to clarify and narrow the issues in dispute and often foster early settlement. These courts also recognize that a developed evidentiary record at the time of the "*Markman*" proceedings assists judges in making claim construction rulings. For these reasons, an automatic stay of discovery pending claim construction is likely to be counterproductive. Simply put, the case has not been made to legislate this one-size-fits-all approach to patent infringement case management.

Although both the Cornyn Bill and the Innovation Act would allow a court to exercise its discretion to expand the scope of discovery for the limited subset of cases where federal law requires completion of the case in a "specified period of time," or "when necessary to resolve a motion properly raised" before the claims construction ruling, neither of these exceptions would remedy the principal concerns with the proposal: that it would prolong almost all patent litigation and substantially increase its already high expense.

The hardship that would be created by this bill would be particularly great on patentees who are marketing products which compete with unlicensed infringements, and whose purpose in bringing suit is to gain relief from the harm being caused them in the marketplace by that infringement. The Innovation Act contains a limited exception in Section (d)(4) for "Actions seeking relief based on competitive harm," but unfortunately limits that exception only to actions seeking preliminary injunctions. If any limitation

[70] The Leahy-Lee Bill, S. 1720, the "Patent Transparency and Improvements Act of 2013," appropriately does not provide for staying discovery.

on discovery is to remain, the words “a preliminary injunction” should be replaced by “relief” to thereby exempt all competitor suits seeking “relief to redress harm arising from any allegedly infringing instrumentality that competes with a product sold or offered for sale, or a process used by a party alleging infringement.”

This proposed change is necessary, because, as the statistics bear out, preliminary injunctions are extremely rare in patent cases, as judges are very reluctant to enjoin a party on a preliminary record. Manufacturers filing legitimate claims for infringement to protect their investments against infringement should not be forced to file needless preliminary injunction motions, which will burden the courts, simply to avoid having the stay of discovery delay resolution of their cases for months. There is no reasonable basis for objection to a broad competitive harm exception for cases involving practicing patent owners by those who believe stays of discovery pending claim construction should be automatic in Non Practicing Entity (NPE) cases. Such an exception would not impact NPE cases.

In addition to the practical difficulties with the proposed stay of discovery provision, it raises serious concerns regarding the role of an independent judiciary. The power of U.S. courts to manage their own calendars and adopt their own case management procedures has long been recognized. The authority to establish and revise the Federal Rules of Civil Procedure has long fallen under the auspices of the United States Supreme Court, which manages the process of reviewing and revising these rules in reliance upon the recommendations of the Judicial Conference of the United States. In respect for this tradition, Congress should not lightly encroach on these procedures. The 21C believes it would be far preferable for Congress to offer recommendations to the Judicial Conference and leave the development of specific in-court practices to its deliberations.

The 21C believes the Leahy-Lee Bill takes the proper course, leaving it to the judiciary to appropriately manage the cases before them.

I. Recommendations to the Federal Judicial Conference in the Innovation Act and Proposals In the Innovation Act & Cornyn Bill Specifying Discovery Sequence, Subject Matter and Cost Shifting

Subsections 6(a)-(b) of the Innovation Act require the Judicial Conference of the United States to develop rules to implement specific requirements set forth in the section to address asymmetries in discovery burdens, including how and when payment for discovery in addition to core discovery is to occur and what information must be presented to demonstrate financial capacity before permitting discovery in addition to core documentary evidence. Section 6 further mandates the specific types of discovery that will and will not be permitted, how it must be requested, and the conditions upon which modifications can be made. Section 6 further instructs the courts as to what must be discussed by the parties concerning discovery, and requires the adoption of such rules, and corresponding local court rules, within specified time frames. The Cornyn Bill goes even further, simply proposing to legislate a one-size-fits-all approach to patent case management.

The Innovation Act and the Cornyn Bill approach to patent case discovery reflects a narrow and one-sided view of patent litigation, in essence legislating that each case be managed in the manner that a defendant in an action brought by a non-practicing entity would seek to have the action managed, when 80% of all patent cases do not involve assertions by such entities. This unbalanced and inflexible approach to all cases is reflected in the automatic stay of discovery pending claim construction, as discussed above. It is also reflected in the definitions of "core documentary evidence" set forth in Section 6(a)(3)(A)(i). Such evidence does not even include, for example, any documents showing the sales of the products accused of infringement, either in dollars or units. On the other hand, the patent owner is required to produce "documents sufficient to show profit attributable to the claimed invention of the patent or patents at issue." Sec. 6(a)(3)(A)(i)(V).

Appropriately, it is within the discretion of the district court judge to decide whether or not to bifurcate damages discovery. But to legislate an approach whereby basic information showing the defendant's sales of the accused product is not "core" discovery, when it is sought by nearly every patent owner in nearly every patent case, and is essential to proving the patent owner's entitlement to its requested relief, reflects a troubling bias against all patent owners seeking to enforce their rights against alleged infringers.

> Putting aside the issues of whether the particular proposals might have merit as to some cases if considered by the Judicial Conference, they raise serious concerns regarding the role of an independent judiciary. As explained above, U.S. courts traditionally manage their own calendars and adopt their own case management procedures. The authority to establish and revise the Federal Rules of Civil Procedure has long fallen under the auspices of the United States Supreme Court, which manages the process of reviewing and revising these rules in reliance upon the recommendations of the Judicial Conference of the United States. Indeed, such an effort is currently underway. For example, Judge Jeffrey S. Sutton, Chair of the Committee on Rules of Practice and Procedure of the Judicial Conference, just published a request for "Comments on Proposed Rules and Forms Amendments" on August 15, 2013. This rules package includes proposals to amend Rule 26, Duty to Disclose; General Provisions Governing Discovery; Rules 30 and 31, Depositions by Oral Examination and by Written Questions; Rule 33, Interrogatories to Parties; and Rule 34, Production of Documents – to list just a few. Comments are due February 15, 2014. The 21C believes Congress should offer recommendations to the Judicial Conference and leave the development of specific in-court practices to its deliberations.

VII. Other Legislative Proposals

A. Double Patenting Codification for First Inventor To File Patents

Section 9(c) of the Innovation Act and Section 9(d) of the Leahy-Lee Bill would add a new § 106 to codify the judge-made law of "double patenting" for patents that will be subject to the AIA's new first-inventor-to-file standard for patentability. Under current law, if an inventor files a patent application within 18 months of a prior patent application claiming an obvious invention from the original invention, there is no mechanism in the AIA to disallow issuance of the obvious invention. The double-patenting doctrine ensures that an inventor cannot secure a second valid U.S. patent that has up to 18 months of additional enforceability by simply making slight variations in the claimed inventions in a first patent. In addition, this provision prevents the possibility that these two patents could become separately owned and be separately enforced, creating the potential for separate assignees to each bring an infringement action against an accused infringer.

The provision would codify the concept that, unless two patents from the same inventor could have validly issued had they been sought by two different inventors, the two patents must be owned by the same entity, and must both terminate upon the earliest termination of either patent.

The 21C supports these amendments.

B. Schumer Bill Proposed Changes To Covered Business Method Patent Reviews

Section 18 of the AIA authorizes certain business method patents to be challenged under the early review procedures established by the AIA. The patents singled out for such challenges are those covering methods or apparatus "used in the practice, administration, or management of a financial product or service" and which are not for "technological inventions." The provision is transitional in nature with an eight-year life because it was intended to apply to a very limited class of patents and the time allotted was deemed sufficient to complete the review.

The Schumer Bill (S. 866) would greatly expand the scope of the business method patents which could be challenged under section 18 by broadening the scope to methods or apparatus used in the management of "an enterprise" or of any "product" and would make section 18 permanent by eliminating its eight-year sunset. 21C believes this change would upset the balance of the carefully constructed 2-tier post grant challenge mechanism established under the AIA. Further, we have yet to see any evidence of a need to expand the program or to make it permanent since it became operational last year.

A major goal of the AIA was to improve the quality of patents. The AIA accomplished this goal by adopting a first-inventor-to-file priority system, simplifying and making more objective the criteria for determining patentability, and making the system more transparent by allowing greater public participation in the patent granting and review process.

Certain enhancements to the review process were key to improving the quality of issued patents. A two-pronged approach was developed: a first prong that allows the public to participate in the examination process by bringing relevant information to the attention of examiners, and a second prong that established two post-grant proceedings in which the public could challenge the validity of issued patents. The first post-grant procedure (Post-Grant Review or PGR) allows any member of the public to challenge the validity of a patent granted under the new first-inventor-to-file rules within nine months of grant on any ground that could be raised under paragraph (2) or (3) of section 282(b). The second post-grant procedure (known as Inter Partes Review or IPR) is available to allow the public to challenge the validity of all patents – both patents granted under the previous first-to-invent rules and, following the 9-month eligibility period for PGR[71], patents granted under the new first-inventor-to-file rules. Patents may be challenged in an IPR until their terms expire, but only on the basis of patents and printed publications.

Together, PGR and IPR are intended to fairly balance the interests of patent holders in obtaining quiet title to their patents and the interests of both the public and patent holders in increasing overall patent quality. PGR allows members of the public to promptly challenge questionable patents on all grounds for the first nine months. The limitation of PGRs to the initial nine months after grant is necessary because all issues of invalidity can be raised – patents, printed publications, and public uses and sales anywhere in the world. The uses and sales could involve evidence based upon oral recollections of events which could have occurred years earlier, including activities that took place outside the United States, in an administrative proceeding with a limited opportunity for discovery. This is just one of the reasons why limiting PGRs to the first nine months is crucial to ensure fairness for patentees.

For those situations where a person has no reason to consider challenging a patent until many years after its issuance, IPR is available throughout the life of a patent to challenge its validity on the basis of patents and printed publications, grounds which do not raise the evidentiary issues of public uses and sales.

[71] Or now, immediately for patents not eligible for PGR.

Rationale for Section 18

The transitional program for challenging "financial sector" business method patents was proposed during the consideration of the legislation that resulted in the AIA as a very narrow and limited one. During the consideration of Section 18, it was made clear that this program was to be narrowly focused, and that it was approved in reliance on its narrow scope. As Chairman Leahy explained,

> "There has been some question about the scope of patents that may be subject to the transitional program for covered business method patents, which is section 18 of the AIA. This provision is intended to cover only those business method patents intended to be used in the practice, administration, or management of financial services or products, and not to technologies common in business environments across sectors and that have no particular relation to the financial services sector, such as computers, communications networks, and business software." 157 Cong. Rec. S5441 (daily ed. Sept. 8, 2011)

Chairman Lamar Smith held a similar view:

> "Section 18 would not cover patents related to the manufacture and distribution of machinery to count, sort, and authenticate currency." 157 Cong. Rec. H4497 (daily ed. June 23, 2011)

Senator Kyl was in full agreement, noting that a CBM patent typically "reads on products or services that are particular to or characteristic of financial institutions"; 157 Cong. Rec. S1379 (daily ed. Mar. 8, 2011) As the time, Senator Schumer assured those concerned that this program might become a vehicle to harass patent owners that this provision was narrowly targeted:

> "In response to concerns that earlier versions of the amendment were too broad, we have modified it so it is narrowly targeted. We want to make sure to capture the business method patents which are at the heart of the problem and avoid any collateral consequences." 157 Cong. Rec. S1053 (daily ed. Mar. 1, 2011) (statement of Sen. Charles E. Schumer).

Senator Schumer also provided an exemplary list of the kinds of "financial products or services" implicated by the statute:

> "[E]xtending credit, servicing loans, activities related to extending and accepting credit, leasing of personal or real property, real estate services, appraisals of real or personal property, deposit-taking activities, selling, providing, issuing or accepting stored value or payment instruments, check cashing, collection or processing, financial data processing, administration and processing of benefits, financial fraud detection and prevention, financial advisory or management consulting services, issuing, selling and trading financial instruments and other securities, insurance products and services, collecting, analyzing, maintaining or providing consumer report information or other account information, asset management, trust functions, annuities, securities brokerage, private placement services, investment transactions, and related support services. 157 Cong. Rec. S5432 (daily ed. Sept. 8, 2011)

Accordingly, at the time of its adoption, critics concerned about the breadth of the program were assured that it was and would remain targeted at patents on a narrow class of financial products and services.

The underlying rationale advanced in support of the program was that the growth in business method patents began in 1998 with the U.S. Court of Appeals for the Federal Circuit decision in *State*

Street Bank & Trust Co. v. Signature Financial Group, Inc.[72] Critics claimed that *State Street* launched an avalanche of patent applications seeking protection for common business practices, but clearly the improved search database created by the Office to review such inventions and the *Bilski* decision's[73] narrowing of the subject matter which could be patented as a business method have ended any such avalanche.

Authorizing such previously granted business method patents to be challenged under the new PGR procedures was said to be necessary because these patents granted by the USPTO following the *State Street* decision were questionable because the Office only had access to "patent defeating information" contained in printed patents and publications, and did not have the ability to uncover public uses and sales of such inventions. Furthermore, the new PGR procedures would allow "financial sector" business method patents to be challenged on the basis that the inventions covered were not eligible for patent protection under section 101 of title 35

But It Is Little Used and Nothing Has Changed

Notwithstanding the alleged urgent need to allow challenges to business method patents under the PGR procedures at the time of the consideration of Section 18, just 39 challenges have been filed and only 12 proceedings have been instituted as of July 31, 2013[74] – barely one per month since the section 18 procedures were available. Moreover, there has been no study or evaluation of the 12 challenges accepted to determine whether or not the expansive procedures of PGR which permit all grounds of patentability to be raised have actually been necessary. It is entirely possible that all of the challenges could have been brought under the IPR procedures which are based only on patents and printed publications. Accordingly, there has been no showing that section 18 has been insufficient to satisfy the purposes for which it was created.

Moreover, no reasons have been given for the need to broaden the definition of the inventions covered in section 18 from methods or corresponding apparatus "used in the practice, administration, or management of a financial product" to a definition expanded to include methods or corresponding apparatus used in the administration or management of "an enterprise" or the practice of a "product." The 21C believes it would increase the opportunities for copyists to harass legitimate patent holders. Absent further study demonstrating that broadening the definition of covered business method patent as proposed in the Schumer Bill (S. 866) is either necessary or effective, the proposed expansion of the definition of the business method patents subject to section 18 challenges would clearly be premature and unfair to inventors and patent owners.

In addition, there is no basis for removing the provision that would sunset section 18 after eight years. By the time the current sunset is reached, all of the patents being granted will be first-inventor-to-file patents and eligible for challenge upon grant under PGR without the need for the transitional provision established by section 18. To extend section 18 indefinitely as proposed in the Schumer Bill would be very prejudicial and unfair to the owners of valuable, new, patent-eligible innovative methods for enhancing commerce and industry because the public will not be encouraged to challenge patents promptly under PGR, but will instead wait and attack later in the life of the patent. This delay will also subject the public to patents which perhaps should not have been granted and would destroy the carefully crafted balance between the PGR and IPR procedures reached during the consideration of the AIA.

[72] 149 F.3d 1368 (Fed. Cir. Jul. 23, 1998).
[73] *Bilski v. Kappos*, 130 S. Ct. 3218 (2010).
[74] See USPTO Trial Proceeding Statistics at http://www.uspto.gov/ip/boards/bpai/stats/aia_trial_proceedings.pdf.

The Schumer Bill (S. 866) would also be detrimental to U.S. industry seeking to protect its innovations abroad. It would set a precedent to which our trading partners could point when amending their patent laws to add special interest exceptions inimical to U.S. inventors.

And now, there is yet another reason not to tinker with the provisions of Section 18. The Supreme Court's has just granted certiorari in *Alice Corp. Pty. Ltd v. CLS Bank International*[75] on December 6, 2013. The Court's answer to the question presented

> "Whether claims to computer-implemented inventions – including claims to systems and machines, processes, and items of manufacture – are directed to patent-eligible subject matter within the meaning of 35 U.S.C. § 101 as interpreted by this Court.?"

will provide additional guidance on the patent eligibility of business method patents. Congress should not prematurely extend Section 18 to address a problem critics assert exists which, if it ever existed, may be totally mooted by the Court's decision.

For all these reasons, 21C opposes amending Section 18 of the AIA at this time.

C. The Innovation Act's Clarification of Limits on Patent Term Adjustment

Section 9(f) of the Innovation Act codifies for currently pending applications the USPTO's *current practice of excluding any time consumed by a request for continued examination ("RCE") from* the calculation of patent term adjustment under 35 U.S.C. §154(b)(1)(B). The amendment would overturn the November 1, 2012 decision of Judge Ellis in the EDVA in *Exelixis, Inc. v. Kappos* I[76] and codify the January 28, 2013 decision of Judge Brinkema, also in the EDVA, in *Exelixis, Inc. v. Kappos* II.[77] In *Exelixis* I, Judge Ellis held that "the plain and unambiguous language of subparagraph (B) requires that the time devoted to an RCE tolls the running of the three year clock if the RCE is filed within the three year period" but has "no impact on PTA if filed after the three year deadline has passed." Judge Brinkema in *Exelixis* II concluded that "the PTO's regulation denying PTA for the time period during which an RCE is under consideration, regardless of when the RCE is filed, is a reasonable implementation of the statute."

Patent term adjustments are critically important to the inventor community. At the time the United States entered the GATT treaty, inventors accepted that their future patents would expire 20 years from their filing date, rather than 17 years from their issue date on the understanding that the terms of these patents would be adjusted to recover any time lost if the USPTO's examination lasted more than 3 years. In recent years, the duration of USPTO examination has substantially increased, meaning that many patents, through no fault of the patent applicants, are entitled to adjustments to extend their patent terms.

A practical reality in the prosecution of patents before the USPTO is that agreement is not always reached in the exchanges that take place between patent examiners and applicants during the initial portion of the examination that is covered as part of the original filing fee paid. To allow for additional consideration and exchanges, USPTO rules provide that an additional fee may be paid together with a

[75] Supreme Court Docket No. 13-298, opinion below, *CLS Bank International v. Alice Corp. Pty. Ltd.*, 717 F.3d 1269 (Fed. Cir. 2013)(en banc)(per curiam), replacing the vacated panel opinion, 685 F.3d 1341 (Fed. Cir. 2011). See http://www.supremecourt.gov/Search.aspx?FileName=/docketfiles/13-298.htm and http://www.supremecourt.gov/qp/13-00298qp.pdf.

[76] *Exelixis, Inc. v. Kappos*, I 12cv96 (E.D. Va. Nov. 1, 2012).

[77] *Exelixis, Inc. v. Kappos*, II 12cv574 (LMB/TRJ) (E.D. Va. Jan. 28, 2013).

request for continued examination, so that the examination may progress further, and hopefully reach a mutually acceptable conclusion. Just as with the negotiation of any agreement, it is usually difficult to assign fault when agreement is reached later rather than sooner. In considering whether an applicant would be credited with pendency towards a patent term adjustment, Judge Ellis in *Exelixis* I appropriately interpreted the statute as allowing for such tolling, provided the RCE was made within the first three years. This is an entirely appropriate outcome that should not be disturbed by statute.

In any event, Congress should not intervene in overruling Exelixis I while the matter is still in the courts. Over fifty civil cases have been filed in the EDVA seeking increases in PTA. Exelixis I has been appealed to the Federal Circuit and it is anticipated that Exelixis II will also be appealed, be joined with Exelixis I, and that a decision will be reached later this year. Given the pending appeal(s) of this question to the Federal Circuit, it would clearly be premature to pursue legislation at this time.

D. The Innovation Act's Clarification of Jurisdiction

Section 9(f) of the Innovation Act would have Congress find that the Federal interest in preventing inconsistent final judicial determinations as to the legal force or effect of the claims in a patent presents a substantial Federal issue that is important to the Federal system as a whole.

As we understand it, this "finding" is intended to address a concern that the Supreme Court's recent decision in Gunn v. Minton 78 has cast doubt over whether state law actions, such as actions for breach of a licensing agreement in which liability turns on whether a party has sold products that infringe a patent,79 continue to "arise under" federal patent law. The Court's opinion in Gunn notes that "arising under" jurisdiction exists when the validity or construction of a federal statute is in question, when a case's resolution will affect numerous other federal cases, or when a case affects the federal government.80 If Gunn's enumeration of "arising under" factors is thus treated as exclusive listing of such factors, "arising under" jurisdiction could be deemed to no longer extend to the case merely threatening inconsistent determinations as to the effect of a patent.

Although the Federal Circuit has recently suggested that its past cases finding "arising under" jurisdiction for patent-related state-law business disparagement and injurious falsehood claims "may well have survived the Supreme Court's decision in Gunn,"81 there is concern that the matter remains unresolved in the Federal Circuit. Moreover, some regional courts of appeals have begun to apply Gunn broadly, effectively treating Gunn's partial enumeration of the factors that can render a patent issue "substantial" for purposes of arising under jurisdiction as an exclusive list.82

It is important that "arising under" jurisdiction continue to extend to these types of cases. If it were otherwise, a patent owner could successfully prosecute an infringement action in federal court with respect to a product, yet simultaneously be held liable for "business disparagement" in state court for asserting that the same product infringes the same patent. Similarly, a licensee manufacturer could successfully assert a defense of noninfringement in federal court, yet be held liable for breach of contract in state court with respect to the same patent and the same product. One of the principal reasons for creating the Federal Circuit in 1982 was to prevent inconsistent adjudications as to the legal effect of a

[78] 133 S. Ct. 1059 (Feb. 20, 2013).
[79] *Scherbatskoy v. Halliburton Co.,* 125 F.3d 288 (Fifth Cir. 1997). Other such causes of action include state-law actions for business disparagement, unfair competition, injurious falsehoods, or interference with prospective economic advantage in which liability depends on whether a patent is infringed by a product, or whether a patent is invalid or unenforceable.
[80] *Gunn*, 133 S.Ct. at 1066-67.
[81] *Forrester Envntl. Servs., Inc. v. Wheelabrator Techs., Inc.*, 715 F.3d 1329 (Fed. Cir. 2013).
[82] *MDS (Canada) Inc. v. Rad Source Technologies, Inc.*, 720 F.3d 833, 842-43 (11th Cir. 2013).

patent – that is, to avoid situations where one circuit finds a patent valid and infringed and another circuit finds the opposite. But a broad reading of Gunn threatens this very type of result.

Ed Reines and Professor Hellman have proposed that, in lieu of the language now contained in section 9(f), the section would add a new subsection to 28 U.S.C. § 1338 that would read as follows:

> (d) For purposes of this section, section 1454, and section 1295(a), a claim of legal malpractice that necessarily raises a disputed question of patent law shall be deemed to arise under an Act of Congress relating to patents.

The 21C generally agrees with what we understand to be the intent of Section 9(f), but we believe the provision would be improved if more directly worded to express its purpose.

VIII. Conclusion

The Coalition for 21st Century Patent Reform appreciates the invitation to provide our views on these and other patent reform proposals, and looks forward to working with Members of the Committee as it continues to consider these issues.