

21C

THE COALITION FOR 21<sup>ST</sup> CENTURY PATENT REFORM  
Protecting Innovation to Enhance American Competitiveness  
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Statement of Kevin H. Rhodes,

Vice President and Chief Intellectual Property  
Counsel of 3M Company,

On Behalf of the  
Coalition for 21<sup>st</sup> Century Patent Reform

To the

Committee on the Judiciary of the  
United States Senate

On

**“S. 1137, the ‘PATENT ACT’ – Finding Effective  
Solutions to Address Abusive Patent Practices”**

May 7, 2015

**Statement of Kevin H. Rhodes**

**Vice President and Chief Intellectual Property Counsel  
3M Company**

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**Executive Summary**

Chairman Grassley, Ranking Member Leahy and Distinguished Members of the Judiciary Committee:

Thank you for the opportunity to testify on “S. 1137, the ‘PATENT ACT’ – Finding Effective Solutions to Address Abusive Patent Practices.” By way of introduction, I am a Vice President and the Chief Intellectual Property Counsel of 3M Company and the President and Chief Intellectual Property Counsel of 3M Innovative Properties Company, based in St. Paul, Minnesota. At 3M, I am responsible for managing the global intellectual property assets of the company and its worldwide affiliates. I testify today on behalf of the Coalition for 21st Century Patent Reform (“21C”), for which I serve as the Chair of the Steering Committee.

21C congratulates Chairman Grassley, Ranking Member Leahy, and Senators Cornyn, Schumer, Hatch, Klobuchar, and Lee on introduction of S. 1137, the “Protecting American Talent and Entrepreneurship Act of 2015” (the “PATENT ACT”). 21C very much appreciates the understanding and hard work by the bill’s sponsors and their staffs to address 21C and other stakeholder concerns that efforts to curb patent litigation abuses do not unduly undermine the ability of all patent owners to bring legitimate infringement actions to enforce their patents. As I explain more fully in Section II that follows, we appreciate that the language of the bill reflects a number of welcome compromises in the provisions on litigation issues such as fee-shifting, fee recovery, pleadings and early disclosures, discovery stays, and customer stays to address abusive litigation practices by some patent owners that have no place in a properly-functioning patent system, while preserving the rights of the overwhelming majority of patent owners to continue in good faith to license, assert, and litigate their patents when necessary to prevent infringement. We believe that the PATENT ACT represents a significant, thoughtful and constructive contribution to the patent reform effort.

But we do not believe that the PATENT ACT is ready to be reported out of this Committee just yet, for the job of patent reform is not yet done. In 21C's view, any meaningful patent reform legislation must also include provisions designed to ensure that the new Inter Partes Review ("IPR") and Post-Grant Review ("PGR") proceedings conducted in the United States Patent and Trademark Office ("PTO") that Congress established in the Leahy-Smith America Invents Act ("AIA") are fair to patent challengers and patent owners alike. Real and effective patent reform must also include provisions to address imbalances that unfortunately have arisen in these AIA review proceedings, as misuse of these reviews against patent owners is a real and growing problem. Abuses are no more acceptable in PTO proceedings adjudicating patents than they are in courts, and we ask this Committee to prioritize reforms of IPR and PGR proceedings equally with litigation reforms.

Let me be clear: IPR and PGR proceedings are important elements in the overall framework of a properly-functioning patent system when they provide faster and less expensive alternatives to litigation to determine the validity of issued patents. But that is only true when those proceedings are conducted in a manner that is equitable and fair to all participants, not when they are so skewed against patent owners that they invite gamesmanship and abuse, which regrettably is the case today. The reforms we propose will restore basic balance and fairness to AIA review proceedings, while retaining their vitality as alternatives to litigation to determine the validity of issued patents.

Contrary to Congressional intent when the AIA was enacted, patent owners have been put at a distinct disadvantage in these proceedings as compared to litigation, leading to high patent invalidation rates and the widespread belief that the procedures are tilted against patent owners. Even worse, patents are being invalidated at such high rates in what are widely perceived to be proceedings biased against patent owners that financial speculators have begun to file IPR petitions to manipulate the stock prices of patent owners for financial gain. Given the widely-reported high "kill rates" for patents in IPR proceedings, the mere filing of the petition can drive down the patent owner's stock price and allow a hedge fund that "shorted" the stock before filing an IPR petition to profit from this scheme. Thus far, one hedge fund in particular has filed IPR petitions to invalidate patents on at least six different pharmaceutical products. The PTO has not yet even decided to institute any of these reviews, let alone made any determination that any of the patents involved are invalid. But the adverse impact on the patent owner starts at the time of filing the review petition, regardless of the ultimate outcome. There can be no doubt that Congress never intended for the IPR and PGR system it created to be gamed in this manner.

Legislation is urgently needed to restore balance and fairness to these proceedings in the manner that Congress intended when it created them, and to reestablish public trust and confidence that they provide all participants – both patent challengers and patent owners – with procedures that comport with basic notions of fairness and due process. As I explain more fully in Section III below, 21C proposes three straightforward legislative changes to accomplish this restoration:

- (1) Reforming the procedures used when the PTO is considering whether to institute an IPR or PGR proceeding to provide a level playing field and basic fairness for all parties;
- (2) Allowing patent owners to have the issues raised in newly-filed petitions first considered in reissue or reexamination proceedings, where they may amend the claims prior to institution of any IPR or PGR; and
- (3) Reviewing the validity of granted patent claims, and substitute claims containing only originally issued claim limitations, by applying the same standards in IPR and PGR proceedings as are applied in courts, including claim construction, burdens of proof and presumptions.

These provisions will achieve increased fairness, predictability and uniformity among proceedings involving granted patents and will reduce duplicative and inconsistent outcomes. By removing the current questions and uncertainty that exist concerning the fairness of the procedures used in these proceedings, Congress will reassure the innovation community that patents can be relied upon to protect and support the investments in research, development, commercialization, technology transfer, and collaborations that are so essential to future innovation.

21C pledges to continue to work with members of this Committee, their staffs, and other stakeholders to couple the provisions in the PATENT ACT as introduced with these additional provisions that are so essential to restore balance and fairness in AIA review proceedings. 21C looks forward to lending its strong support for a bill that addresses both patent litigation and AIA review proceedings in an effective and comprehensive fashion.

## **Statement of Kevin H. Rhodes**

Chairman Grassley, Ranking Member Leahy and Distinguished Members of the Senate Judiciary Committee:

Thank you for the opportunity to testify on “S. 1137, the ‘PATENT ACT’ – Finding Effective Solutions to Address Abusive Patent Practices.” By way of introduction, I am a Vice President and the Chief Intellectual Property Counsel of 3M Company and the President and Chief Intellectual Property Counsel of 3M Innovative Properties Company, based in St. Paul, Minnesota. At 3M, I am responsible for managing the global intellectual property assets of the company and its worldwide affiliates. I am a registered patent attorney and have been practicing for 24 years in the field of intellectual property law and litigation, previously in private practice and for the past 14 years in-house at 3M. I am a member of the Boards of Directors of the American Intellectual Property Law Association, the Intellectual Property Owner’s Association and the Intellectual Property Owner’s Association Educational Foundation. I also serve on the Executive Committee of the Association of Corporate Patent Counsel.

I testify today on behalf of the Coalition for 21st Century Patent Reform (“21C”), for which I serve as the Chair of the Steering Committee. 21C is a broad and diverse group of more than 40 companies, the Steering Committee of which includes 3M, Bristol-Myers Squibb, Caterpillar, Eli Lilly, ExxonMobil, General Electric, Procter & Gamble and Johnson & Johnson. For more than 100 years, our Coalition’s companies have played a critical role in fostering innovation in the United States. 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 devices, pharmaceuticals, and biotechnology, our Coalition has long advocated for patent reforms that will foster investments in innovation and job creation, and promote vigorous competition in bringing new products and services to the market.

### **I. Introduction.**

The member companies of 21C take an intense interest in a properly-functioning patent system, and we approach issues of patent law and policy from a middle-ground perspective. In the case of 3M, for example, 3M is a plaintiff about as often as it is a defendant in patent infringement litigation. On the plaintiff’s side, as an innovator and

market leader, patent enforcement is often necessary for 3M to protect its R&D investments, technologies and products against infringement by others. On the other hand, 3M invests considerable resources to avoid being a defendant in patent infringement litigation. As an integral part of its new product development process, 3M reviews thousands of third-party patents each year to ensure that 3M is not infringing the patent rights of others. Nonetheless, disputes inevitably arise and 3M finds itself on the receiving end of patent demand letters and infringement lawsuits. As a result, in terms of legislation directed to patent litigation rules and practice, 3M, like other 21C member companies, seeks to ensure that balance and fairness is afforded to patent owners and patent defendants alike.

Likewise, with respect to the new Inter Partes Review (“IPR”) and Post-Grant Review (“PGR”) proceedings created by the Leahy-Smith America Invents Act (“AIA”), 3M and its fellow member companies of 21C have balanced interests.<sup>1</sup> Our members have participated in AIA review proceedings both as patent owners and as patent challengers. We believe it is essential to the patent system that these proceedings be designed, structured and conducted in a manner that is fair and unbiased for both patent challengers and patent owners. We believe that is exactly what Congress intended when it created IPR and PGR proceedings to provide expeditious, efficient and cost-effective alternatives to litigation for adjudicating the validity of issued patents.

#### **A. 3M’s and 21C’s Balanced Perspectives on Patent Litigation.**

As a global, diversified technology company based on science and bringing innovative new products to its customers, 3M devotes enormous resources to R&D and to obtaining patent protection for its technologies and innovative products. In 2014 alone, 3M invested \$1.77 billion in R&D and was awarded 625 U.S. patents. 3M obtained its first patent in 1923 and last year received the 100,000<sup>th</sup> patent in its corporate history.

These patent rights are not self-enforcing. It is essential to 3M that it has the ability to assert its patents effectively, efficiently, and expeditiously to prevent infringers from free-riding on 3M’s investments in innovation.

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<sup>1</sup> The AIA also created a third new type of review for certain issued patents, the Transitional Program for Covered Business Method Patents (“CBM” reviews). CBM reviews utilize the procedures of PGRs, so proposals for modifying PGR proceedings address changes for CBM reviews as well.

3M sells over 50,000 products in five different business groups, with total sales in 2014 of nearly \$32 billion. 3M's products range from industrial products like abrasives, adhesives and automotive components; consumer products like Post-it® notes and Scotch® tape; safety and graphics products like RFID tags and readers, respirator masks, and reflective sheeting for road signs; electronics and energy products like optical films for computer screens, window films and components for solar energy generation; and health care products like stethoscopes, dental implants and medical billing software. With so many products in so many different market segments, it is inevitable that 3M sometimes finds itself accused of infringing patents owned by others. 3M thus knows from first-hand experience the challenges involved in defending itself against patent demand letters and infringement lawsuits from non-practicing entities (NPEs) and patent assertion entities (PAEs), as well as competitors.<sup>2</sup>

So on balance, as both plaintiffs and defendants in patent infringement lawsuits, 3M and its fellow member companies of 21C support measured reforms to curb the litigation abuses that undeniably currently exist, balanced against the need to ensure that a patent owner's ability to enforce its patent rights against infringement – a core value of the patent grant – is not unduly undermined by unbalanced, overly-broad reactions to litigation abuses by a few patent owners. That is the balance we have been seeking in the patent reform legislation proposed last year and in this Congress.

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<sup>2</sup> Although the terminology is not well-defined, clear or subject to accepted, shared or even common understandings, as I understand the term, a non-practicing entity (“NPE”) is a patent owner who does not make or sell a product embodying its patented invention. NPEs thus may include a wide variety of patent owners, including not only so-called “patent trolls,” but also universities, individual inventors, startup firms, R&D or engineering entities, patent holding companies, patent aggregators, companies not practicing noncore patents, and even companies that have not yet commercialized a particular patent, but which may in the future depending on their resources, business plans and customer demands. Patent assertion entities (“PAE”), as I understand the term, are a subset of NPEs that acquire patents for the purpose of asserting them against alleged infringers. *See* Fed. Trade Comm'n, *The Evolving IP Marketplace: Aligning Patent Notice and Remedies with Competition*, at p.8 n.5 (2011) (available at <http://www.ftc.gov/os/2011/03/110307patentreport.pdf>).

**B. Reforms To IPR and PGR Proceedings Are Essential Elements for Any Real and Effective “Patent Reform.”**

A focus of proposed patent reform legislation in this Congress and the last has been on proposals to halt abusive litigation practices. That is an essential element of patent reform and one that 21C fully supports. However, it is not enough. Real and effective patent reform must also include reforms to address gamesmanship and abusive practices that have arisen since the PTO began accepting IPR petitions on September 16, 2012, a year following enactment of the AIA.<sup>3</sup> Misuse of these reviews against patent owners is a real and growing problem. Such abuses are no more acceptable in PTO proceedings adjudicating patents than they are in courts, and we ask this Committee to prioritize reforms of IPR and PGR proceedings equally with litigation reforms.

To be clear: what was true when Congress enacted the AIA is still true today – IPR and PGR proceedings are important elements in the overall framework of a properly-functioning patent system when they provide faster and less expensive alternatives to litigation to determine the validity of issued patents. But that is only true when those proceedings are conducted in a manner that is equitable and fair to all participants, not when they are so skewed against patent owners that they invite gamesmanship and abuse, which regrettably is the case today. The reforms we propose will restore basic balance and fairness to AIA review proceedings, while retaining their vitality as alternatives to litigation to determine the validity of issued patents. Just as patent litigation reforms must be measured and balanced to ensure that they do not unduly undermine the rights of patent owners to assert their patents against infringers, so too must reforms to AIA review proceedings be measured and balanced to ensure that these reviews retain their intended purpose of providing viable alternatives to litigation to determine the validity of issued patents.

Unfortunately, many of the problems we see in AIA reviews today are a direct result of the PTO’s implementation of IPR and PGR proceedings in a manner that deviated in several important aspects from the framework established by the AIA and sound patent policy. Contrary to Congressional intent when the AIA was enacted, patent owners have

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<sup>3</sup> Because PGR proceedings are only applicable to patents issued under the first-inventor-to-file regime begun on March 16, 2013, the first PGR petition was not filed until August 5, 2014 and only a handful have been filed thus far. The same problems discussed in connection with IPR proceedings also exist with respect to the PTO’s implementation of PGR proceedings, so the magnitude and impact of these problems will only increase as more first-inventor-to-file patents issue and more PGR petitions are filed.



been put at a distinct disadvantage in these proceedings as compared to litigation, leading to high patent invalidation rates and the widespread belief that the playing field is tilted against patent owners. Legislation is urgently needed to restore balance and fairness to these proceedings in the manner that Congress intended when it created them, and to reestablish public trust and confidence that they provide all participants – both patent challengers and patent owners – with procedures that comport with basic notions of fairness and due process.

Indeed, the importance and urgency of Congressional action can hardly be overstated. The perceived bias of AIA review proceedings against patent owners has incentivized a form of “forum-shopping” spree by patent challengers. The latest statistics from the PTO indicate that 3,176 review petitions have been filed as of April 30, 2015,<sup>4</sup> greatly exceeding the number of petitions expected at the time the AIA was passed.<sup>5</sup> The vast majority of IPR petitions have been filed against patents involved in concurrent litigation (up to 80% by some estimates). Given the speed of AIA review proceedings and the expectation that district courts will liberally grant stays of litigation pending a final decision in a concurrent AIA review, it is no overstatement to say that we are witnessing a sea change in patent adjudication in this country, with the adjudication of the validity of patents being asserted in litigation shifting in huge numbers from district courts to the PTO’s Patent Trial and Appeal Board (PTAB).

The popularity of these proceedings among patent challengers as a parallel pathway to challenge patents in litigation is hardly a surprise, given the perception – and reality – that challengers have significant advantages over patent owners as a result of how the PTO implemented the review procedures. As I explain more fully in Section III below, legislation requiring the PTO to apply the same standards as the courts will achieve increased fairness, predictability and uniformity among proceedings involving granted patents and will reduce duplicative and inconsistent outcomes.

In fact, patents are being invalidated at such high rates in what are widely perceived to be proceedings biased against patent owners that financial speculators have begun to file IPR petitions to manipulate the stock price of patent owners for financial gain. The *Wall*

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<sup>4</sup> See [http://www.uspto.gov/sites/default/files/documents/aia\\_statistics\\_04-30-2015.pdf](http://www.uspto.gov/sites/default/files/documents/aia_statistics_04-30-2015.pdf).

<sup>5</sup> The PTO originally estimated that 460 IPR petitions would be filed annually. See 77 Fed. Reg. 48724 (Aug. 14, 2012). In fiscal year 2014, the number of petitions filed was nearly three times higher (1310). See [http://www.uspto.gov/sites/default/files/documents/aia\\_statistics\\_04-30-2015.pdf](http://www.uspto.gov/sites/default/files/documents/aia_statistics_04-30-2015.pdf).

*Street Journal* reported on this investment scheme, in which a hedge fund takes a short position in the stock of the patent owner and then files IPR petitions against patents protecting its important products.<sup>6</sup> Given the widely-reported high “kill rates” for patents in IPR proceedings, the mere filing of the petition can drive down the patent owner’s stock price and allow the fund to profit from this scheme. Thus far, one hedge fund in particular has filed IPR petitions to invalidate patents on at least six different pharmaceutical products.<sup>7</sup>

The PTO has not yet even decided to institute any of these reviews, let alone made any determination that any of the patents are invalid. But the adverse impact on the patent owner comes upon the mere filing of the review petition, regardless of the ultimate outcome, because the IPR process is so widely viewed as being skewed in favor of patent challengers. There can be no doubt that Congress never intended for the IPR and PGR system it created to be abused in this manner.

This problem is acute and will only grow as more and more review petitions are filed, so we cannot afford to wait to see if the PTO seeks to establish more fairness and balance through a lengthy second rulemaking process to correct the errors of its first rulemaking.<sup>8</sup> Legislation is needed to restore the fairness and balance that Congress

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<sup>6</sup> See <http://www.wsj.com/articles/hedge-fund-manager-kyle-bass-challenges-jazz-pharmaceuticals-patent-1428417408>.

<sup>7</sup> See <http://www.bloomberg.com/news/articles/2015-04-23/celgene-shire-make-five-as-kyle-bass-expands-drug-patent-fight>.

<sup>8</sup> As an example of the need for legislation to correct problems with AIA review proceedings now, rather than waiting for the PTO to fix the problems itself, consider the PTO’s use of the “broadest reasonable interpretation” (“BRI”) for patent claims in IPR and PGR proceedings, which has created a fundamental inconsistency between the adjudication of the validity of issued patent claims in courts and the PTAB. A wide segment of the PTO user community has consistently opposed the use of BRI in IPR and PGR proceedings. Shortly after passage of the AIA, when the PTO proposed implementing rules, the three leading intellectual property law organizations – the American Bar Association Intellectual Property Law Section, the American Intellectual Property Law Association and IPO – submitted multiple joint comments commenting on the regulations the PTO proposed. These organizations were united in urging that BRI not be used for these reviews. See *ABA-IPL, AIPLA and IPO Comments to USPTO on Proposed Rules for AIA Implementation* (April 9, 2012) (available at [http://www.uspto.gov/sites/default/files/aia\\_implementation/comment-aba-aipla-ipo.pdf](http://www.uspto.gov/sites/default/files/aia_implementation/comment-aba-aipla-ipo.pdf)).

In the Fall of 2014, these same organizations were among those that provided comments to the PTO in response to a Federal Register Notice requesting comments on “Trial Proceedings Under the America Invents Act (AIA) Before the Patent Trial and Appeal Board.” 79 Fed. Reg.

intended in the first place for all participants in IPR and PGR proceedings. By removing the current questions and uncertainty that exist concerning the fairness of the procedures used in these proceedings, Congress will reassure the innovation community that patents can be relied upon to protect and support the investments in research, development, commercialization, technology transfer, and collaborations that are so essential to future innovation.

In sum, 3M and other member companies of 21C bring a perspective to proposals for patent reform legislation that is both long-term and balanced. Our primary interest is in making sure that our nation's patent laws reflect sound patent policy and promote our nation's innovation ecosystem. Abusive patent practices have no place in our patent system, and that applies equally to the abuses that can arise in the context of patent litigation and the abuses that can arise from a lack of balance and fairness during IPR and PGR proceedings in the PTO.

From this perspective, I will share 21C's views on the PATENT ACT as introduced and the additional provisions that are essential to correct the imbalances that have arisen in AIA review proceedings. Coupled with the PATENT ACT's litigation reforms, these additional provisions will ensure that the legislation represents an effective and comprehensive achievement in terms of advancing U.S. patent law and policy, and that it helps to maintain our patent system as the gold standard by which all others are measured.

## **II. The PATENT ACT.**

21C supports legislation to target abusive patent enforcement practices. Such practices do not promote American innovation or the interests of the public, and the vast

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36474 (June 27, 2014). Based on two years of experience with AIA review proceedings among their tens of thousands of members, they again unanimously called upon the PTO to cease using the BRI protocol in favor of a claim interpretation standard in AIA reviews consistent with that used in courts. *See ABA-IPL Comments in Response to 79 Fed. Reg. 36474* (available at [http://www.americanbar.org/content/dam/aba/administrative/intellectual\\_property\\_law/advocacy/advocacy-20141016-comments-ptab.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/administrative/intellectual_property_law/advocacy/advocacy-20141016-comments-ptab.authcheckdam.pdf)); *AIPLA Comments in Response to 79 Fed. Reg. 36474* (available at [http://www.uspto.gov/sites/default/files/ip/boards/bpai/aipla\\_20141016.pdf](http://www.uspto.gov/sites/default/files/ip/boards/bpai/aipla_20141016.pdf)); *IPO Comments in Response to 79 Fed. Reg. 36474* (available at [http://www.uspto.gov/sites/default/files/ip/boards/bpai/ipo\\_20140916.pdf](http://www.uspto.gov/sites/default/files/ip/boards/bpai/ipo_20140916.pdf)).

Yet to date, after three years of consistent calls for change, the PTO has not acted upon any of these comments regarding its use of BRI.

majority of patent holders in this country take no part in them. That is why 21C has remained actively engaged in the legislative efforts to curb these abusive practices, while at the same time working to ensure that legislation would not impinge upon the rights of patent owners to continue to license, assert, and litigate their patents in good faith.

21C believes that the provisions directed to patent litigation in the PATENT ACT represent the most balanced legislative approach proposed to date that promises to curb patent litigation abuses without unduly undermining the ability of all patent owners to bring legitimate infringement actions to enforce their patents. I will discuss a number of these provisions below, with particular emphasis on explaining how the language reflects welcome compromises to address 21C and other stakeholder concerns without compromising its effectiveness in curtailing abusive litigation practices.<sup>9</sup>

#### **A. Sec. 3. Pleading and Early Disclosure Requirements.**

Section 3 of the PATENT ACT eliminates Form 18, the bare-bones model complaint for patent infringement that has prevented patent infringement cases from being subject to the same pleading requirements as other types of civil litigation, even following the Supreme Court's opinions in its *Twombly* and *Iqbal* decisions.<sup>10</sup> 21C has supported the elimination of Form 18; but beyond that, 21C has cautioned that Congress should not legislatively mandate so much pleading specificity that every patent infringement complaint spawns needless and burdensome battles about the adequacy of what has been pled. Pleadings should put the parties on fair notice of the claims and defenses at issue in the case, without engendering collateral disputes that increase the costs and burdens of litigation and delay its resolution.

Section 3, while requiring plaintiffs to list each patent and claim allegedly infringed, to identify the products or processes that are accused of infringing, and to describe the alleged infringement, includes safeguards to ensure that patent owners can file complaints even if they lack complete knowledge or information within the control of the defendant. Specifically, subsection (c) permits plaintiffs, consistent with their Rule 11 obligations, to plead information in general terms if it is not accessible to them after an inquiry reasonable

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<sup>9</sup> I will focus my statement on a discussion of the litigation-related provisions of the PATENT ACT; and in the context of an overall bill that achieves the goals discussed herein, 21C finds the other provisions not discussed here to be acceptable as well.

<sup>10</sup> *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544 (2007); and *Ashcroft v. Iqbal*, 556 U.S. 662 (2009).

under the circumstances. In addition, subsection (d) confirms that pleadings in patent cases subject to these requirements can be amended as specified in the Federal Rules of Civil Procedure.

One of the criticisms of earlier proposals for heightened pleading requirements in patent cases arose from requiring complaints to include background information that is not needed to state a claim for relief for patent infringement, such as entities with a financial interest in the case, earlier complaints filed for infringement of the patent-in-suit, and licensing obligations associated with the patent-in-suit. Although such information should be disclosed in litigation, concerns were raised that requiring it to be pled in the complaint simply provides more opportunity for early motions to dismiss to be brought alleging deficiencies in pleading such background information, with such motions being brought not to challenge the sufficiency of infringement allegations, but rather for delay, to drive up costs for plaintiffs, or for other improper tactical purposes. Section 3 of the PATENT ACT addresses these concerns by moving certain background information from the pleadings to a new early disclosure required from the plaintiff not later than 14 days from the filing of the complaint. The plaintiff must disclose entities with rights in the patent-in-suit or financial interests in the case, previous complaints filed alleging infringement of the patent-in-suit, and whether the patent is subject to certain licensing obligations. By requiring that such information be provided in in the form of initial disclosures rather than in pleadings, such information will be disclosed at the outset of cases, as it should, but in a manner that will avoid needless motions.

#### **B. Sec. 4. Customer Stay.**

21C has long advocated for a statutory customer stay provision as one of the most effective measures that Congress could enact to reduce patent litigation abuse. Unfortunately, some patent owners have abused the litigation system by making overly-broad infringement assertions, often against many different participants in a manufacturing/supply/distribution/retailer/end-user chain, intending to extract windfall settlements from multiple defendants seeking only to avoid the cost and disruption of litigation. Non-meritorious litigation positions, espoused by patent owners to force settlements in the face of the staggering costs of litigation, have no place in patent cases. Thus, manufacturers should have the statutory right to intervene in actions against their customers or end users, or to proceed in separate actions against patent owners, and customers 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

infringement suits between patent owners and manufacturers of the accused products or processes. This right to stay customer/end user suits would curtail the practice of filing such suits to coerce settlements from those customers or end users who may lack sufficient technical knowledge of the accused product or the wherewithal to defend against infringement allegations, 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 of the products accused of infringement.

Although this type of customer stay right is easy to state conceptually, drafting a workable framework is much more challenging. A customer stay right must balance fairly all three interests: those of the patent owner, the manufacturer, and the customer/end user. This is especially difficult in the context of complex, nonlinear supply chains, where the distinctions among manufacturers, assemblers, customers and end users may not be entirely clear. The goal is to ensure that stays are available only for those at the end of the supply chain who are simply reselling or using the accused product or process as intended by the manufacturer, not for those who are making or modifying products in a manner alleged to infringe the patent-in-suit and thus are in the best position to defend against infringement allegations based on their actions.

We believe that Section 4 of the PATENT ACT achieves this delicate balance in several ways. For example, it limits the definition of “covered customer” – *i.e.*, a party entitled to a stay – to retailers and end users who are reselling or using a product or process obtained from a manufacturer and who have not made material modifications to the accused product or process in a manner that is alleged to infringe the patent-in-suit. Significantly, a manufacturer of an accused product or process cannot qualify as a covered customer. Through these definitions, the customer stay is available only to those at the end of the supply chain, who are reselling or using a technology acquired from a covered manufacturer, without materially modifying it.

To address manufacturer concerns that the customer stay right not intrude upon the terms of supply contracts or indemnification agreements between suppliers and customers, subsection (c) provides that the covered manufacturer must consent to a stay if it has been made a party to the action on motion by the covered customer. Otherwise, a stay is available only if the manufacturer in essence gives its “consent” by intervening in the action or by filing a separate action involving the same patents and accused products or processes. Consent is not required, however, if the manufacturer has been sued for infringement in the same action as its customer or in a separate action, as in such cases the

manufacturer already must defend itself against the infringement allegations brought by the patent owner.

Section 4 also includes an important safeguard to protect patent owners against being forced to litigate the same issues twice against a covered manufacturer and then a covered customer. In order to obtain a stay, a covered customer must agree to be bound as to issues determined in an action against its manufacturer or supplier without a full and fair opportunity to separately litigate any such issue, but only as to those issues for which all other elements of the common law doctrine of issue preclusion are met. To further protect the patent owner, a stay may be lifted if the action against the covered manufacturer will not resolve major issues in the suit against the covered customer, or where the stay is unreasonably prejudicial or would be manifestly unjust.

Some have criticized the customer stay provision on the grounds that it would deprive patent owners of remedies for infringement if the manufacturer of an accused product is located in a foreign country and is beyond the jurisdiction of U.S courts. Under subsection (b)(1), however, the customer stay is only available to a covered customer if its covered manufacturer is a party to the action against the covered customer or a separate action in a Federal court of the United States involving the same patent or patents relating to the same covered product or process. Thus, a stay of an action brought against a customer accused of infringement would not be available if the manufacturer were beyond the jurisdiction of U.S courts. In fact, a stay would not be available unless the manufacturer is actually a party to an action involving the same patents and products or processes in a federal district court. Otherwise, the patentee's action could proceed against the customer, as under current law.

On balance, therefore, 21C believes that Section 4 creates a customer stay right that appropriately balances the interests of all parties – the patent owner, the covered manufacturer and the covered customer – and thus achieves the goal of protecting retailers and end users from defending patent infringement actions in the first instance, in favor of allowing the litigation to proceed against the manufacturer of the accused product or process, who will be better-positioned to mount a defense. We believe that this provision will discourage the filing of opportunistic patent infringement suits to coerce settlements from parties who lack the knowledge or resources to defend themselves and will promote the efficient resolution of patent disputes between the parties in the best position to litigate the merits of the case.

### **C. Sec. 5. Discovery Limits.**

21C has expressed concerns with previous legislative proposals to stay discovery in patent cases pending the district court's construction of the patent claims at issue. As we have explained, claim construction must take place in nearly every patent case, and it often involves lengthy and complicated briefing, hearings and orders that can take considerable time to complete. Deferring discovery during this process risks undue delay, adding substantially to the total pendency of nearly every patent infringement case, even cases between competitors where prompt resolution of the infringement allegations on the merits may be essential to protecting the patent owner's investments in R&D, products and businesses built upon the patented invention.

Section 5 of the PATENT ACT addresses these concerns by limiting the stay of discovery to the time required to resolve certain motions filed before the first responsive pleading – specifically, motions to dismiss, transfer venue, or sever accused infringers. This still provides meaningful relief from expensive discovery to those defendants who believe they are entitled to dismissal from the case, that the case should be litigated in a different forum or that they have been improperly joined with other defendants. It will curtail the practice of allowing discovery to proceed while a motion to transfer is pending, and then citing that discovery and the court's familiarity with the case as grounds for denying a motion to change venue brought under 28 U.S.C. § 1404(a). But at the same time, it alleviates the risk of prolonged delays in nearly every patent case, which is the risk if discovery is stayed during lengthy claim construction proceedings.

Section 5 includes a number of safeguards to ensure that the stay of discovery is not abused for purposes of delay. For example, as mentioned, any motion on which a stay is premised must be filed prior to the first responsive pleading. Further, courts are afforded discretion to allow limited discovery necessary to resolve such motions or a motion seeking preliminary relief, or if the court finds that additional discovery is necessary to preserve evidence or otherwise prevent specific prejudice to a party. Particularly important, subsection (c)(2) provides that nothing prohibits a court from ordering or local rules from requiring the exchange of contentions by interrogatories or other written initial disclosures. District courts across the country with the most experience and skill in managing patent infringement cases have adopted local rules that specify the timing and scope of such initial disclosures, which help to clarify and narrow issues in dispute, identify potentially dispositive issues for early resolution, and foster opportunities for settlement. Subsection (c)(2) ensures that the stay of discovery does not have the unintended consequence of



bringing these efficient and effective case management practices to a halt whenever a preliminary motion is filed that triggers a stay of more intrusive and expensive discovery.

**D. Sec. 6. Judicial Conference Discovery Reforms.**

Section 6 of the PATENT ACT requires the Judicial Conference of the United States to develop discovery rules and case management procedures to address concerns regarding the asymmetries in discovery burdens and costs that may arise in patent litigation. These include the extent to which each party is entitled to “core documentary evidence” as opposed to “noncore” or “additional” documents, access to electronic discovery and computer code, and which party should be responsible for the costs of production. The Judicial Conference also is required to develop procedures for discovery sequencing and scope, as well as case management procedures for patent cases.

21C believes that this is the right approach to develop more efficiency, consistency, and predictability among district courts across the country in terms of patent litigation discovery and case management. Invoking the process established decades ago under the Rules Enabling Act will allow the federal judiciary, acting through the Judicial Conference, to craft and propose such rules to the Supreme Court and then to Congress. We believe that the federal judiciary, drawing upon its vast experience and knowledge in the litigation of patent disputes, is best positioned to address concerns regarding the asymmetries in discovery burdens and costs that may arise in patent litigation without unduly burdening the ability of patent owners to bring and pursue legitimate claims for infringement of their rights.

**E. Sec. 7. Fees and Recovery.**

21C has long viewed more frequent fee-shifting in patent cases as the single most effective measure that Congress could enact to address abusive behavior in patent cases. If applied in a balanced, principled manner, targeting unreasonable positions or conduct on the part of any litigant, more frequent fee-shifting can encourage meritorious litigation behavior and can discourage the filing of unfounded cases and litigation misconduct.

Accordingly, 21C has long supported changing the “exceptional case” standard of 35 U.S.C. § 285 to permit more frequent fee shifting in patent cases, to encourage both plaintiffs and defendants to assert only meritorious positions, and to discourage litigation misconduct. Although the Supreme Court, during its last term, handed down two

unanimous decisions in *Octane Fitness v. ICON Health & Fitness* and *Highmark v. Allcare Health Management System*<sup>11</sup> that provided district courts with greater authority and discretion to award attorney's fees, 21C believes that legislation is still needed to provide clearer and more consistent standards for patent owners and accused infringers alike regarding when fee-shifting is appropriate in patent infringement cases.

21C supports such legislation, provided that two fundamental principles are met. First, fee-shifting should be applied in a balanced fashion, seeking to curtail abusive litigation behavior whether it comes from a plaintiff or a defendant. Such behavior should be targeted regardless of the party that engages in it, and any litigant asserting unreasonable litigation positions or who engages in misconduct should face the prospect of financial penalties. Second, to avoid unduly chilling the ability of patent owners to bring and pursue objectively reasonable claims for infringement of their rights, and to ensure that defendants can assert and litigate objectively reasonable defenses, it is important not to adopt an automatic "loser pays" regime for patent cases. Rather, fee shifting should be premised on objectively unreasonable positions or misconduct of the losing party, which will target abusive behavior while not making litigation to assert well-founded claims of patent infringement, or the assertion of defenses to infringement, too financially risky.

Section 7 of the PATENT ACT adheres to these two principles. It provides that reasonable attorney fees will be awarded if a court determines the position or conduct of the non-prevailing party (plaintiff or defendant) was not objectively reasonable, unless special circumstances make an award unjust. Thus, we believe that the amendments Section 7 make to Section 285 represent an improvement over current fee-shifting law in patent cases and will provide a more effective deterrent to litigation misconduct.

**Fee Recovery:** 21C recognizes the need for a mechanism to address certain situations where the losing party in an action is unable to satisfy a fee award. This is of particular concern with respect to plaintiff entities in patent cases that may be created and structured to be shell entities with few, if any, assets other than the patents that are being enforced. With respect to an award of attorney's fees, such parties are essentially judgment-proof. For obvious reasons, a fee award that can be recovered only against the nominal parties to the litigation will have no practical effect in deterring abusive litigation by such entities if its effect can be easily avoided by undercapitalizing the plaintiff entity.

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<sup>11</sup> *Octane Fitness LLC v. ICON Health & Fitness Inc.*, 134 S. Ct. 1749 (2014) and *Highmark Inc. v. Allcare Health Mgmt. Sys. Inc.*, 134 S. Ct. 1744 (2014).

Thus, 21C 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 finances patent litigation but transfers the patent to a shell company, with assets inadequate to satisfy a fee award, which then asserts that patent in a way that violates Section 285.

As with other provisions in the complex landscape of patent litigation, this concept is much easier to state than it is to implement effectively and fairly. Previous approaches have included joinder, as parties to the litigation, of certain interested parties with a direct financial interest in the case, and requiring certain plaintiffs to post a bond to ensure that they can satisfy any award of fees that may be entered. Each of these proposals has drawn criticism from stakeholders who have questioned their effectiveness, fairness and impact on patent-related investments.

Section 7, subsection (c) of the PATENT ACT takes a different approach to fee recovery that 21C believes provides a better solution to the problem than does joinder or bonding. In certain situations, it would extend contingent liability for satisfaction of a fee award to certain non-parties related to a losing party against whom fees have been assessed, but only following an award of fees against that losing party. This would avoid questions about whether a patent case could continue on the merits while collateral disputes erupt over bonding or joinder at the outset of the case. Its reach would be limited to nonparties with a substantial financial interest related to the proceeds from any settlement, license, or damages award resulting from the enforcement of the patent in the action by the party alleging infringement, and contingent liability would apply to such nonparties only following the application of a number of procedural safeguards in the interests of fairness and due process. Specifically, interested parties may only be held liable for the portion of a reasonable fee award not satisfied by a named party if such interested parties were given notice of their potential liability, elected not to renounce their financial interest in the lawsuit, and are afforded the right to intervene to contest their liability.

Subsection (c) also addresses concerns about access to the courts that have been expressed with respect to other fee recovery proposals. Under the procedures set forth in subsection (c), no plaintiff would be statutorily prevented from bringing an action for patent infringement. Upon the filing of a patent infringement complaint, the party defending against the charge of infringement may elect to file a statement that it holds a good faith belief that the primary business of the party alleging infringement is the assertion

and enforcement of patents or the licensing resulting therefrom. The party alleging infringement then has several options, none of which risks its case being involuntarily dismissed. It can certify (i) that it will have sufficient funds available to satisfy any award of reasonable attorney fees if an award is assessed; (ii) that its primary business is not the assertion and enforcement of patents or the licensing resulting therefrom; or (iii) that it has no interested parties as defined in subsection (c)(2). If the party alleging infringement makes any of these three certifications, that is the end of the inquiry as to fee recovery. Only if it cannot make any of these certifications is the party alleging infringement required to disclose its interested parties, at which point the procedures for notice, possible renunciation of interest and potential intervention to contest liability begin.

Likewise, subsection (c) also addresses concerns about discouraging investments in patented technology and innovation that have been expressed with respect to fee recovery proposals. The concern is that investors will shy away from making such investments if they could be deemed interested parties subject to joinder or contingent liability for fee awards. As explained above, the definition of “interested party” does not extend to all investors, but rather is limited to persons who have a stake in the proceeds from the litigation. In the words of subsection (c)(2)(A), an interested party is a person who “has a substantial financial interest related to the proceeds from any settlement, license, or damages award resulting from the enforcement of the patent in the action by the party alleging infringement.” To clarify further that the provision is intended to reach litigation funders, not all investors, subsection (c)(2)(d) excludes from the definition of interested party a person “whose financial interest is based solely on an equity or security interest established when the party alleging infringement’s primary business was not the assertion and enforcement of patents or the licensing resulting therefrom.” Finally, subsection 7(c)(1)(G) allows a court to exempt any party identified as an interested party from the applicability of the fee recovery provision as the interest of justice requires.

21C thus believes that the contingent liability approach to fee recovery set forth in Section 7(c) of the PATENT ACT would directly address concerns that fee-shifting might be ineffective because patent owners would bring suits in the name of shell entities that lack adequate funds to satisfy a fee award. It would do so in a manner that is more efficient, fairer, and less disruptive to investments in patent holders, than would the alternative approaches of joinder or bonding.

#### **F. Sec. 8. Pre-Suit Notice/Demand Letters.**

Section 8 of the PATENT ACT would require that a written notice, sent prior to the filing of a civil action for patent infringement, contain an identification of each patent and at least one claim of each patent believed to be infringed, and of each product, process, apparatus, or chemical composition, including its manufacturer, believed to be infringed. In addition, the written notice must contain a description of why each patent is believed to be infringed, inform the recipient that it may have the right to stay any lawsuit, identify any person with the right to enforce each patent, and, if compensation is proposed, a statement as to how that compensation was determined. These requirements would not apply to written communications between parties regarding existing licensing agreements, and they may be waived by a court if it determines it is in the interest of justice to do so.

If the notice does not contain the required information, the defendant's time to respond to the complaint is extended by an additional thirty days. In addition, a letter that fails to include the required information cannot serve as evidence of pre-suit notice to establish willful infringement.

21C understands that this provision is intended to balance the interests of early and meaningful disclosures against remedies for noncompliance that are focused and proportional. 21C suggests, however, that additional consideration be given to protection of the senders of such notices from declaratory judgment actions, to avoid the unintended consequence that this provision requires a pre-suit letter to include so much detail that a letter complying with its requirement would expose the sender to declaratory judgment jurisdiction. Ironically, the provision may incent some patent owners to stop sending letters in favor of a "sue first, talk later" approach, resulting in more, not less, patent litigation.

#### **G. Sec. 9. Abusive Demand Letters.**

21C appreciates that the PATENT ACT seeks to address the problem of bad faith patent demand letters at the federal level. Such letters, designed to intimidate or coerce recipients who may lack the expertise or resources to investigate or defend against bad faith assertions of patent infringement into extortionist settlements, do not belong in our patent system.

As with so many other aspects of patent law and policy, the challenge is finding the right balance to address this problem while avoiding collateral damage to legitimate patent

assertion and licensing communications. Efforts to address what may be a small subset of egregious patent demand letter abuses must not inadvertently chill legitimate patent licensing communications. The patent system is designed to encourage notice and communication to foster respect for patent rights, licensing, and technology dissemination, and legislation addressing demand letters should be carefully-tailored so that it does not impede such communications.

As compared to some other legislative proposals to curb abusive demand letters, Section 9 contains some welcome features to balance these competing concerns. First, it appropriately targets those who engage in the “widespread sending” of abusive demand letters. Targeting the “widespread sending” of unfair or deceptive patent demand letters is an important way to distinguish between legitimate patent licensing communications and schemes to extract extortionist settlements. Focusing enforcement authority on such widespread practices will not diminish the ability of the FTC to protect the public against the extortionist “business model” that has led to widespread calls for patent demand letter legislation.<sup>12</sup> But by targeting enforcement authority against widespread abuses, the provision effectively stops that “business model” while reducing the risk of unintended consequences to legitimate licensing communications. The “widespread sending” limitation also ensures that the FTC will not be drawn into individual disputes between patent owners and particular potential licensees or alleged infringers. Congress should not create the possibility that the recipient of a single demand letter, or a defendant in an ensuing infringement suit, could seek to draw the FTC into the dispute to exert leverage against the patent owner, under the guise of consumer protection. Such individual patent disputes should be decided on their merits by the federal courts applying the Patent Act, not by invoking federal or state enforcement authority under what is designed to be a statute to protect the public against unfair or deceptive acts or practices.

Section 9 also clearly and objectively defines the list of permitted and prohibited contents of demand letters. It provides that a person who commits an unfair or deceptive act or practice in violation of Section 5(a)(1) of the Federal Trade Commission Act<sup>13</sup> in

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<sup>12</sup> The patent demand letter abuses of which we are aware all have involved this “business model” based on the widespread sending of bad faith demand letters, in hopes that some percentage of smaller or unsophisticated recipients will be coerced into settling. *See In the Matter of MPHJ Technology Investments, Jay Mac Rust LLC, and Farney Daniels, P.C.*, FTC, File No. 142 3003 (available at <https://www.ftc.gov/system/files/documents/cases/141106mphjagree.pdf>); *In re Innovatio IP Ventures, LLC Patent Litig.*, 921 F. Supp.2d 903 (N.D. Ill. 2013).

<sup>13</sup> 15 U.S.C. § 45(a)(1).

connection with the assertion of a United States patent, and who engages in the widespread sending of written communications representing that the recipients have or are infringing, shall be deemed to have violated a rule defining an unfair or deceptive act or practice – with the contents of the rule being clearly defined in the remainder of the subsection. This would subject the sender to civil penalties under Section 18(a)(1)(B) of the Federal Trade Commission Act.<sup>14</sup> In this way, the “rules of the road” with respect to permitted and prohibited contents of demand letters are clearly set forth to define the FTC’s civil enforcement authority. The overwhelming majority of patent owners have no wish to send demand letters that are unfair or deceptive, so it is just as much in their interest as it is in the interests of letter recipients that the “rules of the road” as to what can and cannot be put into demand letters be clear and objective.

21C believes that Section 9 could be improved further by the inclusion of a requirement that the letters it targets be sent in bad faith, to avoid ensnaring good faith communications. The appropriate goal of legislation should be to identify, and empower the FTC to address through clearly-defined enforcement powers, those demand letters which are truly and clearly intended to deceive or mislead their recipients. In addition, legislation should not infringe the constitutional protections under the First Amendment afforded to legitimate licensing or assertion communications by patent owners.<sup>15</sup> The bad faith requirement serves both purposes without diminishing the effectiveness of the provision. 21C thus believes that in the interests of sound patent law and policy, and in the interests of preserving the constitutionality of the provision, Section 9 should include a bad faith requirement, with bad faith defined as “knowingly false or knowingly misleading statements or representations, or statements or representations made with reckless disregard for the truth or falsity of such statements or representations.”

Finally, the PATENT ACT would benefit from the addition of language making clear that it creates uniform standards for patent demand letters that apply on a nationwide basis. From its origins in the Constitution, patent law has always been exclusively within the province of federal statutes and courts, and so too should issues relating to patent demand letters be applied consistently and uniformly nationwide through federal legislation, regulation and judicial action. The current patchwork of differing – and often

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<sup>14</sup> 15 U.S.C. § 57a(a)(1)(B).

<sup>15</sup> 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. *See, e.g., In re Innovatio IP Ventures, LLC Patent Litig.*, 921 F. Supp.2d 903, 910 (N.D. Ill. 2013) (collecting cases).

inconsistent – state patent demand letter laws that has arisen over the past two years risks weakening our patent system by making patent licensing and enforcement more difficult, costly, and less certain. Ironically, the difficulty of navigating through the growing maze of differing state laws may incent patent owners to adopt a “sue first, talk later” approach, resulting in more, not less, patent litigation.

Thus, Section 9 should provide nationwide requirements for patent demand letters that replace the current mix of differing state laws. Not only would this achieve the goal of establishing clear and consistent standards for patent demand letters nationwide, it also would bring those same standards to the states that have not enacted patent demand letter laws. Importantly, however, the legislation should deliver this uniformity in a manner that does not preclude the states from taking action to protect their citizens from bad faith demand letters. Both the FTC and the state attorneys general should be authorized to bring civil actions in federal court alleging violations of the PATENT ACT’s demand letter provision. Moreover, Section 9 could make clear that states, while empowered to invoke the PATENT ACT in federal courts against bad faith demand letters, also would retain their existing authority under state consumer protection laws not specifically directed to patent demand letters. In this manner, the legislation would impart uniformity to patent demand letter requirements while preserving the roles of the states in fulfilling their traditional consumer protection function.

### **III. Reforms to IPR and PGR Proceedings That Should Be Added to the PATENT ACT.**

Following passage of the AIA, the PTO proposed and promulgated various implementing regulations for the newly-created IPR and PGR proceedings. As noted above, the three major IP law associations – the ABA-IPL Section, AIPLA and IPO – expressed concerns that the PTO’s rules had the potential to unfairly skew these proceedings in favor of patent challengers. Unfortunately, experience has confirmed these concerns.

IPR and PGR proceedings were created to replace inter partes reexamination, which had been criticized as protracted and ineffective, with new adjudicatory reviews of the validity of issued patents. The new proceedings were intended to allow a member of the public to file a petition requesting that one or more claims in a patent be cancelled on the



ground that they are unpatentable.<sup>16</sup> To institute either proceeding, the Director must determine that, based on the information presented in the petition and any preliminary response filed by the patent owner, “there is a reasonable likelihood that the petitioner would prevail with respect to at least 1 of the claims challenged in the petition”<sup>17</sup> or that “it is more likely than not that at least 1 of the claims challenged in the petition is unpatentable.”<sup>18</sup> These thresholds were intended to be higher than the threshold needed to institute a reexamination – “a substantial new question of patentability” – under which the great majority of reexamination requests were granted. Once instituted, the proceedings are conducted by a panel of three administrative patent judges of the PTAB.

As implemented by the PTO, in the great majority of IPR and PGR proceedings the PTAB finds the institution threshold to be met, and then proceeds to invalidate the great majority of challenged claims. In a presentation at the most recent meeting of the Patent Public Advisory Committee on February 19, 2015, the Chief Judge of the PTAB reported that more than 75% of the IPR and PGR petitions filed resulted in the initiation of PGR or IPR reviews. In those proceedings that have progressed to a final decision, all challenged claims were cancelled in 63% of the proceedings and at least one of the challenged claims was cancelled in 84% of the proceedings.<sup>19</sup>

Patent owner concerns about these AIA review proceedings arise not just from these statistics, but from observations about the procedures that lead to these high invalidation rates. In particular, there is a perception the numbers reflect that PGR and IPR proceedings are unfairly tilted against patent owners. Many believe that is why the number of IPR petitions filed have so greatly exceeded the PTO’s original estimates and why they are so routinely filed in conjunction with district court litigation in which validity of the patent-in-suit is also being adjudicated. This perception of imbalance is undermining public and investor confidence in patent rights and the patent system; and even worse, it is encouraging use of the IPR process in the type of opportunistic financial speculation against patent owners that I described above.

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<sup>16</sup> The grounds for alleging unpatentability are sections 102 and 103 of title 35 and only on the basis of prior art consisting of patents or printed publications for IPRs, and any ground relating to invalidity that could be raised under paragraphs (2) or (3) of section 282(b) of title 35 for PGRs. See 35 U.S.C. §§ 311(b) (IPR); 321(b) (PGR).

<sup>17</sup> 35 U.S.C. § 314(a) (IPR).

<sup>18</sup> 35 U.S.C. § 324(a) (PGR).

<sup>19</sup> See [http://www.uspto.gov/sites/default/files/documents/20150219\\_PPAC\\_PTAB\\_Update.pdf](http://www.uspto.gov/sites/default/files/documents/20150219_PPAC_PTAB_Update.pdf), at slide 15.

Much of the problem stems from the fact that Congress intended these proceedings to serve as alternatives to district court litigation for adjudicating patent validity, yet when it promulgated its implementing rules, the PTO departed from well-settled law regarding the interpretation and scope of patent claims being adjudicated in litigation. Over the objections of a large segment of its user community, the PTO decided that patent claims in AIA review proceedings would be interpreted according to the “broadest reasonable interpretation (“BRI”) standard used during the initial examination of patent applications as well as ex parte reexaminations and reissue patent examinations, rather than construing claims in accordance with their ordinary and customary meaning as understood by one of ordinary skill in the art, just as they are construed when their validity is adjudicated by courts applying the claim construction standards of *Phillips* and *Markman*.<sup>20</sup>

This dichotomy between how the validity of patent claims is adjudicated in courts and in the PTO is an invitation to gamesmanship and serial challenges to patent rights. Because the overwhelming majority of patents involved in IPR proceedings involve patents that are in concurrent district court litigation, applying different standards to patents involved in the different forums invites duplicative proceedings and inconsistent outcomes.

For example, an IPR petition filed on March 9, 2015 illustrates that the difference in claim construction standards applied in the PTO and in courts is not just an academic concern. In the petition, an investment fund challenges the validity of the same patent claim that had withstood validity challenges in federal district court and on appeal to the United States Court of Appeals for the Federal Circuit.<sup>21</sup> In the petition, the challenger argues that the broader claim construction standard in IPR proceedings should lead to a different outcome, despite more than four years of litigation, including an appeal to the same court that would hear any appeal from the IPR proceeding.<sup>22</sup> The AIA was never intended to create an administrative patent review procedure that could consider the same evidence and arguments of invalidity a patent owner had faced in more than four years of litigation, including an appeal to the Federal Circuit, apply different legal standards and reach a different result.

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<sup>20</sup> *Phillips v. AWH Corp.*, 415 F.3d 1303 (Fed. Cir. 2005) (*en banc*); *Markman v. Westview Instruments, Inc.*, 52 F.3d 967 (Fed. Cir. 1995) (*en banc*), *aff'd* 517 U.S. 370 (1996).

<sup>21</sup> *Ferrum Capital, LLC v. Allergan Sales, LLC*, Petition for Inter Partes Review of U.S. Patent No. 7,030,149, IPR2015-00858 (March 9, 2015) (available at <http://www.iam-media.com/files/IPR.pdf>).

<sup>22</sup> *Id.* at 15-17.

In light of such developments, legislation is urgently needed to restore balance and fairness to AIA review proceedings in the manner that Congress intended when it created them. 21C proposes three straightforward legislative changes to accomplish this restoration:

- (1) Reforming the procedures used when the PTO is considering whether to institute an IPR or PGR proceeding, to provide a level playing field and basic fairness for all parties;
- (2) Allowing patent owners to have the issues raised in newly-filed petitions first considered in reissue or reexamination proceedings, where they may amend the claims prior to institution of any IPR or PGR; and
- (3) Reviewing the validity of granted patent claims, and substitute claims containing only originally issued claim limitations, by applying the same standards in IPR and PGR proceedings as are applied in courts, including claim construction, burdens of proof and presumptions.

I will discuss each of these three reforms in more detail, highlighting the issues that have arisen and proposed solutions, including specific recommended amendments to Title 35 that would implement those solutions.

**A. Reforming the Procedures Used When the PTO Is Considering Whether to Institute an IPR or PGR Proceeding, to Provide a Level Playing Field and Basic Fairness for All Parties.**

***Issue:*** A petitioner has unlimited time to prepare its petition, may submit all evidence that supports its position, including expert testimony, and has no duty at the pre-institution stage to disclose evidence in its possession that tends to refute the positions it argues. A patent holder has limited time to prepare its preliminary response, may not present expert testimony or other declarations, and is under a duty of disclosure. Thereafter, discovery in IPR and PGR proceedings is sharply limited as a matter of expedience, largely preventing patent owners from obtaining and presenting evidence that is not within their control. Because the same PTAB panel decides whether to institute the review and then hears the case on the merits, the appearance of being predisposed to rule against the patent holder is created, which is confirmed when the panel's final decision agrees with its original determination. Finally, PTAB panels often refuse to hear oral

testimony at the final hearing, even when the outcome of the proceeding may depend on witness credibility. All this, coupled with the high invalidation rate, is rapidly undermining the public's faith in ability of the PTO to grant patents that are reliably enforceable.

**Solutions:** By ensuring the challenger will be under a duty to disclose all material information known to it that tends refute the positions taken in its petition and that the patent holder will have the ability to introduce expert testimony and declaration evidence in its preliminary response, institution decisions will be made on a more balanced evidentiary record. By ensuring that the Director, or her proper delegate, and not the PTAB, will decide whether to grant the petition, any perception of improper bias of the PTAB merits panel will be eliminated. By ensuring that testimony related to material disputes of fact and witness credibility will be heard live by the PTAB at the final hearing, additional fairness and due process concerns will be alleviated.

**B. Allowing Patent Owners to Have the Issues Raised in Newly-Filed Petitions First Considered in Reissue or Reexamination Proceedings, Where They May Amend the Claims Prior to Institution of Any IPR or PGR.**

**Issue:** The PTO has justified its application of the BRI claim construction standard largely on the ability of a patent owner to amend claims during an IPR or PGR proceeding. But the statutory right to amend claims in AIA review proceedings has been rendered largely illusory by the PTO. The PTAB has denied almost all motions to amend the patent (by most reports, only 3 such motions have been granted in the first 30 months of AIA review proceedings, and one of those three was uncontested). The PTAB's denial of proposed substitute claims appears to be based on the need to complete these proceedings within the statutory one-year period, along with the recognition by the PTAB that, as an adjudicative body, it is not well equipped to examine patent claims during AIA reviews. Yet, were it possible for patent owners to amend their claims to narrower scope in view of prior art newly-cited in IPR or PGR petitions, better patents and fairer results could be obtained.

**Solutions:** Following service of an IPR or PGR petition, but prior to its institution, the patent owner would be permitted to remove any or all of the challenged claims from the IPR/PGR process by filing a request with the PTO to initiate a reissue or reexamination proceeding to address any narrowing claim amendments. Under these procedures, the amended claims would be considered by the PTO in view of the information in the petition, the claims would be construed using BRI (as in other examinations), and amended claims

would be subject to intervening rights. In many cases, further IPR or PGR proceedings would be unnecessary, especially if all of the challenged claims were narrowed or finally rejected. In the meantime, all parties will be spared the much higher expense of an IPR or PGR proceeding. The petitioner would not be estopped by the outcome of any reissue or reexamination, and if the petitioner were dissatisfied with the results, the petitioner would be permitted to file a new IPR or PGR petition.

**C. Reviewing the Validity of Granted Patent Claims, and Substitute Claims Containing Only Originally Issued Claim Limitations, By Applying the Same Standards in IPR and PGR Proceedings as Are Applied in Courts, Including Claim Construction, Burdens of Proof and Presumptions.**

***Issue:*** Currently, in AIA review proceedings, the PTO construes granted patent claims using the BRI standard used during the initial examination of a patent application, where applicants have a liberal right to amend their claims in an iterative process with a patent examiner, rather than using the *Phillips* claim construction standard that courts use for granted patents. Moreover, while granted U.S. patents have a presumption of validity and validity challenges are reviewed under the clear and convincing evidence standard by district courts, the PTO applies lower review thresholds and standards. Lastly, the PTO often grants IPR petitions where the same or substantially the same arguments or prior art were considered during an earlier PTO or district court proceeding.

***Solutions:*** Having the PTO apply the same standards as the courts will achieve increased fairness, predictability and uniformity among the different proceedings involving granted patents. Under this proposal, in AIA review proceedings, claims will be construed under the *Phillips* standard, and substitute claims would be permitted only if they do no more than add limitations that are verbatim the same as limitations already appearing in issued claims of the challenged patent. Moreover, by confirming that the Director or her proper delegate shall deny petitions presenting the same or substantially the same arguments presented in an earlier PTO or district court proceeding, and by applying consistent standards, duplicative proceedings should be avoided.

Proposed amendments to Title 35 to enact these reforms are set forth below in Appendix 1. By adding these provisions to the PATENT ACT, this Committee will be poised to move forward with comprehensive and effective patent reform legislation that 21C will strongly and enthusiastically support.

#### **IV. Conclusion.**

Chairman Grassley, Ranking Member Leahy and Distinguished Members of the Judiciary Committee, I thank you for the opportunity to appear here today and to offer my views on the subject of “S. 1137, the ‘PATENT ACT’ – Finding Effective Solutions to Address Abusive Patent Practices.”

I appreciate the understanding and engagement by Members of this Committee and their staffs to craft patent litigation reforms targeted at abusive practices to minimize negative, unintended consequences for the vast majority of patent owners seeking to protect and enforce their patents in good faith. The PATENT ACT represents a welcome step in that direction.

21C pledges to continue to work with members of the Committee, their staffs, and other stakeholders to couple the provisions in the PATENT ACT as introduced with additional provisions that are so essential to restore balance and fairness in AIA review proceedings. 21C looks forward to lending its strong support for a bill that addresses both patent litigation and AIA reviews in an effective, balanced and comprehensive fashion.

I will be pleased to answer any questions or to supply additional information for the record.

## Appendix 1

### Proposed Statutory Amendments

(1) Amend 35 U.S.C. § 6(b)(4) as follows:

(b) Duties.— The Patent Trial and Appeal Board shall— ... (4) conduct (but not participate in the decision to institute) inter partes reviews and post-grant reviews pursuant to chapters 31 and 32.

(2) Enact § 9(b) of the “Innovation Act of 2015,” H.R. 9 (reproduced below).

(3) Amend § 312(a)(4) as follows:

“(4) the petition provides such other information, including all evidence known to the petitioner that (i) tends to refute positions advanced in the petition, (ii) if obviousness is alleged, that constitutes objective evidence of nonobviousness, and (iii) such other information as the Director may require by regulation; and

Amend § 322(a)(4) as follows:

“(4) the petition provides such other information, including all evidence known to the petitioner that (i) tends to refute positions advanced in the petition, (i) if obviousness is alleged, that constitutes objective evidence of nonobviousness (iii) if prior art other than patents or printed publications is relied upon, evidence related to that prior art, and (iv) such other information as the Director may require by regulation; and

(4) Amend paragraph 9(e) of § 316 as follows:

“(e) EVIDENTIARY STANDARDS.—In an inter partes review instituted under this chapter, pursuant to 35 USC § 282(a), the challenged patent, including any claims substituted therein, shall be presumed to be valid and the petitioner shall have the burden of proving a proposition of invalidity unpatentability by clear and convincing a preponderance of the evidence. Upon request of a party, testimony relating to material disputes of fact or witness credibility shall be heard live before the PTAB panel at the final hearing.

Amend paragraph 9(e) of § 326 as follows:

“(e) EVIDENTIARY STANDARDS.—In a post-grant review instituted under this chapter, pursuant to 35 USC 282(a), the challenged patent, including any claims substituted therein, shall be presumed to be valid and the petitioner shall have the burden of proving a proposition of invalidity unpatentability by clear and convincing a preponderance of the evidence. Upon request of a party, testimony relating to material disputes of fact or witness credibility shall be heard live before the PTAB panel at the final hearing.

(5) Amend § 313 as follows:

“If an inter partes review petition is filed under section 311, the patent owner shall have the right to file a preliminary response to the petition, within a time period set by the Director, that may include evidence, including fact and expert declarations, and set forth reasons why no inter partes review should be instituted based upon the failure of the petition to meet any requirement of this chapter. The patent owner shall have the right to remove any or all challenged claim or claims from the requested inter partes review by filing with the Office within three months of the service of the petition on the patent owner, a request to have such challenged claim or claims examined further by the Office in view of the issues presented in the petition in a reissue or reexamination proceeding. Any such reissue or reexamination proceeding shall be conducted with special dispatch by the Office.

Amend § 323 as follows:

“If a post-grant review petition is filed under section 321, the patent owner shall have the right to file a preliminary response to the petition, within a time period set by the Director, that may include evidence, including fact and expert declarations, and set forth reasons why no post-grant review should be instituted based upon the failure of the petition to meet any requirement of this chapter. The patent owner shall have the right to remove any or all challenged claim or claims from the requested post-grant review by filing with the Office within three months of the service of the petition on the patent owner a request to have such challenged claim or claims examined further by the Office in view of the issues presented in the petition in a reissue or reexamination proceeding. Any such reissue or reexamination proceeding shall be conducted with special dispatch by the Office.

(6) Amend § 316(a)(9) as follows:

“(9) setting forth standards and procedures for allowing the patent owner ~~to move~~ to amend the patent under subsection (d) to cancel a challenged claim ~~and to~~ propose a reasonable number of substitute claims, provided those substitute claims narrow the scope of the cancelled claim only by adding one or more limitations found in other issued claims of the challenged patent, and ensuring that any information submitted by the patent owner in support of any amendment entered under subsection (d) is made available to the public as part of the prosecution history of the patent;

Amend § 326(a)(9) as follows:

“(9) setting forth standards and procedures for allowing the patent owner ~~to move~~ to amend the patent under subsection (d) to cancel a challenged claim ~~and to~~ ~~or~~ propose a reasonable number of substitute claims, provided those substitute claims narrow the scope of the cancelled claim only by adding one or more limitations found in other issued claims of the challenged patent, and ensuring that any information submitted by the patent owner in support of any amendment entered under subsection (d) is made available to the public as part of the prosecution history of the patent;



(7) Amend § 314(a) as follows:

“(a) THRESHOLD.—The Director may not authorize an inter partes review to be instituted unless the Director determines (i) no other proceeding is or has been before the Office in which the same or substantially the same prior art or arguments are or have been presented, (ii) no court of competent jurisdiction has ruled on the validity of the challenged patent in view of the same or substantially the same prior art or arguments, and (iii) information presented in the petition filed under section 311 and any response filed under section 313 shows that there is a reasonable likelihood that the petitioner would prevail with respect to at least 1 of the claims challenged in the petition.

Amend § 324(a) as follows:

“(a) THRESHOLD.—The Director may not authorize a post-grant review to be instituted unless the Director determines that (i) no other proceeding is or has been before the Office in which the same or substantially the same prior art or arguments are or have been presented, (ii) no court of competent jurisdiction has ruled on the validity of the challenged patent in view of the same or substantially the same prior art or arguments, and (iii) the information presented in the petition filed under section 321, if such information is not rebutted, would demonstrate that it is more likely than not that at least 1 of the claims challenged in the petition is unpatentable.

### **Section 9(b) of the Innovation Act of 2015, H.R. 9**

(b) USE OF DISTRICT-COURT CLAIM CONSTRUCTION IN POST-GRANT AND INTER PARTES REVIEWS.—

(1) INTER PARTES REVIEW.—Section 316(a) of 9 title 35, United States Code, is amended—

- (A) in paragraph (12), by striking “; and” and inserting a semicolon;
- (B) in paragraph (13), by striking the period at the end and inserting “; and”; and
- (C) by adding at the end the following new paragraph:

“(14) providing that for all purposes under this chapter—

“(A) each claim of a patent shall be construed as such claim would be in a civil action to invalidate a patent under section 282(b), including construing each claim of the patent in accordance with the ordinary and customary meaning of such claim as understood by one of ordinary skill in the art and the prosecution history pertaining to the patent; and

“(B) if a court has previously construed the claim or a claim term in a civil action in which the patent owner was a party, the Office shall consider such claim construction.”.

(2) POST-GRANT REVIEW.—Section 326(a) of title 35, United States Code, is amended—

- (A) in paragraph (11), by striking “; and” and inserting a semicolon;
- (B) in paragraph (12), by striking the period at the end and inserting “; and”; and
- (C) by adding at the end the following new paragraph:

“(13) providing that for all purposes under this chapter—

“(A) each claim of a patent shall be construed as such claim would be in a civil action to invalidate a patent under section 282(b), including construing each claim of the patent in accordance with the ordinary and customary meaning of such claim as understood by one of ordinary skill in the art and the prosecution history pertaining to the patent; and  
“(B) if a court has previously construed the claim or a claim term in a civil action in which the patent owner was a party, the Office shall consider such claim construction.”