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February 4, 2014

Honorable Patrick J. Leahy
Chairman
Committee on the Judiciary
U.S. Senate
Washington DC, 20510

Honorable Charles E. Grassley
Ranking Member
Committee on the Judiciary
U.S. Senate
Washington DC, 20510

Re: S. 1720, the "Patent Transparency and Improvements Act of 2013," and Related Bills

Dear Chairman Leahy and Ranking Member Grassley:

I am writing to express the views of the American Bar Association on S. 1720 and related bills pending before the Judiciary Committee.

A number of bills have been introduced in the 113th Congress that are designed to curb abusive litigation practices associated with "patent trolls" or "patent assertion entities" (PAEs), entities that are so named because they acquire and hold patents not for commercial exploitation, but primarily, if not solely, to sue for monetary relief or extortionist settlements.

Senate bills include S. 1720 (Leahy), S. 1013 (Cornyn), S. 1612 (Hatch), and S. 866 (Schumer), all of which have been referred to the Judiciary Committee. H.R. 3309 (Goodlatte), a bill that addresses many of the same issues as the Senate bills, passed the House on December 5, 2013, and has been sent to the Senate and referred to the Judiciary Committee. These comments address issues raised by bills pending before the Senate Judiciary Committee, including the House-passed bill, H.R. 3309.

My comments reflect the view of the American Bar Association. Other issues raised by the bills but which have not been addressed in ABA policy are discussed in the attached letter from Robert O. Lindefjeld, Chair of the ABA Section of Intellectual Property Law. Those comments represent the views of the Section of Intellectual Property Law. They have not been submitted to the ABA House of Delegates or Board of Governors, and should not be considered to be views of the Association.

The bills would amend the Patent Code as codified in title 35, U.S. Code, and other provisions of federal law relating to patents in several respects, with the objective of reducing abusive litigation practices in patent cases. The ABA agrees that changes in court procedures relating to pleadings, disclosure of real parties in interest, joinder of parties, and discovery can improve the administration of justice in our nation's federal courts, including in patent cases. However, the ABA is concerned that the proposed reforms will fall short of these objectives, and produce undesired and unintended negative consequences for both patent cases and federal litigation generally. We therefore urge the Committee to continue further development and revision of the legislation to achieve its worthy objectives.

Our primary concerns regard provisions of the bills that call for Congress, rather than the courts, to establish certain rules of procedure for the federal courts, thereby circumventing a rulemaking process that has served our justice system well for almost 80 years. In the Rules Enabling Act, Congress recognized that responsibility for establishing rules of procedure to be applied in our federal courts is best reposed in the Article III courts themselves. Provisions of that Act assure that amendment of the Federal Rules occurs only after a comprehensive and open review is undertaken. Before a proposed rule change can become effective, it must be approved by the Supreme Court and transmitted to Congress, which retains the ultimate power to reject, modify, or defer any rule or amendment before it takes effect.

This circumvention called for in the bills takes two forms: direct legislative enactment of rules of procedure and case management, and statutory direction to the Judicial Conference or the Supreme Court to develop particular rules and procedures for patent cases, with the substance of those rules and procedures specified in the bill. The ABA is pleased that S. 1720 does not call for substantial circumvention of established and well-performing laws and policies for rule making for the federal courts. However, some of the other bills do and since the Committee is expected to conduct a comprehensive review and consideration of all the proposals that have been advanced to address abusive patent litigation, our comments will address those proposals.

H.R. 3309 is representative of the bills that concern the ABA for the manner and extent to which they call for deviation from established rule making for the conduct of patent litigation in the federal courts. Since it is the most comprehensive of the proposals in this regard, we note some of its provisions to illustrate our concerns.

Provisions of H.R. 3309 that circumvent the Rules Enabling Act by directly legislating specific rules of procedure include provisions in section 3 of the bill relating to pleading, joinder, and discovery; requirements in section 4 that an initial complaint include detailed disclosure of parties in interest; and requirements in section 5 to stay actions for patent infringement in certain specified circumstances. Proposed departure from the Rules Enabling Act that leaves rule-making with the courts but dictates the contents of the rules is exemplified by provisions in section 6 directing the Judicial Conference to develop rules and procedures relating to issues of discovery and case management.

The ABA believes that the more effective approach is to adhere to the time-proven policy of allowing the federal judicial system to prescribe procedural rules, augmented by the local rules of the district courts. However, the proposed departures from this system present another concern. By mandating particular rules of procedure applicable only to patent cases, the legislation calls for the same issues to be governed by different rules in patent cases than in all other civil cases. This unhealthy precedent could prompt calls to Congress to provide special rules of procedure for still other areas of the law, leading to the balkanization in the administration of justice—precisely the result that the Rules Enabling Act process was designed by Congress to avoid.

The litigation reform measures before the Committee have the commendable objective of making it more difficult for ill-founded patent suits to succeed, and easier to identify and dispose of those suits more promptly and less expensively. By addressing these abusive litigation tactics, the proposed legislation ideally should lead both plaintiffs and defendants to realize that extortionist settlements should no longer be expected or feared. These are salutary objectives that the ABA supports. At the same time, however, overly prescriptive congressionally mandated rules of procedure may have the unintended result of creating more delay and expense, not less, and ill-serve the worthy objectives of these patent reform efforts.

The ABA urges the Committee to continue reviewing and refining the legislation, with particular emphasis on providing guidance to the Judicial Conference and district courts in their development and improvement of rules of procedure and case management to address the concerns regarding abusive litigation practices that prompted this proposed legislation. Such guidance can and should be provided without abrogating the ability of the judicial branch to carry out its Article III responsibilities by adopting and adapting rules of procedure and case management.

Sincerely,

Thomas M. Susman

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Defending Liberty
Pursuing Justice

AMERICAN BAR ASSOCIATION

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Dear Chairman Leahy and Ranking Member Grassley:

I am writing to express the views of the Section of Intellectual Property Law of American Bar Association on S. 1720 and related bills pending before the Judiciary Committee. These comments represent the views of the Section of Intellectual Property Law. They have not been submitted to the ABA House of Delegates or Board of Governors, and should not be considered to be views of the Association.

A number of bills have been introduced in the 113th Congress that are designed to curb abusive litigation practices associated with "patent trolls" or "patent assertion entities" (PAEs), entities that are so named because they acquire and hold patents not for commercial exploitation, but primarily, if not solely, to sue for monetary relief or extortionist settlements.

Senate bills include S. 1720 (Leahy), S. 1013 (Cornyn), S. 1612 (Hatch), and S. 866 (Schumer), all of which have been referred to the Judiciary Committee. H.R. 3309 (Goodlatte), a bill that addresses many of the same issues as the Senate bills, passed the House on December 5, 2013, and has been sent to the Senate and referred to the Judiciary Committee. These comments address issues raised by bills pending before the Senate Judiciary Committee, including the House-passed bill, H.R. 3309.

A number of significant issues raised by the pending bills relate to the proper allocation of authority and responsibility for rulemaking for the conduct of litigation in U. S. federal courts. Those issues are addressed in policy of the American Bar Association, and are the subject of comments in a letter to you dated today from Thomas A. Susman, Director of the ABA Governmental Affairs Office.

Abusive Litigation Tactics: The Problem and the Congressional Response

There is no doubt that some patent owners and persons acting as patent owners engage in abusive practices to enforce claimed patent rights. Some PAEs acquire patents of dubious value and validity with no intention of practicing the patents by producing and selling a product or protecting the fruits of legitimate research, but instead to collect licensing fees or monetary damages through actual or threatened enforcement actions. Although often characterized as "abusive litigation practices," some of the most objectionable practices begin before suit is filed to extract settlements without the cost of litigation and risk of losing in the suit. Notably and increasingly, these extortionist practices take the form of "demand letters" accusing hundreds or even thousands of recipients of patent infringement, with scant information provided regarding either the patent or the allegedly infringing activity. Under U.S. patent law, selling or even merely using an infringing product constitutes infringement, with no requirement of participation in the creation of the infringing feature, or even of knowledge that it infringes. These circumstances produce low-hanging fruit for PAEs, who often harvest bountiful returns due to a combination of high volume of targets, comparatively low cost per unit to each targeted person for settlement (a small percentage of the cost to defend a law suit, even if successful), and next to no cost per unit to the extortionist.

Similar dynamics apply if there is no settlement and suit is filed. Unlike "Mom and Pop" retailers and mere end-user customers, major commercial interests facing suit have the resources and experience to fight the infringement suit to final judgment, but, even when that outcome seems almost certain to be successful, business considerations dictate resolving suits with relatively small nuisance settlements rather than through protracted and extremely expensive litigation to final judgments.

The Section of Intellectual Property Law believes that what have been identified as abusive activities are undertaken by a small subset of patent litigants, and an appropriate response should focus on those specific activities. In this regard, the Section believes that the approach proposed in section 5 of S. 1720, which identifies specific activities that constitute "bad faith demand letters" and provides for enforcement actions against individual offenders, is an attractive one. It is preferable to wholesale changes in the currently-applicable rules of procedure, which have been crafted to produce a fair, uniform, and consistent administration of justice in all cases, not just in PAE cases, and not just in patent cases.

Fee Shifting

One proposed legislative response to the abusive litigation practices of PAEs is to use fee shifting in patent litigation to deter nuisance lawsuits that seek to force defendants into settlements in which a licensing fee is paid to the PAE plaintiff.

As passed by the House on December 5, H.R. 3309, the "Innovation Act" calls for a mandatory award of attorney fees to a prevailing party in patent litigation, unless the court finds that the position and conduct of the non-prevailing party "were reasonably justified in law and fact or that special circumstances (such as severe economic hardship to a named inventor) make an award unjust."

S. 1013, introduced by Senator Cornyn on May 22, 2013, and S. 1612, which Senator Hatch introduced on October 30, also provide for mandatory awards to prevailing parties, with exceptions similar to those in H.R. 3309.

On June 4, 2013, the White House announced a number of executive actions and legislative recommendations to address these abusive practices, including a proposal to "Permit more discretion in awarding fees to prevailing parties in patent cases, providing district courts with more discretion to award attorney's fees under 35 USC 285 as a sanction for abusive court filings (similar to the legal standard that applies in copyright infringement cases)."

Fee Shifting and the American Rule

The American Rule holds that each litigant must pay its own way. The fundamental policy goal is "to avoid penalizing a party for merely defending or prosecuting a lawsuit." Rohm & Haas Co. v. Crystal Chem. Co., 736 F.2d 688, 690 (Fed. Cir. 1984). Section 285 of the federal patent statute provides a limited exception to the American Rule, in that courts are authorized in their discretion to award attorney fees a prevailing party "in exceptional cases." 35 U.S.C. § 285 (2012). "However, Congress specifically stated that the award of attorney fees under section 285 should not "become an ordinary thing." S. Rep. No. 79-1503 (1946), reprinted in 1946 U.S. Code Cong. Serv. 1386, 1387. By replacing a permissive "may award" with a mandatory "shall," the proposals in question effectively repeal the American Rule in patent cases.

The Section of Intellectual Property Law opposes a mandatory award of attorney fees to a prevailing party in patent litigation, and supports expanding the authority of courts to make discretionary awards under section 285 or successor legislation.

As a result of Federal Circuit precedent, it has become increasingly difficult for prevailing defendants to be awarded attorney fees under section 285. The highly demanding standard for the award of fees to defendants under section 285 is under review in the Supreme Court in *Octane Fitness, LLC v. Icon Health Fitness, Inc*. Absent litigation misconduct, a prevailing party seeking fee shifting must show that the non-prevailing party's position was objectively baseless, and that the non-prevailing party brought the infringement claim in subjective bad faith.

Federal Circuit Interpretation of Section 285: Exceptional Case Requirements

Section 285 gives a district court discretion to award reasonable attorney fees to a prevailing party in patent litigation, if the court determines that the case is exceptional. The district court should engage in a two-step inquiry to determine whether (1) the prevailing party proved the case is exceptional by clear and convincing evidence, and (2) if the case is exceptional, whether an award of attorney fees is justified.

Misconduct in the Course of Litigation or in Securing the Patent

A case may be found exceptional where there is "material inappropriate conduct" related to the litigation, including willful infringement, fraud or inequitable conduct in procuring the patent, misconduct during litigation, vexatious or unjustified litigation, conduct that violates FRCP 11, filing of incomplete or misleading evidence with the court, or a "cavalier attitude towards the patent litigation process as a whole." Several of the factors outlined below in regards to the subjective bad faith requirement may on their own constitute litigation misconduct if the violation is egregious.

Absent such misconduct in securing the patent or in the course of litigation, sanctions may be imposed against a party only if:

(1) the litigation is objectively baseless; and
(2) the litigation is brought in subjective bad faith.

Objective Baselessness

The prevailing party must first show by clear and convincing evidence that the non- prevailing party's asserted position on a claim is objectively baseless.

To be objectively baseless, the infringement allegations must be such that "no reasonable litigant could reasonably expect success on the merits." *Dominant Semiconductors*, 524 F.3d at 1260. The inquiry involves both law and facts, focusing on a party's asserted claims and claim construction, offered evidence, and conduct. The district court will look at all relevant aspects, including the claims, the specification, the prosecution history of the patent, the non-prevailing party's positions and expert testimony, admitted limitations on the claims, and any other actions and behavior evidencing the non-prevailing party's position.

If the claim language as constructed by the court clearly precludes the non-prevailing party's asserted position on the claims as objectively reasonable, the litigation is objectively baseless. A non-prevailing party, however, only need to show that its claim construction position was not "so unreasonable that no reasonable litigant could believe it would succeed." The prevailing party must then overcome a high bar by proving by clear and convincing evidence that the non- prevailing party's position lacks any reasonable interpretation and therefore could not even be reasonably argued.

As a result, the Federal Circuit has held that absent litigation misconduct, surviving a motion for summary judgment shows that the asserted position was not objectively baseless and that the litigation is not eligible for fee shifting under section 285.

Subjective Bad Faith

The Federal Circuit has held that "[a]bsent misconduct in conduct of the litigation or in securing the patent, sanctions may be imposed against the patentee only if both (1) the litigation is brought in subjective bad faith, and (2) the litigation is objectively baseless." *Brooks Furniture Mfg., Inc. v. Dutailier Int'l, Inc.*, 393 F.3d 1378, 1381 (Fed. Cir. 2005). Under this standard, the absence of bad faith in and of itself will preclude a fee award and render any inquiry into the merits of the nonprevailing party's position moot. See, e.g., id. ("Since we conclude that the first requirement (subjective bad faith) is not satisfied here, we need not decide whether the second (objectively baseless) standard was met."). The court's treatment of subjective bad faith and objective baselessness as separate and independent prerequisites for a finding of an exceptional case therefore can prevent fee shifting by permitting a non-prevailing party lacking actual or imputed knowledge of the objective baselessness of its claim or defense to extend the litigation and drive up the prevailing party's costs by means that do not independently constitute litigation misconduct.

Award of Fees should not be Mandatory

The rights granted under a patent are not always clearly defined. Litigation therefore functions to demarcate the boundaries of a contested patent. Mandatory fee shifting in all patent cases is clearly against the American Rule and would deter meritorious litigation, because plaintiffs may seek to avoid the risk of paying the opposing party's fees where an infringement claim has a lower probability of success.

In addition, mandatory fee shifting would eviscerate the traditional balance in American patent law, which allows a patent holder to vigorously assert the rights granted by the patent without fear of being burdened with a substantial financial penalty for losing on a reasonably brought claim. The Section of Intellectual Property Law therefore opposes any fee shifting proposals that would absolutely restrict the conduct of litigants beyond specific actions or claims found to constitute litigation misconduct, or to be objectively baseless.

Recommendations

The Section of Intellectual Property opposes a mandatory award of attorney fees to a prevailing party in patent litigation, as called for in S. 1013, H.R. 3309, and similar legislation.

The Section also supports a more flexible application of 35 U.S.C. § 285. Section 285 is currently interpreted narrowly by the Federal Circuit to only apply in limited circumstances where a non-prevailing party engaged in material inappropriate conduct in litigating or in securing the patent, or its position is both objectively baseless and brought in subjective bad faith. A standard that we recommend would allow fee shifting based on a determination that the non-prevailing party engaged in material inappropriate conduct in litigating or securing the patent, or the non-prevailing party's position was objectively baseless. Subjective bad faith would continue to be relevant to a determination that a case is exceptional by reason of material inappropriate conduct by the non-prevailing party, or that its position was objectively baseless. Under either test for exceptionality, subjective bad faith should be included in the district court's obligation to consider the totality of the circumstances. For reasons explained above, subjective bad should not be an independent requirement for finding a case exceptional even after a determination that a non-prevailing party's position was objectively baseless.

With the abandonment of the conjunctive requirement that a case be both objectively baseless and pursued in subjective bad faith, this disjunctive structure can provide an adequate remedy and deterrent of abusive litigation practices such as those lawsuits filed by PAEs to extract underserved licensing fees.

Some believe that an independent bad faith prong for fee shifting does not capture additional significant sanctionable conduct, but that it does increase the risk of encouraging unnecessary and counterproductive motion practice and wasteful discovery into subjective intent. Their reasoning is that if fees are authorized under the "objectively baseless" prong, it is not necessary to inquire into the subjective intent of the party, and if there is a legitimate basis for the claim or defense, its assertion should not be in bad faith. It is true that under the disjunctive application that we advocate, a finding of "objectively baseless" would, standing alone, qualify a case for fee-shifting, with no need to determine the subjective intent of the non-prevailing party. It is also true that under the prevailing precedent of the Federal Circuit, subjective intent is not an issue if the non-prevailing claim or defense is objectively based.

The Section of Intellectual Property Law believes that, while proof of subjective bad faith should not be required in addition to establishing that a case is objectively baseless, subjective bad faith nonetheless is relevant in a consideration of the totality of circumstances in determining if a case is exceptional, under both a "material inappropriate conduct" and an "objectively baseless" analysis.

Abusive litigation practices by PAEs seem to present appropriate circumstances for such consideration. In the event of a PAE customer suit with little specificity as to the claims that are infringed or the infringing conduct, but with extortionist demands for payments to settle the suit for less than the cost of mounting a defense, subjective bad faith is among the totality of circumstances that should be considered in evaluating both material inappropriate conduct and objective baselessness.

Federal Trade Commission Enforcement Regarding "Bad Faith Demand Letters"

On November 18, 2013, Senator Leahy introduced the "Patent Transparency and Improvements Act" (S. 1720). A key provision of S. 1720, section 5, "Bad Faith Demand Letters," is intended to target the "worst of the worst" abusers of the patent system by making "bad faith" demand letters subject to enforcement under section 5(a) of the Federal Trade Commission Act.

Under U.S. patent law, selling or even merely using an infringing product constitutes infringement, with no requirement of participation in the creation of the infringing feature, or even of knowledge that it infringes. Thus a manufacturer of a sophisticated electronic device such a cellular communications device can be sued for infringement of any one of thousands of patents that are licensed by the manufacturer and integrated into the device. All parties in the distribution chain are also subject to suit, as are all customer end-users of the product. In cases of patent infringement, ignorance of the law is no defense. Indeed, nor is ignorance of the fact that infringement is occurring.

PAEs have come to realize that this feature of U.S. law opens up vast fields of opportunity for them. Everyone in the production, distribution, and consumption stages of a product with an alleged infringing feature can be sued, with low per unit costs of filing suit, and great incentive for defendants, including those who are totally innocent of infringement, to pay nuisance value amounts to settle without going to court.

While the ability to file dozens of frivolous law suits presents a field of opportunity for PAEs, oceans of opportunity lie in the PAEs' ability to issue mass produced demand letters targeting hundreds or thousands of sellers and users of products with allegedly infringing components.

The high volume of demand letters sent by each entity are likely based on the economic calculation that where a certain amount of demand letters are sent out, an anticipated dollar amount will be received in fees collected from recipients who fear expensive patent litigation and therefore decide to pay the demanded fee instead.

The abusive demand letters take advantage of a basic information asymmetry between the sender and the recipient. The abusive demand letters only make vague statements of infringement, including failing to identify (1) the person or entity with a right to enforce the patent; (2) whether the patent is currently valid, or was valid at the time infringement allegedly occurred; (3) how the recipient infringed the patent; and (4) whether the manufacturer of the allegedly infringing technology has already entered into a licensing agreement with the patent owner or an entity having the right to license the patent. Further, some recipients of abusive demand letters were told that the licensing fees would increase if they requested additional information from the sender or if they hired an attorney.

The practice of sending abusive demand letters is therefore predicated on seeking out vulnerable persons and small businesses with little or no technical or legal expertise. Thus, abusive demand letters are not caused by a deficiency in the patent system. Instead, the recent wave of abusive demand letters is caused by unfair and deceptive actions undertaken by persons and entities who have attached their abusive practices to the well-functioning patent system through questionable claims of alleged patent infringement.

The issue to be addressed in stopping abusive demand letters is therefore a matter of unfair trade practices. In assigning responsibility for policing bad faith demand letters to the FTC, S. 1720 provides a means for an agency with a mission and a record of compliance and enforcement against individual transgressors to be responsible for action.

The Section of Intellectual Property Law believes that this approach is strongly preferred over other legislative proposals to address problems generated by PAEs. Those problems are created by the abusive tactics of a small subset of the total population seeking to enforce their patent rights. Enforcement action against that small subset is fairer, more effective, and more efficient than wholesale changes in the procedures and mechanics for the administration of justice that would be applicable in all patent cases.

Section 5 of S. 1720 contains imprecise language that may need to be clarified. For example, it may be difficult to establish what constitutes "widespread sending of written communications" or a "written communication."

The ABA Section of Intellectual Property Law favors enactment of section 5, ("Bad Faith Demand Letters,") of S. 1720, 113th Congress, and recommends amendment of section 5 to increase the effectiveness of FTC enforcement efforts relating to patent demand letters by clearly identifying the conduct that constitutes an unfair act or practice.

Duty to Disclose Real-Party-in-Interest Information

The current debate on the costs imposed on businesses by PAEs using abusive litigation tactics has resulted in several legislative proposals relating to transparency and disclosure of interests in patents that are the subject of litigation. The Section favors reasonable measures increasing transparency in the patent system to the benefit of the public. However, we oppose overly broad measures, which will harm all patent owners with little impact on abusive litigation behavior.

H.R. 3309, the Innovation Act, seeks to increase transparency in patent ownership by requiring a plaintiff upon filing of an initial complaint to disclose real-party-in-interest information (RPI) to the USPTO, the court, and the adverse party. Requiring a plaintiff to notify the courts and the adverse party of the identity of the patent owner(s) serves both public interests and the interests of justice. The reasonable need for information of patent ownership when a patent is asserted, however, should be strictly limited to the information relevant to the proceeding during its pendency. While H.R. 3309 appropriately limits the initial duty of disclosure of RPI to the filing of a complaint, as introduced the proposed legislation creates an on-going duty for the patent owner to disclose RPI to the USPTO within 90 days of any change, for the term of the patent. H.R. 3309 additionally imposes a duty to disclose information that is unlikely to be relevant to a legal action. Specifically, the requirement to publicly disclose financial interests could significantly harm business interests in keeping licensing transactions confidential (for example, the percentage of licensing revenues owed to one or more inventors under the patent). A more appropriate disclosure obligation upon the filing of an initial complaint would be to disclose the "Ultimate Parent Entity" as defined under 16 C.F.R. § 801.1(a)(3), which reads:

> Ultimate parent entity. The term ultimate parent entity means an entity which is not controlled by any other entity.

Examples:

1. If corporation A holds 100 percent of the stock of subsidiary B, and B holds 75 percent of the stock of its subsidiary C, corporation A is the ultimate parent entity, since it controls subsidiary B directly and subsidiary C indirectly, and since it is the entity within the person which is not controlled by any other entity.

2. If corporation A is controlled by natural person D, natural person D is the ultimate parent entity.

3. P and Q are the ultimate parent entities within persons "P" and "Q." If P and Q each own 50 percent of the voting securities of R, then P and Q are both ultimate parents of R, and R is part of both persons "P" and "Q."

No arguments have been presented why other information that may be relevant to the proceeding, including financial interests in the patent, cannot be appropriately obtained in the course of discovery under the current rules. Financial interests are often confidential information. A mandatory disclosure requirement may therefore harm businesses interests by limiting the ability to create value through licensing transactions.

Disclosure of RPI, including any ultimate parent entities, is appropriate upon filing an initial complaint. Requiring disclosure of non-ownership interests, financial interests, and an on-going mandatory life-of-the patent duty to disclose RPI to the USPTO is not justified, and should be opposed.

Stays of Suits Against Customers

We are pleased that S. 1720 and H.R. 3309 include provisions designed to provide for a stay of infringement suits against persons who are downstream sellers or ultimate end users of allegedly infringing products, when the upstream manufacturer or other person with primary responsibility for the infringing feature of the product is also facing suit. H.R. 3309, the House-passed bill, has similar provisions, and our comments below on S. 1720 are also applicable to H.R. 3309.

The actions of PAE's in these so-called "customer suits" and enforcement actions are primary motivating factors behind legislative action to address abusive litigation tactics in patent infringement actions, as well they should be. The tactics of some PAEs in this regard include sending hundreds of identical demand letters to retailers or even to ultimate end user purchasers of consumer products that allegedly embody infringement components. The recipients of these demands typically have no involvement in or knowledge of the introduction of the infringing element into the product, and little or no experience or familiarity with the patent laws or the legal systems for enforcing those laws. Under these circumstances, it is not surprising that these defendants succumb to extortionist demands for licensing fees or other settlements upon learning of the potential costs of defending against even a totally meritless claim.

Section 4 of S. 1720 is intended to address the situation in which a patent plaintiff has, for tactical reasons, sued a party that does not make the allegedly infringing article but rather simply obtains and uses or resells to consumers what it buys from the manufacturer. Stated differently, the suit is against the customer, not the manufacturer. S. 1720 recognizes that this situation may arise in two different contexts. The patent plaintiff may have co-pending suits against the manufacturer and one or more customers, or the patent plaintiff may have opted to sue only customers, without involving the manufacturer.

The goal of the customer suit exception is to provide for a stay of a suit against a downstream alleged infringer provided that there is an adequate remedy against an upstream manufacturer/supplier. However, by providing that any and all downstream parties are "covered customers" entitled to a stay, S. 1720 is overly inclusive. Former Under Secretary of Commerce for Intellectual Property and Director of the USPTO David Kappos has provided an excellent analysis and explanation of the need for amendment. In testimony before the House Judiciary Committee on identical language in a House bill, Kappos noted

> [A]s currently written the stay provision permits all parties in the product channel downstream of the first component part maker to escape infringement liability, including large commercial actors such as manufacturers combining procured components into value-added completed devices, as well as assemblers, and others not operating in the roles of "mere retailers" or "mere end users,"' and certainly not operating in the roles of "mom and pop shops."

The Section of Intellectual Property Law recommends amendment of S. 1720 to limit eligibility of customer stays to retailers and end users who have not materially altered the product or process, or incorporated it into another product or process.

The determination of when a customer stay such as those called for in S. 1720 is appropriate is highly fact- and circumstance-bound. Even under the most carefully crafted legislation, it is extremely difficult, if not impossible, to anticipate and capture all those facts and circumstances. As a result, it is essential that trial judges retain some discretion in granting such stays.

S. 1720 seems to recognize that a rigid “one size fits all” mandate may in fact not produce a just result in all circumstances, in that the bill includes provision for a safety value that can be turned on to release a stay that is not working. The bill permits lifting a customer stay if the remaining action against the manufacturer will not resolve a major issue against the customer, or if the stay unreasonably prejudices and would be manifestly unjust to the party seeking to lift the stay.

The Section of Intellectual Property Law applauds S. 1720’s recognition of the need for such judicial discretion, and it recommends that Congress consider broadening that discretion so that it extends to a decision to grant a stay, as well as to lift an existing stay.

Miscellaneous Corrections and Improvements in the America Invents Act and IP Law

In addition to provisions designed to target the abusive litigation practices of “patent trolls” or PAEs, the bills Congress is considering also include miscellaneous provisions not designed with PAEs in mind, including corrections and improvement to the America Invents Act. In this regard, both S. 1720 and the House-passed bill, H.R. 3309, have provisions that would (1) modify the estoppel effect of Post Grant Review proceedings established by the AIA; (2) modify the claim construction standard in Post Grant Review and Inter Partes Review; (3) codify rules pertaining to double patenting; and (4) amend bankruptcy law to protect intellectual property in bankruptcy.

Senator Schumer’s bill, S.866, would expand the duration and scope of the program established by the America Invents Act for post grant review of covered business method patents.

Those miscellaneous amendments are the subjects of this section of our report and comments.

Estoppel Effect of Unsuccessful Administrative Challenges to Patents

Enacted in September 2011, The America Invents Act establishes a Post Grant Review (PGR) program in the U.S. Patent and Trademark Office for interested parties to challenge the patent eligibility of issued patents. As provided in the AIA, a challenger is estopped from asserting the invalidity of a patent claim determined to be patentable during a PGR proceeding as to all grounds for challenge that the challenger raised “or reasonably could have raised” during the PGR proceeding. The ambiguity of the breadth of the estoppel resulting from the “reasonably could have raised” standard creates a deterrent to challenges to issued patents under the PGR program, and could contribute to the underutilization of the proceeding as a low-cost alternative to patent litigation.

The inclusion of “or reasonably could have raised” in the AIA is widely considered to have been the result of a legislative error in preparing and processing the legislation in the 112th Congress. H.R. 3309 and other bills under consideration in Congress would correct this error. The Section of Intellectual Property Law urges correction of this error, which could diminish the vitality of the post-grant review program.

Interpretation of Patent Claims

The AIA created two new administrative review programs in the U.S. Patent and Trademark Office for challenging the eligibility of issued patents. The post grant review (PGR) and inter partes review (IPR) programs authorize any person other than the owner of a patent to challenge the PTO's issuance of the patent claims or claims in question, which if successful, can result in cancelation of the claim.

In the AIA, Congress directed the PTO to prescribe regulations establishing rules to govern the initiation and conduct of PGR and IPR proceedings. Pursuant to that mandate, PTO rules provide that a "broadest reasonable interpretation" (BRI) standard for claim construction is used for PGR and IPR.

Both S. 1720 and H.R. 3309 would amend the AIA by inserting identical language in the PGR and IPR provisions, directing that the PTO provide by regulation that in PGR and IPR proceedings "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." Enactment of these amendments would mean that the Patent Trial and Appeal Board (PTAB), which administers PGR and IPR proceedings, could no longer apply the BRI standard, but instead would have to apply the standard applicable when a patent is challenged in a civil action in a federal district court. The civil action claim construction standard is considered to be a more rigorous claim interpretation approach than BRI.

The Section of Intellectual Property Law opposes the enactment of legislation dictating the claims construction standard to be applied in PGR and IPR proceedings. Congress has never established a statutory claims construction standard, and should not do so for PGR and IPR administrative proceedings. The AIA properly grants the authority to establish that standard to the USPTO, which has exercised that authority by adopting the BRI standard. That standard is subject to judicial review, which should be relied upon to address how best to interpret patent claim terms in the various proceedings. The Section sees no need or justification for legislative circumvention of these processes, particularly because the programs have not been in operation for a time sufficient to allow full and effective judicial review.

Patent claims serve an important public notice function. An essential purpose of the broadest reasonable claim interpretation standard in the amendment process is to encourage an inventor to fashion clear, unambiguous claims. Patent owners have the opportunity in inter partes and post grant reviews to amend their claims commensurate with their contribution to the art. The application of the broadest reasonable claim interpretation standard can aid the Office in ensuring that uncertainties of claim scope are removed by the inventor. In contrast, patents before a district court are presumed valid with a heightened "clear and convincing" standard of proof to demonstrate invalidity.

Consistent with this heightened presumption of validity—and as there is no opportunity to amend and resolve ambiguities in a district court—courts construe claims to uphold validity. The Office is not so limited in its approach to claim interpretation, given the authority to amend patent claims in the administrative proceedings.

However, the question of claim construction depends heavily on the opportunity for claim amendments in the subject proceeding. It is not yet known to what extent a patent owner will actually be given the opportunity to amend claims in an inter partes review or a post grant review. In both PGR and IPR, the AIA provides that the patent owner "may file 1 motion to amend the patent" and, for each challenged claim, be allowed to "propose a reasonable number of substitute claims." The PGR and IPR programs did not become operational until September, 2012, and appeals to the Federal Circuit from final decisions of the PTAB are just beginning to be heard. Courts have therefore not been given the time and opportunity to evaluate the sufficiency of the claim construction standards being applied in the proceedings of the PTAB.

For these reasons, the Section of Intellectual Property Law opposes the enactment of the provisions in S. 1720 and H.R.3309 that would require the USPTO to abandon the claim construction standard for PGR and IPR proceedings currently applied by the PTAB, and mandate use of the standard be applied in district court actions.

Challenges to Business Method Patents

The purpose of section 18 of the AIA (not codified in Title 35) is to give the USPTO a second chance to examine business method patents related to the financial services and products which were granted subsequent to the Federal Circuit's 1998 decision in *State Street Bank & Trust Co. v. Signature Financial Group, Inc*., 149 F.3d 1368 (Fed. Cir. 1998), but prior to the line of cases starting with the Supreme Court's decision in *Bilski v. Kappos,* 130 S. Ct. 3218 (2010).

Section 18 was authored by Senators Schumer and Kyl to target business method patents issued after *State Street*, which held that a method of doing business is eligible for patenting if it produces a "useful, concrete, and tangible result. . . . even if the useful result is expressed numbers, such as price, profit, percentage, cost, or loss." *State Street* led to a marked increase in applications for business method patents and granting of patents by the USPTO. Further, the quality of some business method patents granted post *State Street* has been questioned due to inadequate consideration of prior art.

The Supreme Court's decision in *Bilski* narrowed the subject matter eligibility of business method patents by affirming the Federal Circuit's own reversal of the "useful, concrete, and tangible result" test articulated in *State Street*. *Bilski* stopped short of finding business methods to be ineligible subject matter per se, but did not articulate a specific treatment of business methods, instead focusing on the traditional exceptions to statutory subject matter: laws of nature, physical phenomena, and abstract ideas. Nevertheless, some business method patents granted by the USPTO in the time period between *State Street* and *Bilski* are likely invalid under current law.

The Covered Business Method Review under AIA section 18 is therefore intended as a mechanism to avoid litigation of patents that are allegedly invalid under current law and may have been examined without taking into account certain relevant prior art. CBM review permits review by the Patent Trial and Appeal Board (PTAB) in a procedure similar to Post Grant Review, which is otherwise not available to patents filed prior to March 16, 2013.

CBM review is temporary and set to expire September 16, 2020. While statements made by Senator Schumer evidence a general disagreement with business methods as constituting patent eligible subject matter per se under 35 U.S.C. § 101, the CBM review under AIA section 18 is limited to a "patent that claims a method or corresponding apparatus for performing data processing or other operations used in the practice, administration, or management of a financial product or service, except that the term does not include patents for technological inventions."

A patent is ineligible for CBM review as a technological invention if "the claimed subject matter as a whole recites a technological feature that is novel and unobvious over the prior art; and solves a technical problem using a technical solution." The definition of "financial product or service" is less clear. The definition is interpreted broadly to include activities "financial in nature, incidental to financial activity or complimentary to a financial activity." The PTAB has also interpreted the definition in accordance with the legislative history:

The plain meaning of ‘financial product or service’ demonstrates that section 18 is not limited to the financial services industry. At its most basic, a financial product is an agreement between two parties stipulating movements of money or other consideration now or in the future.

CBM review occurs in two stages. First, the review will only be instituted if it is more likely than not that at least one claim challenged is unpatentable under sections 101, 102, 103, and 112.10 The claims are not presumed to be valid and are interpreted according the “broadest reasonable interpretation” standard as opposed to the standard used in a civil action in which the claims are presumed to be valid and the 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. If the review is instituted, sequenced discovery is taken and the patentee is permitted the opportunity to amend the claims prior to an oral hearing before the PTAB. The process must be completed within one year of the CBM review being instituted.

Thirty-five petitions for CBM review had been filed of August 30, 2013. The first petition was filed on the first day CBM review became available by *SAP America Inc. v. Versata Development Group*. The petition was the first CBM review instituted, resulting in invalidation of Versata’s patent in June 2013.

As introduced on May 6, 2013, Senator Schumer’s bill, S. 866, would expand the Transitional Program for Covered Transitional Program Business Method Patents (CBMP) in two significant ways. First, it would repeal the sunset provision in the America Invents Act that terminates that program eight years after its initiation. Second, it would expand the subject matter coverage of the program. As enacted, the CBMP procedure can be used to challenge a patent for a method of data processing “used in the practice, administration, or management of a financial product or service.” The Schumer bill would eliminate the limitation to a “financial” product or service, and in addition would extend the category of patents eligible for challenge to those in any “enterprise, product, or service.”

Given the very limited experience with the CBMP program to date, it would be premature to make this transitional program permanent. Similarly, there is no empirical basis for greatly expanding the scope of patents that can be challenged under the program. The Section of Intellectual Property Law therefore opposes these expansions of the CBMP program.

Protection of Intellectual Property Licenses in Bankruptcy

Section 6 of S. 1720 provides for protection of licenses to intellectual property in bankruptcy proceedings. Section 6 of H.R. 3309 calls for similar protection.

Section 365(n) of Title 11 prevents a bankruptcy trustee from terminating licenses to patents and other intellectual property of a debtor. When Congress enacted Section 365(n) in 1989, it recognized that allowing patent and other IP licenses to be revoked in bankruptcy would be damaging to the economy and to both patent owners and licensing manufacturers. Section 365(n) of title 11 therefore is designed to prevent a bankruptcy trustee from terminating licenses to patents and other intellectual property of the debtor.

Manufacturers often invest great amounts of money in the manufacture of products that are covered by a license in reliance on that right to practice the intellectual property. Allowing a license to be eliminated in bankruptcy would create a commercial uncertainty and would undermine the investments in intellectual property and manufacturing.

However, in recent years, attempts have been made to subvert the protections of section 365(n) by filing for bankruptcy in a foreign country, and requesting that U.S. courts extend ‘‘comity’’ to the foreign court's termination of licenses to U.S. intellectual property. The Bankruptcy Code permits recognizing and extending comity to foreign bankruptcy proceedings.

District courts are given discretion in these matters, and determinations currently require case-by-case litigation. Both H.R. 3309 and S. 1720 contain amendments to prevent revocation of IP licenses in bankruptcy. .

The Section of Intellectual Property Law supports amendment of section 1520(a) of Title 11 to protect IP licenses in bankruptcy.

<u>Repeal of Section 145, U.S. Code</u>

Section 145 of title 35 allows a patent applicant whose claims have been rejected by the Patent Office, and who has appealed to the Patent Trial and Appeal Board and lost, to challenge the Board's decision in a Federal district court, as an alternative to appealing to the Federal Circuit.

Section 9(a)(1) of H.R. 3309 as reported by the House Judiciary Committee would repeal section 145. During House consideration of H.R. 3309, an amendment to strike the repeal was adopted by a vote of 260-150. As a result of the adoption of this amendment, none of the bills currently under consideration in the Congress provides for repeal of section 145. However, proponents of the repeal, which include the USPTO, may seek to insert a repeal provision in a pending bill. The Section of Intellectual Property therefore offers its view on repeal of section 145.

<u>The Section opposes repeal.</u>

No compelling justification for repealing 35 U.S.C. 145 has been forthcoming from either the present Administration or Congress, nor has there been an explanation or examination of the logic by anyone else – including the PTO which has long had an aversion to defending civil actions against it and hence stands to benefit from such repeal -- as to why this historic and important route of judicial recourse, which incidentally also exists at the interface between the Judiciary and other agencies, should be abolished. And the proponents of the legislation have failed to acknowledge that repealing section 145 is irrelevant to the expressed purposes of the Bill.

In patent application proceedings, an applicant who disagrees with the Patent Office's refusal to grant a patent can choose to forego direct appeal to the Federal Circuit under 35 U.S.C. 141-144, where review is on a closed evidentiary record fixed in Office proceedings. Section 145 provides the unsuccessful applicant an alternative means for challenging the denial, by filing a civil action in which the record below can be supplemented by additional evidence relevant to patentability. Section 145 stipulates that the plaintiff-applicant who chooses this route must bear all the expenses associated with the action—including the fees and costs of USPTO defendant. The limited number of section 145 actions relative to direct appeals to the Federal Circuit is perhaps due in part to the cost factor of electing this avenue to seek relief. Though rarely used, a section 145 action is useful and appropriate when there is a need for correct results grounded on a more comprehensive evidentiary record than that which was available to the Agency This can occur when additional evidence required for rebuttal by the applicant was not or could not be presented at the administrative stage. In light of those concerns, both the Federal Circuit in 2010 and the Supreme Court in 2012 in *Kappos v. Hyatt*, over the PTO's opposition, recognized the importance of district court adjudicatory, de novo review jurisdiction of PTO decisions, wherein evidence of patentability beyond the administrative record can be obtained, proffered, admitted, and considered in accordance with the Federal Rules of Civil Procedure and the Federal Rules of Evidence.

In fact it appears that it is the recognition by the Supreme Court in *Kappos v. Hyatt* of the scope and purpose of district court review under section 145, and disagreement with that decision that in part prompted the proposal to eliminate this cause of action. House Report 113-279 on H.R. 3309 includes the following in its explanation of the proposed repeal of section 145:

> In its decision in *Kappos v. Hyatt*, however, the Supreme Court swept aside those understood limits on the presentation of new evidence under § 145. Apparently constrained by its own 19th Century precedents, the Court determined that ''there are no limitations on a patent applicant's ability to introduce new evidence in a § 145 proceeding''—and ''[m]oreover, if new evidence is presented on a disputed question of fact, the district court must make de novo factual findings that take account of both the new evidence and the administrative record before the PTO.''

The House Report characterized the Supreme Court decision as "perhaps well suited to antebellum America" and opined that, as interpreted and applied by the Court," this version of § 145 effectively allows applicants to withhold evidence from the PTO. It allows applicants to ignore the administrative process and present their evidence of patentability in the first instance to a district judge, who is required to review it de novo." Concern was also expressed in the Report that the judge, "who rarely has relevant technical training", will be called upon to evaluate new technology "without the benefit of the views of the agency that Congress created and designated to conduct such reviews."

The continued availability of an action under section 145 was also reported to be unnecessary in view of administrative remedies currently made available by statute for offering new evidence after a claim is rejected.

Repeal of section 145 would take away a right that for 175 years has been available to provide an independent and thorough review of a Patent Office final decision to deny a patent. Though rarely used, the circumstances in which a section 145 action is available and used seem meritorious. It is true that Congress created the USPTO for the purpose of reviewing patent applications and making decisions on patentability. However, Congress also established the federal courts and enacted laws empowering courts to make decisions on patentability. One such statute is section 145 of title 35, U.S. Code. The Section of Intellectual Property Law of the ABA opposes its repeal.

Double Patenting

Section 9 of S. 1720 and section 9(d) of H.R. 3309 contain provisions to codify the judge-made doctrine of "double patenting."

Double patenting can exist when for at least one claimed invention in each of the two patents, neither claimed invention constituted prior art under 35 U.S.C. § 102 with respect to the other. For example, when the claimed invention of the first patent would constitute prior art to the claimed invention of the second patent under section 102(a)(2) if an exception under section 102(b)(2) was not applied, double patenting could be used to invalidate the second or double patent. In most applicable situations, the later filed or "double" patent would have a common inventive entity or common ownership with the first patent.

The Section supports the codification of double patenting in order to redirect the course of the judge-made obviousness-type double patenting law. Further, the Section supports application of double patenting in specific situations and its possible use for invalidation of the later filed or "double" patent.

The codification would establish new double patenting rules that are more consistent with the first-inventor-to-file principle and more consistent with the measure of patent term from the original filing date of an issued patent. Current double patenting rules were developed for first-to-invent patents when the first-to-invent patents were all subject to 17-year patent terms measured from the issue date of the patent. This combination of circumstances necessitated, first, that (for two patents issuing on different days) the later-to-issue patent be deemed the "double patent" for double patenting purposes and, second, a "one-way/two-way" analysis for double patenting be considered to account (at least in some situations) for the fact that the "order of invention" was not necessarily the "order of issuance" for the two patents. (Under the first-to-invent rule, the "order of invention" can be essential to determining the manner in which patentably distinctness is properly determined; if a later-made invention is non-obvious over an earlier-made invention, the two inventions are patentably distinct, even if the later-made invention would have anticipated or rendered obvious the earlier-made invention had the order of invention been reversed.)

The first-inventor-to-file principle and the patent term based on filing date effectively dictate that "double patenting" consequences be applied the claimed inventions of the *later-sought patent*. This is essential for two reasons. First, it is the claimed inventions of the later-sought patent that nominally will have the later-expiring patent term. Since "double patenting" seeks in part to redress extension of patent rights for indistinct (*e.g.*, highly similar claims), it is the later-sought patent that normally raises this issue. Second, it is the later-sought patent claims that need to be distinct from the claims of an earlier-sought patent, given that "order of filing" (not "order of invention") is the new (and exclusive) standard for assessing whether the claimed inventions in one patent can constitute prior art with respect to the claimed inventions of a second patent when the claimed invention of the respect patents have different effective filing dates.

Finally, the Section further supports the ability of a patent owner to overcome invalidity resulting from application of the double patenting statute by filing of a terminal disclaimer.

<u>Patent Small Claims Pilot Program</u>

Section 11 (d) of S. 1720 directs the Administrative Office of U.S. Courts to conduct a study of establishing a pilot program for patent small claims courts within the patent pilot districts established pursuant to the mandate in Public Law 111-349.

In 2012 the Section of Intellectual Property Law formed a Small Claims Patent Court Task Force to study issues relating to the establishment of a judicial process for the adjudication of small patent claims. The recommendations of the Task Force included a recommendation that a patent small claims pilot program be established, and that the United States Court of Federal Claims be considered as a forum for the adjudication of such cases.

The Section recommends that the study called for in section 11 (d) of S. 1720 include consideration of the U.S. Court of Federal Claims as a forum for such a pilot program.

Very Truly Yours,

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