



USIJ

STATEMENT FOR THE RECORD

**HOUSE JUDICIARY COMMITTEE
SUBCOMMITTEE ON COURTS, INTELLECTUAL PROPERTY, AND THE
INTERNET**

**HEARING: “EXAMINING RECENT SUPREME COURT CASES IN THE
PATENT ARENA”**

FEBRUARY 24, 2015

USIJ COMMENTS ON HOUSE BILL H.R. 9

The Alliance of U.S. Startups and Inventors for Jobs (USIJ) is a group of nearly 50 Silicon Valley-based innovative startups, inventors, investors and entrepreneurs. Collectively, we have launched dozens of companies in areas ranging from biotechnology to medical devices and wireless technology. We invent real things and create real companies. We also rely on the strength of the U.S. patent system to create these companies, breakthroughs and jobs. In no other country on earth could we do what we do, and it is a direct result of the value the U.S. places on invention and intellectual property.

Our entrepreneurs and venture capitalists have found themselves on both sides of patent litigation – small businesses faced with infringement lawsuits and small businesses that need to assert their patent rights to protect their inventions from being freely copied by others. Like many others, we are increasingly threatened by the ever-escalating complexity and cost of our patent litigation system.

SUMMARY OF USIJ’S COMMENTS

We agree with many of the stated goals that are motivating the desire for patent litigation reform in Congress. Abusive behavior based on deception and threat undermines our patent system and needs to be addressed. However we are very concerned that the approach taken under H.R. 9 -

the Innovation Act. We believe that it would have a devastating effect on venture-backed startups by making patent litigation more expensive and complex for innovative startups.

We are also concerned by the tone of some Members of the Committee at the recent hearing. The testimony and comments presented by the National Venture Capital Association (NVCA) were questioned, not on their substance, but rather with ad hominem attacks on NVCA's witness, Bob Taylor, and the process that the organization used to develop its very clear concerns with H.R. 9. This was not only unfair, but also unfortunate. The issue of patent litigation reform impacts nearly every aspect of the U.S. innovation ecosystem, and warrants a very serious debate focused on facts and the law.

USIJ's views are entirely consistent with NVCA and other inventors, venture capitalists, entrepreneurs and innovators who have urged Congress to take into account the tremendous changes that have occurred in the patent litigation arena over the past year and look to implement true patent litigation reform. We believe that this requires rapid and transparent determination of the merits of a patent case so that all participants in the patent litigation system can be served. Timely, affordable and efficient means to resolve disputes will also once again enable defendants and plaintiffs alike to defend their rights.

The provisions within H.R. 9 that are particularly concerning to USIJ's members are:

- **Changes to Pleading Standards:** Just as with plaintiffs, patent defendants should be required to state what they mean in their pleadings concerning each asserted defense regarding validity and enforcement, including specifically identifying and charting purportedly invalidating prior art, and stating the specific bases for other defenses, if they exist, such as laches or unclean hands.
- **Stay of Discovery:** This provision would unfairly favor the interests of large business over small businesses.
- **Presumptive Fee Shifting:** Although there is some debate whether this provision provides presumptive fee shifting, we believe it does. This provision will add an additional stage at the end of every patent trial in the U.S. that will deter plaintiffs and defendants from aggressively defending themselves. It will force many small businesses to settle prematurely when facing a large company or well-funded NPE on the other side.
- **Joinder of "Interested Parties":** This provision would cause many venture capitalists to avoid investing in innovative startups which are increasingly dependent on their patent portfolios, or quickly abandon their investments when litigation becomes necessary to either enforce patents, or defend infringement claims.
- **Stay of Customer Suits:** Having forced a plaintiff's customer suit to be held in abeyance while a manufacturer suit is litigated, it makes no sense to force the plaintiff to re-litigate the same issues again with the customer.

The aforementioned provisions will make patent cases less efficient, more expensive, and lengthier than they are today for everyone involved, including plaintiffs, defendants, and the courts.

We suggest the following reforms as **alternatives** to create effective change in patent litigation:

- Early, limited mutual discovery narrowly targeted to the real infringement, validity, and damages issues in the case.
- “Quick look” early judicial assessment of case merits and issues, immediately following the early targeted discovery period.
- Graduated implementation of fee shifting.
- Tightened pleading standards.
- Heightened Standards for Notice and Willful Infringement.
- Launch a pilot program at USPTO to develop a public database of frequent patent demand letters.

In what follows, we first explain why the proposed legislation would be devastating to small companies, especially venture backed startups. We also provide a detailed analysis of why the Innovation Act as it is presently drafted would severely damage our venture backed startup economy. We then outline a set of principles and provisions for positive patent litigation reform.

USIJ’S ANALYSIS OF H.R. 9

A frequently cited goal of patent reform is to protect the rights of small businesses. We agree with this goal, and it must extend to those faced with allegations of patent infringement *and* small businesses with patented inventions that are forced to protect their intellectual property against infringements. In its current form, however, the Innovation Act does not strike this balance. While it includes some reasonable measures, such as tightening standards for providing notice of infringement, the overall impact of the bill would be to harm entrepreneurial small businesses. Many of the bill’s provisions would make patent cases less efficient, more expensive, and lengthier than they are today – consequences that necessarily hit small businesses much harder than they would large enterprises, given their more limited resources.

The Innovation Act contains three core provisions that, taken together, would have a devastating impact on venture-backed startups.

The bill’s mandatory delay of essential discovery until late in the trial process forces all parties to spend money and time before they know the essential merits of their case. This is extremely risky for a small company which now must spend a tremendous amount of money (even in a case with a high probability of success) because the critical information to determine the merits of the case will not be available to the startup.

During the hearing, there was a dispute as to whether the Innovation Act making fee shifting mandatory or not. We interpret the disputed provision as presumptive fee shifting, and this threat of presumptive fee shifting significantly escalates the risk and expense to startups. The Innovation Act’s fee shifting provision will add an additional stage at the end of every patent trial in the U.S. that will deter plaintiffs and defendants from aggressively defending themselves. It will force many small businesses to settle prematurely when facing a large company or well-funded NPE on the other side. These entities can handle an expensive trial and the threat of

mandatory fee-shifting, while most venture-backed startups cannot. This provision will not impact large corporations or well-financed NPEs, but it may very well make pursuing legal recourse for infringement or defending against alleged infringement financially ruinous for many venture-backed startups.

This situation is compounded by a provision in the Innovation Act that would allow the joinder of “interested parties” when a non-prevailing party is unable to pay fees and expenses assessed under H.R. 9’s fee shifting provision.

We understand the intent is to address the issue of shell corporations which finance abusive lawsuits; however, the ounce of prevention offered by this provision would have dramatic unintended consequences. Investors in innovative startup companies, particularly in the technology and life sciences industries, know that in the event of a product success the companies they invest in have a high likelihood of being sued by patent holders, or needing to sue companies infringing their patents. Indeed, a recent MIT study on the success of Silicon Valley noted that one of the top indicators of success is, “Startups that get control over their intellectual property in their first year through patents.”¹ This joinder provision would cause many venture capitalists to avoid investing in innovative startups which are increasingly dependent on their patent portfolios, or quickly abandon their investments when litigation becomes necessary to either enforce patents, or defend infringement claims.

Thus, while the Innovation Act is billed as patent litigation reform to help small business, it is exactly the opposite. As proposed, the bill would make it very difficult for small companies, defendants and plaintiffs alike, to successfully litigate patent cases against larger companies. This imbalance would do great harm to the delicate risk-reward balance in venture capital funding for any company that is likely to be sued for patent infringement when it launches a new product or invents a technology that needs patent protections from larger companies.

It is also very important to recognize that any new legislation that reduces transparency regarding the merits of a case, increases litigation time and cost and amplifies risks with fee shifting is uniformly bad for all defendants and plaintiffs, not just small ones, that are interested in a speedy and fair resolution to the question of whether or not a product or service infringes a valid patent. This type of legislation is only in the interests of defendants and plaintiffs that desire to use their size and financial resources to unfairly imbalance the legal process.

Finally, a stay of nearly all discovery prior to a claim construction (“*Markman*”) ruling, appear to be well-intentioned but would unfairly favor the interests of large business over small businesses. Congress should instead work to enact true patent litigation reform that reduces the time, cost and risk required for both sides by inducing an early assessment of the relative merits of their case which in turn will facilitate a timelier and less costly resolution.

¹ http://m.bizjournals.com/sanjose/blog/techflash/2015/02/somas-hot-but-study-finds-heart-of-tech-success-in.html?ana=e_du_wknd&s=article_du&ed=2015-02-14&u=xVuE3P+KD4rm2d5NnbDIA3Jyig5&t=1423933353&r=full

Specific Comments From Experienced Patent Litigators Regarding Current Reform Proposals

The following analysis presents the views of experienced patent litigators concerning the current proposals under consideration by Congress to enact further patent reform just a few years after the America Invents Act. The authors have represented plaintiffs and defendants of all sizes in patent infringement matters, including some of the largest and best-known companies in the world, as well as smaller companies and non-practicing entities, whose primary business is to license intellectual property.

1. Changes to Pleading Standards

No plaintiff in a legitimate patent suit has any reason to fear reforms that require it to state what it means when it pleads infringement of a patent. The proposed changes to pleading standards in the Innovation Act would address the current ability of abusive patent plaintiffs to rely on permissive “notice pleading” standards to assert flimsy claims of patent infringement. However, these changes would do nothing to address the equally abusive practice of patent defendants in reliance on those same permissive pleading standards: the assertion of ill-founded claims of patent invalidity and unenforceability in responsive pleadings, and in declaratory judgment actions. It is routine for patent defendants to assert numerous “kitchen sink” defenses to allegations of patent infringement without regard to their merit, including claims that a patent is invalid in light of prior art, or unenforceable due to reasons such as laches, unclean hands, estoppel, waiver, exhaustion, or implied license.

Leaving “notice pleading” in place for these and similar defenses will encourage defendants to continue to assert baseless, boiler-plate defenses that consume significant time and energy of the parties, regardless of their merit. Just as with plaintiffs, patent defendants should be required to state what they mean in their pleadings concerning each asserted defense regarding validity and enforcement, including specifically identifying and charting purportedly invalidating prior art, and stating the specific bases for other defenses, if they exist, such as laches or unclean hands. The judicially imposed changes to pleading standards for inequitable conduct allegations by defendants, which require specificity in pleading, are a good example of how changes to pleading standards can help ensure that only defenses with sufficient merit are asserted and litigated; these same standards should be applied to all defenses.

Without doubt, it can be difficult for patent defendants to plead defenses with specificity within the short time permitted under the Federal Rules of Civil Procedure to respond to a complaint, but that is not a reason to permit defendants to plead defenses that have no proper basis in fact. When we have represented defendants in patent cases, it is routine to obtain an extension of time to answer of at least 30 days. In those 50 days total, we had no problem preparing internal analyses of our prior art defenses that would have met this more stringent pleading requirement. In addition, the Federal Rules provide for liberal amendment of pleadings “when justice so requires” (F.R.C.P. 15), and, in combination with the special local rules for patent cases that many courts have adopted, these rules would readily permit amendment of defendant pleadings to assert new defenses, once a proper basis for a defense exists and may be stated with the requisite specificity.

2. Fee Shifting Provisions and Joinder of “Interested Parties”

Since the 113th Congress considered the Innovation Act’s fee-shifting proposal, the Supreme Court has significantly broadened the circumstances, codified at 35 USC § 285, under which courts may award attorney fees to a prevailing party under the existing law. In *Octane Fitness v. ICON Health & Fitness*, the Supreme Court rejected the Federal Circuit’s restrictive definition of an “exceptional case” as limited to one in which it can be proved by *clear and convincing evidence* that (1) “there has been some material inappropriate conduct,” or (2) the litigation was “brought in subjective bad faith” and was “objectively baseless.” Instead, under the new *Octane Fitness* standard, a prevailing party must now prove only by a *preponderance of the evidence* (a lower standard) that a case was exceptional – meaning only that the case “stands out from others with respect to the substantive strength of a party’s litigating position (considering both the governing law and the facts of the case) or the unreasonable manner in which the case was litigated.”

The *Octane Fitness* decision has changed the landscape for patent infringement suits, and the new rules provide powerful incentives to patent plaintiffs and their counsel to comprehensively investigate potential claims prior to filing suit, all without departing from the “American Rule,” in which each party pays its own attorney fees in most circumstances. *Octane Fitness* further demonstrates that the courts stand ready to address abusive behavior by litigants through the existing legal and judicial framework. For these reasons, legislative intervention to depart from the “American Rule” regarding fees in patent cases seems both premature and unnecessary at this point. To take further action now, without any assessment of the effect of the *Octane Fitness* decision in deterring abusive patent litigation, runs the risk of harming all patent owners, including individual inventors, start-ups, small companies, universities, and other entities that create and license patented inventions. Imposing such significant barriers to patent assertion by legitimate plaintiffs would discourage, rather than promote, the progress of the useful arts.

Moreover, the proposed rules surrounding required certification of ability to pay fees and joinder of “interested parties” (intended to ensure the presence in suit of an entity capable of paying defendant’s attorney fees) are unhelpfully vague. First, it is unclear when during a patent litigation the proposed motions for certification and joinder of parties are to take place. Presumably, no such motions should occur until such time as a prevailing party has been declared and the court has awarded fees, at which point the amount of fees will be known – a prerequisite for the required certification of ability to pay fees. The proposed legislation is unclear, however. If permitted prior to the finding of a prevailing party and an award of fees, the proposed rules would provide an opportunity for distracting and abusive motion practice by patent defendants that would serve to cut off legitimate patent plaintiffs from sources of capital necessary to conduct a patent litigation.

Second, the proposed rules exempt law firms providing legal representation to a patent plaintiff from being joined as an “interested party” (and therefore potentially liable for a fee award), which is appropriate and necessary to ensure continued access to the courts by small inventors. But the Innovation Act provides this exemption only “if the *sole* basis for the financial interest” of the law firm arises from “receipt of compensation *reasonably related* to the provision of the

legal representation.” This language is ambiguous in that it could be read to suggest that courts must make a determination whether a law firm’s fee agreement with a plaintiff, such as a contingent fee arrangement, is “reasonably related” to the legal services provided or not, with the law firm’s exposure to a fee award hanging in the balance. Such a case-by-case assessment of the “reasonableness” of attorney fees invites mischief, and presents uncertainty to patent holders and their lawyers alike. Should fee-shifting be adopted, the language of this provision should be modified to clarify that where the sole financial interest of a plaintiff’s law firm is its receipt of compensation (in whatever form) for legal services, law firms are exempt from joinder as an “interested party” with potential responsibility for legal fees. If not, the effect of the change would be to all but cut off access to the courts by small inventors with legitimate claims but limited means.

Finally, the proposal to mandate that a plaintiff that delivers a unilateral non-assert covenant as to an asserted patent is a “non-prevailing party” for purposes of fee awards is contrary to law and common sense. Such a result should only obtain if the non-assert covenant applies to all patents-in-suit. The law is clear that settling one patent out of many does not make the defendants a prevailing party; rather, the party that prevails is one that prevails in the case as a whole.

3. Discovery Limitations

The various restrictions on civil discovery proposed by the Innovation Act are unworkable, unnecessary, and unfair. First, the proposed stay of all civil discovery (except discovery related to claim construction) until the issuance of a claim construction ruling is unacceptable. It will dramatically lengthen the time to trial in patent cases, which is already unacceptably long with a median time of 2.5 years to trial across the country. It will lead to endless and expensive disputes about what discovery is and is not needed for claim construction. What’s more, long experience and numerous cases have established that *Markman* proceedings that are conducted without the clear context of the infringement and validity issues in the case – a context that can only be established by discovery – are a waste of time for all parties involved, and typically have to be redone once the issues are clear. The proposal also will conflict with the timing set out in the local patent rules around the country: rules that have been fashioned from long experience by members of the bar and bench, coming from all perspectives, and represent their collective judgment regarding the most efficient case management process for patent cases.

The additional proposed discovery restrictions in Section 6 of the Innovation Act concerning “core discovery,” while structured as a recommended set of considerations for the Judicial Conference when implementing additional discovery limitations in patent cases, would effectively constrain the Judicial Conference to adopt the Innovation’s Act’s recommendations. Those recommendations are inflexible, restrictive, and one-sided in favor of patent defendants, and should be rejected. First, the proposed definition of “core documents” is both unduly narrow and almost entirely one-sided against patent plaintiffs. For example, the current “core document” recommendations appear to provide for *no* discovery regarding patent damages issues by plaintiff. Because the measure of damages in a patent case is often that of a “reasonable royalty” – typically measured in terms of what the defendant would have agreed to pay for a license in an arm’s length negotiation – documents concerning more how a defendant values an accused product is necessarily “core” discovery in a patent case. Such “core documents” include, for example, revenue statements, market forecasts, internal assessments of

the importance of a technology and/or alternative technologies, studies of consumer preferences for technology features, and assessments of other benefits of the accused technology, such as cost savings, improved efficiency, or effect on sales of other products. Such evidence, which is highly probative of damages in a patent case, would be excluded from “core discovery” by the Innovation Act, and it is just one example of the unduly restrictive nature of the “core discovery” approach. Similarly, “core discovery” in any patent case necessarily includes discovery concerning the defenses asserted by defendant, but such discovery is noticeably absent from the “core discovery” provisions of the Innovation Act.

Compounding the issue is the proposal that, beyond “core documents” and limited discovery of e-mail, further discovery (even discovery “otherwise permitted under the Federal Rules of Civil Procedure”), would be permitted only if the requesting party bears the costs, including attorney fees, of the additional discovery, *and* “posts a bond, or provides other security,” in an amount sufficient to cover the cost of such discovery. Such limitations seem specifically designed to hinder small plaintiffs with limited means, and are therefore unacceptable. It is manifestly unfair, and contrary to the principles of our justice system, to provide access to important discovery only to those plaintiffs able to pay for it. Similarly, for discovery of electronic communications, cost shifting should not presumptively occur beyond 5 custodians. Again, such proposals appear better designed to obstruct small inventors’ access to important discovery, than they are to prevent abusive discovery practices. Courts are very experienced in tailoring discovery to balance cost and benefit, but this draft legislation represents a radical departure from core American values regarding access to the courts.

Across all of these proposals, the conclusion is the same: “one size fits all” is not an appropriate maxim for patent litigation. Cases differ, and courts are well equipped to tailor appropriate discovery limits to the particular case before them, in the context of guidelines that many courts have already adopted in the form of patent local rules. There is no need for a legislative approach that overrides these guidelines with an inflexible set of rules; particularly in the case, as here, of rules that are unfair and unworkable.

4. Stay of Customer Suits

The Innovation Act’s proposal under which patent infringement suits against a customer would be stayed pending resolution of a suit involving the manufacturer of an accused product or process concerning the same patent is illogical and unnecessary. In general, there is no basis in fairness or judicial efficiency to disturb a plaintiff’s choice of defendant by permitting manufacturers to effectively force questions of infringement, validity, and damages to be resolved against them, and in their chosen forum, such as by filing a declaratory judgment action against a plaintiff well after initiation of litigation against a customer. Courts already have at their disposal a balanced body of law to ensure efficient and consistent resolution of related infringement issues, including consolidation of cases under Rule 42(a), or under the auspices of the Judicial Panel on Multi-District Litigation (“MDL”). These rules are more than sufficient to address any abusive situations.

Moreover, the provisions of the Innovation Act which would permit courts to decline to bind customers to the outcome of a manufacturer suit are both inefficient and unfair. If a stay is entered in a customer suit pending resolution of patent infringement and validity issues in a

manufacturer suit, the customer should be bound by the outcome of that suit. Having forced a plaintiff's customer suit to be held in abeyance while a manufacturer suit is litigated, it makes no sense to force the plaintiff to re-litigate the same issues again with the customer.

IMPLEMENTING EFFECTIVE REFORM

What is needed is patent reform that addresses the real issues facing patent defendants and plaintiffs, and improves the patent system for large and small businesses alike. Such reform would include:

- **Early, limited mutual discovery narrowly targeted to the real infringement, validity, and damages issues in the case.** This would permit both sides to a patent case to make an informed decision about the status of the dispute, and the best way to resolve it, while still controlling discovery costs.
- **“Quick look” early judicial assessment of case merits and issues, immediately following the early targeted discovery period.** Following a summary presentation of key case issues and evidence by the parties, the district court (or an appointed representative such as a special master or private mediator) would provide a preliminary, nonbinding assessment of case merits, including possible risks of fee shifting and a finding of willful infringement. Early assessment provides both sides to a patent case with the information necessary to properly assess the merits of a patent case and the attendant risks.
- **Graduated implementation of fee shifting.** To ensure fair treatment and equal access to the courts for small businesses, fee shifting rules would take effect only after early judicial assessment of the merits of a patent dispute.
- **Tightened Pleading Standards.** The Innovation Act's heightened pleading standard for patent complaints should be adopted, but along with similarly heightened pleading standards for patent defendants to plead defenses such as validity. Fairness and efficiency are served by requiring both plaintiffs and defendants to articulate (such as through claim charts) the bases for their claims and defenses.
- **Heightened Standards for Notice and Willful Infringement.** The Innovation Act's heightened standard for so-called “notice letters” intended to put a party on notice of its alleged infringement of a patent, and allow for the possibility of a finding of willful infringement, is a sensible and even-handed reform that should be adopted in any patent reform legislation.
- **Launch a pilot program at USPTO to develop a public database of frequent patent demand letters**
 1. Registration in the USPTO database is statutorily required in the event of a trigger defined by:
 - a. Issuing more than 25 (this number is a variable in the concept and can be adjusted down or up) demand letters in less than a one year period that accuse the same product or service with infringement of the same patent claim, and/or
 - b. Filing more than 25 (a variable) patent lawsuits in less than a one year period that accuse the same product or service with infringement of the same patent claim.

2. Once the “behavior trigger” is satisfied, the issuer of the demand letters or the filer of the patent lawsuits is required to do the following:
 - a. Register each demand letter and cross reference each of the recipients of the demand letters and/or each of the defendants of the lawsuits setting forth the identity of all the other demand letter recipients and/or lawsuit defendants and explaining what the basis is for the accused infringement for each of the demand letter recipients and/or defendants, including searchable patent numbers, etc.

CONCLUSION

We are committed to working with policy makers to reverse the trend towards ever more complex, risky, time consuming and expensive patent lawsuits. This trend is transforming the U.S. patent system into one where small defendants and plaintiffs are forced to give up their rights regardless of the merits of their case because they cannot afford the cost, distraction and risk in pursuing patent litigation. We oppose any patent legislation that continues the trend toward increased cost, risk and time involved with patent litigation. We oppose these things because if we allow them to continue the only entities that will be able to afford to use patent litigation will be the wealthiest companies and this will result in smaller entities abandoning their rights, whether they be defendants or plaintiffs, regardless of the merits of their case.

The U.S. has a 200-year legacy of respecting invention that traces its roots to the Constitution. Our system can always be improved, but we must prioritize the role that inventors, entrepreneurs and job creators play and we must recognize that they are dependent on strong patent protection to drive investment and support their success in the market. Large companies have many different assets to protect their business, small inventors and startups require the protection of their sweat and equity for which the patent system was created.

We understand the various patent reform proposals found in the Innovation Act are designed to address abusive behavior that has led to expensive litigation and deceptive practices by those who have made a business out of patent litigation. But for those of us who have made a business out of invention and creating companies, they could have a devastating effect.