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A New Approach to Curbing Copyright Trolls

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Why Rush Patent Reform?

By Circuit Judge Paul R. Michel (Ret.)

The United States has the best patent system in the world. Others refer to it as the gold standard. It is widely imitated around the globe. It was the primary driver of our technological progress and world leadership for over 200 years. In the twentieth century, of the 100 most important inventions in the world, nearly every important new invention was made here. And on it goes today.

The U.S. Patent and Trademark Office (USPTO) and the U.S. federal court system are its principal institutions, and the U.S. Patent Act its charter. The Act, one of the first enactments of the very first Congress in 1790, implemented the authorization of the U.S. Constitution itself, to grant to inventors the exclusive rights to their discoveries for a limited period of time. The Patent Clause of the Constitution, found in Article I, Section 8, Clause 8, urges and authorizes the use of patents to promote progress in science and useful arts, even before the clause establishing an Army and Navy. Patents—as the key to industrialization of what was then a poor, agrarian country—were that high a priority of the nation's founders.

In 1982, Congress created the U.S. Court of Appeals for the Federal Circuit to unify, clarify, and revive U.S. patent law. The objective was to help the nation overcome decades of legal confusion that stunted economic growth. It was a reaction to the scary prospect of continued industrial stagnation, for America was starting to lose its technological preeminence. Within less than a decade, the court achieved its purposes.

Then, in the 1990s, the value of patents as a corporate asset dramatically increased. While always important for companies as instruments of growth, patents gradually became the primary assets of many leading companies. For them, the value of patent portfolios and other intangible property exceeded the value of all physical assets. Patent values began to determine company values and influence stock prices. Patents also came to be seen as assets to be monetized through sale or licensing and related enforcement efforts. Patent portfolios that once sat dormant on corporate shelves became prime means for corporate profitability.

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That is our history; those are our roots. This should remind would-be reformers that they are tinkering with the main engine of economic growth and national prosperity. They should adhere to the physicians' Hippocratic Oath: "First, do no harm."

Only three years ago, Congress enacted the most fundamental revision of the Patent Act since 1952. Implementation of its changes is still in the early days, with many effects not yet fully revealed. Yet in recent months, legislative leaders have announced new plans for a further revision of the Patent Act.

Proposed Changes

The intended target of further "reform" is the management of patent infringement suits in the federal district courts. One might have thought that to be the business of federal judges, but certain industrial sectors, particularly giant global information technology (IT) corporations, are pushing hard to limit the discretion of federal judges and to micromanage patent cases by legislative fiat. They would thereby tie the hands of the very officials with the experience, expertise, and responsibility to manage trial proceedings.

In the process, these legislative proposals would alter the rules that have governed all civil litigation in America since 1938, creating one set of rules for patent cases only, while all other cases would follow a different set. Such changes would also represent the first time the legislative branch dictated procedural rules to the independent, coequal judicial branch.

Thus, the questions that immediately arise include: is this necessary, is it wise, and is it constitutional? Further questions also arise: how did we as a country get to this place? What are the forces at work? What evolution of events now presents the prospect of further and more radical changes to the patent laws on which the innovation ecosystem depends? As usual, answering such questions requires understanding and some history.

The passage in 2011 of the America Invents Act (AIA) was a major revision of the patent system. The noteworthy characteristics of the AIA were that it was developed slowly and carefully, that it avoided disrupting the system, and that the reforms adopted represented consensus views. Earlier versions had emphasized restrictions on damages, venue choices, and allowing immediate appeal of bare claim construction rulings. But Congress ultimately dropped these measures because Federal Circuit decisions had addressed the

perceived problems sufficiently. Instead, Congress focused on issues the courts had not and could not address, such as changing the United States from being the only “first-to-invent” patent system to the global standard of “first-to-file.” The AIA, then, adhered to the maxim “first do no harm.”

The question now is whether Congress in 2015 will abandon this approach and intervene in the management of individual patent cases with broad legislative mandates that favor defendants and impede plaintiffs, no matter how valid their patents or how evident the infringement. After being so careful in the seven-year effort leading to the AIA in 2011, why would Congress reverse its approach? Three new dynamics suggest answers to this question.

First, the level of news coverage of all matters patent escalated significantly during the last half decade. Dramatic damages awards and huge dollar amounts for sales of portfolios are now highlighted by newspapers, TV, radio, and blogs. Monographs began to appear on patent reform topics—addressed not to patent lawyers and technologists, but to general readers. Even the President became involved, speaking repeatedly about patents and patent reform, and thus further increasing media attention.

Second, several coalitions of major industrial groups formed, each advocating strongly for its own vision of patent reform. Aligning with the Financial Services Roundtable and arising from Business Software Alliance, the Coalition for Patent Fairness (CPF) advocated and lobbied for major limits on litigation as well as USPTO grants and reviews. Its opposite number was the much smaller Innovation Alliance, which promoted strong and enforceable patents. In the middle of the policy spectrum was the Coalition for 21st Century Patent Reform, also known as 21C. It consisted of several dozen large and diverse companies, such as GE, Johnson & Johnson, and Procter & Gamble. It generally favored selected, measured reforms, opposing some of the more aggressive, anti-patent proposals of the CPF.

The important point is that these groups amassed funding for massive public relations campaigns and intensive lobbying of members of Congress. Huge sums were also spent on fundraisers and campaign contributions. In addition to many public hearings, there were dozens of closed-door “stakeholder” meetings and thousands of private visits to Capitol Hill. As a result of such campaigns, numerous editorials began to appear—some planted, others spontaneous; full-page ads were placed on reform issues.

Third, a new powerful dynamic appeared when mass mailing of letters to small businesses across America threatened patent suits if the recipients did not pay the sender a stated sum. The reaction was a firestorm of protest heard loud and clear by every member of Congress. The demand for reforms addressing such “demand letters” added to the preexisting cry for curbing patent enforcement.

Consequently, it became conventional wisdom on Capitol Hill that additional major reforms were needed, and needed immediately. The challenge this presented to measured, careful reform cannot be overstated. In the rush to act, will good policy get mangled?

A Work in Progress: Implementation of the America Invents Act

The work of the trial courts is greatly affected by the new review procedures of the AIA for challenging patents. Because the reviews must conclude within one year, the results come faster than with validity challenges in court, which typically take three years or more. In addition, early USPTO results showed both a high rate of initiation and a high rate of invalidation—around 80 percent for each.

Consequently, defendants resorted increasingly to USPTO reviews, and courts increasingly granted stays pending completion of reviews. Now, the stay rate is exceeding 50 percent and continually rising. So is the percentage of cases in which stays are sought. It may well soon reach 90 percent. These developments represent a sea change. The patent enforcement regime now includes first a USPTO review and later a federal court trial if validity is sustained.

The new reality for patent owners is also that reviews are held under circumstances and regulations unfavorable to owners:

- The Patent Trial and Appeal Board (PTAB) applies the “broadest reasonable construction,” rather than the “correct construction” applied by courts;
- The PTAB requires only preponderance of the evidence to invalidate, when the courts require clear and convincing evidence;
- The PTAB panel deciding validity has already ruled at the petition stage that one or more claims are likely invalid, so decisional inertia may set in; and
- The presumption of validity, strong in court, is gone at the USPTO.

Moreover, the opportunity to amend claims is restricted by tight page limitations and the requirement that new claims must be shown patentable not merely over prior art cited by the petitioner, but all prior art. Consequently, amendments are rarely allowed. Also, patents are reviewed under the more restrictive decisions of intervening Supreme Court cases on obviousness and eligibility even though granted years ago under lower standards.

It is too early to assess the full effects of these AIA reviews. They will reduce and may virtually eliminate any need for further patent reform legislation. One would hope that Congress would await the results of the AIA before enacting still stronger anti-patent measures.

What's at Risk

The stakes for companies and the country are very high. They involve the incentives to invest in research and development (R&D) and also in commercialization. Both require substantial sums. If patent values and patent portfolio values fall significantly under the AIA, will such incentives not fall as well? And if they do, what will that mean for investments, the future of technological advancement, global competitiveness, job creation, overall economic growth, and prosperity?

Government investments in such activities are going down fast. The budget of the National Institutes of Health (actually 27 agencies) decreased 25 percent in two years, and so too at the Departments of Energy and Defense. Obviously, public money cannot begin to make up the difference in reduced levels of private investment.

Today there are approximately two million patents in force in America. They represent the majority of the value of most companies. When the value of patents falls, the value of the companies and the price of their stock will follow. That means investments must fall. It could not come at a worse time, as economic rivals like China continue to invest heavily in R&D and related commercialization.

New factories making new products offer good wages. Economists say that every production worker supports multiple jobs elsewhere. If R&D and commercialization investments fall, will new factories get built? The fate of many unemployed and underemployed workers is threatened, as is the prosperity of all citizens. A sensible national policy would aim to *increase* incentives to make such investments, yet we seem to be moving in exactly the opposite direction, and Congress is poised to make it worse still.

Why? Congress continues to be heavily lobbied by the CPF and allied special interests to pass new legislation that would add delay, costs, and uncertainties above those already impeding enforcement of patents.

A Caution to Congress

Congress needs to remember: patents are not self-enforcing, and no private or public institution except the federal courts can enforce them.

In effect, a patent is simply the right to sue an infringer. Most patent rights are voluntarily licensed between informed, consenting parties. For every lawsuit, there are hundreds or perhaps thousands of such quiet agreements. Yet they all occur in the shadow of the courthouse because all parties understand the patent owner can always resort to the courts.

In fact, owners do so at the rate of 3,000–5,000 suits per year. For a country of 300 million people, two million patents, 30,000 corporations of over 100 employees, and untold numbers of small firms, even 5,000 filings per year is not excessive. Only 1.5 percent of patents in force at any given time result in suits, a rate that has not changed in over a century.

So when “reformers” claim there is a “litigation explosion,” the statistics refute that claim. It is true that there were higher numbers of suits filed in recent years than decades ago, but that only reflects the greater number of patents now held. Also, what in years past was counted as one suit with 15 defendants is now counted under the AIA as 15 separate suits. More importantly, the number of suits filed this year is far below the last. Any contribution to the filing rate of suits of patent assertion entities (PAEs) is relatively minor; as the Government Accountability Office reported, only 20 percent of the suits involve PAEs.

The Goodlatte Bill: Is It Good?

House Judiciary Chairman Bob Goodlatte is urging the new Congress to pass the bill the House passed in 2013. The Senate’s counterpart bills, considered but abandoned in May 2014, were similar in most respects, although adding some flexibility in judicial decision making. But new legislation—if passed—is likely to mirror the Goodlatte bill in substance.

Certain effects include: greater delay, cost, disruption, and unpredictability. The supposed benefits are to save defense costs. Some proponents also hope such legislation will decrease the

number of lawsuits. There is reason to doubt that will be so. It is conceivable, however, that a number of frivolous suits may be avoided, but the number is likely to be extremely limited.

Proponents also claim baseless demand letters will diminish. The proportion of demand letters (legitimately used by all companies) that are baseless is small. Their sheer number is large, however, as is the public outrage over mass mailings of baseless demand letters to small businesses. So the danger as to both legitimate suits and responsible demand letters to infringers is that their sponsors will be penalized despite being innocent of bad conduct, and irresponsible infringers will be aided. One would hope Congress is capable of directing remedies toward bad behavior rather than broadly discriminating against whole classes of plaintiffs.

But the Goodlatte bill’s assumption is that many, if not most, plaintiffs are irresponsible abusive trolls and most infringement suits are frivolous actions against innocent victims. The statistics provide no support for such assumptions, but rather refute them.

In the current atmosphere dominated by special interest propaganda, it is easy to forget that PAEs or nonpracticing entities (NPEs) include all universities, all research institutions, all startups, and all individual inventors. Edison, Bell, Salk, and many other famous inventors were NPEs. Even IBM and like companies are NPEs when asserting patents they do not practice. The category is meaningless.

All the above players made great inventions and continue to do so. That they, for various reasons, do not also manufacture the patented products is irrelevant. Yet CPF advocates suggest that only manufacturers should be allowed to enforce patents.

Other proponents of such bills attack acquisition of patents as inherently evil or at least suspect. But patents are property and, like land and stock, can be freely sold and bought. Congress should realize the most recent buyer upholds the value of a patent that traces back to the inventor who was always the original owner, or at least to the company employing that inventor.

The litigation mechanisms such bills would employ include mandatory fee-shifting against the losing party and mandatory delay in discovery until claim construction is concluded, which often takes a year or more. Although there are escape clauses allowing judges to avoid these mandates, they are very restrictive and add work to already overburdened district judges. Again, the benefit cited as justifying such measures is that they will stop or impede true trolls. There is no evidence to support that claim. What is certain is that the legislation would injure legitimate plaintiffs.

Moreover, judges now shift fees and delay discovery in appropriate cases, but in most cases, neither is appropriate. There is no evidence that district judges ignore clear abuses and frivolous suits. And, they are now acting against abuses more aggressively than ever before, thanks in part to a pair of recent Supreme Court cases making fee-shifting easier to justify and harder to reverse on appeal.

Best Outcome: A Measured Approach

From 22 years as a judge on the Federal Circuit, I know that most litigated cases are close. Often, the outcome is not clear until the appeal is concluded. I doubt I saw two dozen frivolous suits out of 2,000 I reviewed. That is not a crisis.

As to baseless demand letters, present Federal Trade Commission (FTC) powers can halt them. Indeed, that no such action has been filed suggests that at least claims of demand letters citing patents that were all expired or not owned by the sender must be exaggerated or fabricated. Fraudulent demand letters are illegal. Let the FTC act. If it needs broader powers, Congress can and should provide them.

Congress seems unaware of what the judiciary is doing. How odd that the experts on managing patent trials—the judges themselves—have not been asked for advice and called as witnesses at hearings. The patent trial system must seek to balance competing values and interests. Management decisions at trials must be based on the particular circumstances in the case before the

court. They cannot be appropriately made by Congress, as they are inherently judicial in nature. And they cannot be usefully engineered by Congress, because they are case-specific.

The best outcome for the patent system and the country would be for Congress to do nothing now on litigation management, and to monitor the emerging effects of the AIA and the ongoing developments in the USPTO and the courts. (Demand letters are a separate problem requiring consumer protection laws to be strengthened.)

Then, with advice from broad-based, expert associations like the ABA-IPL Section, sensible, targeted litigation changes that may be needed could be carefully structured. Until then, Congress should “first, do no harm.” ■

When Dreams Come True?

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Kidde & Co., 170 F.2d 437 (2d Cir. 1948); Brennan v. Hawley Prods. Co., 98 F. Supp. 369 (N.D. Ill. 1951).

9. See Mach. Corp. of Am. v. Gullfiber AB, 774 F.2d 467 (Fed. Cir. 1985) (explaining addition of the “exceptional case” language).

10. Compare Phonometrics, Inc. v. IIT Sheraton Corp., 64 F. App’x 219 (Fed. Cir. 2003) (reversing § 285 award against lawyer), with Phonometrics, Inc. v. Westin Hotel Co., 350 F.3d 1242, 1253 (Fed. Cir. 2003) (affirming an apparent award of joint and several liability against client and lawyer over the dissent of Judge Newman, who argued that awards against counsel under § 285 were permissible only for egregious conduct). See also Stillman v. Edmund Scientific Co., 522 F.2d 798, 800 (4th Cir. 1975) (opining that “it is not the purpose of [§ 285] to discipline uncooperative or overzealous counsel”).

11. 17 U.S.C. § 505 (emphasis added).

12. “[M]any cases under rule 38 assess sanctions against offending counsel, alone or jointly with the client . . .” Coghlan v. Starkey, 852 F.2d 806, 818 (5th Cir. 1988) (citing cases).

13. See HRICK, PATENT ETHICS, *supra* note 2, § 5.03[5][b] (collecting cases).

14. FED. R. CIV. P. 11(c)(5)(A).

15. See Young Apartments, Inc. v. Town of Jupiter, Fla., 503 F. App’x

711 (11th Cir. 2013) (collecting cases and discussing policy issues); N.Y. Cnty. Lawyers’ Ass’n Comm. on Prof’l Ethics, Op. 683 (Nov. 15, 1990) (analyzing propriety of clients reimbursing lawyers for sanctions).

16. If a lawyer brings a patent case and fees are shifted under § 285 and imposed on the patentee, the patentee can contend that that lawyer acted incompetently by pursuing the case at all, or continuing after some point. Courts have already entertained these suits. For example, in *E-Pass Technologies v. Moses & Singer, LLP*, fees had been imposed on a losing patentee who then brought a legal malpractice claim against its lawyers. No. C-09-5967, 2011 WL 5357912 (N.D. Cal. Nov. 4, 2011); see also *Deutch & Shur, P.C. v. Roth*, 663 A.2d 1373, 1375 (N.J. Super. Ct. 1995) (stating that “the client may seek indemnification against the attorney for sanctions”); *In re S. Bay Med. Assocs.*, 184 B.R. 963 (C.D. Cal. 1995) (analyzing indemnity of sanctions orders). Of course, and particularly under the broader *Octane* standard, simply because fees are imposed under § 285 does not automatically evidence incompetence.

17. *E.g.*, *Neft v. Vidmark, Inc.*, 923 F.2d 746, 747 (9th Cir. 1991).

18. For a discussion of indemnification in the context of sanctions, see N.Y. Cnty. Lawyers’ Ass’n Comm. on Prof’l Ethics, Op. 683 (Nov. 15, 1990).

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