

April 5, 2013

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Ms. Frances Marshall  
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**Re: Comments on the FTC/DOJ Patent Assertion Entity  
Activities Workshop, December 10, 2012.**

Dear Mss. Munck, Marshall, and Mintzer:

The American Intellectual Property Law Association (AIPLA) appreciates the opportunity to present its views with regard to the issues considered at the “Patent Assertion Entity Activities Workshop” (“Workshop”), jointly conducted on December 10, 2012, by the Federal Trade Commission (FTC) and the Department of Justice (DOJ). AIPLA believes that the Workshop explored important issues related to patent enforcement, both abusive and legitimate, which require careful attention to balance the interests of patent owners and users of technology.

AIPLA is a national bar association whose approximately 14,000 members are primarily lawyers in private and corporate practice, in government service, and in the academic community. AIPLA represents a wide and diverse spectrum of individuals, companies and institutions involved directly or indirectly in the practice of trademark, copyright, patent and unfair competition law, as well as other fields of law affecting intellectual property. Our members represent both owners and users of intellectual property.

The Workshop focused on complaints about abusive litigation activities by certain patent owners. The practice that receives the most attention often involves allegedly invalid or overbroad patents, which have been aggregated and asserted against multiple defendants for the single purpose of threatening litigation that could cost millions of dollars to provoke settlements for hundreds of thousands of dollars.

Discussions of this kind often use labels to identify the actors (as in the case of the Workshop). Unfortunately, the labels often receive more attention than the abusive litigation activities themselves. Thus, the complaints use labels such as “trolls,” “non-practicing entities,” or “patent assertion entities” to target the abusive enforcement litigation practices of certain patent owners. These labels, as with most labels, suffer from the risk of over-inclusiveness. Some who attempt to target the bad actors with respect to litigation abuse use broad brush terms that at times sweep in independent inventors, universities, and technology licensing organizations. One result of this has been to distract the IP stakeholder community from the important steps that have already been taken to address litigation abuse and from the capabilities that have long been in the hands of the judiciary to handle such behavior.

## **I. Executive Summary**

To the extent that labels must be used, AIPLA believes it is important to point out that non-practicing entities (NPEs), patent monetization entities (PMEs), patent assertion entities (PAEs), and other intellectual property licensing organizations and firms span a wide variety of business models. As described during the Workshop, some of these entities may, in fact, tend to assert overbroad or invalid patent claims with an intent to extract settlements from multiple potential defendants, who may settle simply to avoid the cost of litigation. Individually, these settlements are far less costly than litigation, but collectively they are worth millions. It is also important to note that patent litigation abuse is not limited only to patent holders, but may also be practiced by accused infringers who advance specious defenses and/or engage in vexatious practices to thwart the successful enforcement of meritorious patents.

On the other hand, many other PAEs, NPEs and PMEs believe that their services help unlock value in the patented technology of others, whether from solo inventors, small companies, research universities, or from the storehouses of assets of large corporations who spend billions of dollars on research each year, and which other companies build upon. Moreover, the ability to aggregate patented technologies may enable manufacturers to produce highly advanced products that otherwise could not have been produced.

Clearly defining these entities (which this letter now refer to as PAEs collectively) and their activities has been a challenge for some time, as demonstrated by the requirement in Section 34 of the recently enacted Leahy-Smith America Invents Act (AIA) that the General Accountability Office (GAO) undertake a study of the matter. The charge to the GAO is to study the consequences of “litigation by non-practicing entities, or by patent assertion entities, related to patent claims made under title 35, United States Code, and regulations authorized by that title.”<sup>1</sup> The report to Congress on this study, which was due last September, is of interest to all stakeholders in the patent system. AIPLA encourages the FTC and DOJ to carefully review the results of this study in conjunction with any efforts to impact PAE activity.

With respect to the Workshop itself, the presentations addressed many of the issues facing both PAE stakeholders and PAE targets. In this comment letter, AIPLA would like to (1) highlight some of those issues, (2) discuss some of the recent legislative and judicial changes that may yet lessen many of the perceived problems attributed to PAEs, and (3) caution against actions that may have unintended consequences or otherwise adversely impact the overall patent ecosystem. We also will touch on some of the corrective proposals that have been put forward, noting that we believe further consideration of their effectiveness and impact is needed.

First and foremost, it must be kept in mind that PAE-type activity is not necessarily problematic or anti-competitive. Like any other form of property, patents are freely alienable, and the value of a patent in the marketplace derives from its enforceability. Many PAEs buy and litigate the patents of small companies and individual inventors who are otherwise unable to monetize their inventions through the production and sales of the patented product. This, in turn, gives the innovator the ability to invest in further research and development. However, the positive aspects of this process may be distorted when specious claims of patent infringement are made in

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<sup>1</sup> Leahy-Smith America Invents Act, Pub. L. No. 112-29, § 34 (2011).

order to extort royalties, especially with below-the-cost-of-defense settlements, from would-be infringers.

Second, we believe it is helpful to understand the factors and environment that tend to promote allegedly harmful PAE activity. In the worst case, a company may acquire overly broad patents and assert them en masse against an industry or entire manufacturing/supply/distribution chain. Some companies have succeeded with this tactic by relying on the potentially devastating cost of litigation and the risk and uncertainty involved in asserting and defending against claims of patent infringement. Specific changes to increase certainty and reduce needless costs early in the litigation process could go a long way to address the assertion of questionable patents by PAEs as well as unnecessary or specious defenses by accused infringers.

Third, the AIA includes a variety of reforms directed to improving the quality of pending patent applications and the enforceability of issued patents. With respect to patent quality, the legislation institutes a first-inventor-to-file system that will provide a more objective basis for establishing the priority of rights. It also provides tools to allow third parties to participate in patent examination<sup>2</sup> or challenge the validity of an issued patent.<sup>3</sup> These tools are expected to decrease abusive patent litigation practices by reducing the issuance of low quality patents and by providing a lower-cost administrative procedure for challenging issued patents. With respect to patent enforcement, the AIA reforms to prior user rights,<sup>4</sup> case removal,<sup>5</sup> false marking,<sup>6</sup> and joinder practice,<sup>7</sup> are all areas in which the interests of plaintiffs and defendants were in need of rebalancing. The exact balance struck by these various reform provisions is just beginning to unfold.

Finally, further rebalancing of plaintiff and defendant interests may be necessary, but any remedial steps must be undertaken with a view to remedying abuses without undermining basic features of a patent that are at the core of its value. For example, a patent protects a particular innovation, it is property, it is presumed to be valid, it is freely assignable, and it includes the right to refuse to license. The value represented by these and other features of a patent is endangered when enforcement opportunities for all are encumbered by a one-size-fits-all solution to abuses by the few.

## **II. Detailed Discussion**

### **a. Introduction**

The patent system was authorized in the Constitution in order to promote innovation.<sup>8</sup> Congress implemented the patent system by granting patent owners the right to exclude others from making, using, selling, or importing the claimed invention for a limited period of time. This exclusivity period promotes economic development by allowing innovators to recoup the costs of

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<sup>2</sup> AIA, Pub. L. No. 112-29, § 8.

<sup>3</sup> AIA, Pub. L. No. 112-29, § 6.

<sup>4</sup> AIA, Pub. L. No. 112-29, § 5.

<sup>5</sup> AIA, Pub. L. No. 112-29, § 19(c).

<sup>6</sup> AIA, Pub. L. No. 112-29, § 16(b).

<sup>7</sup> AIA, Pub. L. No. 112-29, § 19(d)(1).

<sup>8</sup> U.S. CONST. art. 1, § 8 ¶8.

research and development (R&D) through exclusive manufacture, sales, or licensing of a patented product. The innovators can then reinvest in further R&D, creating jobs in the process. In a letter to the House Subcommittee on Courts, Intellectual Property and the Internet, Professor Arthur Miller put it this way:

From its inception the U.S. system was designed to encourage people to buy and sell patents, because doing so enabled the ordinary worker or inventor that didn't have capital to commercialize his or her own discoveries to still participate in the economic upside of inventing and publishing those inventions. This ability to license patent rights turned inventing into a career path for thousands of poor, but technically creative citizens.<sup>9</sup>

Many NPEs, such as universities, research entities, and individual inventors, serve a necessary and important role in our economy by focusing on the development of new innovations and improvements to technology rather than on manufacturing or selling products that embody their innovations. As Philip S. Johnson explained in his written testimony to the House Subcommittee on Courts, Intellectual Property, and the Internet:

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

For others, superseding circumstances may effectively prevent or limit the inventors from commercializing their inventions. For example, if the invention is an improvement on existing patented technology, the owner of the original patent rights on that technology may be the only licensee for the improvement, at least until the original patents expire. Or should an existing unlicensed competitor copy and begin marketing the inventor's invention before the inventor is able to, the inventor's ability to later market that invention may be substantially impaired. In those circumstances, the only recourse available to the inventor may be to bring suit against the infringing company to abate the infringement and/or to recover fair compensation for the unlicensed use of the invention. By the same token, when an inventor's invention relates to an improvement useful in an industry with high barriers to initial entry and/or one in which the market is shared by just a few well entrenched competitors, the only practical way for an inventor to commercialize his invention may be to license one or more of those competitors.<sup>10</sup>

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<sup>9</sup> Letter from Professor Arthur Miller and Bernard Cassidy to Chairman Howard Coble and Ranking Member Mel Watt, House Subcommittee on Court, Intellectual Property and the Internet, March 5, 2013. On file with the Subcommittee.

<sup>10</sup> *Abusive Patent Litigation: The Impact on American Innovation & Jobs, and Potential Solutions Hearing before the H. Subcomm. on Courts, Intellectual Property and the Internet of the H. Comm. On the Judiciary*, 113<sup>th</sup> Cong. (2013) (statement of Philip S. Johnson, Chief Intellectual Property Counsel, Johnson & Johnson).

This description of the dynamics of innovation and the options for reaping the rewards of a patent illustrates the variety of transactions that nurture the system contemplated in the Constitution. In the case of inventors who do not manufacture, the ability to license or sell patent rights gives them multiple routes for monetizing their innovations so they can perform further R&D.

### **b. The Problem**

Congress, courts, and federal agencies understandably are concerned about abusive PAE litigation where a party asserts specious claims of patent infringement that exceed the scope of the patent in order to obtain settlement agreements from multiple parties. The claims asserted may be vague, overbroad, or simply invalid. The complexity and cost of patent litigation has made this activity a lucrative practice since the cost of defending a case may far exceed the settlement amount proposed by the PAE. Results of a 2011 survey of AIPLA members indicates that the median cost to litigate a patent can range from \$650,000 where less than \$1 million is at risk, and up to \$5 million where more than \$25 million is at risk.<sup>11</sup> Patent discovery can account for much of this extreme expense; it involves millions of documents and a large number of potential witnesses to depose, producing a huge drain on company resources and personnel.

Under these circumstances, companies who may have meritorious noninfringement or invalidity defenses may settle for a relatively modest amount rather than risk the financial burden and resource drain of successfully litigating a case to final judgment. Additionally, these kinds of cases often are not filed against the manufacturer of an allegedly infringing product, but against downstream businesses such as distributors and retailers who sell or use the patented product. These parties frequently do not have detailed technical information on the products at issue and they may be quick to settle.

### **c. Attempted Solutions to Date**

#### *i. Legislative Reforms*

In the AIA, Congress enacted the most comprehensive reforms to the patent law in decades, and these reforms include many provisions that can be expected to affect the litigation abuses by some PAEs. The changes improve the objectivity and transparency of issuing patents, and improve the quality of issued patents through public participation and post-grant opportunities to challenge questionable patents.

A fundamental element of PAE litigation abuse—the assertion of patents that never should have been issued—is addressed by the AIA’s adoption of a first-inventor-to-file system. This change provides a greater level of objectivity and certainty over the first-to-invent system it replaced, where questions of priority turned on complex and arcane questions of conception and reduction to practice. This legislative change promises to dramatically improve the determinations of novelty and nonobviousness, and hence the quality of patents that are issued going forward. This provision only went into effect March 16, 2013.

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<sup>11</sup> AIPLA Report of the Economic Survey 2011, at p. 35.

The AIA also gives third parties the opportunity to participate in the patent examination process by allowing them to submit prior art into the record of a pending patent application.<sup>12</sup> Under a new Section 122(e) of the Patent Act, a third party may submit for consideration and for the record of a patent application any patent, published patent application, or other printed publication of potential relevance to the examination of the application. The positive effect of this provision on patent quality is apparent, but since it has only been in effect since September 16, 2012, some passage of time is necessary for its effects to be demonstrated.

Once a patent issues, the AIA also provides improved opportunities for further scrutiny and improvements in the quality of patents with administrative procedures that are designed to be far less costly than district court litigation. The statute leaves in place the well-established *ex parte* reexamination procedure, but Section 6 of the AIA sets out new, improved, and expanded *inter partes* procedures for review of an issued patent. Under this new procedure, the patent can be challenged under a new and improved set of procedures (“*Inter Partes Review*”) that have replaced the former *inter partes* reexamination provisions.<sup>13</sup> The scope of this review remains the same as under the former reexamination procedure (prior art patents and printed publications), but the new provisions significantly improve the effectiveness of the procedure.

Even more significantly, a new “*Post-Grant Review*” (PGR) procedure is now available for broad substantive review of an issued patent on any validity ground that could be raised in court.<sup>14</sup> This option is open for the first nine months after issuance, and is intended to be similar to the opposition system used in the European Patent Office, with the cases being heard before a three judge panel of patent-savvy judges within the USPTO. With limited but efficient discovery, far more interactive third party participation and a speedy turnaround time, the PGR process should serve as a primary vehicle for weeding out or amending lower quality patents, and over time, limiting the opportunities for abusive PAEs to use lower quality patents to abuse the system. PGR is a cornerstone of the AIA reforms, and one which should be given time to demonstrate its potential for alleviating PAE abuses before more drastic remedies are considered or implemented.

The AIA also included a litigation reform—amendments to joinder practice—that was directed at a particular litigation abuse by PAEs. As described above, an abusive tactic that is fairly common is for the patent owner to charge multiple defendants with infringing a particular patent in order to obtain a settlement that is relatively low for an individual party but collectively substantial. However, Section 19(d) of the legislation addresses this practice by adding a new Section 299 to the Patent Act, entitled “*Joinder of Accused Infringers*.” The provision states that accused infringers may only be joined in a single action if the asserted right to relief arose out of the same transaction for all parties, and if questions of fact common to all defendants will arise in the action. The provision expressly bars joinder where the sole reason is that all parties are alleged to have infringed the same patent. There is some question whether this amendment, which has been in effect since the September 16, 2011, has changed PAE behavior, but it is a reform to the system that also needs more time to play out.

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<sup>12</sup> AIA, Pub. L. No. 112-29, §8.

<sup>13</sup> 35 U.S.C. §§311-319.

<sup>14</sup> 35 U.S.C. §§321-329.

In 2011, Congress enacted another law that will enhance the review of issued patents by creating a 10-year pilot for certain district courts in which patent cases could be assigned to those district court judges with both the expressed interest and experience in this area of the law.<sup>15</sup> Under the legislation, the Administrative Office of the United States Courts selected the participating district courts from those with the largest number of patent cases filed or those that had adopted local patent rules. The participating courts are required to report to Congress on the program's impact on the level of expertise of the judges, the efficiency of the courts, the reversal rates of the decisions of the specialized judges, and the amount of time it takes for the courts to resolve patent cases. As all of these factors have a bearing on the efficient management of patent cases and the cost of litigation, this pilot project is another undertaking that can be expected to affect the incidence of litigation abuses by PAEs.

### *ii. Judicial Reforms*

Over the years leading up to enactment of the AIA, proposed legislation included a variety of litigation reforms, addressing damages, injunctions, appellate review, willfulness, and claim construction. These matters were hotly debated, but across that period of time the judiciary independently made its own course corrections on many of these issues, and the effects are now being felt.

A particularly important reform was handed down by the Supreme Court in the area of injunctive relief. It had been the case that injunctive relief was assured for the prevailing patentee in an infringement suit primarily because a presumption of irreparable harm arose out of the patentee's right to exclude.<sup>16</sup> In *eBay, Inc. v. MercExchange*, the Court reversed this practice, requiring instead that courts decide the issue of injunctive relief with the exercise of discretion in equity by considering the traditional four-factor test: (1) proof of irreparable harm; (2) inadequate legal relief; (3) balance of the hardships of relief; and (4) the public interest.<sup>17</sup> Justice Thomas acknowledged that the right to exclude was said to justify automatic injunctive relief, but he pointed out that "the creation of a right is distinct from the provision of remedies for violations of that right."<sup>18</sup> This reduction in the availability of injunctive relief has significantly reduced the leverage that a PAE can apply as a litigation tactic.

There have been other developments in the judiciary that have had an equally significant impact on the kind of overreaching that is attributed to PAEs:

- Plaintiff's choice of venue, while entitled to deference, must be weighed against other factors demonstrating a more convenient venue. *In re TS Tech USA Corp.*, 551 F. 3d 1315 (Fed. Cir. 2008).
- A court's determination that a patent is invalid for obviousness need not be based on precise teachings about the subject matter of the challenged claim, and can take account

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<sup>15</sup> Pub. L. No. 111-349.

<sup>16</sup> *Richardson v. Suzuki Motor Co.*, 868 F.2d 1226, 1246-47 (Fed. Cir. 1989)

<sup>17</sup> *eBay, Inc. v. MercExchange*, 547 U.S. 388 (2006).

<sup>18</sup> *Id.* at 392.

of the inferences and creative steps that a person of ordinary skill in the art would employ. *KSR International Co. v. Teleflex, Inc.*, 550 US 398 (2007).

- Proof of willful infringement and possible treble damages requires clear and convincing evidence that: (1) the infringer acted despite an objectively high likelihood that its actions constituted infringement of a validity patent; and (2) it knew or should have known of the risk of infringement. *In re Seagate Technology, LLC*, 497 F. 3d 1360 (Fed. Cir. 2007).
- Application of the “entire market value” rule for damages must be supported by substantial evidence that the patent-related feature was “the basis” for consumer demand of the accused product. *Lucent Technologies, Inc. v. Microsoft Corp.*, 580 F. 3d 1301 (Fed. Cir. 2009).
- A patent specification must not only enable the making and using a claimed invention, but must also provide a written description of the claimed invention itself, apart from satisfying the enablement requirement. *Ariad Pharmaceuticals, Inc. v. Eli Lilly and Co.*, 598 F. 3d 1336 (Fed. Cir. 2010).

These cases have shown that the judiciary has taken away many of the arrows from the quiver of those motivated to engage in litigation abuse, with more case-specific and careful balancing between patent owners and accused infringers. These cases also underscore that the judiciary continues to have the capacity to redress many of the problems that have been attributed to PAEs.

#### **d. Proposed New Solutions**

Despite these developments, however, AIPLA agrees that some abusive litigation may continue and may require further consideration and possible remediation. In fact, the House Judiciary Subcommittee on Courts, Intellectual Property, and the Internet, recently held a hearing on the matter, entitled “Abusive Patent Litigation: The Impact on American Innovation & Jobs, and Potential Solutions.” The March 14, 2013, hearing included testimony that actions by PAEs have developed into a business model that is encouraged by specific characteristics of the U.S. judicial process, and a significant number of additional solutions have been proposed.

AIPLA does not take a position on these proposals at present, but we urge that any attempt to pursue them should carefully consider their impact on the entire patent system and not just their potential impact on PAE activity. In addition, AIPLA believes that reforms that would help reduce uncertainty and excessive costs of patent litigation and would have an impact early on in the litigation process are most likely to be most effective in reducing specious PAE activity and are worthy of further consideration.

##### *i. More Active Litigation Management to Streamline Costs, including Discovery Costs*

Typically, an expense that can spin out of control in a PAE action (indeed, in any patent litigation) is the cost of discovery. These costs tend to fall disproportionately on defendants because the PAE usually has very little documentation and few witnesses, if any. By contrast, the PAE can request millions of documents and emails from the corporate party and schedule



multiple depositions, which produce the high discovery costs that may be a factor in forcing companies to settle.

The Federal Circuit Advisory Council has recognized this and in 2011 adopted a Model E-discovery Order in an effort to curb the overbroad and expensive discovery of electronically stored information, including email production requests that have become routine in patent litigation. Chief Judge Rader explained that “litigation costs should not be permitted to unduly interfere with the availability of the court to those who seek to vindicate their patent rights—the enforcement of such rights is both an obligation of the legal system and important to innovation. Likewise, disproportionate expense should not be permitted to force those accused of infringement to acquiesce to non-meritorious claims.”<sup>19</sup>

Under the Model Order, parties are required to disclose “core documentation concerning the patent, the accused product, the prior art, and the finances” before they can request further e-discovery.<sup>20</sup> To reduce the burdens of blanket production requests, the Model Order requires email production requests to be directed towards specific issues in the case. The Model Order also presumptively limits email discovery requests to up to five custodians per producing party and five search terms per custodian per party. The parties can jointly agree to increase those limitations. Finally, the Model Order shifts the costs for “disproportionate [Electronically Stored Information] production requests.”

This type of measure represents a positive step toward curtailing PAE litigation abuses insofar as it establishes stages of discovery in the litigation which would tend to lower costs. It would allow the action and the costs to develop incrementally and hopefully permit preliminary determinations on the merits of an action before the expense becomes prohibitive. In fact, AIPLA believes that litigation management measures that would emphasize early disclosures of basic information, including damages allegations and their basis, may help influence PAE enforcement and defense earlier in the process.

Another proposal that moves in the same direction would encourage judges to consider and decide motions to transfer a case to another venue before discovery is complete. Again, such a proposal would provide some opportunity of relief from a difficult venue before excessive discovery costs are imposed. However, such a proposal also adds to the litigation expense of a venue proceeding, including briefing and related discovery.<sup>21</sup>

AIPLA believes that it is worth pursuing measures to manage or control discovery (often reducing discovery costs), to promote early disclosures and encourage early decisions on key claim construction issues before proceeding with full discovery, and to encourage early summary judgment rulings. These steps would streamline issues in a case and help to create more certainty in the litigation process, reducing the overall costs of litigation and weeding out

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<sup>19</sup> An E-Discovery Model Order, page 2. Available at [http://www.cafc.uscourts.gov/images/stories/the-court/Ediscovery\\_Model\\_Order.pdf](http://www.cafc.uscourts.gov/images/stories/the-court/Ediscovery_Model_Order.pdf).

<sup>20</sup> *Id.* at pages 2-3.

<sup>21</sup> District Courts have the authority under 28 U.S.C. 1997 to require attorneys to pay costs, expenses and fees for “unreasonably and vexatiously” multiplying the proceedings in any case.

specious infringement allegations by PAEs. In addition, more rigorous and early gatekeeping by the courts with respect to unrealistic damages claims would help to deter baseless PAE activity.

One perhaps more dramatic suggestion to consider with regard to the courts would be to establish a single set of Patent Litigation Rules which would be applied uniformly for patent cases in all jurisdictions. While likely to be controversial among some district judges, the advantage to having a single set of rules as it may help alleviate the abusive PAE problem is clear. Many practitioners cite examples where a failure to decide summary judgment motions or render *Markman* claim construction rulings early in a litigation allow PAEs with frivolous actions to prolong the process and its attendant costs in discovery, etc. Moreover, in a legal area where we have unified appellate practice and nationwide remedies, it would seem logical also to have uniform Patent Litigation Rules. At a minimum, such rules could be adopted by those jurisdictions participating in the Patent Pilot Program, either mandatorily or by the adoption of a set of Model Patent Litigation Rules.

On the regulatory front, in November, 2012, the USPTO proposed Real-Party-in-Interest (RPI) recordation procedures to improve the transparency and efficiency of the patent system.<sup>22</sup> Although AIPLA believed that the USPTO's proposal was unduly burdensome from a practical point of view, we also believe that a procedure for requesting information about the RPI at appropriate times could assist in solving the issues under discussion here. For example, it might be useful for parties accused of infringement to obtain some information about the RPI in order to better assess the litigation risks that they might be facing.

#### *ii. Heightened Pleading Requirements and Rule 11*

Another possible solution to help reduce specious PAE litigation could include greater enforcement of pleading requirements at the outset of a case and greater utilization of Rule 11 when applicable.<sup>23</sup> While the Federal Rules require notice pleading, some courts require little beyond the identification of a patent and a product to meet the pleading requirements of a complaint. The Supreme Court has required more than a loose pleading standard, and the Federal Circuit has developed a standard for patent pleadings with Supreme Court guidance.<sup>24</sup>

Sometimes complaints are very general, making it difficult for accused infringers to evaluate infringement allegations even before they are required to answer. If plaintiffs were required to include more specificity up front, it might help to increase certainty and require both the plaintiff and the defendant to evaluate the merits of a case early on. A district court could and should play a more active role in policing the quality of complaints at an early stage of the proceeding, permitting the scope of the litigation to be determined before excessive costs have been incurred. Likewise, if courts were to consider Rule 11 obligations earlier in the case, it would help to increase certainty and reduce specious claims—both of infringement and defenses to liability.

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<sup>22</sup> “Notice of Roundtable on Proposed Requirements for Recordation of Real-Party-in-Interest Information Throughout Application Pendency and Patent Term,” 77 Fed. Reg. 70385, November 26, 2012.

<sup>23</sup> *Ashcroft v. Iqbal*, 556 U.S. 662 (2009); *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544 (2007).

<sup>24</sup> *In re Bill of Lading Transmission and Processing System*, 681 F.3d 1323 (Fed. Cir. 2012).

### *iii. Greater Certainty in Markman Rulings*

Uncertainty in claim construction during a patent litigation is another factor that encourages defendants to settle cases early regardless of the merits of the case. The Supreme Court in *Markman v. Westview Instruments, Inc.* held that although the Seventh Amendment right to a jury trial applies to patent cases, issues of claim construction are to be determined by a judge, rather than a jury.<sup>25</sup> The Court stated that “we see the importance of uniformity in the treatment of a given patent as an independent reason to allocate all issues of construction to the court.”<sup>26</sup>

However, *Markman* hearings on claim construction have increased the uncertainty of patent litigation, in part, because the Federal Circuit has characterized claim construction as purely an issue of law that is subject to *de novo* review.<sup>27</sup> The risk of differing interpretations between a district court and appellate court may have a bearing on early settlement, as a party dissatisfied with the district court’s claim interpretation might prefer to press forward with the litigation to see if the appellate court agrees.

The Federal Circuit recently granted a petition for rehearing *en banc* in *Lighting Ballast Control LLC v. Philips Electronics North America Corporation* to address what level of deference, if any, should be given to a district court’s claim construction.<sup>28</sup>

### *iv. Small Claims Court Pilots*

Another area being explored to alter the patent litigation landscape is the creation of a patent small claims proceeding to serve as a low cost alternative for smaller patent cases. This idea has been suggested as an alternative that could benefit individual inventors or small companies by giving them an affordable option for enforcing their own patent rights.

The U.S. Patent and Trademark Office issued a request for comments in December, 2012 on this issue to determine “whether there is a need and desire for this type of proceeding, in what circumstances is this proceeding needed if such a need exists, and what features this proceeding should possess” particularly the “core characteristics of a patent small claims proceeding including characteristics such as subject matter jurisdiction, venue, case management, appellate review, available remedies, and conformity with the U.S. constitutional framework (e.g. 7th Amendment).”<sup>29</sup>

AIPLA recognizes that the cost of patent litigation may be disproportionately high in cases where only a small amount of damages is at stake and supports exploring the concept of a streamlined small claims proceeding in such cases. However, we caution that there are many issues that still need to be worked out, such as the appropriate venue, remedies, and how to achieve low cost procedures. Additionally, AIPLA would want to make sure that a small claims proceeding could not lead to further litigation abuses by providing another venue in which plaintiffs can bring frivolous claims in order to extract settlements. In order to answer some of

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<sup>25</sup> 517 U.S. 370, 391 (1996).

<sup>26</sup> *Id.*

<sup>27</sup> *Cybor Corp. v. FAS Technologies, Inc.*, 138 F.3d 1448 (Fed. Cir. 1998).

<sup>28</sup> No. 2012-1014,-1015 (Fed. Cir. 2013) (order granting rehearing *en banc*).

<sup>29</sup> 77 Fed. Reg. 74830 (December 18, 2012).

these questions, if such a system is pursued, AIPLA would encourage at least a limited pilot small claims proceeding be created first to establish whether such a program would be effective.

*v. Stay of Customer Suits*

Another feature of the stereotypical PAE business model is to send demand letters or to initiate infringement actions against retailers or other downstream end users of a patented product. The tactical advantage to the PAE is in targeting multiple user entities to increase settlement prospects and in pursuing defendants with inadequate experience or resources to litigate the matter.

At least one legislative proposal has been put forward to deter such suits by providing a stay of such actions. The proposal suggests that these actions against end users could be curtailed by codifying a rule that would require courts to permit manufacturers/suppliers to intervene in actions against end users and to stay the action against the accused end users pending the outcome of an infringement suit.

AIPLA believes such a suggestion needs further study, but we recognize that the manufacturer/supplier relationship is frequently implicated by PAE litigation abuse. Staying litigation practice would be consistent with the rule that infringement actions against manufacturers have priority over infringement actions against customers, despite the general rule that a first-filed suit has priority over a later-filed suit.<sup>30</sup> The Federal Circuit has explained that “[t]he customer suit exception is based on the manufacturer's presumed greater interest in defending its actions against charges of patent infringement; and to guard against possibility of abuse.”<sup>31</sup>

Stay of customer suits could permit the real parties in interest—the patent owner and the manufacturer of the infringing product—to resolve the patent dispute without proliferating unwarranted settlements with downstream parties. While a stay of proceedings may be warranted in some circumstances, because allegations often involve multiple potentially responsible parties or real-parties-in-interest, and manufacturers are often overseas and not subject to ready service of process, such a suggestion may do little to reduce specious patent assertions, especially in multi-supplier markets with non-linear supply chains. Also, this proposal could have the unintended consequence of impacting the contractual obligations between suppliers and purchasers. Further, where legitimate infringement claims extend beyond the mere use of the manufacturer's product as such, then allowing such customer suit to go forward may be quite appropriate.

As of now, the availability of a stay of the customer suit is not automatic, as it is committed to the discretion of the district court. For this reason, a codification of the circumstances under which a court would be required to allow the intervention of a manufacturer in a customer suit could provide an effective deterrent against these downstream actions by PAEs. However, it could add to the complexity of cases and add yet one other issue to regularly be litigated, including whether a party should be able to intervene, especially if the accused infringer has

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<sup>30</sup> *Gluckin & Co. v. International Playtex Corp.*, 407 F.2d 177, 179 (2d Cir. 1969).

<sup>31</sup> *Kahn v. General Motors Corp.*, 889 F. 2d 1078, 1081 (Fed. Cir. 1989).

multiple suppliers. Also, for patent(s) in suit that involve system or method claims, there may be additional disputes regarding who is the real-party-in-interest.

*vi. International Trade Commission Remedies*

Another area of concern is that PAEs may be engaged in abusive litigation in enforcement actions before the International Trade Commission (ITC). At the ITC, a patent owner can exclude the importation of infringing goods under Section 337 of the Tariff Act of 1930, 19 U.S.C. § 1337. Some argue that the ITC is an appealing forum for PAEs because exclusion orders are not subject to the higher burden in the district court for injunctive relief created by the Supreme Court in *eBay*, and that this makes threats of an ITC exclusion order a powerful weapon for obtaining settlements.

However, a careful review of ITC procedures demonstrates that obtaining an exclusion order from the ITC may not be an easier course than obtaining injunctive relief from district courts. A ban on infringing imports is available only if a U.S. industry relating to the infringing imports exists or is in the process of being established. For purposes of the statute, the existence of such a U.S. industry can be shown with evidence of (1) significant investment in plant and equipment, (2) significant employment of labor or capital, or (3) substantial investment in its exploitation, including engineering, research and development, or licensing.<sup>32</sup>

Some PAEs are able to meet the domestic industry standard through the ITC's licensing provision, and some stakeholders argue that the domestic industry standard should be amended to expressly exclude PAEs. We are not convinced that such an amendment is necessary. The ITC distinguishes on a case-by-case basis genuine licensing investments from sham activities designed solely to create a basis for ITC jurisdiction, and there is no evidence that it has failed or will fail to make appropriate domestic industry determinations. In fact, in a recent investigation, the Commission ordered the administrative law judge to provide an early determination on whether a non-practicing entity complainant satisfied the economic prong of the domestic industry requirement.<sup>33</sup>

It is true that after *eBay* injunctive relief for a prevailing patent owner is no longer automatic. However, because of the unique characteristics of the ITC proceedings, the *eBay* factors do not apply there. In 1988 Congress enacted Section 337 without requiring that IP owners show that infringing imports will harm a domestic industry because it is presumed that irreparable harm is inherent in the importation of infringing articles. It is also significant that *eBay* factor 2—the inadequacy of legal relief—is entirely inapplicable since no monetary relief is available from the ITC at all.

As for the other *eBay* factors, an examination of Section 337(d) and ITC case law reveals that these factors are effectively already part of the process for determining whether exclusion orders are appropriate. Under Section 337(d), the ITC considers four public interest factors for determining whether to issue an exclusion order: (1) the public health and welfare, (2)

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<sup>32</sup> 19 U.S.C. 1337(a)(3)(C).

<sup>33</sup> See 78 Fed. Reg. 19008 (March 28, 2013).

competitive conditions in the United States economy, (3) the production of like or directly competitive articles in the United States, and (4) United States consumers.

Moreover, ITC case law has developed additional factors, known as the “EPROM factors,” which already account for effectively all of the remaining *eBay* factors.<sup>34</sup> Those factors include:

- the value of the infringing articles compared to the value of the downstream products in which they are incorporated;
- the identity of the manufacturer of the downstream products, i.e., whether it can be determined that the downstream products are manufactured by a respondent or by a third party;
- the incremental value to a complainant of the exclusion of downstream products;
- the incremental detriment to a respondent from exclusion of such products;
- the burdens imposed on third parties resulting from exclusion of downstream products;
- the availability of alternative downstream products that do not contain the infringing articles;
- the likelihood that the downstream products actually contain the infringing articles and are thereby subject to exclusion;
- the opportunity for evasion of an exclusion order that does not include downstream products; and the enforceability of an order by Customs.

These ITC factors assure that obtaining an exclusion order from the ITC is not an easier course than obtaining injunctive relief from district courts.

#### *vii. Loser Pays*

The baseline “American Rule” on awards of fees and costs is that parties are generally responsible for their own legal expenses. One exception under the Patent Act at 35 U.S.C. §285 is that reasonable attorneys’ fees may be awarded to the prevailing party “in exceptional cases.” This has been held to involve willful infringement, inequitable conduct before the USPTO, litigation misconduct, and vexatious or bad faith litigation in a frivolous suit.<sup>35</sup>

Some witnesses at the recent House Subcommittee hearing considered the Section 285 standard inadequate to deter PAE actions, and they advocated the amendments in the recently introduced H.R. 865 (the “SHIELD Act”). The bill would create a limited loser-pays system by permitting awards of full litigation costs to the prevailing party (without the “exceptional case” limitation) unless the plaintiff is (1) the inventor, (2) the original assignee, (3) one who produced or sold items covered by the patent, or (4) a university or technology transfer organization.

One shortcoming of this “loser pays” approach is that it may devalue the patent right with assignments beyond the original assignee, undermining the important free-assignability feature of patent rights. In addition, the reforms proposed by the SHIELD Act are tied to the status of the party to the proceeding rather than to the conduct deemed abusive, and they would apply

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<sup>34</sup> See Inv. No. 337-TA-276, Comm. Op. at 125-26 (May 1989), *aff’d sub. nom., Hyundai v. U.S. Int’l Trade Comm’n*, 899 F.2d 1204 (Fed. Cir. 1990).

<sup>35</sup> *Forest Laboratories, Inc. v. Abbot-Laboratories*, 339 F.3d 1324, 1327-1329 (Fed. Cir. 2003)

only to product claims and not method claims. At a more basic level, however, as a solution that carves out exceptions to the American Rule, it could have the unintended consequence of distorting for all litigants the existing allocation of risks provided by the present fee-sharing structure.

Some have suggested that the current standard at the Federal Circuit for the application of the Section 285 is too strict. That standard requires (1) the legal determination that the litigation is “objectively baseless,” and (2) the factual determination that it was brought in “subjective bad faith.”<sup>36</sup> The Federal Circuit had described the “objectively baseless” condition as one where “no reasonable litigant could reasonably expect success on the merits,”<sup>37</sup> and said that this determination is reviewable de novo.<sup>38</sup> An “exceptional case” may be found, for example, based on determinations of inequitable conduct, bad faith litigation or litigation misconduct. However, even if a finding of “exceptional case” is made, courts still have discretion regarding whether to award attorneys fees.<sup>39</sup> More rigorous application of Section 285 in appropriate cases, including more frequent exercise of discretion by courts, may help deter abusive PAE practices.

One alternative that has been suggested is simply broadening the attorneys’ fees provision at Section 285, requiring the court to make the award to the prevailing party unless the position of the losing party was “substantially justified” or special circumstances would make the award unjust. But this suggestion also impacts the American Rule except where a court applies the somewhat vague standards of “substantially justified” or injustice in choosing not to make the award. It also would likely add another layer of issues needing to be litigated, further adding to the cost of litigation.

Such fee-shifting reforms are laden with the risk of significant unpredictable and unintended consequences. Also, given that “loser pays” provisions require a case reach a final judgment, this is not the type of reform that necessarily would affect behavior early in the litigation process, nor does it necessarily increase the predictability of particular litigation. In fact, loser pays can make things worse: a losing PAE facing a significant fees penalty may forego earlier settlement in favor of prolonging the litigation and subsequent appeals. In addition, a loser pays system may have little impact on the behavior of PAEs or NPEs, who may be considered “judgment proof,” but may have an unintended deterrent effect on smaller patent owners who become more risk-averse to asserting their valuable patent rights.

### **III. Conclusion**

AIPLA recognizes that the patent litigation process is being abused by some, and that this has resulted in serious hardships to many. It is particularly troublesome that these practices appear to have become a business model that distorts the fair resolution of rights between patent owners and technology users no less than champerty did in the past.

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<sup>36</sup> *Checkpoint Systems, Inc. v. All-Tag Security S.A.* No. 12-1085, (Fed. Cir. 2013), Opinion, March 21, 2013;

<sup>37</sup> *Dominant Semiconductors Sdn. Bhd. v. OSRAM GmbH*, 524 F.3d 1254, 1260 (Fed.Cir.2008)

<sup>38</sup> *Highmark, Inc. v. Allcare Health Mgmt. Sys., Inc.*, 687 F.3d 1300, (Fed. Cir. 2012).

<sup>39</sup> *SC Johnson & Son, Inc. v. Carter-Wallace, Inc.*, 781 F.2d 198, 201-202 (Fed. Cir. 1986)

AIPLA believes that the judicial system has procedures that can be applied more often to police some of these abuses, and while some further steps may be warranted, great care must be exercised in pursuing a remedy to this abuse because the cure could be worse than the disease. As explained above, the IP system is in a period of transition in which the judiciary has responded to parties who push the envelope and in which the AIA has provided a wide assortment of new procedures that could change the enforcement picture. Where there are wrongs, they must be addressed, but any steps to do so must not inflict harm to the value of patents and to legitimate rights holders.

AIPLA is very grateful for the opportunity to comment on this important matter, and we would be pleased to be available in the future if we can be of further assistance.

Sincerely,

A handwritten signature in black ink, appearing to read "Jeffrey I.D. Lewis". The signature is fluid and cursive, with the first name "Jeffrey" being the most prominent part.

Jeffrey I.D. Lewis  
President  
American Intellectual Property Law Association