

Reducing Litigation Abuse by Reducing the Government's Role in the Patent System¹
Testimony of Colleen V. Chien,² Santa Clara University School of Law
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A “patent troll” does not make money by manufacturing, innovating or transferring technology, but by holding patents and suing those who do. Patent trolls demand money to use products they did not create. Patent trolls are so notorious that they have been accused of “hijack[ing] someone else’s idea and see[ing] if they can extort some money.” And worse.

But demonizing patent “trolls” overlooks their compelling economics. Using economies of scale and contingent fee lawyers, patent assertion entities (PAEs) have dismantled traditional obstacles to suit. For years, patent holders couldn’t monetize their patents because it was too risky and large companies ignored their demands.

But things have changed. Instead of ignorance, enforcement is now the new normal. PAEs paved the way, by showing how powerful the threat of prolonged litigation can be in getting companies to pay settlements. Following their lead, large companies are monetizing and asserting their patents at a greater rate as well, e.g. through the smartphone wars. Those who aren’t are being pressed to think about making money off their patents by their CFOs, including by partnering with PAEs.

The freedom of PAEs to litigate has created serious issues for the patent system. Scads of entities that have nothing to do with the patent system – e.g. retailers, bakeries, funeral homes, advertising firms, and even politicians –are getting sued and receiving demand letters. While large tech companies capture most of the patent headlines, last year, more non-tech companies were sued. Companies that make \$10M or less in revenue are the majority of unique defendants. Startups are particularly vulnerable. Although startups are a crucial source of new jobs, PAE demands have impacted their ability to hire and meet other milestones, caused them change their products, and shut down lines of business, according to a survey I conducted. 40% were targeted because of technology that they did not make, but implemented or used.

Yet the economics of patent assertion are so favorable that over 15 publicly traded companies now use the stock market to bankroll patent lawsuits. Intellectual-property funds generate annualized returns between 10% and 20%, reports Julie Steinberg in her Wall Street Journal article of earlier this year, “Stocks, Drugs, Rock 'n' Roll.” You can bet on individual patent litigation events. Foreign governments are getting into the game: Korea’s Intellectual Discovery Fund, France’s Brevets, and the Innovation Network Corp of Japan for example. It is only in this context that the filing of complaint by Swiss-investor backed PAE Beacon Navigation GmbH against US car companies that employ thousands an International Trade Commission (ITC), a venue designed to protect domestic industries, makes any sense.

¹ Due to time constraints, this testimony is being submitted without footnotes, however I will post a version with footnotes to SSRN (http://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=362060).

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As PAEs increase their footprint, they increase the burdens on our courts and the public: last year PAEs filed over 50% of patent cases in district courts, independent sources have found. Patent cases are complicated and time-consuming. They can be torturous for jurors. They clog our dockets. Yet, some of them are rightful vindications of patent rights. How can we streamline litigation to reduce the over incentive for enforcement but without limiting meritorious claims? In this testimony I provide three suggestions for consideration:

First, we should reduce duplication in our patent system by improving coordination between patent entities. It makes no sense to have more than one court simultaneously decide a patent's validity or whether the same act constitutes infringement. Yet this is what we do now –more than 90% of patent litigations in the ITC last year were also filed in district court. Congress should reduce the overlap by making ITC jurisdiction exclusive of district court jurisdiction or reducing the incentives to file in both. Similarly, many administrative reviews in the PTO involve pending litigation at the district court. The PTO and courts should implement post-issuance administrative reviews in a coordinated fashion that eliminates the overlap. PAEs are now suing multiple users of goods, rather than the single supplier or manufacturer of the good. Congress should reduce the duplication that results, by immunizing or limiting liability for innocent end-users or implementers that use the invention as intended and notice the suppliers of the use.

Second, we should reduce waste in our patent system, following the example of the Federal Circuit Advisory Council's model order initiative. Courts should focus the key issues, hold early, pre-discovery claim construction, and consider early damages contentions. Courts should encourage dispositive motions, e.g., concerning standing, section 101 patentability, or whether the patentee's rights have been exhausted via license, to be heard and ruled on early in the case, if they have merit. Congress should facilitate the benchmarking of courts trying these innovations in the Patent Pilot Program so that best practices for reducing waste can be observed and disseminated. Congress should also discourage lawsuits on weak claims by increased fee-shifting, and wasteful discovery by requiring parties to pay for it beyond core documents.

Third, we should reduce the government's role in deciding patent disputes. The government should give members of the public, and in particular the public that is not patent-savvy or well-funded, information from which they can help themselves, rather than going to court or lawyer. Congress should require governmental data storehouses to provide data on patent litigations, reexaminations, ITC actions, and ownership information to third party providers who promise to consolidate and make information available to the public in an accessible form at no or low cost. The FTC or PTO should provide authoritative information about patents and options for responding to demand letters for the many companies that are receiving demand letters to rely upon. Congress should also authorize a study, to be taken by the government or a respected institution like the National Academy Sciences, to pave the way towards real-world determinations for establishing the value of patents, outside the theatre of patent litigation. Patentholders and licensees should be able to know ahead of time the range of a patent's worth. And they should be able to reach determinations on their own rather than having to remain at the mercy of courts and juries.

The duplication, redundancies, and lack of access to information in our patent system invite abuse and forum shopping. They clog the docket and consume our precious judicial resources. They create lucrative opportunities for patent assertion that is attracting financing, and more suits. As a result, we are spending far too much time and money fighting about patents.

In the following paragraphs I suggest ways to reverse these trends by reducing duplication, waste, and the role of the government in resolving patent disputes.

Reducing Duplication

The ITC-District Court Interface

Patentholders can enforce their rights at District Court and through a Section 337 action at the ITC. Although the ITC was created as a special solution to the special problem of foreign piracy, its jurisdiction has become as mainstream as overseas manufacturing. Yet the convergence of jurisdiction has been accompanied by a divergence in procedures and remedies. The ITC takes about half as much time to decide cases, is four times more likely to adjudicate its cases (44 percent vs. 11 percent), and more readily awards injunctions to prevailing patentees (100 percent vs. 79 percent) than district court. But the ITC cannot award damages, and its decisions do not bind district courts. The relief it provides is thus neither complete nor final.

This creates incentives for litigants to file in both venues. By our count, over 90% of 337 patent cases were filed in 2012 had a counterpart in the district court. This implies that the ITC is not being used for its original intended purpose – to reach litigants that district court can't. Just as with district court, PAEs are also using the ITC – by our count more than a quarter of patent investigations and nearly half of PAE defendants are there due to a PAE. Because of the expense of bringing an ITC action, these entities tend to be well-capitalized companies rather than individual inventors. Many of them are seeking the increased leverage that accompanies the threat of an injunction, which they are frustrated they can no longer get in district court post-eBay.

A 90% duplication rate is wasteful. It could be eliminated by stripping jurisdiction from the ITC by limiting it to cases where the district court lacks jurisdiction, or the need for the ITC's special remedies can be demonstrated (e.g. because of the evasive behavior of a counterfeiter). This proposal has the advantage of freeing up the ITC to focus more on the types of piratical infringement it was originally intended to address.

As an alternative, the incentive to file in both venues could be reduced by harmonizing them. If one venue offers only injunctions, and the other only damages, parties will naturally want to file in both. The differences between ITC and district court law, procedures, and remedies would need to be reconciled, in particular the law of the domestic industry requirement and remedies. The district court could adopt exclusion orders, or the ITC could adopt eBay; if the latter, it should be given damages authority.

Section 1659 regulates the interface between the ITC and district court, allowing the 337 case go forward first. However, stays aren't mandatory and apply only 60% of the time when the cases are overlapping in time. Neither does it make sense for the 337 case to go first unless the party is seeking the ITC's unique remedy of an exclusion order, rather than settlement. That is because 337 cases don't bind district court, it's the other way around. In addition, ITC cases go to trial four times more than district court cases – the natural settlement points of claim construction and summary judgment are missing due to the tight timeframe. Although the ITC has promulgated new ESI rules, discovery at the ITC is necessarily more expansive and more expensive— according to industry estimates about 50% more.

Congress should streamline the ITC-District Court interface by making their jurisdiction exclusive or harmonizing the venues. At the very least, it should rethink the ITC-District court interface and consider resolving parallel cases in favor of the district court, to eliminate duplication and gamesmanship.

The PTO- Court Interface

Following the AIA, up to five different forms of administrative review are available for issued patents. Fortunately, the PTO has the authority to streamline and coordinate different administrative proceedings under the AIA, by consolidating diverse challenges involving a single patent into one proceeding.

The big challenge will be to minimize duplication by the PTO and district court. Right now many perhaps most of 100+ inter partes reviews (IPR) filed to date have been on patents in litigation. It doesn't make sense for the IPR and district court cases to proceed in parallel as the district court case may resolve with the PTO's outcome.

Yet, courts are not convinced that stays will further the efficient resolution of a case. Furthermore, the AIA creates some uncertainty by allowing six-month extensions for good cause. Even those judges willing to grant a stay wonder how long it will be until the PTO rules (and appeals are completed). Justice delayed is justice denied.

The PTO must do all it can to bolster confidence that its reviews are being handled timely. It should make the status of administrative proceedings transparent and accessible. It should publish target dates for the completion of its proceedings, like the ITC does. It could also consider creating a "fast track" for high impact patents that have been asserted against more than a threshold number of targets. The potential gains for the system are high in these situations –the elimination of large numbers of disputes and parties.

The courts should stay cases in deference to the PTO, particularly in cases where no market harm is threatened. A party that undertakes administrative review without confidence that the court will pause costly discovery and wait for the PTO will not be able to afford the risk even if with strong invalidity arguments. Justice accelerated may lead to injustice.

The court should also suspend enforcement activities while administrative challenges are pending. It doesn't make sense for new complaints based on the patent to be named and settlements to be demanded, as they have been for example in the Lodsys case. If the patents are ultimately narrowed or invalidated, settlement fees should be returned or the fees shifted. Certainly, parties named during this period should not be able to be found willful when they have taken notice of the reexamination challenge.

Customer-Supplier Suits

A troubling PAE tactic is to sue or threaten customers in order to wrest small settlements from unsophisticated parties - for example \$1,000 per employee for use of a scanner or \$1,000 per node for use of Wi-Fi. While businesses don't usually sue their customers, PAEs can do this because they have no customers. But this sort of tactic is not unique to patent law, in this very Committee, on the day before its last hearing on patent litigation abuses, the Constitution Subcommittee heard from a small business trade association about a scheme of "fleecing small business owners," in which an unscrupulous attorney received hundreds of settlements of \$1,000 or more from "mom and pop" stores throughout the state after suing them for minor violations of the state business code.

In PAE customer disputes, the right party is the supplier of the technology who is more knowledgeable about patents and has better access to the relevant documents and witnesses. Yet the PAE may choose customer defendants over manufacturers because they are unsophisticated, and it's cheaper to pay the nuisance value settlement sought than to fight.

To reduce the duplication and ensure that the right party is named, Congress should limit or immunize end users from liability. In particular when the invention is embodied in a staple article or commodity of commerce that the end users uses in the intended form, the end user lacks specific knowledge of the patent, and when there is jurisdiction and a cause of action available over a supplier who has been noticed. An outright immunity, or limiting remedies to injunctions, or damages to the cost of product acquisition, would go far in reducing the *in terrorem* impact of patent demands on the most vulnerable targets, like municipalities, non-profits, and small businesses who have no idea what their exposure might be. Although the amount of money at stake in each individual case is relatively small, it can devastate the target in unanticipated ways –one small company I talked to offered physical therapy services to autistic kids. A suit would jeopardize its ability to accept government funding for services, a core source of revenue. A startup I talked to lost key customers because of technology it had implemented led it to be sued. These companies which employ people, are casualties of an inefficient system that is being exploited for financial gain.

But the government can end this practice through an immunity or providing certainty about exposure. At the very least, an end-user should generally not be liable for treble damages liability when they give notice to the supplier. Even a basic fact sheet from a trusted source explaining that the receipt of a demand letter or even suit does not legally obligate the recipient to pay the demander could help.

When suits involving end-users and manufacturers are pending that involve the same basic facts, they should be consolidated or the customer suit stayed. But it would be more equitable and simpler to limit the liability of end users, particularly for using the tools of modern day commerce like Wi-Fi and scanners. In some European and Asian countries this is the law in certain contexts. Allowing suits against customers as we currently do puts small suppliers in a difficult position—as others have said, they make small suppliers unattractive, because of their inability to indemnify large companies.

Reducing Waste

Waste can be reduced by paring down to the essentials and taking high impact, low-cost interventions. As applied to patent cases, this means focusing issues and discovery. It also means that dispositive motions deserve prioritized attention.

E-Discovery Model Order

The cost and complexity of patent litigation can be staggering. I therefore join the chorus of those that applaud the efforts of the Federal Circuit Advisory Council including Chief Judge James Ware (ND Cal), Judge Virginia Kendall (ND Ill), Magistrate Judge Chad Everingham (ED Tex), Tina Chappell, Richard “Chip” Lutton, Joe Re, Edward Reines, Steve Susman, and John Whealan, led by Chief Judge Randall Rader (Fed. Cir.) to streamline and limit the cost of patent litigation through their model e-discovery order.

Focusing and Prioritizing Issues

Considerable savings could also be captured by focusing issues. The number of claims and terms in claim construction is one example. Another is to hear dispositive motions early. For example, in the Lodsys case which involves app developers, Apple has asserted an exhaustion defense that would immunize its implementers from liability. Deciding this issue early could dismiss scores of demands and litigants from the challenge. Other dispositive motions such as 101 patent eligibility and standing present low risk high reward propositions for the court. If the motion is successful, the case goes away, and if it is denied, the case proceeds. To avoid waste, it makes sense to know whether or not the patent actually passes these basic screens. The ITC’s recent innovation of ordering a domestic industry determination

within the first 100-days of a case is a great example of how such prioritization may align the parties' and courts' interests. By setting aside a period of time to hear dispositive motions, as the ITC did, unnecessary delays and abuse are reduced.

Whatever can be done to support and encourage best practices should be done. Congress can help by facilitating the benchmarking of courts trying innovations in the Patent Pilot Program so that what works, and what doesn't, can be observed and disseminated, e.g. through the model order instrument.

Fee Shifting

Congress should encourage courts to use fee-shifting as a tool to discourage wasteful litigation and litigation practices. A one-way shift such as is found in the SHIELD Act can help fund meritorious defenses in the same that one-way fee shifts in civil rights contexts have funded meritorious cases. A bond requirement, with the normal exceptions for indigency and related conditions, would prevent circumvention of the rule. Just as in the medical malpractice contexts in which bonds also appear, PAE suits have the potential to significantly impact the livelihood of small defendants. Fees would still be available to prevailing plaintiffs under the existing statute.

Congress should also consider authorizing more liberal fee-shifting prior to the resolution of a case as few small companies have the ability to "go all the way" in litigation. Requiring parties to pay for discovery beyond core documents, as has been proposed by SAS, for example, would correct the asymmetries that produce unfair leverage.

Reducing the Government's Role in Deciding Patent Cases

Consolidated Information

The government should give the public, and in particular the public that is not patent-savvy or well-funded, information from which they can help themselves, rather than going to court or a lawyer. Congress should require the Secretary of States, EDIS, PACER and the PTO to provide data e.g. on patent litigations, reexaminations, ITC actions, and to third party providers who promise to consolidate and make information available to the public in an accessible form at no or low cost and allow public interest groups to monitor implementation. Google Patents and Patent Bulk downloads would be a natural choice for a partner. Or Congress should empower and fund one of the agencies to provide this information. This information can inform market initiatives to provide defense service offerings. So much of the litigation landscape is opaque, but sunshine can reduce returns to information arbitrage. In this regard, I commend the FTC/DOJ's recent efforts and urge the FTC to conduct a 6(B) study.

It needs to be easier for the courts to understand the status of parallel litigations, reexaminations, and previous cases involving the patent in order to reduce duplication. A court may stay a case if another body is handling the same or a related dispute. A member of the public needs to be able to find, by patent number, the status of the patent, who owns it, whether it has been reexamined, and other litigations involving the patent and what other patents are owned by entities with interests in the assertion. Such records can reveal that the patent has already been licensed, through a different name, the other assets of the patentee that might be asserted against the target, and other basic information which can now be hidden behind obfuscatory name changes such as have been engaged in by scanner PAEs, frustrating information sharing efforts. While this information should ideally be available for all patents, if it's not, it should be made available upon proof of a demand letter to the information supplier.

Patent Demand Letter Information Website

The FTC or PTO should provide authoritative information about patents and options for responding that the many companies receiving demand letters can rely upon. Increasingly people who have little to no familiarity with the patent system need basic information like what a patent is, what infringement is, where to get information, what kind of lawyer might be needed, and what options for responding are available need to be disseminated. This kind of information can be powerful for helping unsophisticated targets know their rights, and that receiving a letter, even when it has a potential complaint attached to it, does not obligate them to pay. This simple and inexpensive intervention could go far in reducing fear, uncertainty, and doubt as well as unnecessary payments. The FTC experience with educating consumers can go far in making such an initiative effective.

Damages Study

Congress should also authorize a study, to be taken by the government or a respected institution like the National Academy Sciences, to pave the way towards real-world determinations for establishing the value of patents, outside the theatre of patent litigation. This study should consider real-life ex ante negotiations for determining a patent's technical and economic value. Patentholders and their targets should know ahead of time what the range of a patent's worth, instead of relying on courts to do so.

Identifying High Impact Patents and Connecting Small Defendants

Not all patent campaigns are created equal. For example, in the Innovatio case, 13,000 letters were sent to users of Wi-Fi routers. Where a dispute impacts so many members of the public the sheer numbers of relevant parties transform the case from a private dispute into a public concern. The FTC or PTO should accept information from members of the public who have received a demand, much like a "We the People" petition so that social impact can be gauged and appropriate interventions, by the public or public interest agencies, can be prioritized. The agency should also serve a coordinating role between small defendants who may want to band together and form common defenses. The inability of these parties to find each means that they cannot access the same options available to larger parties. But if they band together, they may be able to. Public interest agencies like EFF who are experienced with serving small companies and individuals can help as well but the agencies are in a better position to handle certain aspects of such an effort.

Conclusion

Subcommittee members, I thank you again for the honor of testifying before you today on ways to reduce litigation abuse in our patent system. I look forward to responding to your questions

Colleen V. Chien