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on behalf of The Clearing House Payments Company L.L.C., the Clearing House Association L.L.C. and Financial Services Roundtable

"The Impact of Bad Patents on American Businesses"

House Judiciary Subcommittee on Courts, Intellectual Property, and the Internet

July 13, 2017

Chairman Issa, Vice Chairman Collins, Ranking Member Nadler, and Members of the Committee, my name is Sean Reilly and I am Senior Vice President and Associate General Counsel of The Clearing House Payments Company L.L.C. I am here today to testify on behalf of The Clearing House Payments Company L.L.C., the Clearing House Association L.L.C. and the Financial Services Roundtable.

The Clearing House is a banking association and payments company that dates back to 1853. The Clearing House Payments Company L.L.C. owns and operates core payments system infrastructure in the United States and is currently working to modernize that infrastructure by building a new, ubiquitous, real-time payment system. The Payments Company is the only private-sector Automated Clearing House (ACH) and wire operator in the United States, clearing and settling nearly $2 trillion in payments each day, representing half of all commercial ACH and wire volume.

The Clearing House Payments Company's affiliate, The Clearing House Association L.L.C., is a nonpartisan organization that engages in research, analysis, advocacy and litigation focused on financial regulation that supports a safe, sound and competitive banking system. It is owned by 25 banks which provide commercial banking services on a regional or national basis, and in some cases, are also active participants in global capital markets as broker-dealers and custodians. Our owner-banks fund more than 40 percent of the nation's business loans held by banks, which include almost $200 billion in small business loans, and more than 75 percent of loans to households.

Financial Services Roundtable (FSR) is the leading advocacy organization for America's financial services industry. FSR members include the leading banking, insurance, asset management, finance and credit card companies in America.

Although the financial services industry has an interest in all proposed revisions to the America Invents Act, my testimony today focuses primarily on the critical importance of the Covered Business Method (CBM) program. Section 18 has played and should continue to play a critical role in ameliorating the harmful effects that the assertion of low quality business method patents has on innovation. I will also briefly address potential legislative changes. But before I address those topics, I will describe why our member companies have a unique stake in these issues.

I. THE FINANCIAL SERVICES INDUSTRY DEPENDS ON STRONG PATENT PROTECTION FOR INNOVATIONS, BUT ALSO BEARS THE BRUNT OF THE HARM FROM LOW QUALITY PATENT ASSERTIONS

The financial services industry has a strong interest in ensuring that the U.S. patent system provides robust protection for meaningful innovations while also ensuring that low quality patents, particularly those relating to business methods, are not used in abusive litigation. Our member companies, including banks, insurers and services providers, serve a multifaceted role in the U.S. economy, because they are both innovators themselves and financiers of innovation.

Today, financial services companies are heavily investing in developing technologies related to fraud detection, blockchain, advanced authentication, faster payments, and big data analytics, to name a few. Moreover, our industry provides frictionless movement of capital in every sort of financial transaction including credit card purchases, ATM withdrawals, online and mobile banking and digital wallet payments – all of which are fundamental to the modern financial system. Financial services companies have increasingly sought to protect such innovation through the patent system in recent years. In 2016, a sample of ten major financial services companies obtained more than ten times the number of patents that those same companies obtained in 2010.[1]

Additionally, the financial services industry is the primary source of capital for start-ups of every kind. Based on the most recent data from the Small Business Administration, as of June 2015 there were $599 billion in small business loans outstanding.[2] Traditional banks also help fund millions of businesses every year, and have a strong interest in seeing those entities achieve returns on their innovations. As lenders, therefore, it is essential that the intellectual property that we may rely on as collateral be the product of a high-quality examination.

Due to the ubiquity of financial services platforms, however, our industry is also uniquely vulnerable to the assertion of low quality patents by non-practicing entities (NPEs). If an NPE has a low-quality business method patent that it asserts against one credit union, bank or merchant, it likely means that patent can be asserted against every other entity operating in that same space. Given the high cost of patent litigation, banks are heavily incentivized to settle and license rather than litigate. And every dollar spent on such meritless litigation is one less dollar that can be deployed in our nation's communities.

II. THE COVERED BUSINESS METHOD PROGRAM STRENGTHENS THE PATENT SYSTEM AND AMELIORATES THE HARMFUL IMPACTS OF LOW QUALITY BUSINESS METHOD PATENTS ON THE U.S. ECONOMY

The CBM patent program is a landmark effort by Congress to create "a relatively cheap alternative to civil litigation for challenging [low quality patents], and will reduce the burden on the courts of dealing with the backwash of invalid

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[1] The sample of financial services companies consists of Visa, MasterCard, American Express, State Farm, Allstate, AIG, Bank of America, Capital One, JPMorgan Chase, and USAA.

[2] https://www.sba.gov/sites/default/files/Banking_study_Full_Report_508_FINAL.pdf

business-method patents."[3] Thus far, it has operated precisely as Congress intended. As CBM program data demonstrates, it has enabled the PTO to re-examine CBM-eligible patents against the most relevant grounds of invalidity, and many of those patents have been invalidated. CBM is a narrowly tailored, carefully constructed procedure that preserves and enhances incentives for innovation by protecting legitimate patents while providing an efficient, cost-effective alternative to litigation for the review of questionable business method patents because it allows challenges based on all grounds of invalidity.

The CBM program should be made permanent. This could be done either by simply removing the sunset on the program or, alternatively, by adjusting the IPR program to eliminate the current special interest carve-out in IPR that prevents subject matter patentability challenges and prevents challenges based on certain prior art, such as evidence of prior use, sale or offer for sale.

In the absence of a meaningful alternative, if the CBM program is allowed to sunset, NPEs will be free to assert low-quality business method patents and defendants will be left with little choice but to incur the enormous cost of litigation or to simply settle and license. This stifles innovation and is bad policy. Every industry, company and individual should have a viable option for post-grant proceedings as an alternative to costly litigation. Without CBM, companies sued on low quality business method patents in this space are denied such access.

CBM Is Needed and Is Achieving Its Intended Goals.

There are more than 85,000 business method patents that have already been issued and that number continues to grow. While the PTO has made progress at improving patent quality, the issuance of low quality business method patents continues to be a problem.

During consideration of the AIA, opponents of CBM raised several concerns regarding how the program would operate in practice. As such, Congress opted to establish the CBM as a "transitional" program to determine both its effectiveness. Five years into the program, the performance data reinforces the wisdom of Congress in establishing the program as an efficient means for addressing the problem of litigation initiated by NPEs based on low-quality business method patents. This data supports extending the CBM program.

To obtain review under the CBM program the petitioner must demonstrate that the challenged patent is "more likely than not invalid." As a result, for those CBM reviews that are instituted CBM has a high rate of invalidation. 79% of final written decisions issued in connection with CBM proceedings have invalidated the challenged patent, in whole or in part. Because challenges under sections 101 and

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[3] 157 Cong. Rec. S1367 (Mar. 8, 2011) (statement of Sen. Kyl).

112 are not available in IPR, roughly 50% of the invalidity findings could not have been made if the CBM program did not exist.

In light of its effectiveness, the CBM program has had a powerful impact on addressing low quality business method patents. Through July 11, 2017, 358 patents were the subject of CBM review. These 358 patents had been asserted in a total of 1,662 patent infringement lawsuits. Thus, CBM review has had a significant ripple effect in terms of collateral beneficiaries of the program.

***CBM Plugs the Loophole in the AIA's Post-Grant Proceedings Coverage*.**

CBM is necessary because, unlike IPR, it enables a petitioner to raise nearly any invalidity challenge that would be available in federal court. These include challenges to subject matter eligibility under § 101 and also prior use/prior sale defenses under §§ 102 and 103. Should Congress allow CBM to sunset, defendants in many patent litigations involving business method patents that are invalid would have no choice but incur the high costs of invalidating the patent in court or submit to paying for a license to the invalid patent. This would discriminate against financial services and electronic commerce innovation and ultimately impose large and unnecessary costs on the economy.

CBM Includes Safeguards to Prevent Abuse.

CBM includes strong gatekeeping provisions. Such safeguards prevent the harassment of patent holders and ensure that only those patents that claim covered business methods and that are more likely than not to invalid are ever subjected to review.

The first safeguard is that, unlike IPR, a patent only becomes eligible for the CBM when the patent holder threatens or elects to pursue litigation on that patent. And only parties that have a direct interest in addressing the charge of infringement of that patent can petition for review under CBM.

Also unlike IPR, CBM sets a high bar for review. Petitioners are required to establish that the patent is "more likely than not" is invalid in order to obtain review. As of November 2016, roughly 34% of CBM petitions had been rejected under this standard.

Further unlike IPR, only a specific subset of patents is subject to CBM. To be eligible, a challenged patent must (1) claim a method or corresponding apparatus for performing data processing or other operations used in the practice, administration, or management of a financial product or service, and (2) not be a patent on a technological invention.

Finally, filing a CBM is a high stakes risk for the company that files the petition challenging the patent. Because the challenger must have been charged with infringement in order to qualify for CBM review, should the challenger fail to prove invalidity, it is necessarily at increased risk in that existing litigation. And, the challenger will be estopped from raising in court the same arguments raised during CBM proceedings. These are very significant deterrents against filing a meritless petition.

The Most Frequent Criticisms of the CBM Program are Not Supported by the Data.

Opponents of the CBM program argue that it was a special interest handout to the big banks. In practice, however, banks, financial service companies, and other electronic commerce companies have not been the largest direct beneficiaries of the CBM program. To the contrary, as of November 2016 banks constituted only 8% of CBM petitioners. Non-bank financial institutions, such as insurance companies, constituted another 17 percent of petitioners. The other 75% of petitioners that obtained CBM review were in non-financial industries as follows:

- 41% - computers, software, printing, publishing and advertising
- 26% - services
- 18 % - retail trade
- 9% - transportation and communications
- 6% - manufacturing

Other opponents of CBM have claimed that the threat of CBM review has undermined the perceived value of software patents and resulted in a decreased appetite for investing in small business innovation by venture capitalists. But analysis of venture capital funding patterns belies the claim that CBM has created a "cloud" over innovation generally or software patents specifically. Since enactment of the AIA in 2012, venture capital funding has increased every year. Venture capital funding was up 7% from 2012 to 2013, and up almost 62% from 2013 to 2014. Venture capital funding in 2014 was at the highest level since 2007. In 2014, software was the single largest investment sector for venture capitalists. In fact, venture capital funding for software increased 77% over 2013.

Indeed, NPEs have faced the bulk of CBM petitions. As of November 2016, of the patent owners whose patents have been subjected to CBM challenges, 59% were NPEs.

III. Potential Legislative Changes

I would also like to very briefly address two important potential legislative issues: (1) the suggestions that 35 U.S.C. § 101 should be amended, and (2) the Federal Circuit's recent interpretation of the boundaries of Section 18 of the AIA in *Secure Axcess LLC v. PNC Bank NA.*

There is No Compelling Reason to Amend 35 U.S.C. § 101*.*

Over the past several years, numerous proposals have surfaced including amendments that Congress could make to 35 U.S.C. § 101. I do not plan to address any specific proposal. The Supreme Court and other federal courts have a long history of interpreting and applying § 101 and, over the decades and centuries, they have gradually developed jurisprudence on what does and what does not constitute subject matter that is eligible for patenting. They will continue to do so, allowing the law to evolve to address new circumstances, such as the proliferation of business method patents in the late 1990s and in subsequent decades. The current § 101 standard does not signal that legitimate software inventions are not patent eligible. Indeed, since the Supreme Court's decision in *Alice*, the Federal Circuit has continued to define the contours of Section 101, concluding in several cases that the challenged software patents did not claim ineligible subject matter. *See*, for example, *DDR Holdings, LLC v. Hotels.com, L.P.*, 773 F.3d 1245 (Fed. Cir. 2014); *Enfish, LLC v. Microsoft Corp.*, 822 F.3d 1327 (Fed. Cir. 2016); *BASCOM Global Internet Services, Inc. v. AT&T Mobility LLC*, 827 F.3d 1341 (Fed. Cir. 2016); *McRo, Inc. v. Bandai Namco Games America, Inc.*, 837 F.3d 1299 (Fed. Cir. 2016); and *Amdocs (Israel) Ltd. v. Openet Telecom, Inc.*, 841 F3d 1288 (Fed. Cir. 2016).

Congress Has an Opportunity to Clarify The Scope of the CBM Program**.**

While amending 35 U.S.C. § 101 is unwarranted, Congress should take the opportunity to make a clarifying amendment to Section 18 of the AIA, in order to correct the Federal Circuit's recent misinterpretation of the CBM provision. This past June, by a sharply divided 6-5 vote, the *en banc* Federal Circuit declined to correct a serious error in statutory interpretation in *Secure Axcess LLC v. PNC Bank National Association*, No. 2016-1353 (Fed. Cir. June 6, 2017). As a result of this decision, CBM review is likely available only if there is a "financial activity element" expressly limiting the invention only to use in connection with a financial service. Thus, even patents that are specifically (and singularly) directed at financial business methods may not be subject to CBM review unless their claims were drafted to expressly limit their scope to financial services.

Under the statute, CBM review is supposed to be available for any "patent that claims a method or corresponding apparatus for performing data processing or other operations ***used in*** the practice, administration, or management of a financial product or service." Section 18 of the AIA (emphasis added.) But the Federal Circuit's decision in *Secure Axcess* effectively re-writes the statute to require that the claims be written specifically such that the method is "**[*only*]** ***used***" "in the practice, administration, or management of a financial product or service." This interpretation is contrary to the statute's plain meaning, which unambiguously includes patents claiming a method or apparatus for data processing, *e.g.,* an authentication system, that is used to provide a "financial product or service," and does not require that the claims exclude the possibility of any other use of the invention whatsoever. Congress may take this opportunity to make its intentions clear with regard to this recent decision.

IV. CONCLUSION

There are no existing alternatives to the CBM program to rid the system of weak business method patents. IPR does not allow for a determination as to whether a patent is invalid under §101 or under use and sale prior art. But invalidity challenges based on § 101 and use and sale prior art are the critical grounds for challenging low quality financial patents, and the alternative of pursuing these defenses in efficient post-grant proceedings is crucial to addressing NPE litigation asymmetries.

In short, as Congress continues efforts to address the challenge of non-practicing entities asserting low quality patents, CBM should remain in place. Moreover, while we are actively involved in improving patent quality at the outset, low quality patents are still issued today which only reiterates the need for CBM moving forward. The only other alternative would be to provide for a uniform patent system by closing the IPR loophole and allowing the best prior art and subject matter eligibility challenges under IPR in the same way they are currently allowed under both PGR and CBM.

Thank you for this opportunity to testify on this extremely important issue for our industry, for consumers and for the country. We look forward to working with Congress and the stakeholder community to address these issues moving forward.