

Statement of

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**Before the
Subcommittee on Courts, Intellectual Property, and the Internet**

**COMMITTEE ON THE JUDICIARY
United States House of Representatives**

“The Impact of Bad Patents on American Businesses”

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Chairman Issa, Ranking Member Nadler and Members of the Committee and Subcommittee:

Everyone understands that the American economy depends heavily on invention—that is why it is referred to as the “Innovation Economy.” Invention and innovation, in turn, depend critically on adequate incentives to invest, because most invention is very risky and very expensive. A well-functioning patent system then is essential to securing such investments, both of company revenues and outside funding from venture capitalists, private equity firms, pension funds, commercial banks and other like sources. But, money managers in both worlds have many alternatives other than innovation. So, if risks are lower and rewards higher in other countries or in other endeavors such as entertainment, that is where the money will flow. The primary basis for most investment in useful innovation is the return on investment (ROI) assured by enforceable patents.

The health of the American patent system is therefore of high national importance. On it depends the sufficiency of incentives to make the necessary investments. With sufficient incentives, our country will see the following effects:

- economic growth
- creation of net new jobs(at good salaries)
- productivity increases
- enhanced global competitiveness
- increased family and individual incomes
- increased tax revenues to support crucial upgrades in citizen welfare and physical infrastructure
- technological leadership
- economic and national security.

We have seen all these effects in recent decades under a healthy patent system. What about at present? Well, in just the past 3–4 years the patent world has been turned upside down. The combination of how the Patent and Trademark Office’s Patent Trial and Appeal Board shaped and implemented procedures governing the AIA reviews, unintended consequences of a few design feature in the AIA itself, continuing, aggressive interventions by the Supreme Court, particularly on eligibility, and Rules and practice changes in the lower courts has totally changed perceptions of the current patent system. It is no longer viewed as reliable.

Our system dropped from its customary first place in the annual Chamber of Commerce global ranking to an embarrassing tenth place, tied with former Soviet Bloc country, Hungary.

Patent values have plummeted, by as much as 60% according to several studies by economists, based on public sales and licenses.

Venture investing has shifted heavily out of America to overseas competitors, particularly to Europe and China where eligibility is broader than here and enforcement far faster and cheaper, with injunctions, now rare here, routine there. America is already suffering a massive money-drain with the portion of venture funding staying here dropping from 83% to 54%, with the rest going overseas, often to China.

In some technologies it has all but dried up.

Start-ups, the source of most new technologies, most economic growth and most net new jobs, are shrinking in number. More now die each year in America than are born, for the first time ever.

Enforcement of valid and infringed patents, always very slow, and very expensive, has become much more so. *Inter partes* reviews have become less than Congressionally-intended “alternative to expensive court litigation” than the prelude to court action, adding some \$500,000 per challenge and typically 2.5 years of delay, as suits are routinely stayed for the duration.

Eligibility law under the *Alice/Mayo* regime has become highly uncertain and unpredictable. And results have been as inconsistent as unpredictable.

The net impact of these and related changes has convinced most investors that patents are now too unreliable as to validity, and too difficult to enforce, with excessive risk, delay and weak remedies.

Indeed, most owners of patents can no longer afford to enforce them. The majority have been priced out of our justice system. Experts opine that to enforce a small portfolio an owner needs \$15 million in cash and \$3 billion in market cap. So, wages now say that the “sport of kings”, horse racing, has been replaced by patent litigation.

The impacts on start-ups, research universities, university spin-offs, small and medium sized businesses and nearly all but giant multi-national corporations has been devastating. Even large companies, such as pharmaceutical firms, are hurting, many shrinking labs and decreasing or out-sourcing R & D, sometimes to foreign nations.

In sum, I must report in candor to the Committee that the health of the American patent system is not good, but has declined sharply in just the past few years.

Why? With the best of intentions, the three stewards of the patent system, the Supreme Court, the Congress and the PTO, have worked so hard to root out invalid patents, stem frivolous suits, and curb abusers of the patent system that its efficacy has been diminished or destroyed for the majority of owners who are responsible actors. That seems an absurd and unnecessary price for America to pay. Abusers can be punished and deterred by surgical means and weakening the entire system is surely unnecessary and unwise.

How then did we arrive at this worrisome circumstance?

Three myths pervaded the policy debates even before and particularly since passage of the AIA:

The first myth is that most asserted patents are “bad.” Not so.

The second myth is that most suits are frivolous. No so.

The third myth is that the courts are unwilling or unable to deal with the limited number of actual abusers of the patent system. Also not so.

Another phenomenon was that the three Branches of Government did not adequately coordinate their interventions to improve performance of the system. So, the PTO implemented the AIA reviews with procedures that, in my view, in certain respects departed from Congressional intent. The Supreme Court revolutionized the law of patent eligibility, but provided wholly inadequate guidance for those who must apply the new standards: 8,300 examiners, 1,000 district judges, 263 APJs on the PTAB and many thousands of private and corporate attorneys who advise business decision-makers. They, after all control much of the money that could go into R & D and follow-on commercialization that actually puts cures in the hands of physicians and new products on store shelves for consumers, or not.

The PTO appears to have been so worried about missing the Congressionally-required deadline of one year for a Final Written Decision in an AIA review that they never used the extra 6 months the Congress provided to them and made the procedures for AIA reviews so difficult for patent owners as to be unfair or, at least unjust compared to procedures in a court of law. For example, Congress wanted owners to be able to amend claims in IPRs, but the PTAB virtually always denies amendment. Courts of law require patents to be correctly construed, but the PTAB applies a broader, laxer, inaccurate construction, called Broadest Reasonable Interpretation. So, there was not much follow-up on PTO implementation by the Congress. Similarly, Congress worked hard to assure that repetitive challenges to a patent on the same ground would be barred by legislatively-required estoppel. But, as implemented by the PTO Director and the PTAB, estoppels are so weak as to be almost meaningless, with a challenger being permitted to file multiple petitions against the same patent and numerous other parties to file petitions on the same or very similar grounds. Again, with its other duties, follow-up by Congress, understandably has not, so far, been a priority.

But not all in recent years has harmed investment and made the system less efficient. And, many complaints are now summarily dismissed for failing to meet the new requirement of fact-pleading the new Rules and the Supreme Court decisions in *Twombly* and *Iqbal* instituted. Many patents are now being invalidated as indefinite before trial under the Supreme Court's decision in *Nautilus*. And, fee-shifting against parties advancing "exceptionally weak claims" is now quite common as trial judges implement the Supreme Court mandate of *Octane Fitness*. Discovery limits under the new Rules of Civil Procedure are reducing costs to both plaintiffs and defendants. In my estimation, then, the court system has demonstrated great capability to combat the true “patent trolls.” That make the overreach by the PTO Director and the PTAB all the more regrettable.

Overreach, however, has not been limited to the PTO and PTAB. I consider that eligibility for patenting (assuming all other “conditions of patentability” are met) to have been resolved by the Congress as a matter of national economic policy in Section 101 of the Patent Act. That section very clearly provides that “any machine” is eligible. But in *Alice*, the Supreme Court effectively contradicted Congress' mandate, holding that only those machines it deems eligible shall be so. If the patent claiming a machine is deemed too reliant on an “abstract idea”, then it is ineligible, per the Court, regardless what the statute provides.

Certainly, one can agree that a claim to $E=mc^2$ would not be valid and perhaps not even eligible. But there are no such patent claims. But to hold that if a claim “is directed to” an abstract idea (whatever that means) it is ineligible despite claiming a “machine”, as Congress explicitly allows, seems highly inappropriate as an apparent invasion of the Constitutional prerogatives of the Legislative Branch. Further, the Court implies its cases are a permissible exercise of judicial power under Article III because Congress have not legislatively abrogated them. That seems a stretch to me.

Even worse, the *Mayo* decision has cast a dark cloud of doubtful validity over many thousands of important patents in the health sciences. That is choking off funding for bio-tech firms just when they are on the cusp of breakthrough discoveries that would revolutionize human health and longevity. If Congress is as concerned as I am sure it is with human health, it should be motivated to abrogate *Mayo* as well.

It almost appears to me as if Congress is unaware of all these recent developments and still thinks that “trolls” are the biggest problem in the patent system. That is clearly not so. Yes, there are still some frivolous suits, but not many, as they have been deterred by those very developments, including the AIA itself. That is why the incidence of frivolity found by the courts as so small.

The AIA's creation of IPRs was, in my view, a very constructive step, even though I find fault with some aspects of its implementation by the PTO. They serve as a huge deterrent to dubious assertions, as does the new fee-shifting regime. In this and many other ways the AIA properly set the policies for patenting and patent reviews. But, it is a very different thing for the Congress to attempt to micro-manage the details of an ongoing patent suit. In my opinion, only the judge presiding over that case has the expertise and experience to realistically and competently do so. Therefore, as much as I support the AIA, I cannot support legislation such as the Innovation Act introduced in past Congresses. In view of all the developments of the past few years, to pile on still more patent “reform” at this juncture when the system is still reeling from the destabilizing and degrading effects of recent interventions by all three Branches seems inappropriate. It can only further weaken the investment incentives that have already been seriously diminished.

In the current circumstance, patience is a signal virtue, as developments continue to unfold. For example, much has been speculated about the future practical effects of the recent Supreme Court decision in *TC Heartland*. Realistically, it is too soon to know. Surely, there will be fewer cases in Eastern Texas and more in the district courts in California, Chicago, Wilmington, New York and elsewhere. In my opinion, that is a good thing, and I submitted an amicus brief to the Court to encourage a broader distribution of cases across the country and its 94 judicial

districts. But only time will reveal if further adjustments of venue law are needed and appropriate. Much will depend on exactly how the lower courts interpret the statutory phrase “regular and established place of business.” That cannot be predicted.

The same can be said about damages law. It continues to undergoes significant changes. Important improvements have been instituted by the courts. Whether there will be a useful role for Congress is as yet unclear. I doubt it, but one cannot be sure from what is visible at present.

As to “loser pays” proposals, application of *Octane Fitness* by the trial courts has tripled the incidence of fee-shifting, so again, it is questionable whether Congressional action is ripe or appropriate, much less necessary.

If I may suggest an improvement in the dialogue among all parties interested in the patent system, it would be to use more accurate terminology. The epithet “troll” is meaningless as an accepted definition is impossible to state. “Patent assertion entities” suffers the same deficiency. In fact, so does the phrase “bad patents.” Patents are neither bad nor good. As legal instruments, they are only valid or invalid under the terms of the Patent Act.

As a national asset, the patent system needs balance, balance between the interests of applicants and petitioners, between plaintiffs and defendants, between giant corporations and start-ups, between “tech” and bio/pharma, between and among hundreds of different industries. The system has to serve all interests reasonably well. If any one interest is given all it prefers, then the balance is destroyed. Sure, if I were a counsel at Google or a similar Silicon Valley company, I would want the weakest patent enforcement as possible. Same if I were a lawyer at Target or a similar retail giant. But such a parochial viewpoint does not deserve adoption if it harms American competitiveness or economic growth. The national interest requires balancing the interests of all participants in the system.

The problem is simply put: if in the interest of further combatting the relatively few system abusers, we further dismantle the system itself, our country will be committing economic suicide. Instead, the three Branches need to improve the operation of the system with surgical strikes, best done by the courts for the most part, not carpet bomb it into oblivion.

Foreign competitors must be watching in astonishment to observe us continually weakening of our patent system. But, they have not been idle. They have enlarged eligibility to take advantage of our shrinking it. They have assured injunctive relief as the norm, while we have largely blocked it. They have made enforcement suits faster, surer and cheaper than here. They have given equal treatment to U. S. companies, of late, even China.

One consequence is that American multi-nationals are now increasingly preferring to enforce first in Europe, particularly Germany, or even in China. That is a sad state of affairs for some of our most successful companies to encounter.

In my view, the Committee should primarily focus on how to strengthen our system, make it cheaper, faster, more reliable. Bad patents and patent abusers are increasingly under effective

control, thanks in no small part to the prior work of this committee. For that, it is to be greatly commended.

Thank you.