



SMU | DEDMAN
SCHOOL OF LAW



Legislative Responses to Patent Assertion Entities

David O. Taylor, Assistant Professor, SMU Dedman School of Law
16th Annual IP Symposium: Patent Assertion Entities
The University of Texas School of Law, February 20, 2015

Introduction

- This Essay contributes to the ongoing debate concerning patent assertion entities by analyzing the current state of affairs regarding patent reform legislation.
- In particular, it analyzes the extent to which legislation addresses the primary problems with the patent system that some patent assertion entities exploit.
- More broadly, it analyzes whether legislative reform rather than judicial or agency reform is the best avenue to address these primary problems.



Primary Problems with the Patent System

- There are three primary problems with the patent system that some patent assertion entities exploit:
 - Poor patent quality
 - Problems with patent litigation
 - Various asymmetries
- When there is criticism generally of patent assertion entities, the root of these criticisms usually is at least one of these three primary problems.



Poor Patent Quality

- One way to think of poor patent quality is the idea that too many patents do not satisfy the existing standards of patentability.
 - Pursuant to this view, both the Patent Office and the courts too often incorrectly allow patents to issue and remain in force.
 - If this is the problem, of course, then better enforcement of existing standards is the appropriate response.
- Another way to think of poor patent quality is the idea that the existing standards of patentability are too lax.
 - According to this second critique, the standards themselves need to change to eliminate more patents.
 - This critique supports aggressive modifications to substantive patentability standards by Congress as well as courts with control over the interpretation of these standards.



Problems with Patent Litigation

- There are four problems with patent litigation:
 - Uncertainty
 - A lack of effective disincentives to poor quality patent assertions
 - Excessive cost
 - Problems with remedies



Uncertainty

- According to Federal Circuit Judge Plager, there is an “endemic problem of uncertainty in law and the judicial decisional process, and particularly in patent law.”
 - Uncertainty exists in patent law in particular because of the difficulty drafting clear claims and, moreover, the difficulty predicting how courts will interpret these patent claims to define the scope of the right to exclude, uncertainties that infect the invalidity and infringement analyses.
 - But the level of uncertainty in patent law is high based in part on the Supreme Court’s repeated rejection of bright line rules adopted by the Federal Circuit to govern various substantive doctrines.
 - A recent, contributing factor to the current level of uncertainty in patent law is the numerous doctrinal changes to the patent system given recent legislation and Supreme Court cases.



Lack of Effective Disincentives to Poor Assertions

- Poor quality patent assertions includes the assertion of poor quality patents—patents that are likely invalid—but also the assertion of patent claims that, even if valid, are likely not infringed.
 - The lack of clarity in patent claims and their correct interpretation leads to poor patent assertions.
 - But so has the lack of an effective incentive for patent owners not to adopt a very broad interpretation of a claim in an effort to prove infringement.
 - While broad interpretations increase the risk of invalidation based on the novelty, non-obviousness, enablement and written description requirements, these defenses must be proven by clear and convincing evidence in litigation.
 - Until recently, the Federal Circuit required a district court to find both subjective bad faith and objective reasonableness before finding a case exceptional and awarding fees to the prevailing party in a patent infringement case.



Excessive Cost

- Relative to other litigation, patent litigation is significantly more expensive.
 - The technical nature of the litigation no doubt contributes.
 - Procedural complexity, including the use of separate claim construction hearings, also contributes.
 - Perhaps procedures required by patent local rules are too complex and compliance is too costly.
 - Another cause of expense is the complexity of substantive patent law.
 - Prosecution history estoppel is the exception to the exception to non-infringement—and yet it has its own exceptions.
 - There are no less than fifteen factors relevant to determining a reasonable royalty—and they are still non-exclusive.
 - Excessive discovery costs, including costs associated with electronic discovery, given the high stakes.



Problems with Remedies

- The law currently does not ensure that reasonable royalties—the main remedy patent assertion entities seek—reflect only the value of the patented technology, rather than the value of the ability to impose risk of liability and negotiation and litigation costs on accused infringers.
- Likewise, it is seen as problematic if courts grant patent owners injunctions that prohibit the use of entire devices when only particular components of those devices infringe.
- Given that patent licensing occurs in view of the remedies that a patent owner receives or can expect to receive in patent litigation, these problems may infect licensing agreements.



Various Asymmetries

- There are three asymmetries:
 - Information asymmetry
 - Cost asymmetry
 - Risk asymmetry



Information Asymmetry

- The patent system has not solved how to disseminate effectively information regarding inventions—and the fact that they are patented—from inventors to potential users.
 - Certainly the purpose of the enablement and written description requirements is to increase the quality of the disclosure.
 - Furthermore, the marking requirement encourages constructive notice of at least some types of patents (system but not method patents) with respect to at least some patent owners (those who practice patented technologies or license others to do so)
 - But these requirements do not provide a mechanism of dissemination.
 - The current approach is to publish patent applications and patents and make searchable databases available.
 - It is a continuing concern that information regarding inventions fails to reach other potential inventors and users of technology.



Ex Ante Information Asymmetry

- Ex ante information asymmetry is the failure of information exchange and the resulting imbalance of information between original inventors and later inventors and users before re-invention or use of the patented technology begins.
- It results in inefficient, redundant invention.



Ex Post Information Asymmetry

- Ex post information asymmetry is the failure of information exchange and the resulting imbalance of information between original inventors and later inventors and users after re-invention or use of the patented technology begins.
- It results in inefficient inadvertent infringement and patent litigation rather than licensing.



Cost Asymmetry

- Patent litigation is more expensive for accused infringers than patent owners.
- Typically accused infringers themselves bear the cost of paying attorneys to represent them by the hour, while patent owners may be able to avoid bearing the upfront cost of attorneys fees using contingent fee arrangements.
- One set of infringement contentions based on documents produced by accused infringers, versus invalidity contentions for each located piece of prior art.
- The cost asymmetry between an accused infringer and a patent owner is more pronounced when the patent owner is a patent assertion entity.
 - Discovery costs are the best example.



Risk Asymmetry

- Patent owners risk invalidity, non-infringement, or unenforceability, judgments that affect the patent owners' ability to obtain cash in the future.
 - The patent owner, even if it has existing licenses, does not have to pay a dime out of pocket, absent the extreme case where a judge finds the case exceptional or frivolous.
- Accused infringers risk judgments leading to orders to pay the patent owner lost profits or reasonable royalties and to discontinue profitable sales or uses of products and services.
 - In other words, the accused infringer is risking a judgment that will cause it to pay money out of pocket and lose future profit.
- The difference in risk is more significant if the patent owners are non-practicing entities.



Primary Problems with the Patent System

- Poor patent quality
- Problems with patent litigation
 - Uncertainty
 - A lack of effective disincentives to poor quality patent assertions
 - Excessive cost
 - Problems with remedies
- Various asymmetries
 - Information asymmetry
 - Ex ante information asymmetry
 - Ex post information asymmetry
 - Cost asymmetry
 - Risk asymmetry



Legislative Responses to These Primary Problems

- Congress as well as state legislatures have considered and enacted legislation in the last few years targeting the patent system and patent assertion entities' exploitation of problems with it.
 - The America Invents Act
 - State Legislation Regarding Bad Faith Patent Licensing
 - The Innovation Act



The America Invents Act

- Patent Quality
 - The most significant revisions to the patent statute made by the America Invents Act relate to the shift from a first-to-invent paradigm to a first-inventor-to-file paradigm.
 - These revisions, however, did little to improve patent quality.
 - Other provisions of the America Invents Act hold great potential to improve patent quality.
 - The most significant of the provisions affecting patent quality relate to the revision of old procedures and the creation of new procedures governing the review of issued patents.
 - Allowing third parties to submit prior art to examiners during the original examination of a patent application may increase the ability of examiners to identify the best prior art to compare to the claims in pending patent applications.



The America Invents Act

- Patent Quality

- While these aspects of the America Invents Act hold the potential to improve patent quality, what cannot be ignored is the fact that little, if anything, in the America Invents Act changed substantive patent law in an effort to improve patent quality.
- And it is important, moreover, at least to recognize that other revisions may hurt patent quality.
 - The elimination of the ability to allege a violation of the best mode requirement in litigation.
 - To the extent the new law is interpreted to eliminate the potential prior art status of secret commercial uses by patent applicants, the Act permits the patenting of inventions long after their creation without encouraging public disclosure shortly after their first commercial use.



The America Invents Act

- Problems with Patent Litigation
 - Little of the Act directly addressed problems with patent litigation, and those that did arguably have little impact.
 - The legislative fix to the statutory provision governing the jurisdiction of the Federal Circuit
 - The new statutory provision governing joinder of accused infringers
 - Yet the America Invents Act may be understood as addressing at least some of the problems associated with patent litigation by creating (or improving) alternatives to it.
 - New review proceedings
 - Related provisions effectively requiring stays of patent litigation
 - These alternative procedures provide disincentives to poor quality assertions.
 - Broadest reasonable interpretation; preponderance burden; increased ability to stay
 - They also reduce cost



The America Invents Act

- Asymmetries
 - Considering cost, as already discussed the Act provides alternative lower cost procedures available to challenge the validity of issued patents rather than patent litigation.
 - Considering risk, the modified interpretation and burden of proof substantially increase the risk of invalidity borne by a patent owner in one of the modified or new proceedings.



State Legislation Regarding Bad Faith Licensing

- State legislation has focused on information asymmetry, at least the ex post variety
 - Vermont’s law seeks to provide these benefits, first, by broadly outlawing “bad faith assertion[s] of patent infringement.”
 - Factors include whether the demand letter contains certain information: “(A) the patent number; (B) the name and address of the patent owner or owners and assignee or assignees, if any; and (C) factual allegations concerning the specific areas in which the target’s products, services, and technology infringe the patent or are covered by the claims in the patent.”
 - Thus, Vermont’s statute seeks to ensure the disclosure of information that may be useful to resolve disputes over liability for infringement short of litigation and its expense.



The Innovation Act

- What is left to fix? What more can and should be done?
 - The glaring omission of these previous attempts to reform the patent system is any direct attempt to solve the problems with patent litigation.
 - Moreover, little in these prior efforts at reform have impacted ex ante information asymmetry.
- So what problems with the patent system does the Innovation Act address?



The Innovation Act

- If enacted, it would not directly impact patent quality other than changes in a section of the Act described as improvements or technical corrections to the America Invents Act.
 - It would limit the preclusive effect of post-grant review to future cases where the challenger attempts to argue that a claim is invalid on any ground that the challenger actually raised during the post-grant review.
 - It would do require the Patent Trial and Appeal Board to conduct review proceedings using the claim construction that a court would use.
 - Expansion of the transitional post-grant review proceeding for covered business method patents.
 - Codification of the non-statutory obviousness-type double-patenting doctrine for patents subject to first-inventor-to-file.



The Innovation Act

- It primarily seeks to address two of the four problems with patent litigation: the lack of disincentives to poor quality patent assertions and the high cost of patent litigation.
 - It addresses the lack of appropriate disincentives to poor quality patent assertions by effectively reversing the current approach to fee shifting in patent litigation.
 - It seeks to reduce the cost of patent litigation in several ways.
 - By severely limiting discovery prior to resolution of disputes over claim construction.
 - By requiring the Judicial Conference of the United States to develop rules and procedures to address specific issues and to implement specific proposals identified by Congress “to address the asymmetries in discovery burdens and costs” in patent litigation.



The Innovation Act

- The Act also addresses both types of information asymmetry
- Ex ante information asymmetry
 - The Act would require most parties asserting infringement to disclose information regarding the assignee, interested parties, and their parent entities to the accused infringer, and it would require this information to be sent to the Patent Office.
 - It would require certain information to be exchanged when the party asserting infringement is not a publicly traded entity, where that information would include the names and contact information of interested individuals.
 - The Patent Office would be required to put this information, as well as other information about the lawsuit, the parties, and the asserted patents, on its website.



The Innovation Act

- Ex post information asymmetry
 - Would dramatically increase the pleading standard for most patent infringement cases.
 - It also seeks to influence how courts decide claims relating to patent licensing (fraud, alleged violations of consumer protection laws, and motions seeking shifting of fees based on exceptional circumstances) by emphasizing that a demand letter should include certain basic information.
 - It would restrict the ability to award enhanced damages for willful infringement based on pre-suit notification to situations where certain information is included in the pre-suit notification.
 - It would require most parties asserting infringement to disclose to the accused infringer the identity of the owner of the asserted patents, any entity with a right to sublicense or enforce the patents, any entities with financial interests in the patents or in the plaintiff, and the ultimate parent entity of any of the entities.



The Innovation Act

- Ex post information asymmetry
 - It would codify a version of the existing customer suit exception to the first to file rule to seek to ensure that patent owners cannot take advantage of ex post information asymmetry to railroad customers into settlements.
 - Would require the Patent Office to “develop educational resources for small businesses to address concerns arising from patent infringement” and to “provide education and awareness on abusive patent litigation practices.”



The Innovation Act

- Cost asymmetry
 - Would reduce cost asymmetry by limiting discovery prior to resolution of claim construction disputes.
 - Would also do by forcing the Judicial Conference of the United States to develop rules and procedures to implement specific proposals identified by Congress “to address the asymmetries in discovery burdens and costs” in patent litigation.
- Risk asymmetry
 - The reduction of costs
 - The reduction of cost asymmetry
 - Changing the fee-shifting presumption in favor of shifting fees
 - Allowing for the elimination of lawsuits against customers in favor of litigation by manufacturers



Using Legislation to Solve Problems

- To summarize (and overgeneralize):
 - The America Invents Act primarily impacts patent quality, cost asymmetry, and risk asymmetry by creating alternative lower-cost options compared to patent litigation for invalidity claims.
 - The new state laws primarily impact ex post information asymmetry.
 - The pending Innovation Act would primarily impact two of the four problems with patent litigation (its lack of disincentives to poor quality assertions and its excessive cost), as well as the information, cost, and risk asymmetries in the patent system.
- No legislation addresses problems with uncertainty and remedies in litigation.
 - Perhaps that is because courts are better equipped to address these problems, because of concerns with separation of powers, or because courts are already addressing these problems.



Alternatives to Using Legislation

- Is legislative reform the best avenue to address problems with the patent system that the America Invents Act and state legislators did not address or that they did not address adequately, or instead would judicial or agency action be better?
 - With the exception of the problems with patent litigation, many of these problems have already been addressed by the America Invents Act and state laws regarding patent licensing practices.
 - And to the extent further reform is necessary to address problems with patent litigation, there remains a significant question whether Congress is the right entity to seek to correct these problems.



Alternatives to Using Legislation

- Courts have more experience and expertise concerning the problems with patent litigation.
- There are significant separate-of-powers concerns with the President and Congress enacting a law that effectively governs the day-to-day control of patent litigation by trumping the Federal Rules of Civil Procedure.
- Relative absence of debate concerning the relative competence and propriety of legislation rather than judicial action to correct problems with patent litigation.



Alternatives to Legislation

- Why is legislation rather than judicial reform necessary or appropriate, particularly with respect to some of the more exceptional provisions in the Innovation Act that ignore or overlook courts' institutional competence and can be seen as impinging on the power of the judiciary to govern its procedures?
- There seem to be unsettling parallels between the Innovation Act and the America Invents Act's overturning of the Federal Rules of Civil Procedure regarding joinder.
 - It was not debated in any detail by Congress, was not presented to the Judicial Conference, was not analyzed in advance by law professors, and which, perhaps as a result, ultimately proved unnecessary and even problematic given the Federal Circuit's subsequent interpretation of Rule 20.





SMU | DEDMAN
SCHOOL OF LAW



Questions?