

BACKGROUND

No. 2873 | JANUARY 9, 2014

A Balanced Approach to Patent Reform: Addressing the Patent-Troll Problem Without Stifling Innovation

John G. Malcolm and Andrew Kloster

Abstract

The term “patent troll” conjures up images of short, grotesque, hairy creatures that act like humans but have little redeeming social value. It has also arisen as convenient shorthand for those bad actors who abuse the patent litigation system. Yet not every patent holder who chooses not to use his or her patent lives under a bridge and eats passersby. Indeed, there are a number of legitimate reasons for not using a patent. While patent reform is essential to continued economic growth, the devil is in the details, and the proper way to address patent reform is by using some of the same means and methods that would likely work against “ambulance chasers” or other bad actors who exist in other areas of the law.

Patent rights, like other property rights, serve as a vital engine of economic growth, improving the quality (and length, in the case of innovative medical devices and techniques and new pharmaceuticals) of Americans’ lives. Garage inventors and multinational companies alike spend time and money researching and developing new ideas and technologies that make people’s lives better.

America’s Founding Fathers, recognizing the importance of encouraging and fostering innovation, enshrined adequate incentives to do so in the Constitution. Specifically, the Patent and Copyright Clause provides: “The Congress shall have Power To ... promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries....”¹

KEY POINTS

- Patent rights are critical, constitutionally enshrined property rights that promote American innovation and improve the quality and length of Americans’ lives. They should be strongly protected.
- The proper way to address patent trolls is by using the same means and methods that would likely work against “ambulance chasers” or other bad actors who exist in other areas of the law.
- Patent lawsuits have the same pitfalls as other civil lawsuits: Rapacious trial lawyers should be discouraged so that business can innovate without undue fear of court costs.
- Patent litigation reform should be balanced and not simply shift burdens in order to water down patent rights.
- Judges should be empowered and encouraged to employ sanctions and bond requirements to deter abusive litigants of all types, not based on whether they are plaintiffs or defendants or whether they are patent assertion entities or “active users” of a patent.

This paper, in its entirety, can be found at <http://report.heritage.org/bg2873>

Produced by the Edwin Meese III Center for Legal and Judicial Studies

The Heritage Foundation
214 Massachusetts Avenue, NE
Washington, DC 20002
(202) 546-4400 | heritage.org

Nothing written here is to be construed as necessarily reflecting the views of The Heritage Foundation or as an attempt to aid or hinder the passage of any bill before Congress.

Thus, the Founders envisioned providing economic monopoly protection to inventors through property rights in innovation. The Patent and Copyright Clause represents their well-considered political judgment that providing broad protection for limited periods of time promotes technical knowledge and spurs innovation.

Patent rights—the exclusive ability to sell an invention for a period of years—provide powerful financial incentives to companies to research and develop technologies that benefit society.

Although the patent system has changed throughout American history, the basic principles underlying the system have remained the same:

- They authorize the patent holder to pursue a variety of remedies against those who make unauthorized use of the covered invention,
- The patent holder can sue infringers in federal court to obtain monetary damages or injunctive relief, and
- The patent holder can also ask the United States International Trade Commission (ITC) to block the importation of infringing articles.

Patents are treated similarly to any other piece of property: They can be bought and sold on the open market, and what a patent holder does with a patent is his business. Just as a homeowner might decide to purchase a piece of land and not develop it or permit others to use it, a patent holder may also choose to do nothing with the patented invention. Alternatively, the patent holder might autho-

rize someone else to utilize his patented invention (which could be a product or business process); license it to others for their use; or hold on to the patent as an investment until he decides to sell it (or it expires).

Certainly, there are many who invent simply due to curiosity about how the world works and a desire to solve problems. However, patent rights—the exclusive ability to sell an invention for a period of years—provide powerful financial incentives to companies to research and develop technologies that benefit society.

For example, Pfizer’s 2010 sales of Lipitor, its blockbuster cholesterol medication, were \$5.3 billion, or roughly \$14.6 million per day. It is the relentless search for new markets that leads Pfizer to spend billions of dollars² every year on research and development. In 2011, the Lipitor patent expired and generic drugs flooded the market. Pfizer developed the drug and made billions over its patent term. Now anyone can make it, and the American public benefits from this advancement in medical treatment—a classic success story envisioned by the U.S. Constitution.

In spite of its huge importance to the American economy,³ which in other areas of the law might lead to regulatory capture, the legal framework of the patent system has remained stable. In 2011, however, Congress passed the America Invents Act (AIA), which was signed into law by President Barack Obama. Although many of its provisions did not go into effect until early in 2013, the AIA radically overhauled the American patent system.

Yet to some Members of Congress, “despite the breadth and depth of the AIA’s reforms ... it was apparent even before the Act was signed into law that further legislative work remained to be done.”⁴ Specifically, during the first session of the 113th Congress, Members went back to the drawing board, seeking to address a problem that hinders American innovation: patent litigation abuse, commonly called “pat-

1. U.S. CONST. art. I, § 8, cl. 8.

2. John Carroll, *Pfizer on Track to Chop R&D Budget Back to \$6.5B–\$7B Range*, FIERCEBIOTECH (Jan. 29, 2013), available at <http://www.fiercebiotech.com/story/pfizer-track-chop-rd-budget-back-65b-7b-range/2013-01-29>.

3. Jonathan Rothwell, José Lobo, Deborah Strumsky, and Mark Muro, *Patenting Prosperity: Invention and Economic Performance in the United States and Its Metropolitan Areas*, THE BROOKINGS INSTITUTION (Feb. 1, 2013), available at <http://www.brookings.edu/research/reports/2013/02/patenting-prosperity-rothwell>.

4. Report, together with Dissenting Views and Additional Views, H.R. 3309, 113th Cong. (2013), available at <http://docs.house.gov/billsthisweek/20131202/HRPT-113-OJCR-HR3309.pdf> (last visited December 28, 2013).

ent trolling.” Patent reform has become such a priority that even President Obama and others who do not usually support such reforms have called for change.

Assessing the Scope of the Patent-Troll Problem

Litigation is leverage. Rapacious trial lawyers and their unscrupulous clients can make a killing by filing frivolous lawsuits and extracting unfair settlements from people who cannot fight back, do not know how to fight back, or simply find it cheaper and easier not to fight back. In other contexts, these lawyers are sometimes called “ambulance chasers,” and abusive lawsuits designed to extract settlements are sometimes called “nuisance suits” or “strike suits.” Legal fights about the validity and scope of patents are no exception.

The term “patent troll” (bringing to mind short, grotesque, hairy creatures who act like humans but have little redeeming social value) has arisen as convenient shorthand for those bad actors who abuse the patent litigation system. A number of colorful anecdotes highlight this problem:

- Innovatio, a company holding certain Wi-Fi patents, claims that anybody using Wi-Fi, including a home user, is infringing its patents. The company has sent demand letters to “coffee shops, hotels, grocery stores and restaurants offering Wi-Fi, demanding \$2,300 to \$5,000 to settle.”⁵
- MPHJ Technology Investments has sent demand letters to hundreds of American businesses, claiming infringement of their patents involving

scanner technology and seeking \$1,000 per worker in licensing royalties.⁶

- Eolas, a company that claimed it owned “essentially the whole Internet,” sued Microsoft, obtained a \$565 million judgment, and settled for an undisclosed amount even though its patents were ultimately invalidated.⁷

One difficulty, however, in defining the scope of the problem is determining who is a patent troll and how the law can identify these bad actors in advance. While the above-noted anecdotes are shocking, is there hard evidence that patent trolling is a *systemic* problem with patent litigation that necessitates *systemic* reform?

Reformers contend that the number of patent cases has more than doubled in the past few years, from 2,304 lawsuits in 2009 to 4,731 in 2012, with the increase largely attributable to suits filed by patent trolls, also known as patent assertion or non-practicing entities.⁸ Significantly, however, these reformers fail to take account of a significant change in the law in 2011; specifically, the AIA expressly prohibited joinder of multiple defendants in a single patent lawsuit. Consequently, with no real increase in litigation, some cases that might have been filed and remained single lawsuits in 2010 now account for multiple lawsuits.⁹

In reality, the volume of patent lawsuits has remained remarkably stable over the years, and the rate of infringement suits filed is currently about 1.5 percent of the volume of patents issued by the United States Patent and Trademark Office (PTO) each

5. *WiFi Patent Troll Told That Each License Should Be Less Than 10 Cents*, TECHDIRT (Oct. 4, 2013), available at <http://www.techdirt.com/articles/20131004/03110024747/wifi-patent-troll-told-that-each-license-should-be-less-than-10-cents.shtml>.

6. MANHATTAN INSTITUTE FOR POLICY RESEARCH, A REPORT ON THE LITIGATION INDUSTRY’S INTELLECTUAL PROPERTY LINE OF BUSINESS: TRIAL LAWYERS INC. (July 2013), available at http://www.triallawyersinc.com/updates/tli_update11.html.

7. *Id.*

8. David Segal, *Has Patent, Will Sue: An Alert to Corporate America*, N.Y. TIMES, July 13, 2013, available at <http://www.nytimes.com/2013/07/14/business/has-patent-will-sue-an-alert-to-corporate-america.html?pagewanted=all&r=0>. These data come from an RPX study, discussed *infra* at notes 11 and 17 and accompanying text.

9. See 35 U.S.C. § 299(b); Adam Mossoff, *The Myth of the “Patent Troll” Litigation Explosion*, TRUTH ON THE MARKET (Aug. 12, 2013), available at <http://truthonthemarket.com/2013/08/12/the-myth-of-the-patent-troll-litigation-explosion/>. In fact, a recent study using publicly available data concluded that the so-called litigation explosion in the patent space is “almost entirely” driven by the procedural joinder rules change in the AIA itself. Christopher Anthony Cotropia, Jay P. Kesan, & David L. Schwartz, *Patent Assertion Entities (PAEs) Under the Microscope: An Empirical Investigation of Patent Holders as Litigants*, UNIVERSITY OF ILLINOIS COLLEGE OF LAW, ILLINOIS PROGRAM IN LAW, BEHAVIOR AND SOCIAL SCIENCE PAPER No. LBSS 14-20, ILLINOIS PUBLIC LAW RESEARCH PAPER No. 14-17, available at <http://ssrn.com/abstract=2346381> (last visited Dec. 28, 2013). This study analyzed every patent case filed from 2010 to 2012 and concluded that the number of unique patentees involved in litigation increased only marginally between those years, from 1610 to 1696. Furthermore, the type of litigant has remained stable.

year.¹⁰ Moreover, since the number of patents being issued by the PTO has increased, it could well be that some of the rise in infringement lawsuits is attributable to the fact that the PTO has issued more patents, which is not necessarily bad and may well reflect an actual increase in patent-worthy innovation.

Reformers further allege that patent trolls cost the American economy \$29 billion annually—a statistic that has been largely debunked, in part because it came from a study relying on undisclosed data funded by RPX, a lobbying group that represents patent defendants.¹¹

A significant problem with the RPX study is that it defines as a patent-troll suit any lawsuit filed on a patent that is not being used to manufacture a product at that time. Patent trolls are often defined as patent holders who are not actively exploiting their patents by manufacturing products that incorporate them—as if that was always a bad thing. Such a proposition, however, is dubious at best. There are many perfectly legitimate reasons why a patent holder might not be using his patent at the specific moment that a lawsuit is filed alleging infringement of that patent, all of which leads to the important issue of how “patent troll” is defined.

What Is a Patent Troll?

The White House has defined trolls as those who “use patents primarily to obtain license fees rather than to support the development or transfer of technology.”¹² Such a broad definition would ensnare a host of patent holders with legitimate reasons for not using their patents. For example, Kodak, which generated “more than \$3 billion” in licensing fees by filing lawsuits, might be covered by this overbroad

definition. Yet when Kodak went through bankruptcy, it sold its patent portfolio for \$525 million to a number of other companies such as Apple, Google, and Microsoft, which have given no indication that they will use these patents to build anything.¹³

A patent holder might file a legitimate infringement lawsuit even though it is not itself manufacturing a product that incorporates that patent at that time. Any definition of a patent troll that includes such actors would be throwing the baby out with the bathwater.

Additionally, many universities conduct research and obtain patents never intending to manufacture anything. The same thing can be said for garage inventors who come up with patentable inventions with the intention of selling or licensing those patents so that they can move on to the next invention.

Some companies obtain patents for innovations that they consider intermediate steps to longer-term research projects or opt to conduct marketing studies before exploiting those patents by manufacturing something or licensing them for use by others. Some companies holding valuable patents may be in the process of selling their businesses or going out of business, yet they feel compelled to sue an infringer to preserve this valuable asset for a would-be buyer or to protect creditors and shareholders.

-
10. PRICEWATERHOUSECOOPERS, 2013 PATENT LITIGATION STUDY: BIG CASES MAKE HEADLINES, WHILE PATENT CASES PROLIFERATE, available at http://www.pwc.com/en_US/us/forensic-services/publications/assets/2013-patent-litigation-study.pdf. See also Adam Mossoff, *The Sewing Machine Patent Wars*, SLATE, available at http://www.slate.com/articles/technology/future_tense/2013/12/sewing_machine_patent_wars_of_the_1850s_what_they_tell_us_about_the_patent.2.html (last visited Dec. 28, 2013).
 11. See Assessing Factors That Affect Patent Infringement Litigation Could Help Improve Patent Quality, GAO-13-465 (Aug. 22, 2013) (noting that the RPX study is “nonrandom” and “nongeneralizable”), available at <http://www.gao.gov/products/GAO-13-465>. See also Joe Mullin, *New Study, Same Authors: Patent Trolls Cost Economy \$29 Billion Yearly*, ARSTECHNICA (July 3, 2012), <http://arstechnica.com/tech-policy/2012/07/new-study-same-authors-patent-trolls-cost-economy-29-billion-yearly/>. See also David Schwartz and Jay P. Kesan, *Analyzing the Role of Non-Practicing Entities in the Patent System*, ___ CORNELL L.REV. ___, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2117421.
 12. Jared A. Favole and Brent Kendall, *Obama Plans to Take Action Against Patent Holding Firms*, WALL ST. J., June 4, 2013, available at <http://online.wsj.com/article/SB10001424127887324563004578524182593163220.html>; THE WHITE HOUSE, EXEC. OFFICE OF THE PRES., PATENT ASSERTION AND U.S. INNOVATION (June 2013), http://www.whitehouse.gov/sites/default/files/docs/patent_report.pdf.
 13. Beth Jinks, *Apple, Google in Group Buying Kodak Patents*, BLOOMBERG TECH (Dec. 19, 2012), available at <http://www.bloomberg.com/news/2012-12-19/kodak-agrees-to-sell-imaging-patents-for-525-million.html>.

There are many other reasons why a patent holder might file a legitimate infringement lawsuit even though it is not itself manufacturing a product that incorporates that patent at that time. Any definition of a patent troll that includes such actors would be throwing the baby out with the bathwater.

The proper way to address patent trolls is by using the same means and methods that would likely work against other individuals who gin up or grossly exaggerate alleged injuries and then make unreasonable demands to extort settlements up to and including filing frivolous lawsuits.

Furthermore, even entities whose business model relies on purchasing patents and licensing them or suing those who refuse to enter into licensing agreements and infringe those patents can serve a useful—indeed, a vital—purpose. Some infringers may be large companies that infringe the patents of smaller companies or individual inventors, banking on the fact that such a small-time inventor will be less likely to file a lawsuit against a well-financed entity. Patent aggregators, often backed by well-heeled investors, help to level the playing field and can prevent such abuses.

More important, patent aggregators facilitate an efficient division of labor between inventors and those who wish to use those inventions for the betterment of their fellow man, allowing inventors to spend their time doing what they do best: inventing. Patent aggregators can expand access to patent pools that allow third parties to deal with one vendor instead of many, provide much-needed capital to inventors, and lead to a variety of licensing and sublicensing agreements that create and reflect a valuable and vibrant marketplace for patent holders and provide the kinds of incentives that spur innovation. They can also aggregate patents for liti-

gation purposes, purchasing patents and licensing them in bundles.

This has at least two advantages: It can reduce the transaction costs for licensing multiple patents, and it can help to outsource and centralize patent litigation for multiple patent holders, thereby decreasing the costs associated with such litigation. In the copyright space, the American Society of Composers, Authors, and Publishers plays a similar role.

All of this is to say that there can be good patent assertion entities that seek licensing agreements and file claims to enforce legitimate patents and bad patent assertion entities that purchase broad and vague patents and make absurd demands to extort license payments or settlements. The proper way, therefore, to address patent trolls is by using the same means and methods that would likely work against “ambulance chasers” or other bad actors who exist in other areas of the law, such as medical malpractice, securities fraud, and product liability—individuals who gin up or grossly exaggerate alleged injuries and then make unreasonable demands to extort settlements up to and including filing frivolous lawsuits.

Bad Patents Enable Bad Lawsuits

The PTO’s issuance of bad patents is a contributing factor in patent trolling. For a long time, critics have pointed out that reforming the PTO’s processes (for example, by enabling it to keep fees and increase its staff)¹⁴ and limiting the scope of patentable subject matter could reduce much of the troll problem. While there are advantages and disadvantages to each of these proposals, the underlying premise that bad patents enable bad lawsuits is certainly correct, and the PTO has been using its regulatory authority to improve patent quality.¹⁵ These efforts are important because downstream reform of patents in court will never be as effective as weeding out bad patents at the issuance stage.

Additionally, the Supreme Court of the United States has agreed to hear a case¹⁶ in which it may clarify whether and when computer code should receive patent protection. Many critics point to the

14. H.R. Res 3309, Improving the Patent System to Promote American Innovation and Competitiveness Before the H. Comm. on the Judiciary, 113th Cong. 3–4 (statement of Robert A. Armitage), available at <http://judiciary.house.gov/hearings/113th/10292013/Armitage%20Testimony.pdf>.

15. Assessing Factors That Affect Patent Infringement Litigation Could Help Improve Patent Quality, *supra* note 11.

16. *Alice Corp. Pty. Ltd. v. CLS Bank Int’l*, 717 F.3d 1269 (Fed. Cir. 2013), *cert. granted*, 82 U.S.L.W. 3131 (U.S. Dec. 6, 2013) (No. 13-298).

vague standards currently used for granting software patents as being a major source of the patent troll problem.

While the patent troll problem may be smaller than the RPX study would suggest, it still exists and can result in injustices that can be corrected. For example, the RPX study's definition of "troll" is overbroad and therefore exaggerates the scope of the problem; however, it does suggest that patent assertion entities tend to file lawsuits against more defendants than other types of patent holders.¹⁷ Although anecdotal evidence might not be proof of a systemic problem, it still can sway public opinion and represents injustices in need of correction.

Litigation is subject to abuse by patent holders asserting frivolous claims in the case of an invalid or excessively vague patent and by infringers who do not want to pay a reasonable amount for the right to use a valid patent. Any legislative proposal should take account of this fact.

Moreover, since many patent assertion entities are backed by financial investors who may be somewhat disconnected from the innovation process, some of them may be more tempted than non-patent assertion entities to seek a quick return on their investment by being overly aggressive in interpreting the scope of their patents or pursuing dubious claims against a wide array of vulnerable defendants. Because many of these defendants may be small businesses incapable of fighting back, this sort of behavior must be discouraged.

Patent Reform Proposals Being Considered

When it comes to patent litigation reform, the devil is in the details. During the current Congress, there have been several proposed reforms.¹⁸ Major provisions of the AIA went into effect in 2013, and many PTO processes have not yet been ironed out. Hence, there is a dearth of data regarding the AIA's actual effect on the patent system, what new problems have arisen, what old problems have been exacerbated, and what problems the AIA solved. As a result, there are no hard data about the potential costs and benefits of these new proposals.

As previously stated, litigation is leverage. It is subject to abuse by patent holders asserting frivolous claims in the case of an invalid or excessively vague patent, and it is subject to abuse by recalcitrant, willful infringers who do not want to pay a reasonable amount for the right to use a valid patent—thereby weakening the value of the patent and resulting in significant commercial losses to the patent holder. Any legislative proposal should take account of this fact and strive to do everything possible to try to limit the former without encouraging the latter.

Limiting Injunctive Relief. The White House has proposed limiting patent holders' access to injunctive relief before the United States International Trade Commission (ITC).¹⁹ Currently, the ITC can issue orders barring importation of infringing goods almost automatically once the infringement and validity of the patent are established. The White House would prefer the ITC to apply the four-factor test referenced in *eBay v. MercExchange*, in which the Supreme Court held that proof of infringement and validity of a patent would not necessarily equate to a showing of irreparable harm for purposes of issuing an injunction.²⁰

17. See PRICEWATERHOUSECOOPERS, *supra* note 10.

18. See, e.g., Saving High-Tech Innovators from Egregious Legal Disputes Act of 2013, H.R. 845, 113th Cong. (2013); Innovation Act, H.R. 3309, 113th Cong. (2013); Patent Quality Improvement Act, S. 866, 113th Cong. (2013); Stopping the Offensive Use of Patents Act, H.R. Res 2766, 113th Cong. (2013); End Anonymous Patents Act, H.R. Res 2024, 113th Cong. (2013); Patent Litigation and Innovation Act, H.R. Res 2639, 113th Cong. (2013); Patent Abuse Reduction Act, S. Res 1013, 113th Cong. (2013).

19. Alex Fitzpatrick, *Obama Targets Patent Trolls With Executive Actions*, MASHABLE (June 4, 2013), available at <http://mashable.com/2013/06/04/obama-patent-trolls-actions/>.

20. 547 U.S. 388 (2006). Under this test, before excluding imports, the ITC would have to determine whether the patent holder will (1) suffer an irreparable injury for which (2) remedies at law are inadequate and whether (3) the balance of hardships between plaintiff and defendant and (4) the public interest warrants the issuance of an exclusion order. Courts have looked to a number of factors in evaluating the "irreparable harm" factor including the market impact of the infringement, the amount of competition in the market, the practice of the invention by the patent holder, and the business importance of the invention to the patent holder.

The White House has also signaled its support for the argument that the ITC should not be permitted to issue injunctions in the form of exclusion orders at all, absent extraordinary circumstances, for particular types of patents—specifically, standard essential patents.²¹ This proposal would limit the rights of all patent holders. When dealing with infringing importation, sometimes the only remedy that has any value to a patent holder is injunctive relief, since monetary relief is often unattainable when the infringer is overseas. Furthermore, the ITC has expertise that many district courts do not have, and its processes are relatively quick and cost-effective.²² Limiting injunctive relief before the ITC might harm American innovation, a possibility that ought to give lawmakers pause.

Heightened Pleading Requirements and Transparency Provisions. Several patent reform proposals require that persons suing for infringement provide additional information at the pleading stage of litigation. These proposals call for heightened pleading requirements for parties in civil suits alleging infringement by requiring the disclosure of:

1. Identification of the patent(s) and each patent claim for those patents that are allegedly being infringed;
2. Identification of the allegedly infringing device or process;
3. Identification for each allegedly infringing device of its name or model number or, if none exists, an adequate description of the device; and
4. An explanation of where each element of each claim is found within the allegedly infringing device.

Other proposals would focus on the true parties in interest and would require disclosure of the authority of the party alleging infringement to assert the claims contained in the complaint; a description of

the principal place of business, if any, of the complainant; a list of each complaint under the relevant patents that the party has previously filed; whether the patent is a “standard-essential patent”; the identity of any assignee of the patent(s) in question; and the identity of others with a financial interest in the patent or a right to enforce the patent.

The White House has signaled its support for the argument that the ITC should not be permitted to issue injunctions in the form of exclusion orders at all, absent extraordinary circumstances, for standard essential patents. This would limit the rights of all patent holders.

As a general matter, having a heightened pleading standard in a technical area that is potentially subject to abuse by a broad or nebulous assertion of infringement would be a positive development, as would requiring the party filing the complaint to provide identifying information including that party’s history with respect to defending those patents. This sort of information allows defendants to analyze the legitimacy of claims asserted against them and to prepare a defense in a manner that is faster and more cost-effective than speculating about what the plaintiff has in mind. Obviously, there should be “good faith” exceptions for plaintiffs who, for reasons beyond their control, currently lack information necessary to satisfy the heightened standards, but such a scenario should rarely be the case.

While defendants would benefit from knowing against whom they are litigating for a number of reasons,²³ too much transparency might risk compelling the disclosure of confidential licensing relationships, thereby deterring economic growth. As Professor Richard Epstein has noted:

21. See Exec. Office of the President, Letter from U. S. Trade Representative to Chairman Williamson of the U.S. Int’l Trade Comm. (Aug. 3, 2013), available at http://www.ustr.gov/sites/default/files/08032013%20Letter_1.PDF.

22. Steven Seidenberg, *ITC Granting Fast Injunctions in Infringement Cases*, INSIDE COUNSEL (May 1, 2011), available at <http://www.insidecounsel.com/2011/05/01/itc-granting-fast-injunctions-in-infringement-cases>.

23. This information can, for example, help defendants to determine viable counterclaims and assess discovery needs and can inform a defendant as to the possibility of recovering attorneys’ fees and costs from parties with an interest in the outcome of the litigation.

[P]atent holders have a legitimate gripe against any novel statutory requirement that they both create and update lists of all parties at any time who buy and license their patents. The administrative burdens over the entire patent life could prove substantial given the rapid pace and innovative forms of patent licensing. And the publication of that information hits both venture capitalists and lenders who rightly regard the composition of their patent portfolios as trade secrets.²⁴

Finally, at some point, heightened pleading standards might become onerous and deter the filing of meritorious infringement claims. Congress should keep the garage inventor in mind as it considers changes in the law.

Shifting the Costs of Litigation. Some proposals involve shifting some or all of the costs of litigation to the loser of the lawsuit. This could include awarding actual attorney’s fees, reasonable attorney’s fees, or reasonable fees and other expenses. Fees could be awarded to all winners or only to winners when a judge finds that the loser’s litigation position was substantially unjustified. Some proposals have permissive joinder rules that allow defendants to add “interested parties” to the litigation in certain circumstances. Such leniency would help to ensure that trolls cannot set up shell companies to litigate and then go belly-up when they lose. Some proposals also include bonding provisions that, on the one hand, guarantee that a winning party will recover costs but, on the other hand, might deter a garage inventor from vindicating his property rights in court.

This sort of fee-shifting is generally a good idea so long as the court has discretion to require that each side bear its own costs when it determines that the non-prevailing party’s position was “substantially justified.”²⁵ This is an important exception because it deters better-financed parties from simply outspending the losing parties and shifting costs to them.

Some proposals would also shift the costs of pre-trial discovery, which is the process whereby the

litigants demand materials and the production of witnesses related to the litigation from the other parties. Abusive litigants will often use discovery rules to try to bankrupt defendants; therefore, some patent-troll reform proposals require that discovery costs be shifted when one party requires more information than is really necessary for the litigation. Indeed, the mere threat of imposing crippling discovery costs on a defendant can, and often does, induce defendants to settle rather than fight—even though the claim may be frivolous.

Shifting discovery costs is generally warranted in any context in which the discovery being sought is overbroad, unreasonable, or pertains to matters that are not germane to the main issues of the lawsuit. If one party goes on a “fishing expedition,” that party ought to pay for it.

For this reason, shifting discovery costs is generally warranted in any context in which the discovery being sought is overbroad, unreasonable, or pertains to matters that are not germane to the main issues of the lawsuit. If one party goes on a “fishing expedition,” that party ought to pay for it.

The Innovation Act,²⁶ for example, would require the Judicial Conference of the United States to develop and implement discovery rules that bifurcate discovery costs: “Core documentary evidence” (defined in the statute as including essentially any material relevant to patent validity, patent infringement, and potential damages²⁷) costs would be borne by the producing party, while the production costs associated with discovery requests beyond core documentary evidence would be borne by the requesting party, who would be required to post a bond sufficient to cover the expected discovery costs. These reasonable proposals attempt to discourage discov-

24. Richard Epstein, *Rep. Goodlatte’s Patent Reform Will Smother Technological Innovation*, FORBES (Dec. 04, 2013), available at <http://www.forbes.com/sites/richardepstein/2013/12/04/rep-goodlatte-patent-reform-will-smother-technological-innovation/>.

25. The Equal Justice Act requires such discretion in lawsuits against the United States. 28 U.S.C. 2412(d).

26. H.R. Res 3309, 113th Cong. (2013). This bill, passed by the House of Representatives on December 5, 2013, was introduced by Chairman Bob Goodlatte (R-VA).

27. *Id.* at Sec. 6(a)3(A).

ery abuse by shifting costs where appropriate while making sure that the default position is that each party bears its own costs.

Interestingly, the Supreme Court is scheduled to hear a pair of cases involving attorney's fees under the current patent statute. Both *Highmark, Inc. v. Allcare Health Management System* and *Octane Fitness v. Icon Health & Fitness* will bear on the ability of district courts to award attorney's fees. A statutory fix might rob the Supreme Court of an opportunity to decide these cases.

While shifting litigation costs and discovery fees would be a positive change, it is important to define what fee shifting is available at the outset. Critically, the Innovation Act fails to define what "reasonable fees and other expenses ... in connection with a civil action" related to patent infringement means.²⁸ This language therefore might or might not be intended to include expenses related to post-grant review at the PTO, for example. Congress should clarify what is covered, because a lack of clarity will only invite costly litigation on these issues.

Staying Suits Against Covered Customer. Another proposed reform would allow infringing manufacturers and "covered customers" to agree to stay a lawsuit against the customer that is related to a "covered product or process" so long as certain conditions are met. Valid patent holders are well within their rights to sue customers who use infringing products; the rights of patent holders extend to "whoever without authority makes, uses, offers to sell, or sells any patented invention ... during the term of the patent...."²⁹ Today, however, many patent lawsuits extend well beyond those sectors that are directly involved in technological innovation and affect businesses that have no connection to the patent process. The customer suit exception is therefore desirable.

This provision seeks to protect so-called end users of infringing products who have been targeted by patent trolls. It provides for a right to a stay, subject to some sensible exceptions, if the manufacturer has joined the suit or filed a related suit; if both the customer and the manufacturer agree to the stay; and if the customer agrees to be bound

by any resolution of issues that the manufacturer and customer have in common. Such a provision is voluntary in that both the manufacturer and the customer must agree that the manufacturer is in a better position to defend against the suit, but the customer must be prepared to bear the risk that he may be bound by any judgment rendered against the manufacturer.

Congress should provide sufficient guidance about what would constitute "common issues." Otherwise, this could result in needless litigation that would unduly delay the day of reckoning for infringing parties and cause additional harm to legitimate patent holders.

The exceptions include when the plaintiff asserts a major issue against the customer that would be incapable of resolution if the stay is granted, such as when the manufacturer agrees that the patent is valid and that it has been infringed but claims that it is the way the customer is using the product—not the product itself—that renders it an infringement. Moreover, although a stay may be granted, the customer remains a party to the suit, enabling the plaintiff to obtain whatever discovery might be necessary to prove the case against the manufacturer or other suppliers of infringing products.

Although, under current law, a customer can seek a stay,³⁰ the granting of such a motion is left to the discretion of the district court, and courts have been reluctant to do so. In most cases, the manufacturer has a better understanding of the product and is in a better position to defend against the alleged infringement than is a customer defendant. Lawsuits can be very disruptive to a defendant's business, and that defendant may be far less motivated to litigate the case than is the manufacturer that sold the allegedly infringing product.

In most cases, a suit against the manufacturer will be enough to settle the matter. If the patent is

28. *Id.* at Sec. 3(b)(1).

29. 35 U.S.C. § 271(a). Moreover, it is clear that unauthorized use of a patented product, without more, can constitute infringement. *Aro Manufacturing Co., Inc., et al. v. Convertible Top Replacement Co.*, 365 U.S. 336 364 (1961).

30. *Katz v. Lear Siegler, Inc.*, 909 F.2d 1459 (Fed. Cir. 1990).

declared invalid or not infringed by the manufacturer's product, that will decide the matter with respect to any downstream consumers. On the other hand, if the patent is found to be valid and the manufacturer's product infringing, the manufacturer may decide, for business reasons or if the manufacturer had previously agreed to indemnify its customers, to pay all the damages, and, if not, the customer will already have agreed to be bound by the judgment with respect to "common issues."

The act of sending shocking demand letters based on spurious claims of infringement could rise to the level of prosecutable state or federal fraud. In particularly egregious cases, this might prove an adequate (or preferable) remedy.

Of course, Congress should provide sufficient guidance about what would constitute "common issues." Otherwise, this could result in needless litigation that would unduly delay the day of reckoning for infringing parties and cause additional harm to legitimate patent holders.

Curbing Abuse of Demand Letters. Another reform seeks to curtail the practice of sending threatening and nebulous demand letters informing recipients, without providing any specifics whatsoever, that they are infringing a patent and demanding money in the form of a license fee or settlement. Many of these letters make not-so-subtle references to the costs and tremendous inconvenience that the recipient would likely incur if the demand is not met and a lawsuit is filed.

Some proposals, like heightened pleading standards, would require that demand letters contain more information about the alleged infringement so that the recipient can assess the validity of the claim. Other proposals would require that the party sending the demand letter disclose in some public fashion, such as with the PTO, how many demand letters it has sent out and to whom.

For the same reasons that heightened pleading standards make sense and to avoid what in some cases amounts to extortion, such proposals warrant consideration. Due consideration, however, should be given to how such requirements would be enforced and who would enforce them, as well as whether these requirements could be imposed in a way that is consistent with the First Amendment's general prohibition against compelled speech.³¹

It is worth noting that the act of sending shocking demand letters based on spurious claims of infringement could rise to the level of prosecutable state or federal fraud. In particularly egregious cases, this might prove an adequate (or preferable) remedy.

A Good Model for Broader Litigation Reform

Historically, many proposals championed as solutions to the patent-troll problem have fallen under the heading of "tort reform." In fact, many of the improvements to the abusive patent litigation situation that have been proposed could be applied just as sensibly in other areas of the law that are currently subject to abuse.

As one prominent patent expert has testified, "[A] clear consensus exists across the patent community today that meritorious patents should be more easily, inexpensively and predictably enforced—and patents lacking merit should be more easily, inexpensively and predictably eliminated."³² These principles could be applied in any area of civil litigation.

This similarity between tort reform and patent reform is no accident; the lawsuits called "troll" lawsuits in the patent context are quite often called "strike" suits in other contexts. For many years, leading advocates of tort reform such as the American Tort Reform Association and the U.S. Chamber of Commerce have supported bonding requirements, limitations on discovery, heightened pleading, and loser-pays systems because such reforms deter frivolous lawsuits. Some have also advocated for allowing, encouraging, or even requiring judges to sanction attorneys for unethical behavior more often and more strongly.

Sanctioning bad behavior in court is important: "Patent trolls" are not the only trolls out there. Amer-

31. Cf. *West Virginia Bd. of Educ. v. Barnette*, 319 U.S. 624 (1943) (holding that the First Amendment prohibited a school board from requiring students to salute the American flag and recite the Pledge of Allegiance).

32. Statement of Robert A. Armitage, *supra* fn. 14 at 1.

ica's judicial system is teeming with all kinds of abusive litigants, including personal injury trolls, class action trolls, and employment lawsuit trolls. Should patent reform be enacted, its effectiveness might well have a bearing on future civil justice reform efforts in other areas.

Suggestions for Reform

Assessing and improving the functioning of America's world-class patent system is an important goal of Congress. When considering any legislative patent-reform proposal, both the public and Members of Congress should keep the following principles in mind:

1. Patent rights are critical, constitutionally enshrined property rights that promote American innovation and should be strongly protected.
2. Patent lawsuits have the same pitfalls as other civil lawsuits: Rapacious trial lawyers should be discouraged so that business can innovate without undue fear of court costs.
3. Patent litigation reform should be balanced and not simply shift burdens in order to water down patent rights.
4. Judges should be empowered and encouraged to employ sanctions and bond requirements to deter abusive litigants of all types, not based on whether they are plaintiffs or defendants or whether they are patent assertion entities or "active users" of a patent.

By enacting these reforms, Congress can ensure that patent rights continue to drive economic growth and improve the lives of all Americans.

—*John G. Malcolm* is Director of and *Ed Gilbertson* and *Sherry Lindberg Gilbertson* Senior Legal Fellow in, and *Andrew Kloster* is a Legal Fellow in, the *Edwin Meese III Center for Legal and Judicial Studies* at *The Heritage Foundation*.