
The PATENT and Innovation Acts – Targeting Patent Troll Abuses – Voted Out of the Judiciary Committee in the Senate and House

**By Christine Wilson Feller
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Patent reform legislation targeting patent trolls continues to move forward as the Senate's PATENT Act, introduced into the Senate at the end of April, was voted out of Committee by a 16-4 vote on Thursday, June 4, 2015; and the Innovation Act, introduced into the House of Representatives in February was voted out of Committee by a 24-8 vote on Thursday, June 11, 2015. As we reported at the end of April, multiple bills have been introduced in the U.S. House of Representatives and the U.S. Senate this year targeting litigation and pre-litigation tactics often employed by patent trolls. These bills include the TROL Act, targeting abusive patent demand letters; the STRONG Patents Act, addressing post-grant proceedings and abusive patent demand letters; and the two omnibus bills, the Innovation Act and the PATENT Act.

Before their mark-ups, the Innovation Act and PATENT Act were both amended to address concerns raised by the pharmaceutical and biotechnological industries regarding post-grant proceedings. Yet, certain industries and groups remain concerned about the reach of these bills and the possible unintended and negative consequences for individual inventors, small businesses and start-ups, venture capital firms, as well as universities and research institutes. It was clear during the mark-up of both bills that more work needs to be done to achieve the "right" balance.

Background

The PATENT Act, introduced into the U.S. Senate on April 29, 2015, and the Innovation Act, introduced into the U.S. House of Representatives on February 2, 2015, are comprehensive and wide-ranging bills. If passed, they would amend the America Invents Act (AIA) by introducing provisions covering heightened pleading requirements; mandatory early disclosures regarding interested parties, patent ownership, and infringement allegations; limitations on discovery; early motion practice; stays on actions against end-users and customers; fee-shifting; recovering fee awards from financially interested parties, and certain changes to inter-partes and post-grant review systems at the Patent Trial and Appeals Board (PTAB) under the AIA.

On May 7, 2015, less than a week after it was introduced, hearings were held on the PATENT Act. As introduced, the PATENT Act was controversial on at least two fronts. First, critics believed, and some still believe, it goes too far, targeting not only "patent trolls," but also making enforcement more difficult and onerous for individual inventors, start-up companies and small businesses, the investment community that provides their funding, as well as universities and research centers. Second, the bill was also criticized for what it did not include, namely changes to the inter-partes review (IPR) and post-grant review (PGR) procedures at the PTAB, a sticking point for the pharmaceutical industry in particular. After the May 7th hearings, the PATENT Act was amended, adding provisions directed to post grant proceedings as well as some minimal language meant to clarify the fee-shifting provision.

The Innovation Act, introduced in February, has been even more controversial than the Senate bill, as its provisions, particularly those provisions addressing fee-shifting, the customer stay provision, and the recovery of fees from "interested parties," are drafted for even broader coverage. Hearings were held on the Innovation Act and the bill has been amended to address some of the concerns raised about the scope of the bill as well as the concerns of the pharmaceutical industry. Amendments to the Innovation Act include changes to the joinder provision allowing for recovery of fees from "interested parties," the introduction of a venue provision intended to curb the practice of patent trolls setting up an office only for the purposes of litigating in favorable venues, such as the Eastern District of Texas, changes to the customer stay provision intended to target those at the end of the supply chain, and changes to IPR proceedings to curb the use of IPR proceedings in order to manipulate markets. Although the amendments made to the Innovation Act prior to mark-up were generally welcome, groups such as the Association of American

Universities, Association of Public & Land Grant Universities, the Innovation Alliance, the Medical Device Manufacturers Association, the National Venture Capital Association and the Alliance of U.S. Startups and Inventors for Jobs continue to oppose the Innovation Act because the changes “do not go far enough” and will “harm U.S. competitiveness and undermine a patent system that has been critical to incentivizing innovation and job creation in our country for more than 200 years.”

Post-Grant Proceedings Amendments Suggested to Limit IPRs

Calling the IPR procedures “a ‘death squad’ for legitimate patents and patent holders” because of a “pro-challenger bias,” PhRMA (Pharmaceutical Research and Manufacturers of America) opposed the PATENT Act as originally written. (See <http://www.phrma.org/media-releases/phrma-response-to-introduction-of-senate-patent-bill#sthash.crNypUKQ.dpuf>). Some pharmaceutical companies have also been concerned with these PTAB review processes because of the actions of Kyle Bass, a hedge fund manager who has filed numerous IPR petitions against pharmaceutical companies. Other groups, such as the Innovation Alliance, were concerned about the efficacy of IPRs and noted that “[s]ince the IPR program was implemented in September 2012, more than 2,700 requests for IPRs have been made at USPTO, and 78 percent have been decided against the patent holder.” (“Innovation Alliance Priority Positions on S. 1137, the Senate Protecting American Talent and Entrepreneurship (PATENT) Act” May. 6, 2015).

In response to these stated concerns, the proposed PATENT Act was amended to contain provisions that would change certain aspects of the post-grant proceedings, including provisions that would require:

- 1) Application of a district court claim construction standard;
- 2) Consideration of a district court’s claim construction or determination of validity;
- 3) A presumption of validity for all challenged patents;
- 4) A rule that would allow for sanctions for frivolous or unsubstantiated petitions.

While the amendments to the PATENT Act did not directly address the Kyle Bass-type scenario, the amendments to the Innovation Act did. The Innovation Act does not make wide-reaching changes to the IPR and PGR procedures, but targets the Kyle Bass scenario by requiring the petitioner to certify that it and “the real parties in interest” does “not own and will not acquire a financial instrument . . . that is designed to hedge or offset any decrease in the market value of an equity security of the patent owner” or an affiliate. The Innovation Act also contains an amendment to stop a practice that Rep. Goodlatte (R-VA), the main sponsor of the bill, has equated to extortion, namely demands by a party not charged with infringement for payment in exchange for not instituting an IPR proceeding. Similar to the amended PATENT Act, the Innovation Act has contained language since its introduction that would apply the district court claim construction standard of “ordinary and customary meaning” as understood by one skilled in the art at PTAB proceedings as opposed to the currently used “broadest reasonable construction” standard.

Controversy Over Fee-Shifting and Recovery of Fee Awards Resulted in Only Minimal Changes

Both the Innovation Act and the PATENT Act propose fee-shifting provisions, allowing the winning party in a patent litigation to recover attorneys’ fees and other expenses from the losing party. Given the longstanding American Rule rejecting a “loser-pays” system, the fact that patent litigation can be quite expensive, and that the Patent Act already allows fees to be awarded to the prevailing party in “exceptional cases” under 35 U.S.C. §285, these provisions have been controversial on multiple fronts.

Proponents of the PATENT Act have emphasized that its fee-shifting provision is more reasonable than the Innovation Act’s, which presumptively award fees and expenses to the winning party, because a court must affirmatively find that the losing party was not “objectively reasonable” before granting a fee award. In addition, the amended bill makes clear that “the burden is on the party seeking fees to show that fees should be awarded” and adds language “to protect named inventors and institutions of higher education if they are subject of a fee award.”

(Statement of Sen. Patrick Leahy (D-VT), June 4, 2015). The fee shifting provision in the Innovation Act was not amended prior to mark-up, even though there has been vocal criticism of this particular language in the bill.

Regarding recovery of fees, the PATENT Act defines an interested party more narrowly than the Innovation Act, as “a person who has substantial financial interest related to the proceeds from any settlement, license, or damages award,” whereas the Innovation Act defines an interested party as an assignee of the patent; a party that has a right, even if contingent, to enforce or sublicense the patent; or a party with a “direct financial interest” in the patent, including having the right to “any part of an award of damages or any part of licensing revenue.” The Innovation Act was amended prior to mark-up, however, “to ensure that the provision is targeted to insolvent companies, and does not include inventors, legitimate start-ups, banks, and VCs.” An exception for universities and technology transfer organizations, similar to an exception in the PATENT Act, was also added to the Innovation Act, as was an exemption for employees of the company alleging infringement and inventors, parties that practice or implement the patent, and those engaged in research and development in the field of technology covered by the patent.

Heightened Pleading Requirements

Both bills would require the party enforcing a patent to identify each patent and claim that is alleged to be infringed; the accused process, machine or composition alleged to infringe each identified claim; a description of the elements of each identified claim that are infringed by the product and how it infringes those elements; and where indirect infringement is alleged, a description of the acts of the alleged infringer that contribute or induce the infringement. The PATENT Act would also eliminate Form 18, which allows a bare-bones complaint to be filed in a patent infringement action. The Judicial Conference recommended the abrogation of Rule 84 and the elimination of Form 18 in September of 2014, and the U.S. Supreme Court approved this recommendation and submitted it to Congress on April 29, 2015. Unless modified by Congress before December 1, 2015, the elimination of Form 18 would subject patent infringement complaints to the same federal pleading standards that apply in other federal cases, the *Iqbal/Twombly* standard.

Staying Lawsuits Against Customers and End-Users

Both bills provide for “covered customers” to stay the litigation against themselves in favor of litigation against a manufacturer. The concept of the customer or end-user stay enjoys general support, but criticism has arisen regarding how a “covered customer” should be defined. The Innovation Act originally defined a “covered customer” very broadly, but was amended prior to mark-up to narrow that definition to cover only end-users and retailers, and to exclude parties that manufacture or cause the manufacture of the allegedly infringing product. This amendment brings the language more in line with the PATENT Act. However, the customer stay provision, even as more narrowly drawn in the PATENT Act, has raised concerns from such groups as the Innovation Alliance, whose members include Qualcomm, Dolby, and InterDigital, who claim that “the actual language of the definitions potentially cover any party in a chain of commerce, even those device manufacturers and product designers who profit most from infringement” and possibly “immunizing from liability culpable infringers throughout the supply chain, including large companies who rely on offshore subcontractors to build or assemble their products, and leave patent holders without recourse to enforce their patent rights.” (“Innovation Alliance Priority Positions on S. 1137, the Senate Protecting American Talent and Entrepreneurship (PATENT) Act” May. 6, 2015).

On the other hand, even large companies can be end-users of patented technology. Ms. Lettellier, Sr. Managing Counsel for J.C. Penney, testified at the May 7th hearings that the retailer has been a defendant in 30 lawsuits brought by NPEs (non-practicing entities) in the last six years, all the lawsuits relate to technology used in the stores or in e-commerce, and that it can no longer afford to invest in and adopt new technology because of the abusive litigation tactics of the NPEs.

The Debate at the Senate and House Judiciary Mark-Up

IPR/PGR Amendments

At the Senate mark-up, it was noted that the provisions regarding post-grant proceedings were not yet complete. In particular, two areas will be subject to continued negotiations. First, in Sen. Grassley’s (R-IA) opening remarks he

noted that the language in the Act regarding the amendment of claims in the post-grant proceedings was just a “placeholder” until a compromise can be reached. Second, the committee is considering whether to exempt patents that are subject to the Hatch-Waxman Act and Biologics Price Competition and Innovation Act (BPCIA) statutory processes. Sen. Hatch (R-UT) spoke in favor of exempting patents already subject to Hatch-Waxman and Biosimilar legislation arguing that the right balance has already been established through these statutes and should not be undermined by the IPR proceedings.

At the House mark-up, an amendment offered by Rep. Chaffetz (R-UT) that would have struck the entire portion of the Innovation Act addressing IPR and PGR proceedings was withdrawn at Chairman Goodlatte’s suggestion, but the discussion indicated that there will be continuing negotiations regarding the IPR and PGR provisions of the Innovation Act.

Heightened Pleading Standards & Fee-Shifting

At the Senate mark-up, Sens. Coons, Durbin and Whitehouse (D-RI) expressed concern that serious unintended consequences were likely for individual inventors, start-ups and small businesses, especially regarding the pleading standards and fee-shifting provisions, and that the concerns of large established companies were being heard over the voices of others. Sen. Coons in particular took issue with individual inventors and small entities developing or practicing new technologies being lumped together with patent trolls, and stated that the problem with the Act is that its rules are neutral, and will hurt patent trolls along with everyone else. Sens. Cruz (R-TX) and Vitter (R-LA) also expressed concern that the PATENT Act as passed by the Judiciary Committee did not do enough to protect inventors and their property rights in their patents.

At the House mark-up, Rep. Johnson (D-GA) introduced an amendment that would have adopted the language of the PATENT Act regarding fee shifting, echoing concerns raised since the introduction of the bill that the Innovation Act’s fee-shifting provision goes too far by presumptively awarding fees to the prevailing party. Although the amendment received strong vocal support by some Democrats on the committee, indicating that fee-shifting will continue to be a point of contention, it failed by a 10-22 vote. Johnson also introduced an amendment that would have excluded inventors from the fee-shifting provisions, but that amendment was also voted down.

Heightened pleading standards were also the subject of debate at the House mark-up. Rep. Peters (D-CA) introduced an amendment that would have exempted certain parties from having to comply with the standards set in the bill. Although the amendment was voted down, the issue was raised, as it was in the Senate, whether all parties, in particular individual inventors, should be subject to the same requirements as the actual patent trolls.

Abusive Patent Demand Letters

Also of note is an amendment introduced by Sen. Feinstein (D-CA) during the Senate mark-up that was passed and which relates to initial patent demand letters. It would forbid an initial demand letter from including a demand for a specific amount of money, which Sen. Feinstein likened to extortion. The only consequences, however, if a party sends such a letter are strictly related to any ensuing litigation. This does nothing to stem letters that demand specific amounts of money where the sender of the letter has no intention of litigating.

Finally, the end-user stay provision was not a major subject of debate during either mark-up.

The Upshot

The version of the PATENT Act that was voted out of Committee is likely to change at the very least in regards to post-grant proceedings, although these amendments will not be without their own controversy. Not all groups are on board with changing IPR proceedings to make it more difficult to invalidate patents, and see IPR proceedings as an important mechanism to invalidate weak or bad patents, which in their view are plentiful. Those same groups support most of the other provisions in the PATENT Act regarding heightened pleading standards, limits on discovery, early disclosures, as well as the fee-shifting provisions.

The debate during the mark-up of the Innovation Act made it clear that, in particular, the fee-shifting and heightened pleading standards, as well as any changes made to the IPR and PGR proceedings, will continue to be sources of

contention. The support by some on the House Judiciary Committee for the Senate language regarding fee-shifting may indicate that any final bill will not have the presumptive "loser-pays" language contained in the Innovation Act. It remains to be seen whether either bill can garner broad congressional support across the House and the Senate.

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