

Client Alert

November 20, 2013

For Whom the Bell Trolls, Episode II: The Judiciary Strikes Back

By **Scott F. Llewellyn, Wendy J. Ray and Rose S. Lee**

Patent reform legislation continues to be hotly debated, both in the public arena and before Congress. Federal Circuit Chief Judge Randall R. Rader recently said that Congress should leave reform to the courts, echoing comments by former Chief Judge of the Federal Circuit Paul Michel and Federal Circuit Judge Kathleen O'Malley. But business interests continue to press for action by Congress, consistent with efforts by the Executive branch and agencies to curb litigation abuse. While legislation continues to move forward (as summarized below), it remains unclear which (if any) of the proposals will be put to a vote, or in what form. Given the support of business, the Executive branch, various agencies, and various legislators, however, legislative action seems likely, notwithstanding the concerns expressed by the judiciary.

THE JUDICIARY WEIGHS IN

On November 1, during a keynote address to the Eastern District of Texas Bench Bar Conference, Chief Judge Rader urged Congress to refrain from passing legislation aimed at curbing litigation abuse by patent trolls. Judge Rader seemed to recognize that the patent system currently faces a crisis in confidence, driven in part by patent trolls attempting to obtain settlements based on the cost of defense, rather than the merits. Judge Rader nonetheless indicated that he does not support a legislative solution, instead believing that judges are best-equipped to recognize and address litigation abuse. Judge Rader identified three ways in which the courts can address litigation abuse: (1) increased use of summary judgment to dispose of meritless cases; (2) increased discretion for district judges to determine which cases are "exceptional" and thus warrant an award of fees; and (3) decreased litigation costs, which provide the leverage for much litigation abuse.

A transcript of Judge Rader's speech is available at:

<http://www.fedcirbar.org/olc/filelib/LVFC/cpages/9008/Library/Rader%202013%20ED%20Tex%20BB%20Speech.pdf>

Judge Rader's statements are consistent with opinions recently expressed by other members of the judiciary, including Judge Michel and Judge O'Malley. On October 9, Judge Michel asserted that "Congress can't micromanage litigation effectively," and expressed concerns that many of the proposed litigation reforms would weaken the patent system and interfere with judicial discretion. He reiterated his concerns early this week during his keynote speech at Fordham Law School's IP Summit, urging lawyers to speak out to stop the proposed bills from becoming law and expressing support "for smart patent reform by litigators who understand how the patent system works, not by congressional staffers and lobbyists." A few months earlier, on September 17, Judge O'Malley had gone even further, asserting that the proposed legislation could violate the constitutional separation of powers, by encroaching on the authority of judges to manage their dockets. Just days ago (on November 19),

Client Alert

two Democratic members of the House Judiciary Committee (Representatives Conyers and Watt) expressed similar concerns, stating that they opposed legislation that would “encroach on the independence of the federal judiciary.”

A transcript of Judge O'Malley's speech is available at:

<http://www.ipo.org/wp-content/uploads/2013/02/IPO-Annual-Meeting-Keynote-Speech-09-17-13.pdf>

BUSINESS WEIGHS IN

Despite the concerns expressed by the judiciary, various venture capitalists and businesses continue to lobby for legislation. For example, in a November 6 letter to Congress, venture capitalists endorsed several measures to protect startups from frivolous lawsuits, including (1) limiting the scope of discovery to prevent patent assertion entities from using litigation costs to leverage settlements; (2) requiring plaintiffs to pay defendants legal fees in connection with baseless suits; and (3) tightening pleading requirements for patent complaints. Similarly, during a Senate Commerce Committee hearing on November 7, venture capitalists called for rules requiring patent licensing demand letters to include more information about how the patents-at-issue are allegedly infringed.

Like these venture capitalists, a broad coalition of businesses (including Amazon and Google) supports patent legislation reform. In a July 30 letter, the coalition urged Congress to expand the Covered Business Method (CBM) program of the America Invents Act (AIA) to include all business method patents, rather than just those related to financial services, thereby increasing the number of patents subject to additional review by the U.S. Patent and Trademark Office (PTO).

Not all businesses, however, support reform. For example, some companies with a large number of patents (such as IBM and Qualcomm) have expressed concerns regarding legislative proposals that might make it easier to invalidate patents held by entities that are not patent trolls or otherwise engaged in litigation abuse.

AGENCIES WEIGH IN

The PTO's Acting Director, Teresa Stanek Rea, has expressed support for patent reform legislation that would (1) make patent ownership information more transparent; (2) allow courts to award attorneys' fees in “exceptional” cases; and (3) expand the AIA's CBM program. And the Federal Trade Commission (FTC) announced on September 27 that, to help combat litigation abuse, it will begin an investigation of patent trolls. The probe will include the issuance of subpoenas to twenty-five patent assertion entities seeking data about their operations, to develop a better understanding of how patent assertion entities impact innovation and competition.

CURRENT LEGISLATIVE PROPOSALS

Since our last survey of legislative proposals and related developments (available at:

<http://www.mofo.com/files/Uploads/Images/130612-Summary-Patent-Initiatives.pdf>), several new patent reform bills have been introduced, including the Patent Transparency and Improvement Act of 2013 (S. 1720), the Patent Litigation Integrity Act (S. 1612), the Innovation Act (H.R. 3309), the Stopping the Offensive Use of Patents Act (H.R. 2766), the Lawsuit Abuse Reduction Act of 2013 (H.R. 2655), and the Patent Litigation and Innovation Act (H.R. 2639).

Client Alert

1. The Patent Transparency and Improvement Act of 2013 (S. 1720)

- **Introduced:** November 18, 2013, in the Senate Judiciary Committee by Senate Judiciary Chairman Patrick Leahy (D-VT).
- **Key provisions:**
 - **Real party-in-interest.** Provisions in the bill would require disclosure of real party-in-interest information in litigation and to the PTO within three months after assignment.
 - **Customer suits.** The bill allows patent infringement suits against customers to be stayed while the manufacturer litigates.
 - **Post-grant review.** The bill eliminates the AIA provision barring a post-grant-review petitioner from later asserting in a civil action that a claim is invalid on any ground that the petitioner “reasonably could have raised” during post-grant review. The bill also requires the PTO to use district-court claim construction in post-grant review and *inter partes* review proceedings.
 - **Bad-faith demand letters.** The bill defines the sending of fraudulent or materially misleading demand letters in connection with the assertion of a patent as an unfair and deceptive trade practice under Section 5 of the Federal Trade Commission Act.
 - **Double patenting.** The bill codifies the doctrine of double patenting for first-inventor-to-file patents.
 - **Bankruptcy protection.** Provisions in the bill bar a bankruptcy trustee from terminating certain licenses, and hold the bankruptcy trustee to any contractual obligation to monitor and control the quality of a licensed product or service. Provisions also add trademarks to the definition of “intellectual property” in Title 11 of the Bankruptcy Code.
- **Status:** The Patent Transparency and Improvement Act of 2013 is currently in the Senate Judiciary Committee. It is co-sponsored by Senators Mike Lee (R-UT) and Sheldon Whitehouse (D-RI). The White House has also signaled its support for the Senate legislation. Gene Sperling, director of President Obama’s National Economic Council, stated on November 18, 2013 that the bill is “a big step in the right direction.”
- **Available at:** <http://www.leahy.senate.gov/download/patent-transparency-and-improvements-act-of-2013>

2. The Patent Litigation Integrity Act (S. 1612)

- **Introduced:** October 30, 2013, in the Senate Judiciary Committee by Senator Orrin Hatch (R-UT).
- **Key provisions:** The stated purpose of the Patent Litigation Integrity Act is to lower economic incentives for bringing frivolous patent suits through fee-shifting.
 - **Attorneys’ fees.** Provisions in the bill would require courts to award attorneys’ fees to the prevailing party absent a showing that the non-prevailing party’s position was “substantially justified” or there

Client Alert

are special circumstances that would make an award unjust. The bill would also allow defendants to file a motion requiring plaintiffs to post bonds covering fee awards.

- **Status:** The Patent Litigation Integrity Act is currently in the Senate Judiciary Committee. It was read twice and referred to the Senate Committee on October 30, 2013.

- **Available at:** <http://www.gpo.gov/fdsys/pkg/BILLS-113s1612is/pdf/BILLS-113s1612is.pdf>

3. The Innovation Act (H.R. 3309)

- **Introduced:** October 23, 2013, by Representative Bob Goodlatte (R-VA), Chairman of the House Judiciary Committee. It was co-sponsored at introduction by Representatives Spencer Bachus (R-AL), Jason Chaffetz (R-UT), Howard Coble (R-NC), Peter DeFazio (D-OR), Anna Eshoo (D-CA), Blake Farenthold (R-TX), George Holding (R-NC), Zoe Lofgren (D-CA), Tom Marino (R-PA), and Lamar Smith (R-TX).
- **Key provisions:** The proposed bill combines a variety of proposed amendments to the U.S. Patent Act — several of which have been proposed in prior bills — into a comprehensive legislative proposal.
 - **Real party-in-interest.** Provisions in the bill require that parties asserting patents disclose to the court, the defendant, and the PTO all entities having a financial interest in the asserted patents, as well as the asserting party's ultimate parent company and any entity having enforcement rights on the patents. The bill also imposes an ongoing duty of disclosure to the PTO if changes to previously disclosed information occur.
 - **Discovery.** The bill seeks to limit discovery prior to *Markman* hearings to information relevant to claim construction, and includes provisions allowing judges to make additional rulings to stage discovery as they see fit. Parties would be required to pay their own document production costs, but parties requesting irrelevant materials would also have to pay the opposing party's production costs.
 - **Joinder.** The bill would change procedural joinder requirements to allow defendants to join any "interested party" to the case. "Interested party" is defined as any assignee, entity with a right to sublicense, or entity with a direct financial interest in the asserted patent. Exceptions include attorneys representing parties or entities with an equity interest but no influence over the action. The provisions also would not apply if the party to be joined is not subject to service of process, if joinder would deprive the court of subject matter jurisdiction, or if joinder would create improper venue.
 - **Customer suits.** Provisions in the bill seek to address the practice employed by some patent assertion entities of suing a product's end users for using an allegedly infringing product. When a manufacturer intervenes in a case, a court would be required to stay an action brought against an end user if certain requirements are met.
 - **Pleading.** The proposal would require all plaintiffs in patent suits to disclose which claims are being infringed, and to specify which products are allegedly infringing and on what grounds. It would also require a plaintiff to describe its principal business and demonstrate its right to assert the patent.

Client Alert

- **Attorneys' fees.** The bill would require courts to award attorneys' fees to the prevailing party absent a showing that the non-prevailing party's position and conduct were "substantially justified" or there are special circumstances making an award unjust. Fees would be recoverable from all parties having a financial interest in the suit, rather than only those parties with an ownership interest in the patent.
- **Covered business methods.** The AIA's CBM program permits parties charged with infringing a CBM patent to initiate a review proceeding at the PTO in which the validity of the patent may be challenged. Originally, the Innovation Act would have eliminated the program's current 2020 expiration date, and codified the Patent Trial and Appeals Board (PTAB) decision interpreting CBM patents to include those claiming inventions incidental to financial service. Representative Bob Goodlatte announced on November 18, however, that he would remove provisions to expand the AIA's CBM program.
- **Status:** The bill is currently in the House Judiciary Committee. Hearings were held on October 29, 2013, and the bill is set for a vote on November 20, 2013. House Judiciary Chairman Bob Goodlatte announced on November 18, 2013, that he will mark up the bill on November 20, 2013, and published a "manager's amendment" showing changes he will propose at markup. The most significant change in the manager's amendment is the removal of provisions to expand the AIA's transitional program for CBM patents.
- **Available at:** <http://judiciary.house.gov/news/2013/10232013%20%20Innovation%20Act.pdf>
- **Amendment available at:**
http://judiciary.house.gov/hearings/Markups%202013/mark_11202013/GOODLA_058_xml.pdf

4. The Stopping the Offensive Use of Patents Act (the STOP Act) (H.R. 2766)

- **Introduced:** July 22, 2013, by Representatives Darrell E. Issa (R-CA) and Judy Chu (D-CA).
- **Key provisions:**
 - **Covered business methods.** The purpose of the bill is to expand CBM Review at the PTO. The provisions relating to covered business methods are nearly identical to those in the Patent Quality Improvement Act (S. 866), discussed above.
- **Status:** The STOP Act was referred to the Subcommittee on Courts, Intellectual Property, and the Internet of the House Judiciary Committee on September 13, 2013. It is co-sponsored by Representatives Jared Huffman (D-CA), Betty McCollum (D-MN), and Jason Chaffetz (R-UT).
- **Available at:** <http://www.gpo.gov/fdsys/pkg/BILLS-113hr2766ih/pdf/BILLS-113hr2766ih.pdf>

Client Alert

5. Lawsuit Abuse Reduction Act of 2013 (H.R. 2655)

- **Introduced:** July 11, 2013, in the House Judiciary Committee by Representative Lamar Smith (R-TX).
- **Key provisions:** Although not a patent-specific bill, if enacted, the legislation could have a substantial impact on patent cases.
 - **Sanctions.** Provisions in the bill amend Federal Rule of Civil Procedure 11(c) by essentially making sanctions mandatory for violations of Rule 11(b) certifications. In addition, the amendment would mandate that any sanctions compensate reasonable expenses of the opposing party and permit additional monetary and non-monetary sanctions as appropriate.
- **Status:** The House of Representatives passed the Lawsuit Abuse Reduction Act of 2013 on November 14, 2013. The bill now moves to the Senate for considerations. It is co-sponsored by Representatives Jason Chaffetz (R-UT), Blake Farenthold (R-TX), Trent Franks (R-AZ), Bob Goodlatte (R-VA), George Holding (R-NC), Jim Jordan (R-OH), and Tom Marino (R-PA).
- **Available at:** <http://www.gpo.gov/fdsys/pkg/BILLS-113hr2655eh/pdf/BILLS-113hr2655eh.pdf>

6. Patent Litigation and Innovation Act (H.R. 2639)

- **Introduced:** June 10, 2013, in the House Judiciary Committee by Representative Hakeem Jeffries (D-NY).
- **Key provisions:**
 - **Real party-in-interest.** These requirements are similar to those proposed under the Innovation Act (H.R. 3309) and the Patent Abuse Reduction Act (S. 1013). The Patent Litigation and Innovation Act, however, does not require parties to disclose prior or pending litigation.
 - **Discovery.** The bill would allow courts to stay discovery until they have ruled on motions to dismiss, motions to transfer venue, and claim construction issues. The bill also allows courts to expand discovery in extraordinary circumstances.
 - **Customer suits.** This provision is similar to the one in the Innovation Act (H.R. 3309), discussed above. The principal distinction is that the Patent Litigation and Innovation Act covers not only consumers, but also entities that either resell or redistribute patented articles.
 - **Joinder.** This provision of the bill is similar to the joinder provision in the Innovation Act (H.R. 3309), discussed above, though it does not define the term “interested party.” It also requires parties to file a motion for joinder within 120 days of the first complaint, answer, or counterclaim.
 - **Sanctions.** Provisions in the bill provide patent litigation defendants with additional protection by making it easier for judges to award sanctions for abusive litigation. Judges would be required to apply greater scrutiny in their analyses under Rule 11 of the Federal Rules of Civil Procedure, and to include specific findings in the record as to abusive practices that take place during trial. The bill also

Client Alert

requires judges to enforce these sanctions against noncompliant attorneys and their respective clients.

- **Status:** The Patent Litigation and Innovation Act was referred to the Subcommittee on Courts, Intellectual Property, and the Internet of the House Judiciary Committee on September 13, 2013. It is co-sponsored by Representative Blake Farenthold (R-TX).
- **Available at:** <http://www.gpo.gov/fdsys/pkg/BILLS-113hr2639ih/pdf/BILLS-113hr2639ih.pdf>

7. The Patent Abuse Reduction Act (S. 1013)

- **Introduced:** May 22, 2013, in the Senate Judiciary Committee by Senator John Cornyn (R-TX).
- **Key provisions:** The legislation would make procedural changes to several aspects of patent litigation. Many of the proposed changes, including those related to real party-in-interest information, discovery, attorneys' fees, and joinder, have been incorporated in the Innovation Act (H.R. 3309).
- **Status:** The Patent Abuse Reduction Act was read twice and referred to the Senate Judiciary Committee on May 22, 2013. It is co-sponsored by Senator Charles Grassley (R-IA).
- **Available at:** <http://www.gpo.gov/fdsys/pkg/BILLS-113s1013is/pdf/BILLS-113s1013is.pdf>

8. The End Anonymous Patents Act (H.R. 2024)

- **Introduced:** May 16, 2013, by Representative Theodore E. Deutch (D-FL).
- **Key provisions:** The purpose of the bill is to add transparency to the patent system by requiring parties to report patent transfers and real party-in-interest information.
 - **Real party-in-interest.** The bill requires the Director of the PTO to develop regulations relating to the disclosure of each entity having the legal right to enforce a patent, its ultimate parent entity, and any entity having a controlling interest in the enforcement of a patent. Such disclosures would be required of patent applicants upon the issuance of a new patent, payment of maintenance fees, and transfer of existing patents.
- **Status:** The End Anonymous Patents Act was referred to the Subcommittee on Courts, Intellectual Property, and the Internet of the House Judiciary Committee on June 14, 2013.
- **Available at:** <http://www.gpo.gov/fdsys/pkg/BILLS-113hr2024ih/pdf/BILLS-113hr2024ih.pdf>

9. The Patent Quality Improvement Act (S. 866)

- **Introduced:** May 6, 2013, by Senator Charles E. Schumer (D-NY).

Client Alert

- **Key provisions:**

- **Covered business methods.** The bill amends the AIA by making permanent a temporary provision allowing the PTO to review a patent after it has been granted. It also expands the scope of covered business method patents eligible for post-grant review, from business method patents related to “financial services” to all business method patents.

- **Status:** The Patent Quality Improvement Act was read twice and referred to the Senate Judiciary Committee on May 6, 2013.

- **Available at:** <http://www.gpo.gov/fdsys/pkg/BILLS-113s866is/pdf/BILLS-113s866is.pdf>

10. The Saving High-Tech Innovators from Egregious Legal Disputes Act (the SHIELD Act) (H.R. 845)

- **Introduced:** August 1, 2012, by Representatives Peter DeFazio (D-OR) and Jason Chaffetz (R-UT). A second draft was introduced on February 27, 2013.

- **Key provisions:** The SHIELD Act focuses on fee shifting.

- **Attorneys’ fees.** The bill modifies the current fee-shifting provision, under which fee-shifting is limited to “exceptional” cases. It allows a defendant to file a motion to determine whether the plaintiff asserting a patent is an inventor or assignee of the asserted patent, a university or university-affiliated technology transfer association, or a party that has otherwise made a substantial investment in the patent. If the plaintiff is determined by the court not to meet one of these conditions, it must post bond in an amount calculated to cover the recovery of costs by the defendant.

- **Status:** The SHIELD Act was referred to the Subcommittee on Courts, Intellectual Property, and the Internet of the House Judiciary Committee on April 8, 2013. It is co-sponsored by Representatives Kerry Bentivolio (R-MI), Tim Walberg (R-MI), and Peter Welch (D-VT).

- **Available at:** <http://www.gpo.gov/fdsys/pkg/BILLS-113hr845ih/pdf/BILLS-113hr845ih.pdf>

11. White House Recommendations

On June 4, 2013, the White House outlined seven recommended legislative actions and issued five executive actions intended to “increase clarity and level the playing field for innovators.”

- Many of the legislative recommendations are already reflected in the proposed bills circulating in Congress, including:

- **Real party-in-interest.** The document recommends legislation that requires any party sending demand letters, filing an infringement suit, or seeking PTO review of a patent file, to update patent ownership information with the PTO. It also recommends legislation that enables the PTO or district courts to impose sanctions for noncompliance.

Client Alert

- **Demand letter disclosure.** The document recommends that legislative incentives be created to have patent demand letters filed publicly in a manner that is accessible to and searchable by the public.
- **Attorneys' fees.** The document recommends "providing district courts with more discretion to award attorney's fees under 35 U.S.C. 285 as a sanction for abusive court filings."
- **Customer suits.** The document recommends legislation protecting consumers and businesses from infringement suits for the use of "off-the-shelf" products. It also recommends that such suits be stayed when an infringement suit has been brought against the product manufacturer.
- **ITC standards.** The document recommends legislation adjusting the International Trade Commission (ITC) standard for obtaining an injunction to be consistent with the standard set by the Supreme Court in *eBay v. MercExchange*.
- **Covered business methods.** The document recommends expanding the AIA's CBM program to "include a broader category of computer-enabled patents and permit a wider range of challengers to petition for review of issued patents before the Patent Trial and Appeals Board (PTAB)."
- The executive actions differ significantly in their scope and the processes required for implementation. Of the five executive actions, four were tasked to the PTO. The PTO has posted a draft "2014–2018 Strategic Plan," which incorporates the Administration's executive actions, and is accepting comments and feedback until November 25, 2013.
 - **Making "real party-in-interest" the new default.** The PTO will begin a rulemaking process to require patent applicants and owners to designate the "ultimate parent entity" in control of the patent or application when they are involved in proceedings before the PTO.
 - **Tightening functional claiming.** The PTO will provide new targeted training to its examiners on scrutiny of functional claims and develop strategies to improve claim clarity, such as the use of glossaries in patent specifications to assist examiners in the software field. A Software Partnership Meeting will be held on December 5, 2013, to bring stakeholders together to share ideas, experiences, and insights, and to provide a forum for informal discussion of topics specific to the software community.
 - **Empowering downstream users.** The PTO will publish new education and outreach materials, including an accessible, plain-English website offering answers to common questions asked by those facing demands from a patent assertion entity.
 - **Expanding dedicated outreach and study.** The Department of Justice (DOJ), PTO, and FTC will expand their outreach efforts to stakeholders such as patent holders, research institutions, consumer advocates, public interest groups, and the general public. This will include holding events across the country to develop new ideas and consensus around updates to patent policies and laws. The PTO has already expanded its Edison Scholars Program to develop more robust data and research on issues bearing on abusive litigation.

Client Alert

- **Strengthen enforcement process of exclusion orders.** The U.S. Intellectual Property Enforcement Coordinator (IPEC) is launching an interagency review of existing procedures that Customs and Border Protection and the U.S. International Trade Commission use to evaluate the scope of exclusion orders and work to ensure the process and standards utilized during exclusion order enforcement. The IPEC is also working to ensure that the process and standards utilized during exclusion order enforcement activities are transparent, effective, and efficient. A request for public submissions was posted on June 20, 2013, and the comment period closed on July 21, 2013.
- **Available at:**
<http://www.whitehouse.gov/the-press-office/2013/06/04/fact-sheet-white-house-task-force-high-tech-patent-issues>

Contact:

Scott F. Llewellyn
(303) 592-2204
slllewellyn@mofo.com

About Morrison & Foerster:

We are Morrison & Foerster—a global firm of exceptional credentials. Our clients include some of the largest financial institutions, investment banks, Fortune 100, technology and life science companies. We've been included on *The American Lawyer's* A-List for 10 straight years, and *Fortune* named us one of the "100 Best Companies to Work For." Our lawyers are committed to achieving innovative and business-minded results for our clients, while preserving the differences that make us stronger. This is MoFo. Visit us at www.mofo.com.

Because of the generality of this update, the information provided herein may not be applicable in all situations and should not be acted upon without specific legal advice based on particular situations. Prior results do not guarantee a similar outcome.