An Examination of the Economics of the U.S. Patent System

The Consequences of Pending Legislation

and Proposed Alternatives

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Summary

The Patent Act of 1790 granted patents to "*he, she, or they*"[i] at a cost that even a pauper could afford.[ii] At a time when women and blacks could not own property, both could own patents… and both did. In 1809, Mary Kies became the first woman patentee for her invention related to weaving straw hats. In 1821, Thomas L. Jennings became the first black patentee by inventing a method of dry scouring clothes. During the 1800's, some 3,300 women invented and patented 4,196 inventions [iii] and many made their full living by licensing their inventions. The U.S. patent system leveled the field for all regardless of race, gender or economic status.

Largely because of broad-based participation and strong patent rights, [iv] the U.S. patent system has fueled the greatest economic expansion in the history of man, propelling America to lead the world in virtually every technology revolution, including the one we are in right now. Great inventors like Eli Whitney, Thomas Edison, Alexander Graham Bell, and others like Mary Kies and Thomas L. Jennings, inspired generations of inventors. The rich history of the U.S. patent system, the value to our economy, [1] and its promise to each of us is the heart and soul of America.

Today, the U.S. patent system is under a lethal legislative attack [v] encouraged by the lobbying and public relations efforts of large corporations. [vi] [vii] [viii] This attack is ostensibly directed at the problem of so-called "patent trolls" for the benefit of small businesses. [ix] [x] Incredibly, data supporting this legislation are fabricated and secret, and then false conclusions based on that data are repeated so often that it appears true. It is, however, not true.

Nonetheless, the anti-troll legislation currently rocketing through Congress will levy its damage on the patent system in general – disabling it for independent inventors and small businesses for the benefit of large corporations. The legislation will damage the investment qualities of patents, which will make it impossible for the large majority of independent inventors and small businesses to recover any value of a patent. If passed, current legislation will kill the patent system for most Americans.

To understand how this round of anti-troll legislation will cause such widespread damage, it is necessary to understand the economy of the U.S. patent system.

This paper is directed toward that understanding, along with understanding the so-called "patent troll" situation, and proposes legislation to fix the root of the problem.

[1] The national value of our collective patent assets was illustrated in Microsoft v. i4i. Amicus briefs. Some argued the economic losses to the economy might enter the trillions of dollars and disrupt capital markets.

What is a productive patent system?

A productive patent system has two parts. First, it encourages an inventor to publicly disclose an invention so others can build upon it. Second, it promotes adoption of the invention so that society can benefit.

To satisfy the first part, disclosure, the inventor's contribution to society is returned with an *Exclusive Right* to the invention, which is the right to exclude others from making, using, importing or selling the inventions, for a short period. A patent is nothing but an *Exclusive Right* granted to an inventor traded for the public disclosure for the invention.

The second part, adoption, is made possible by the *Exclusive Right* as applied to our free-market economy. The *Exclusive Right* enables the inventor to secure a return on the investment and hard work expended on an invention that is proportional to its market value; by keeping would-be competitors at bay, the inventor is able to secure a toehold in the market. While some argue that this is monopolistic and anti-free market, the invention did not publicly exist at the time the inventor disclosed it. The inventor took nothing from society in trade for the *Exclusive Right*, and had the inventor not disclosed it, society would recognize no loss except for the lost opportunity of the invention. However, because the inventor disclosed it, society recognizes a gain; society can access an invention and build upon it, thus expanding innovation and the economy. Notably, a second gain is recognized when the *Exclusive Right* expires and society owns the invention.

Millions of dollars may be needed to bring an invention to market. As discussed previously, one positive result of the U.S. patent system is broad-based participation that encourages everyday people to disclose inventions. However, most everyday people do not have a lot of money. So to build a company based on an invention, most inventors need to attract capital investment.

Investors manage their risk so that they get a return on their investment, hopefully at a profit. To determine the probability of that return, a company's financials and assets are analyzed. Assets serve as a floor for losses as assets can be sold in the event the company fails. An inventor starting a company based on an invention may only have a patent. Therefore, a patent must be capable of attracting capital investment; it must be an investment grade asset.

While the U.S. Constitution wisely secures the *Exclusive Right,* that alone is not enough to make it an investment grade asset. A patent is an intangible asset. It is an idea that has been reduced to practice and publicly disclosed. In other words, the invention disclosed in a patent can be built just by reading and understanding the patent. Unsurprisingly, a patented invention can be easily copied and brought to market by someone other than the inventor. Doing so would be in conflict

with the Constitution, but Congress writes the laws that support the Constitution, and the courts uphold the laws as written by Congress. Law itself must support the *Exclusive Right* of a patent.

Any asset capable of investment must be valid on its face; it must be well-known that its rights will be upheld in court. For example, the deed to your house gives you the sole right to your house and courts protect that right. If laws did not clearly grant you the sole right to your house or if the courts did not uphold those laws, no bank would lend against it because you could lose ownership of the house and the bank would lose their security interest. Patents work the same way as other asset. Law must grant a patent its *Exclusive Right* and the courts must uphold that right. This is called the *Presumption of Validity*. Without a *Presumption of Validity*, a patent is merely a publicly disclosed invention that may or may not be valid, which will not attract investment. [2]

Any asset put up as security against a loan must be capable of transferring ownership in the event a loan against it is not repaid. For example, no bank will loan money against your house if they cannot take possession of it if you do not pay them. It is the same for patents. Few investors will invest in a patent if its ownership cannot be transferred to the investor.

Just transferring ownership is not enough. It must also transfer all of the patent's capabilities (*Presumption of Validity* and *Exclusive Right)*. Imagine if you sell your house to someone and that person cannot use the kitchen, it would obviously not be worth as much to the new owner as it was to you. If the bank repossessed your house, it would not be able recover the debt because the next buyer would not pay as much as you did. Banks value assets on the value that will exist after you – not the value that exists when you owned it. Patents work the same way and law must allow transfer of all capabilities to any subsequent owner.

If an inventor accepts investment, uses that money to build a practicing company, and fails, [3] the investor will likely take ownership of the patent. [4] However, the investor is not likely to practice

[2] Recently the *Exclusive Right* has been eliminated and the *Presumption of Validity* has been severely damaged as will be discussed later in this paper.

[3] One major reason practicing companies fail is that better-positioned companies take the market for an invention and saturate it with infringing products. Investors in the failed company may end up owning the patents, which may be used to recoup losses by selling or licensing the patent to the infringing companies. This indirectly supports valuations of all patent-based start-ups.

[4] Many inventions are ahead of their time. If significant market adoption occurs, it often occurs years after the invention was patented; sometimes long after the doors of the startup company closed. Consider the 1968 inventor who presented the first automatic credit card payment machine to the CEO of Standard Oil: He replied, "That's a clever machine, but people will never pump their own gas." Patents provide the possibility for early stage investors to recover some of their lost investment by licensing the patents. This ability to recoup lost investment encourages investment in early stage companies. In the example here, Howard Hughes and the inventor he funded never made a return.

the invention. After all, investors do what they do best, they invest money – they do not run product companies. The investor then becomes what is now called a "patent troll." As previously discussed, an investor will only value a patent at the value that they receive. If law only grants a portion of the rights enjoyed by the inventor to a "patent troll", investors will only invest based on the rights awarded to the "patent troll". If patent rights are degraded for the investor (aka "patent troll"), a patent could become valueless to the inventor. [5]

It is important to understand that for independent inventors to attract capital investment and start new companies, law must ensure that all capabilities are the same for any subsequent owner regardless of whether or not the invention is practiced and regardless of who owns the patent.

The term "intellectual property" was first used in the mid 1700's. The Founders viewed patent rights just like property rights [xi] and understood that independent inventors and investors must rely on predictable rules for transferring and enforcing a patent. To encourage investment in intellectual property, they enshrined the *Exclusive Right* in Article 1, Section 8 of the Constitution. Congress followed up in the Patent Act of 1790 by providing strong laws protecting the *Exclusive Right* and establishing a strong *Presumption of Validity* for patents. The courts then upheld these laws, [xii] which created a patent with a defined and durable value that investors and competitors would desire. Congress created an investment grade asset. [xiii]

The creation of the investment grade patent is the true genius of the U.S. patent system. [xiv] A U.S. patent, standing on its own can be bought and sold like any other asset. A free market emerged around patents, which enabled independent inventors to attract capital so they can build businesses and protect their inventions. The adoption of a patent asset into our free market economy fueled the overall economy, creating jobs and dynamically expanding innovation. [xv] The U.S. patent economy is a marriage of independent inventors and capital with a patent pulling the two together. [6]

[5] Currently, Congress is contemplating granting different patent rights to inventors than they grant to subsequent owners. Provisions in various bills like loser-pay, bonding, joinder, and others apply to investors but do not apply to inventors. An investor must consider the value that the patent would grant to them – not the value that the patent would grant to the inventor – so these provisions have the unintended consequence of affecting the inventor in the same way as it affects the investor. Any law must consider the downstream effects on the investment grade value of a patent.

[6] In our "knowledge economy" there exists already innovation to remove the market inefficiencies. For example, James E. Malackowski of Ocean Tomo, LLC, developed open patent auctions where anyone could bid on patents. Malackowski is now exploring a patent rights exchange. The exchange would serve the secondary market to permit undersold producers to sell unused rights to more successful producers in need of additional rights. Ideas like these will ultimately solve the "patent troll" situation better than legislation, which damages the asset value and kills inventors.

Weakening patent rights weakens the patent economy by reducing investment in patents and thus weakens the overall economy. If weakened enough, the patent economy will collapse and with it the U.S. patent system, dealing severe damage to the overall economy.

This is shown to be true historically. Where patent rights are uncertain, expensive, driven by class hierarchy, or otherwise weak, which were the hallmarks of patent systems prior to the U.S. patent system, [xvi] a patent is often too expensive to obtain and too risky enforce. Thus, it is incapable of attracting capital investment.

If a patent cannot attract capital, it cannot be practiced or protected, and therefore, cannot return value to the inventor. Few independent inventors will expend the exceptional levels of time and money required to get a patent if there is no reasonable chance of return on that investment. [7]

This all boils down to one thing – the strength of a patent asset. Weak patent rights create a perverse incentive to secret inventions or ignore them altogether, which hobbles innovation, slows job growth, and harms the economy. In contrast, strong patent rights foster more and more inventions that attract investment, start companies and fuel economic growth. [8]

It is important to recognize that virtually all patent laws passed by Congress in first 221-years of U.S. patent system supported strong patent rights until the America Invents Act (AIA) of 2011, which weakened patent rights. [9]

Unfortunately, Congress is set to pass another patent weakening law.

What's wrong with the "patent troll" argument and the data supporting it?

Some characterize "patent trolls" as rich investors who hijack [xvii] patents from inventors. Then, while providing no product and therefore no societal value, these "patent trolls" are viewed as extorting billions of dollars from small businesses and threatening R&D-related value creation

[7] The current disruption of settled expectations – sharing an invention in exchange for an *Exclusive Right* – has caused widespread questioning of the most sensible path and the best options remaining for the world's talented inventors to be fairly compensated for their contributions. European experiments have already proven that science medals do not accomplish the same thing, and if the psychological and legal contract is further breached with America's inventors, innovation will indeed be stifled.
http://en.wikipedia.org/wiki/Prizes_as_an_alternative_to_patents

[8] The simple proof lies in the reading of forward citations. A core invention spawns a host of related inventions. Later inventions are built on top former inventions. Typically, the later inventions cite former invention in its patent and other documents. These citations are referred to as forward citations. Forward citations show the trail of invention and that everyone, from inventors to large corporations, profits from a publicly disclosed invention by building upon it.

[9] The negative effects of the America Invents Act are discussed throughout this document.

based on the patent. [xviii] [xix] Others describe "patent trolls" as lying in wait for the market to develop on an invention, and then they sneak up and attack unsuspecting infringers. [xx] Confusingly, some even assert pejoratively that "patent trolls" actually invent new technologies themselves and then they patent it. [xxi]

Incredibly, the figures supporting this characterization are false and unprovable. The underlying data, and conclusions based on that data, come from biased sources with vested interests in a weak patent system. [xxii] Worse, the underlying data is secreted [10] [11] making it impossible for others to verify the findings. [xxiii] For example, one widely publicized report attacking the quality of patents owned by "patent trolls" states that ~90% of cases brought by "patent trolls" lose when brought to court. [xxiv] This report is highly disputed with contrary evidence showing virtually no difference between "patent troll" owned patents and all others. [xxv] Another report attacking the societal cost of "patent trolls" states that the "direct accrued costs" of "patent trolls" was $29B in 2011 and that this is somehow a bad thing. [xxvi] This report is frequently cited despite that "direct accrued cost" actually represents perfectly legitimate and often voluntary licenses paid to patent holders for the use of their patented technologies. [xxvii] Yet another report states that the cost to our economy is $84B. [xxviii] This report cynically measures stock price drops during the five-day period after a company is sued for infringement and then adds it all up to equal $84B. Curiously, the report considers no other market factors and fails to add back stock price gains after the suit is finished even though some gains were larger than the initial loss. [xxix] In a widely used and misleading report, the number of lawsuits filed by so-called "patent trolls" has more than doubled from 29% to 62% since 2011. [xxx] The actual increase is near zero; the cited numerical increase is a direct result of rule changes in the America Invents Act (AIA) that forced suits against multiple infringers to be filed separately. [xxxi] In other words, the AIA forced the most compelling statistic supporting the anti-troll legislation – case count – to move significantly up, thereby creating a false basis supporting the latest round of anti-troll legislation.

It is important to note that all reports where the underlying data is made publicly available contradict the reports where data is secreted. The truth is, even if there is a real problem with a few people abusing the system, the economic impact is far lower than claimed and is no different than has been the case for over 200 years. [xxxii] The risk associated with such misconceptions is

[10] RPX is the source of much of the secreted data. RPX provides a defensive portfolio that is licensed by companies so that if a practicing company sues them for infringement, RPX will counter sue the plaintiff for infringement. Inventors are directly in competition with RPX's business model because they cannot be counter sued for patent infringement, thus RPX reaps rich rewards if inventors are eliminated.

[11] Another secreted source of data is Patent Freedom, which is fully committed to perpetuating the fiction of "patent trolls" profiting from consulting to infringing companies about "patent trolls."

that the proposed legislation is fixing a problem that does not exist and may well kill independent inventors and small patent-based businesses. [12]

In an echo chamber that silences criticism, [13] lobbyists, the media, and politicians repeat these fabricated numbers as if they are true. The danger is that a falsehood repeated enough times, will become a credible perception of truth, as has apparently become the case.

The sardonic definitions used to describe "patent trolls" actually identify independent inventors, universities, small patent-based businesses, practicing companies and other legitimate patent holders who legally and rightfully enforce their hard-earned patent rights. [xxxiii] [xxxiv] [xxxv] [xxxvi] [xxxvii] [xxxviii] [xxxix]

As will become apparent in this document, the anti-troll legislation, while targeted at perceived bad actors, will damage the U.S. patent system in general and fully disable it for independent inventors and small businesses – the very people this legislation and US patent system purports to help. Curiously, large corporations will still be able to enforce their patents against smaller competitors.

Some have observed that perhaps the unintended consequences are intended.

What's wrong with the current U.S. patent system?

Over the last decade, our government has damaged patents in several critical ways.

- The *Exclusive Right* was eliminated by the Supreme Court in *eBay v. MercExchange.* The result is that a patent holder cannot exclude others from the invention because injunctive relief is now highly restricted. Injunctive relief is a primary reason that potential infringers would license a patent before they build products on it. Why invest potentially millions of dollars if you can lose the whole thing later? Without the *Exclusive Right*, better positioned companies build products with no concern for patent rights and then saturate the market with infringing products. Once the market is saturated, a patent that is incapable of injunctive relief is also incapable of attracting investment to practice the invention. Why

[12] Indeed, the across the board imposition of Sarbanes-Oxley regulations seemed like a great idea at the time and was passed unanimously. The intended result of reducing financial fraud was barely curbed, but businesses, particularly smaller ones, faced mountains of paperwork and skyrocketing accounting costs and IPO activity moved offshore. http://en.wikipedia.org/wiki/Sarbanes%E2%80%93Oxley_Act#Criticism

[13] Attorneys who believe deeply in the patent system and its laws, are muted by their high paying corporate anti-troll clients while others have left large firms to preserve their values and professional practice preferences.

invest in a start-up company with no real patent protection to compete in a saturated market? If they steal it, they keep it.

Without the *Exclusive Right*, arbitrary forced licenses are the primary remedy. Thus, a patent becomes an asset of arbitrary value, which severely damages its ability to attract investment.

Thus, without the *Exclusive Right*, an infringer finds it economically advantageous to steal the invention, take the market and then litigate the inventor into oblivion or into capitulation with an arbitrary settlement. Indeed, attorneys advise their infringing clients to do exactly that. [xl]

- The Supreme Court weakened the *Presumption of Validity* in both KSR v. Teleflex and Bilski v Kappos. Both of these decisions increase the risk that a patent can be invalidated. Then, the AIA added new Post-Issuance Procedures (PIP). Prior to the AIA, the only path to invalidate a patent was through the courts by showing clear and convincing evidence of a failure to meet statutory requirements of patentability with the burden of proof placed on the party seeking to invalidate the patent. Even though a patent is presumed valid in black letter law, a PIP presumes a patent invalid (as opposed to valid). This is because a PIP uses the administrative branch of government to validate (as opposed to invalidate) the patent with the burden of proof placed on the inventor who must again prove the patent valid. The lowest level of evidence - more likely than not – is all that is required to initiate a PIP.

  PIP's turn the *Presumption of Validity* on its head [14] by using dissimilar standards of evidence, conflicting methods of review, opposite burdens of proof and different branches of government. PIP's presume *invalidity*, which severely devalues a patent because infringers have incentive to litigate until the patent holder proves validity once again. [xli]

- The AIA forced patent suits against similarly situated infringers to be filed separately. [15] Independent of that, courts sometimes reassign patent cases to jurisdictions closest to the infringer. When taken together, each of those separately filed cases can be reassigned to different geographically dispersed courts. This radically increases risk for the inventor

[14] SAP v. Versata is a classic example of the PGR problem. Versata sued SAP for infringement. The court determined that Versata's patent was valid and infringed, and damages were awarded; Versata won. During the case, SAP filed for PGR with the USPTO. After the case was won by Versata, the USPTO invalidated Versata's patent. Two coequal branches of government using different standards came to opposite rulings on the validity of the same patent. This creates enormous uncertainty in the patent system.

[15] As previously discussed, this change from the AIA causing suits that were filed in a single suit to be filed separately has created the single most compelling statistic in support of patent reform – case count – to go up. When this statistic is normalized to the pre-AIA case filing, there is no change in the number of cases filed by so-called "patent trolls".

because it opens the very real possibility of managing dozens of suits in multiple jurisdictions each requiring local counsel and each with potential to produce conflicting decisions on the validity of the patent.

This increase in risk severely damages the investment qualities of a patent.

- A patent can take ten or more years of examination at the United States Patent and Trademark Office (USPTO) before it is allowed, and present patent terms begin on the filing date and end 20 years later. [16] In one extreme case, a patent application has been in examination for almost forty years. [xlii] This extraordinarily long delay creates incentive for potential infringers to strip inventions right from the USPTO website, incorporate the inventions into the company's current product offerings and saturate the market long before an inventor has an enforceable asset. Careers are made in less time. Startup companies go public in less time. Once the market is saturated, it is often impossible to leverage the patent to retake the market.

  Underfunding of the USPTO by transferring its earned fees to the general fund creates long examination delays and produces poor quality patents. Both increase incentives to infringe.

When you add all this up, potential infringers have strong incentives to steal patented inventions, massively commercialize them, and then, if they are caught, litigate the inventor into oblivion or capitulation. [xliii] Most corporations are well capitalized and set up for litigation. Independent inventors are neither.

The deck is severely stacked against the inventor patent holder and these risks act together to inhibit investment in patented technologies at any stage. *Without investors, independent inventors cannot build companies and recover losses from infringement.*

Why do so-called "patent trolls" even exist?

Today, patent rights are the weakest they have ever been in the 224 years of our patent system. Because of the loss of the *Exclusive Right*, the new presumption of *invalidity* and the extremely high cost of litigating a patent law suit, patents are often sold to wealthy investors who specialize in converting patents into cash – the so called "patent trolls". [17]

[16] Patent applications (except national security inventions) are open to the public after 18 months regardless of examination status.

[17] The legal systems of many countries do not impose the burden of litigation on the patent holder; for example, China, while widely criticized for not respecting intellectual property rights, operates a government

As previously discussed, the claim is that "patent trolls" are a problem and they need to be addressed. However, a recent GAO report required by the AIA [xliv] [xlv] shows there is no "patent troll" problem in the first place. It is fiction [xlvi] created by large corporations [xlvii] who suffer the consequences of infringement and wish to steal inventions without such consequences; by patent aggregators like RPX [xlviii] who will receive a windfall of profits if independent inventors are eliminated; and by lobbyists like the Electronic Frontier Foundation [xlix] and Patent Freedom [l] who are paid incredible sums of money to maximize the fabricated "patent troll" problem.

One repeated argument supporting the existence of a "patent trolls" problem is that "patent trolls" attack defenseless small businesses. The allegation is that a "patent troll" somehow believes the patent is probably not valid, but an unsophisticated small business cannot afford to fight and will settle anyway, so they send demand letters threatening litigation to extract easy money from defenseless targets. On the surface, it sounds plausible, but the truth is far different.

While there may be some bad actors, there are few, if any, known nefarious cases. [18] The larger truth is that when a small business is sent a demand letter, the patent holder believes that business is infringing on a valid patent. [li] [19] Demand letters provide a means to settle infringement disputes without litigation thereby lowering cost and speeding the process for everyone. Notably, they do so with inherent risk for the patent holder. Any recipient of a demand letter can file a declaratory judgment of non-infringement and invalidity in their local federal court if they believe that they have been unjustly accused. This is a major drawback for the patent holder because they risk having many actual court cases in multiple courts and if they lose on validity on any one of those cases, they lose the patent altogether.

To understand the current situation, it is necessary to understand how patent holders react in an extreme high-risk environment. As previously discussed, the courts and the AIA have seriously weakened both the *Exclusive Right* and the *Presumption of Validity*. There are multiple ways to

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office to address infringement and pirating. The patent holder brings the patent and a sample of the alleged infringing product to this "bureau" and the government takes over, applying often severe remedies if it determines the infringing product is in the claimed and patented invention. As such, the Chinese legal system has no need for independent funding sources to enforce rights.

[18] While the scanner-to-email patents owned by MPHJ are an infamous demand letter culprit, the demand letters are largely political theater used for election year positioning. The MPHJ demand letters have been found to be legal in federal court stopping the Nebraska AG from taking action against them. The New York AG approved new MPHJ demand letters that are substantially the same as demand letters actually sent by MPHJ. While it is likely that some nefarious demand letters exist, the vast majority are legal. The authors of this paper have been unable to identify a single nefarious demand letter (see footnote 17). We believe them to be only slightly more common than Unicorns and Big Foot.

[19] TrollingEffects.com consolidates demand letters, which can be read by anyone. These demand letters simply inform a potential infringer of possible infringement and ask to discuss the situation and avoid court.

invalidate a patent that lead to unending litigation. A loss in any of the multiple ways could kill the patent altogether and with it goes all of the investment and hard work that went into it. There is a very real high risk of total loss.

Naturally, patent holders are risk adverse. However, risk is not shared. Large corporations do not risk the loss of the business made possible by the invention since the *Exclusive Right* was judicially eliminated. And, because the *Presumption of Validity* has been degraded, they may only risk the cost of litigation and potentially a nuisance settlement.

Large corporations are well aware of this situation and are advised by their law firms to litigate until the patent holder capitulates and settles for the nuisance value of the suit [lii] – a far lower number than the invention's market value. As a result, large corporations often all but dare patent holders to sue them. Independent inventors often approach infringing companies in an attempt to sell or license their patents. An author of this paper has made contact via phone, email, third parties, certified mail, in person and through attorneys. Most did not respond and none would talk unless sued. Largely, infringers have no interest in purchasing or voluntarily licensing patents. None at all. [20] [liii] There is economic incentive to do nothing and then litigate.

For a patent holder, what remains is litigation with all of the associated risk. Determining the best patent litigation strategy centers on minimizing risk in a very high-risk environment. If you sue a large corporation, you will likely enter perpetual litigation with a high risk of invalidation. If you sue multiple midsized companies, you risk multiple suits in multiple jurisdictions hiring local counsel in each jurisdiction at very high cost, extreme complications, and significant risk of multiple conflicting decisions from different courts. However, if you sue smaller companies that risk drops and it may be the only remaining option.

While the authors disagree that there is a "patent troll" problem, if there one, it is best explained by how patent holders react to today's extreme high-risk environment of weakened patent rights by pursuing smaller businesses to manage that risk.

[20] It is undisputed that investors acquire some patents at IP auctions. However, these auctions are also open to the infringers. In fact, auctioneers have even gone to great lengths to permit silent "phone bank" bidding so infringers need not disclose their identities. After rejecting participation, these same infringers swarm Washington crying "patent troll" while pointing at the winning bidders. Rather than buy legitimate rights, infringers are simply asking legislators to render patents worthless.

Paradoxically, further weakening patent rights will cause more independent inventors to sell to patent licensing companies, who may be forced to pursue small businesses to manage an even higher risk environment. [21] [liv]

What's wrong with the current proposed legislation?

It is no surprise that none of the provisions in any of the current legislation (HR 3309 and the Senate bills) are directed to even attempt to fix the fabricated problem of "patent trolls". Instead, the considerable damage is curiously levied on the patent system in general and independent inventors and small businesses specifically.

- **Patent Term Adjustment**. HR 3309 and other bills would eliminate any patent term adjustment for a delay created by the USPTO (a request for continued examination (RCE) or an appeal). This provision would unfairly reduce the patent term of a large number of issued and pending patents – some by a decade or more, and a few would be eliminated altogether.
- **Shrinking Post Grant Review (PGR) Estoppel**. (A PGR is one of the PIPs created in the AIA) The purported purpose of a PGR is to decrease the cost of litigation and to speed the process for both parties. Under the current law, a PGR prohibits the petitioner from later arguing "*any ground that the petitioner raised <u>or reasonably could have raised</u> during that post-grant review*." HR 3309 and other bills would strike "*<u>or reasonably could have raised</u>*." This will allow a petitioner to argue any ground that could have been raised, but was not, in other post issuance proceedings and/or in court, thereby allowing daisy-chained defenses adding massive unnecessary cost and further perpetuating litigation.[22] [23]

[21] The German market has a relatively cheap, efficient patent litigation system that, unlike the one in the US, offers all successful plaintiffs the possibility of an injunction. This makes patents of interest to buyers. "The difference with the US, though, is that because it is far less expensive to litigate in Germany, trolls are never going to find it a very attractive venue in which to operate. Thus, the market is only for what might be deemed "quality" patents." http://www.iam-magazine.com/blog/Detail.aspx?g=4f83debb-e9ef-4885-be69-78caf94a28dc

[22] While some argue that daisy-chained PGR's are not possible because the window to file a PGR is nine months from issuance of the patent, this is not true. Most inventors file a continuance when a patent issues to encompass multiple variations of the same invention. Often a continuation can issue in a year, so a new PGR can be filed every year. While some PGR decisions may not affect previous patents, some can take down the entire family.

[23] Moreover, like the AIA requirement to force separate filings against similar infringers, this approach demonstrates contempt for judicial economy and files in the face of long established legal principle. In any legal process, there is a time and place to "lay your cards on the table" and to waive future arguments. Giving defendants multiple bites at the apple violates sound legal principles and is particularly hostile to inventors.

- **Loser-Pay**. [24] Patent litigation is already very expensive, highly risky and skewed unfairly in the favor of the infringer. Loser-pay will eliminate patent protection for smaller inventions. This is because smaller inventions cannot generate enough revenue to balance the increased risk of potentially millions in additional legal costs if the patent holder loses. Smaller inventions make up the majority of inventions by independent inventors and small businesses. Because of the substantial risk of losing a patent lawsuit already (and if this legislation is passed, even higher risk), few will enforce their patents and those that do could risk their patents and their company, and as you will see in the next bullet, their personal assets as well. The risk of loser-pay to a large corporation is equivalent to a rounding error in the greater scheme of their financials.

  Another unintended consequence is damage to small business defendants. Under HR 3309 and other versions of Senate bills, a "reasonable" or "substantially justified" case does not trigger loser-pay provisions. In any patent infringement suit, the defendant can ask that the case be dismissed early in the suit. If the case is not dismissed and the defendant prevails, the defendant will have a difficult time explaining to the same judge why the plaintiff case was unreasonable or not justified. This acts to get the patent holder off the hook for loser pay early in the case, but the defendant is never off the hook. In fact, loser pay may very well harm the small businesses in which it is intended to help. For example, if a small business fights what they perceive as an unreasonable case and lose, they could very well have to pay the patent holder's legal fees. [25]

- **Collecting fees from non-plaintiffs.** HR 3309 and other bills have a provision adding to Loser-Pay that allows prevailing accused infringers to collect legal fees from non-plaintiffs who have an interest in the case (for example, investors). Few investors are willing to accept the risk of losing their personal assets in the event that the business fails, whether that business is patent related or otherwise. Not surprisingly, this provision is lethal to the investment value of patents.

[24] Proponents of loser-pay often argue that contingency attorneys are more likely to file unreasonable patent lawsuits. This is an unreasonable assumption. A contingency lawyer is only paid if the suit is successful; they do not get paid if the patent holder loses. Enforcing bad patents is bad business for contingency law firms.

[25] As is often discussed in the recent demand letter fiasco, small businesses have limited knowledge and experience in patent lawsuits and they are likely to hire their known and trusted local trial lawyers for defense against infringement suits often at their own peril.

As previously discussed, it takes both investors and independent inventors for the patent system to work. If it is lethal to investors, it is lethal to independent inventors; without both, the patent system will fail.

- **Bonding**. Some Senate bills include a bonding requirement for the patent holder, but not for the defendant. Because of the extreme high cost of patent litigation for both parties, the bonding requirement could add tens of thousands of dollars to the patent holder's cost putting may legitimate patent protection actions out of reach for many patent holders. It is worth noting that the bonding requirement only applies to the patent holder and not the accused infringer further unbalancing the playing field.
- **Enhanced Pleadings and Limited Discovery.** HR 3309 and other bills have a provision that dictates enhanced pleadings requiring that the plaintiff produce substantially more information, and a provision limiting discovery prior to claim construction. Patent suits are among the most complicated and detailed with a plethora of variables. The trial judge is the closest to the case and legislating how that judge manages the case will damage the trial judge's ability to bring a fair solution to both parties. What's more, both of these changes affect the inventor negatively and the infringer positively, thus stacking the deck even further against the inventor.

  In addition to litigating court procedure, enhanced pleadings will "result in delays in filing suit and additional costs, and initial disputes in litigation about the adequacy of the complaints would increase the costs of litigation." And, limited discovery will "delay resolution" to "disadvantage of patent owner" even with "meritorious claims" thus the "alleged infringer is incentivized to draw out" the claim construction ruling. [lv]

How do we fix the real problem?

To address the real problem, we must strengthen the investment value of patents – not weaken it as the proposed legislation intends to do. This will enable independent inventors to get the capital they need to practice and protect their inventions. It will return value to independent inventors for sharing their inventions so others can build upon it, thus driving innovation. It will dramatically cut litigation costs and time for all parties so that we can all get back to work and put our efforts into innovation just like we used to do. It will create much needed jobs and improve our economic competitiveness at home and abroad.

Four things must be done to fix the real problem in the U.S. Patent System:

- Reinstate the *Exclusive Right* guaranteed in the Constitution, black letter law and 224 years of precedent, which was judicially eliminated in *eBay v. MercExchange*.
- Eliminate all Post-Issuance Procedures (with the possible exception of ex-parte re-examination) to reinstate the presumption that a patent is valid.
- Allow patent lawsuits to be filed against multiple similarly situated infringers in one court and ensure that same court keeps the suits.
- Fully fund the PTO with all of the fees it earns so that it can do its job increasing patent quality and reducing pendency.
- Although not discussed previously in this document, eliminate the judicially created "*abstract idea*" category of subject matter eligibility and instead invalidate junk patents on the other statutory conditions of patentability like obviousness and anticipation. [26]

It is appalling that the U.S. patent system has become as weak as it has become. [lvi] [27] The U.S. patent system is a major part of the American story and American identity. It has enabled common people to compete on par with large corporations for the market created by an invention. It has propelled women and minorities to the highest social and economic levels in our society. It has driven the greatest economic engine ever devised by man.

The U.S. patent system is highly valued and loved by Americans and has been the very heart and soul of America for over 200 years. It must be protected.

If Congress makes even small changes damaging the value of patents any further while patents are as weak as they are now, there will be no patent system except that which remains for large corporations to attack smaller companies.

[26] The question of what subject matter is eligible to be patented has caused and is continuing to cause much confusion especially in software related patents. The problem is based on a judicially created category of "abstract idea." Defining an abstract idea has proven to be an abstract concept in itself, but then applying that abstract concept of an abstract idea to a particular technological advancement is highly subjective and has thrown subject matter eligibility into chaos. See CLS Bank v. Alice Corp where the Federal Circuit produced multiple definitions and theories, none of which are supported by a majority. Today, a subject matter eligibility determination is a crapshoot entirely dependent on which three judges are drawn on appeal.

[27] Heritage Foundation scholar Peter Schweitzer recently published a book featured on "60 Minutes" revealing how relatively small amounts invested in lobbying can influence multi-billion dollar legislation. Unfortunately, the bulk of the world's inventing falls upon relatively few shoulders. The benefited population takes the process largely for granted, generally unaware of whether the inventor gets his investment returned. In situations when very few are affected by changes to law, the outcome is particularly vulnerable to self-serving influences and thus it is left to the integrity and wisdom of lawmakers to do the right thing.

It is time we stand up to the moneyed multinationals and rebuild our national treasure.

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