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“Examining Recent Supreme Court Cases in the Patent Arena”

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Intellectual Property, and the Internet
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Chairman Issa, Ranking Member Nadler, and members of the Subcommittee.

My name is Andrew Pincus, and I am a partner in the law firm Mayer Brown LLP. I am honored to appear before the Subcommittee today.

A significant part of my law practice focuses on Supreme Court and appellate litigation, including patent litigation. I participated in most of the Supreme Court’s recent cases addressing patent issues. From 1997 to 2000, I served as the General Counsel of the United States Department of Commerce, where I was responsible for a number of intellectual property issues.

The Supreme Court’s increased focus on patent issues over the past few years has been dramatic. In the ten years from the October 2000 Term through the October 2009 Term, the Court decided 11 patent cases; in the five Terms ending this June the Court will resolve 18 patent cases. The Court’s increased attention to patent law is particularly noteworthy because the principal reason the Court grants review of statutory issues—the need to resolve conflicting decisions by different courts of appeals—can never arise in the patent context because of the exclusive jurisdiction exercised by the United States Court of Appeals for the Federal Circuit.

Why is the Supreme Court so concerned about patent law? Most likely because of a variety of factors:

- The increased importance of intellectual property in our knowledge-based economy;
- Changes in the nature of patent litigation—the increased cost of litigation and increased stakes; the assertion of claims by non-practicing entities; and clear evidence that the litigation system is being abused to coerce unjustified settlements;
- Concerns that judicially-created standards governing patent lawsuits are being exploited as a result of the changes in the nature of the litigation; and

- Significant evidence that the Federal Circuit’s approach in interpreting the Patent Act differs significantly from the statutory construction principles that the Supreme Court uses to determine the meaning of laws enacted by Congress.

The Supreme Court, of course, does not have free-floating policy authority to address concerns about the patent litigation system—its responsibility is to interpret the statutory text when an issue is brought before it. Some of the Court’s decisions have overturned Federal Circuit rulings that promoted abusive litigation. But other Supreme Court decisions have had the opposite effect, increasing the cost and complexity of patent cases. And the effect of some of the Court’s decisions remains uncertain.

Most importantly, the text of the Patent Act does not authorize the Court to address the principal factor producing abusive lawsuits: the ability of plaintiffs to inflict huge litigation costs on defendants, while the plaintiffs pay relatively little themselves, even when the underlying claim is meritless—which enables plaintiffs to coerce unjustified settlements. Congressional action is needed to address this critical flaw in the current litigation system.

I. The Problem Of Abusive Patent Litigation

Everyone recognizes that a robust patent litigation system is necessary to ensure that inventors can capture an appropriate share of the value created by their inventions. But a substantial portion of modern patent litigation has little to do with securing appropriate compensation for actual infringement of valid patents. Instead, these lawsuits are brought to extract a cash settlement—not to win at trial. The plaintiff will assert either a patent that is exceptionally weak (and thus likely to be invalidated during the course of litigation) or a tenuous theory of patent infringement unlikely to withstand scrutiny. Plaintiffs bring these suits because very large asymmetrical litigation costs create heavy incentives for defendants to capitulate and settle the lawsuit at a cost that is invariably less than what it would take to defend the action. Plaintiffs therefore have a substantial incentive to assert claims regardless of the underlying merits, because the merits are not likely to be litigated to conclusion, and the plaintiff is likely to obtain a settlement payment that provides a significant profit over and above its cost of litigating the case.

Certainly there can be no doubt that patent litigation is enormously expensive, and the costs are growing. A 2011 survey by the American Intellectual Property Law Association found that the median cost of a medium-sized patent litigation is approximately \$6 million dollars per party, double the cost reported in 2009 and four times the cost reported in 2001. Am. Intellectual Prop. Law Ass’n, Report of the Economic Survey 2011, at I-155 to I-156 (2011). These extraordinary expenses enable abusive litigation tactics. “[T]he greatest factor contributing to the existence of nuisance-value patent suits is the high cost of patent litigation.” Ranganath Sudarshan, *Nuisance-Value Patent Suits: An Economic Model and Proposal*, 25 Santa Clara Computer & High Tech. L.J. 159, 172 (2009).

The asymmetries in patent litigation costs have three basic causes: **weak pleading standards** that permit a plaintiff to file suit with minimal investigation and no developed theory

of infringement; essentially **one-direction discovery**—the defendant will be forced to shoulder enormous discovery requests, whereas a plaintiff will generally be obliged to provide little or no discovery; and a **low likelihood that a victorious defendant will be able to recover its litigation costs**—because the Patent Act’s fee-shifting provision maybe invoked only if a case is “exceptional” and because many plaintiffs would be unable to pay a fee award.

Asymmetrical discovery obligations. To begin with, the discovery costs in a patent dispute are massive and almost entirely one-sided. Abusive patent litigation is often brought by a shell corporation with no meaningful activities or assets other than the patents it asserts. And, in any event, a plaintiff’s records are generally irrelevant to infringement contentions. But, particularly in light of broadly-framed infringement complaints, a patent plaintiff will typically seek access to a wide range of the defendant’s product-development records, requiring a defendant to undertake time-consuming and costly searches through years of data. Unlike other types of litigation, moreover, dismissals in patent cases rarely occur prior to the *Markman* hearing, but pre-hearing discovery is often permitted and the *Markman* hearing itself inflicts costs on the defendant. This is exactly the kind of situation where “the threat of discovery expense will push cost-conscious defendants to settle even anemic cases before reaching those proceedings.” *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 559 (2007).

Weak pleading standards. These enormous discovery costs are compounded by existing Federal Circuit standards that permit a patent lawsuit to proceed with minimal allegations. The Supreme Court has held that “[t]o survive a motion to dismiss, a complaint must contain sufficient factual matter, accepted as true, to ‘state a claim to relief that is plausible on its face.’” *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009) (quoting *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570 (2007)). But the Federal Circuit expressly exempts patent suits from this pleading standard, holding that the patent plaintiff must allege only that it owns a patent and assert that the defendant is infringing that patent. No additional detail is required—such as *how* a defendant is infringing the patent, much less which particular patent claims are being asserted. As a result, plaintiffs can file meritless infringement suits in an effort to extract settlement value, and defendants have no ready recourse to a motion to dismiss for failure to state a claim—the tool that any other defendant would use in these circumstances.

No realistic possibility of fee-shifting. Lawyers representing patent plaintiffs often operate on contingency, requiring little or no up-front cost to the plaintiff, with the lawyer agreeing to share in any prospective recovery. Defendants, by contrast, must pay defense lawyers for their services on an ongoing basis. While Section 285 of the Patent Act permits a prevailing party to recover fees in “exceptional” cases, recent Supreme Court cases—which I discuss more fully below—make clear that a case is exceptional only if it is unusually weak. Moreover, because district courts now have substantial discretion to decide whether to award fees, district courts that signal a reluctance to shift fees will invariably attract greater proportions of future patent lawsuits from plaintiffs eager to avoid any risk of fee-shifting. Finally, even when a court does shift fees to a plaintiff, the shell-corporation structure of many abusive litigants precludes any meaningful recovery for the defendant. So long as the entity that owns the patent rights holds no other assets, patent plaintiffs can effectively render themselves judgment proof.

A recent White House report recognized that these asymmetries enable the filing of abusive claims. Patent owners may seek “to settle out of court for amounts that have not so much to do with the economic value of their patents or the probability that they have infringed;” rather, settlements are “affected more by the parties’ relative opportunity costs of going to trial and attitudes towards risk.” Executive Office of the President, *Patent Assertion & U.S. Innovation*, at 6 (2013), <http://tinyurl.com/lvk6ajl>. When parties face asymmetrical costs—such as when plaintiffs have lower costs than defendants—they may “have an incentive to drag out litigation, to increase pressure on defendants to settle the case.” *Id.*

At bottom, the result is clear: a rational defendant will—absent a reliable fee-shifting mechanism—agree to settle a suit *whenever* the settlement offer is less than the cost to defend against the suit. Thus, it is basic economics that *whenever* a plaintiff’s out-of-pocket expenses (i.e., the cost of acquiring the relevant patents, the filing fee, and cost of the plaintiff’s lawyer) are less than the likely cost of a defense, an economically rational plaintiff will file suit, and an economically rational defendant will settle. See David Rosenberg & Steven Shavell, *A Model in Which Suits Are Brought for Their Nuisance Value*, 5 Int’l R. of L. & Econ. 3 (1985); Sudarshan, 25 Santa Clara Computer & High Tech. L.J. at 161-169. The current asymmetries thus permit plaintiffs to effectuate naked wealth transfers under the guise of patent litigation.

The impact of patent lawsuits “on smaller startups is particularly acute.” *Patent Assertion & U.S. Innovation*, *supra*, at 10. One survey indicates that, over an approximately six-year period, roughly 66% of unique patent defendants are firms with annual revenue of less than \$100 million. Colleen V. Chien, *Startups & Patent Trolls*, Santa Clara Univ. Legal Studies Research Paper No. 09-12, at 1-2 (Sept. 28, 2012). Forty percent of companies sued represented that the lawsuit caused a “significant operational impact,” such as “delayed hiring or achievement of another milestone, change in the product, a pivot in business strategy, a shut-down business line or the entire business, and/or lost valuation.” *Id.* at 2. Commentators have thus noted that “small companies—not tech giants—are the predominant targets” in certain abusive lawsuits. Brian J. Love & James C. Yoon, *Expanding Patent Law’s Customer Suit Exception*, 93 B.U. L. Rev. 1605, 1611 (2013).

A recent survey of venture capitalists confirms this conclusion. Seventy percent of venture capitalists have portfolio companies that have received patent demands, and roughly one in three startup companies report receiving such demands. The overwhelming majority of venture capitalists and startup companies “report that patent demands had a significant impact on a company.” Robin Feldman, *Patent Demands & Startup Companies: The View from the Venture Capital Community*, at 2.

II. Recent Supreme Court Decisions

Some of the Court’s decisions in its last Term and during the Term now underway have eliminated legal rules that promoted abusive litigation. Yet other decisions—including an important decision this Term—will *increase* the cost of patent litigation, creating new opportunities for patent plaintiffs to extract settlements based on nothing more than the cost of defense that they can inflict simply by filing suit.

A. Steps by the Supreme Court that restore some balance to patent litigation.

In three different areas—standards for determining whether a patent is sufficiently definite, induced infringement, and so-called “divided” patent infringement—Supreme Court decisions will aid in deterring patent plaintiffs from employing certain abusive tactics.

Indefiniteness: *Nautilus*.

Section 112 of the Patent Act requires patent claims to, among other things, “particularly point[] out and distinctly claim[] the subject matter which the applicant regards as [the] invention.” A patent claim that fails to provide sufficient definiteness is invalid; for example, the claim may not specify a particular result without explaining the steps necessary to achieve that result.

The question in *Nautilus, Inc. v. Biosig Instruments, Inc.*, 134 S. Ct. 2120 (2014), was whether the Federal Circuit was correct in holding that a patent claim fails the definiteness requirement “only when it is ‘not amenable to construction’ or ‘insolubly ambiguous.’” This amorphous test significantly reduced the impact of the definiteness requirement by salvaging vague and highly ambiguous claims.

The Supreme Court rejected the Federal Circuit test, concluding instead that “a patent is invalid for indefiniteness if its claims, read in light of the specification delineating the patent, and the prosecution history, fail to inform, with reasonable certainty, those skilled in the art about the scope of the invention.” *Id.* at 2124. By providing the lower courts with an appropriate, more restrictive standard for definiteness under Section 112, the Supreme Court’s decision will enhance patent quality, an essential antidote to abusive patent litigation.

Induced Infringement: *Global-Tech Appliances*.

The Patent Act imposes liability on a person who induces another to infringe. 35 U.S.C. § 271(b). Inducement liability is important in a number of circumstances; it may, for example, provide a means to bring a patent infringement suit against manufacturers operating outside the United States, who sell products knowing that it will be used to infringe a patent within the United States. Inducement claims are also brought against companies that know their products will be used by customers in a way that infringes a patent. One common form of abusive patent claims is a lawsuit against the manufacturer of a component, asserting that the component supplier knew—or should have known—that its products would later be used by a *different* manufacturer in a way that infringes a patent.

It has long been established that an induced infringement claim requires a plaintiff to prove that a defendant acted with some degree of knowledge that its acts were inducing patent infringement. The Federal Circuit, however, had watered down this requirement, finding it sufficient for a plaintiff to demonstrate that a defendant was merely deliberately indifferent to the possibility of patent infringement.

In *Global-Tech Appliances, Inc. v. SEB S.A.*, 131 S. Ct. 2060, 2068 (2011), the Supreme Court reversed, holding that induced infringement turns on a showing that the defendant actually

knew “that the induced acts constitute patent infringement.” Absent such knowledge—or the legal equivalent, that a defendant engaged in affirmative conduct to willfully blind itself to the relevant facts—induced infringement is not available. This holding eliminates the ability of plaintiffs to assert tenuous inducement theories against multiple stages of a manufacturing chain.

Commil USA, LLC v. Cisco Systems, Inc., No. 13-896, currently pending at the Supreme Court, poses an important issue subsequent to *Global-Tech*: whether a defendant’s good-faith belief that a patent is invalid is a defense to patent infringement. Applying *Global-Tech*, the Federal Circuit held that such a good-faith belief *does* defeat the knowledge required for an induced infringement claim. But the federal government has taken the position that patent *validity* and patent *infringement* are two separate questions, meaning that a good-faith belief that a patent is invalid does *not* provide a defense to an induced infringement claim.

Affirming the result reached by the Federal Circuit—that a good-faith belief in invalidity *does* pose a defense to infringement—will aid in foreclosing low-merit, abusive patent suits. Indeed, what typically renders such lawsuits meritless is that the patent asserted is of exceptionally low quality. When a manufacturer has a reasonable basis to believe that a patent is invalid, it lacks the requisite knowledge that it is inducing others to infringe. If the Supreme Court were to agree with the government’s contrary submission, it would embolden those who assert patents of dubious validity.

“Divided” Infringement: *Limelight Networks*.

Last Term, in *Limelight Networks, Inc. v. Akamai Technologies, Inc.*, 134 S. Ct. 2111 (2014), the Court confronted a different question with respect to induced infringement—whether a party may be held liable for inducing infringement when no single party completed every step of a method patent necessary for *direct* patent infringement. The *en banc* Federal Circuit had concluded that a defendant could be liable for induced infringement pursuant to Section 271(b) so long as the defendant carried out some steps constituting a method patent and encouraged others to complete the remaining steps, even if no one person or entity would be liable as a direct infringer. This decision provided an incentive for plaintiffs to cobble together tenuous theories of patent infringement, asserting that multiple different parties joined together to infringe a single method. The Supreme Court rejected the Federal Circuit approach, however, concluding that induced infringement turns on a demonstration that *direct* infringement occurred.

Attorneys’ Fees: *Highmark & Octane*.

As mentioned above, Section 285 of the Patent Act provides that a court may require the losing party to pay the prevailing party’s attorneys’ fees only in an “exceptional” case. The Federal Circuit had interpreted the statute to mean that, absent unusual circumstances, a case could qualify as exceptional only if a defendant could show that a plaintiff brought a lawsuit in subjective bad faith *and* the litigation was objectively baseless.

In *Octane Fitness, LLC v. ICON Health & Fitness, Inc.*, 134 S. Ct. 1749, 1756 (2014), the Supreme Court held that this standard was too restrictive, concluding instead that a court must determine whether the case is one that “stands out from others with respect to the substantive strength of a party’s litigating position ... or the unreasonable manner in which the

case was litigated.” At the same time, the Court concluded in *Highmark Inc. v. Allcare Health Mgmt. Sys., Inc.*, 134 S. Ct. 1744, 1746 (2014), that the Federal Circuit must defer to a district court’s decision under Section 285, reviewing it only for abuse of discretion.

Octane and *Highmark* together give district courts more discretion to award fees. But the “exceptional” requirement in Section 285, the Supreme Court confirmed, means that fee shifting is an option only in a small minority of cases. A defendant deciding whether to settle or fight, therefore, cannot count on the availability of a mechanism to offset the plaintiff’s ability to inflict significant litigation costs on defendants—which is the key characteristic of patent litigation that plaintiffs exploit to coerce settlement. A rational defendant therefore is still likely to view settlement as the economically sensible option.

B. Decisions *increasing* litigation costs.

On the other hand, some decisions of the Supreme Court will have the effect of increasing the costs of patent litigation and thereby creating greater leverage for plaintiffs to unfairly extract nuisance-value settlements.

Claim Construction: *Teva Pharmaceuticals*.

A critical step in virtually every patent dispute is interpreting the meaning of the words used in patent claims—such “claim construction” will often control whether a patent is valid (such as whether it is novel and non-obvious), as well as whether the defendant infringes the patent claims. To construe a patent claim, a court may consider the language of the patent claims themselves, the patent’s specifications, and the prosecution record (all of which is referred to as “intrinsic” evidence) as well as certain “extrinsic” evidence, including expert testimony. Because claim construction is a task for a judge, it takes place following a so-called “*Markman* Hearing” at which the relevant evidence is put before the judge.

The Federal Circuit had long held that it reviews *all* aspects of claim construction *de novo*, including those “extrinsic” issues which turn on a resolution of factual disputes.

In *Teva Pharmaceuticals USA, Inc. v. Sandoz, Inc.*, 135 S. Ct. 831 (2015), the Supreme Court reversed, holding that Federal Rule of Civil Procedure 52(a)(6) requires a “clearly erroneous” standard of review with respect to such factual determinations by a district court. The Supreme Court seems to have been motivated, at least in part, by the Federal Circuit’s high reversal rate of claim construction orders.

Teva Pharmaceuticals may, however, have a significant consequence on litigation costs. Previously, introduction of expert testimony in the course of a *Markman* hearing was relatively rare. Often, a case could complete the claim construction phase—and perhaps even reach a determination of non-infringement—*without* any need for expert testimony. But *Teva Pharmaceuticals* will likely be read by some district courts as an implicit endorsement of reliance upon expert testimony and other “extrinsic” evidence in the course of claim construction, as district courts may increasingly ground their claim construction orders in the resolution of factual disputes in order to insulate them from *de novo* review.

Following the Supreme Court’s decision, parties are substantially rethinking the role of experts in *Markman* hearings. The likely outcome is that the “war of experts” will begin much earlier in patent litigation. The resulting increased costs will often inure to the benefit of patent plaintiffs, who will have yet another cost burden to exploit in order to increase the settlement pressure on the defendant.

Standard of Proof for Patent Invalidity: *Microsoft Corp. v. i4i Ltd. P’ship*.

The Supreme Court missed another opportunity to reduce the costs associated with patent litigation in *Microsoft Corp. v. i4i Ltd. P’ship*, 131 S. Ct. 2238 (2011). In the course of patent litigation, the defendant often challenges the asserted patent’s validity; a litigant may contend, for example, that a patent is invalid because it lacks novelty or is obvious. In *i4i*, the Supreme Court agreed to review the standard of proof a party must satisfy in order to demonstrate, in the course of litigation, that a patent is invalid. In a divided opinion, the Supreme Court affirmed the approach long taken by a Federal Circuit—that a litigant must demonstrate a patent is invalid by “clear and convincing evidence.”

The result of *i4i* is that there is a heavy thumb on the scale in favor of granted patents—even in circumstances, such as those present in *i4i*, where the prior art most relevant to the novelty or obviousness inquiry was never put before the PTO. Given that the scope of permissible prior art is enormous—an unpublished doctoral thesis available only in the library of Freiburg University was subsequently found to invalidate a granted patent (*In re Hall*, 781 F.2d 897, 899-900 (Fed. Cir. 1986))—the PTO often does not examine the most relevant prior art. This built-in advantage for the patent plaintiff creates enhanced risk for defendants who wish to defend against a patent claim, creating yet more pressure for defendants to settle dubious lawsuits.

C. The impact of some Supreme Court decisions is not yet clear.

The Supreme Court has also recently been active in defining the scope of subject matter that is patent eligible pursuant to Section 101 of the Patent Act. The Court has long held that certain subject matter—abstract ideas, laws of nature, and physical phenomena—are exempt from patent protection, because they constitute the basic building blocks of innovation.

Last year, in *Alice Corp. Pty. v. CLS Bank Int’l*, 134 S. Ct. 2347 (2014), the Supreme Court held ineligible claims directed to computer software for electronic, intermediated financial settlements. The Court concluded that the claims merely implemented, via computer, a long prevalent, fundamental economic practice. In other words, taking a basic business concept and saying “implement it on a computer” without any specificity regarding how to do so did not provide a sufficient limitation on the abstract idea to render it patent eligible.

In the aftermath of *Alice Corp.*, courts around the country are continuing to assess the scope of patentable subject matter as it relates to computer software. While it is likely too early to assess the full implications of *Alice Corp.*, a few lessons have emerged.

First, there is no serious doubt that software, as a general matter, is eligible for patent protection. Software innovation has provided a key engine of economic growth over the past

decade, the Supreme Court and Federal Circuit have upheld software patents, and no court has even suggested that software is outside the scope of the Patent Act. Instead, the critical question is how precisely to calibrate protections for software innovation.

Second, the lower courts are finding application of the Supreme Court’s eligibility test very challenging in practice. The Court stated that although an abstract idea or law of nature itself cannot be patented, the practical application of such an idea or law will generally be patentable. Unfortunately, the Court did not provide clear guidance on how to distinguish between an idea and its application, stating only that the invention must add enough to the abstract idea to ensure that it amounts to “significantly more” than the idea itself. Currently, there is little consensus in the lower courts regarding what is necessary to satisfy this “significantly more” standard, but several potential approaches have emerged. Perhaps the most promising focuses on evaluating the extent that a software innovation enhances the functioning of a computer system. When a software innovation creates a solution to a particular technical problem—rather than just implementing an offline idea digitally—it is likely to satisfy the Section 101 requirement.

Third, although Section 101 plays a partial function in screening out weak and abusive patent suits, other requirements in the Patent Act—that a patent must be novel (Section 102), non-obvious (Section 103), and sufficiently definite (Section 112)—often will provide more appropriate and substantial protections for defendants against meritless patent suits. So, too, does an early and effective means for a defendant to demonstrate that it does not infringe the patent claims.

The Federal Circuit now has before it cases that will require the court to flesh out the standard adopted by the Supreme Court in *Alice*.

III. The Need For Congressional Reform

Although the Supreme Court has taken some steps to correct the imbalanced incentives in patent litigation, the courts are powerless to alter certain structural obstacles to restoring parity between patent plaintiffs and patent defendants. Action by Congress is necessary to address the asymmetries that drive abusive litigation. These reforms should include:

- **Addressing large and asymmetric discovery costs:** One of the most substantial asymmetries imposed by patent plaintiffs is forcing massive amounts of costly discovery early in a litigation. Currently, discovery often proceeds parallel to, or even in advance of, the district court’s claim construction and its determination of dispositive motions—such as whether asserted patent claims are valid. But the court’s resolution of claim construction and validity contentions often may conclude the lawsuit, obviating the need for discovery. Alternatively, the claim construction decision can significantly narrow the scope of the dispute, reducing the volume of discovery needed. Requiring discovery to proceed in stages, and permitting only limited discovery relating to the particular issue before the district, will reduce this cost burden. Another approach to consider is requiring the party seeking discovery to bear the costs of obtaining the information when its discovery requests range beyond the core issues in the case.

- **Tightening pleading standards:** Applying to patent cases the pleading standards that govern other categories of litigation will require plaintiffs to explain their theories of infringement. Not only does such a requirement force plaintiffs to undertake an appropriate pre-suit investigation, but specifying a clear theory of liability will reduce a defendant's cost of defending a suit by constraining the scope of discovery and making it easier for defendants to identify and rebut abusive claims.
- **Ensuring that judges have the power to utilize fee-shifting in appropriate cases:** Revising Section 285 to give judges the authority to impose fee-shifting on plaintiffs who institute abusive cases will give patent plaintiffs a strong monetary incentive to self-police the quality of the litigation that they initiate.

Thank you for the opportunity to appear before the Subcommittee. I look forward to answering your questions.