

STATEMENT OF
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BEFORE THE

COMMITTEE ON THE JUDICIARY
U.S. House of Representatives

H.R. 3309 Innovation Act

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Introduction

Chairman Goodlatte, Ranking Member Conyers, and Members of the Committee:

Thank you for this opportunity to provide my views on H.R. 3309. I am testifying today solely on my own behalf.

Innovation continues to be a principal driver of our country's economic growth and job creation. An efficient and balanced patent system centered on strong patent protection, delivers that innovation to the marketplace. Recalling a 2012 study by the Economics and Statistics Administration and the USPTO, IP-intensive industries accounted for 40 million jobs, or 27.7% of all jobs in the US economy, in 2010. According to that same study, IP-intensive industries accounted for over \$5 trillion in value added, or 34.8% of US GDP in 2010.

Given the enormous size and importance of US innovation-based industries, rooted in an innovation ecosystem that remains the envy of the world and unequalled in all of human existence, substantial alternations to this ecosystem must be undertaken with extreme caution. Innovation, based on strong IP rights, is quite literally the goose laying our golden egg.

Let me start by congratulating you Mr. Chairman, on introducing H.R. 3309, a bill designed to improve our strong patent system by removing litigation loopholes that debase strong patent rights. Various provisions of this important legislation can achieve that objective, given further discussion and refinement as is always necessary to perfect complex legislation. Other provisions, as I will explain below, will require more substantial deliberation, or would best be deferred.

H.R. 3309, Mr. Chairman, writes on a page whose ink is barely dry. The America Invents Act was signed into law barely 2 years ago. Its major provisions are just getting underway. And while the AIA was unquestionably pro-innovator legislation, its post-grant challenge provisions also unquestionably shifted the balance of rights toward implementers and away from patent holders. The only remaining question, brought on by the adolescence of the AIA, is – just how much has that balance shifted?

Before turning to H.R. 3309, the most important point I will make today – the most important by some wide margin – is that Congress simply *must* ensure full funding of the USPTO. Less than 2 years after passage of the AIA and all the accompanying focus on USPTO user fee diversion, we found ourselves again looking at an Agency having its lifeblood, the user fees that come with all the work asked of USPTO by American innovators, drained away. I simply cannot overstate the destruction this is causing, as the work remains without the funding to handle it, creating an innovation deficit that will require future generations of innovators to pay into the Agency again in hopes their fees can actually be used to undertake the work for which those fees are paid. Nor will it be possible for the USPTO to accomplish the mandates of the AIA, much less the added responsibilities contemplated by parts of H.R. 3309, without access to the user fees calculated to meet those challenges. The USPTO is making progress in improving examination rigor, patent quality, and reduction of its backlogs. But none of this will continue, and backsliding is inevitable, unless full user fee access is provided to the Agency. Full fee access must be job one.

At the outset of considering further changes to our patent system, we must recognize that the time constant of the patent system – the period between new patent application and court decision on a patent infringement claim – is very long. Many years. As such, the impact of Congress' very recent major change to our patent system has barely begun to be felt. In such long time constant situations, every engineering instinct and every leadership instinct tells me: proceed with caution.

Moreover, in long time constant systems such as our patent system, over-correction is a major danger. By the time an over-correction is apparent, it will be years after the system is badly damaged. And we are not tinkering with just any system here; we are reworking the greatest innovation engine the world has ever known, almost instantly after it has just been significantly overhauled. If there were ever a case where caution is called for, this is it.

Caution in turn calls for a deliberative process that takes the time to reach out and listen to all stakeholders, including those who will not be the fastest ones off the mark. Many small innovators – today's Edisons – have not had time to make their views heard. Others having various levels of dependence on strong IP rights are just now beginning to consider the prospect of further changes to our patent system. We need to allow these important stakeholders their time to participate.

Caution also calls for us to ask: is the building on fire? Do we have an emergency that requires immediate action? No. The building is not on fire. As the recent Government

Accountability Office report found, patent assertion entities (also known as non-practicing entities) are *not* driving patent litigation, and broad new legislation to constrain patent assertion entities is not needed. And why the much-cited spike in patent litigation in recent years? In fact, it is entirely attributable to the joinder restrictions included in the AIA. When normalized for the effects of the AIA, patent litigation rates show no significant change in recent years. And what of those dire reports from some scholars claiming fantastical losses of hundreds of billions of dollars to the US economy attributable to “patent trolls”? Other equally credible scholars deeply question the methodology used and the applicability of the economics. Simply put, there is no fire.

I will also register my disagreement with those who frame the problem in terms of “patent trolls” or the slightly doctored “non-practicing entities”. Attempting to label and then discriminate based on identity is bad policy, or worse. The problem must be framed in terms of actions and behaviors, enabling us to identify behaviors that fall outside appropriate bounds and then prohibit or regulate those behaviors.

Finally, when contemplating changes to any critical legal system, it is important to bear in mind two terminal questions: does a successful “fix” require 100% elimination of the problem, and is collateral damage acceptable as a cost to achieve this?

Three points apply in answering these questions. First, where innovation is concerned, success and failure very much happens at the margins. So even a small change in the underlying system – changing the margins – can have a major impact on actors in the system. Second, where profit-seeking behavior in a capitalist system is concerned, there is tremendous overlap between actions that can be deemed acceptable in one context, versus unacceptable in another. So it is impossible to categorically define either bad actors or bad acts. And third, collateral damage in this case means both damaging the US innovation engine – which despite its imperfections continues to outpace all others – and forgoing new lifesaving treatments and new products that enrich our lives, which but-for the disincentives appurtenant to fixing the troll problem, would have been created and brought to market. Put differently, who among us would be comfortable standing by the bedside of a suffering loved one, and explaining that while their disease goes uncured, they should be happy there are no more trolls filling inappropriate lawsuits?

Given the above, it is clear that the goal cannot be perfect elimination of abusive patent litigation – that is not necessary nor possible nor appropriate. What is needed is light touch adjustments. We can expect such adjustments to have significant impact on the problem, with less risk of straying into over-prescription that will negatively impact legitimate actors and actions.

Mr. Chairman, I believe that a number of the provisions contained in H.R. 3309 have the potential to improve our patent litigation processes, reduce litigation uncertainties and costs, and increase the value of legitimate patent rights for American innovators. But, I also believe significant further work is necessary, and I reiterate my note of caution. Input is needed from key stakeholders on the provisions of H.R. 3309. A careful and deliberative process is needed to avoid major negative unintended and unanticipated

consequences of over-correction – consequences more harmful than the problems the legislation is intended to address.

My thoughts on some of the most critical provisions of H.R. 3309 are as follows:

Fee Shifting, Real-Party in Interest Disclosure, Litigation Procedure, Joinder

Subject to the comments above, all of these provisions of H.R. 3309 represent good policy. With further refinement, they can cut wasteful expense for all parties in patent infringement disputes.

Appropriately calibrated fee shifting will help discourage frivolous suits. Enhanced disclosure of real-party in interest information will improve transparency of patent ownership and thus efficiency for all participants in the patent system. Higher pleading standards regarding claims allegedly infringed and products allegedly infringing will prevent unnecessary expense, as will case management that focuses early discovery on claim interpretation as a gateway to determining what other discovery will be required. Discovery generally can be contained better by requiring the requestor to pay for discovery beyond the basics.

As most of these provisions directly impact the work of judges, it bears emphasizing that further effort is needed on H.R. 3309 to ensure judges are not deprived of their ability to exercise judgment – based on knowledge of applicable facts, context, and case-specific details. Indeed, the opposition to the litigation procedure provisions voiced by the Judicial Conference is well-taken. In this regard, consideration should be given to reducing prescription to a minimum, and tasking the judiciary with the detailed work needed to turn broad legislative guidance into properly calibrated court procedure.

H.R. 3309's litigation reforms should also be further examined for their impact on legitimate patent holders, including independent inventors and startups. The heightened pleading requirements may make sense for defendants as well as plaintiffs, so that allegations of invalidity and non-infringement are backed up with the same level of detail that will be required for allegations of infringement. Fee-shifting may benefit from greater flexibility to account for situations where the prevailing party engages in conduct that drives up litigation expense or is otherwise untoward. And consideration should be given to the situation where a mom-and-pop-shop is confronted with a valid but narrow patent, exposing them to the risk of paying millions of dollars for the patentee's legal expenses in addition to an otherwise inconsequential judgment. The possibility of parties opportunistically litigating on the other side's dime cuts both ways.

The purpose of the joinder provision is clearly laudable: ensuring those who are ultimately accountable can be held accountable. But the provision as drafted is confusing and overbroad, apparently assuming standing well beyond that actually provided in the law, and requiring joinder well beyond parties truly accountable for frivolous patent assertions. And as a matter of fairness to all parties, defendants using clever facades to avoid payment of fee awards should be held to account just as surely as plaintiffs. Given

all these problems, the joinder provision needs to be rethought to ensure it meets its purpose without significantly overreaching.

Finally, as regards fee-shifting, we now have the U.S. Supreme Court reviewing two pertinent cases on certiorari from the Federal Circuit. As we saw with the discussions leading up to the AIA, the courts can and do interpret the laws to resolve thorny issues. It would be no surprise to see the same transpire in these cases, and that prospect should be taken into account.

Amendment to AIA Section 18 – Covered Business Methods

Section 18 of the AIA was designed for the very special and singular purpose of creating a limited-time opportunity to challenge certain patents covering methods of doing business. I have always supported this provision as good policy and good practice – recognizing that many patents had been granted before important guiding court decisions like *Bilski*, and before the courts’ and the USPTO’s increased focus on claim scope and claim clarity under Section 112, and that those patents covering methods of doing business also inherently cover all technology solving the affected business problem.

Section 18 has been in-effect for about 13 months – far too short a period of time to judge its effectiveness. While over 70 CBM proceedings have been filed to date, only one has run fully to conclusion. This should come as no surprise, as the AIA itself calls for these proceedings to run at least 15 months. Indeed, Congress recognized that some time would be required before Section 18’s effectiveness could be measured, and wisely called for a study of Section 18 (along with the other post-grant procedures of the AIA) in September 2015.

In taking an early “temperature reading” on Section 18 so far, I would say it is slightly over-achieving its intended purpose. Encouraged by the legislative record leading to enactment of the AIA, USPTO interpreted the critical terms “covered business method” and “technological” broadly, and indeed, a slightly greater number of the procedures have been granted so far, versus what was expected. If the first decision – the *Versata* case – is to be taken as an indicator, operating companies concerned about defending against overbroad business method patents must surely be taking comfort, as the Patent Trial and Appeal Board in that case found the claims entirely unpatentable despite that a district court had previously found the same claims valid and infringed, awarding a judgment in excess of \$400M. And the USPTO significantly over-achieved in terms of the time to decision in that case, completing it in well under a year from initiation.

Indeed, the interpretation of the critical terms “covered business method” and “technological” were broad enough in the Versata decision that many are asking whether the interpretation was overbroad. But in fairness to all, terms like “technological” and “business method” have proven exceedingly difficult – perhaps impossible – to define categorically. The Europeans have struggled for decades with these terms, and the US courts have as well.

With all of the above in view, I believe the best balance between discretion and valor in this situation is to let Section 18 settle in further before modifying it. The courts are in a much better position than Congress to review the USPTO’s interpretations of “covered business method” and “technological”, and through the time-tested case-based model, gradually refine those important definitions. The provision is certainly not being interpreted too narrowly thus far. It is premature to legislate a standard for “covered business method” or “technological”. Congress wisely avoided doing that just over two years ago, and there is no reason to abandon that wise approach now. Let the other two branches of government do their work for awhile.

Similarly, it is simply too early to say whether Section 18 needs to be made permanent. The provision was intended from the beginning to act as a bridge to more settled law. There is no reason at this early stage to depart from that view.

Finally, and most importantly, extension of Section 18 to software-related inventions generally should be clearly avoided. Such an over-extension carries several negative consequences: it devalues innovation implemented in software – one of America’s most important and innovative sectors; it overtly discriminates against a critical and growing field of technological innovation, likely in violation of our treaty obligations; and it reneges on the balance between the AIA’s numerous post-grant provisions. Why in the world would we, the country that is home to the world’s most dynamic software industry – an industry that dominates and dazzles the world – want to tell ourselves and the world that we’ve decided software innovation is less important than other kinds of innovation? America remains the world’s *destination* for software innovators – they come here to grow their ideas and their companies because America loves software innovation. We would send a terrible policy message by turning Section 18 of the AIA to take aim at America’s software industry and our software innovators.

It may be that some of the amendments contemplated in H.R. 3309 for the AIA’s Section 18 will prove advisable. But it is too early to say that now. And there certainly is no data supporting amendments now that reverse wise policy decisions made by Congress barely two years ago.

Stays of Litigation for Covered Customers

H.R. 3309’s provision offering protection for innocent end-users and retailers of products and services from patent infringement claims represents good policy. Too often these parties become pawns in patent infringement disputes properly brought between patentees and product manufacturers or service providers. Substantial litigation resources

can be saved for many parties by enabling innocents to stay patent infringement claims against them where manufacturers and service providers are willing and able to step in and handle claims.

A number of improvements to the language of the Bill are needed, however, to ensure against abuse and unintended consequences. First, as currently written the stay provision permits all parties in the product channel downstream of the first component part maker to escape infringement liability, including large commercial actors such as manufacturers combining procured components into value-added completed devices, as well as assemblers, and others not operating in the roles of “mere retailers” or “mere end users”, and certainly not operating in the roles of “mom and pop shops”. This unnecessarily devalues intellectual property and thus innovation by artificially limiting or even eliminating legitimate patentees’ ability to protect their innovations. It also may leave an American innovator with no infringer at all to pursue where infringing manufacturers are located outside the reach of the US courts, such as overseas, or lack adequate assets to answer for infringement.

Second, further work is needed to specify the level of commonality needed between claims in order to trigger the right to stay, and to define “covered manufacturer” and “covered customer”, to avoid significantly disrupting settled relationships between many commercial suppliers and their commercial customers, with parties jockeying for more or less indemnity coverage than is otherwise obtainable under existing contract law.

Third, further effort will be needed to avoid creating a donut hole in the patent law where a downstream party (a “covered customer”) is the direct infringer of a legitimate patents claim, while the upstream “covered manufacturer” is an indirect infringer. Under current law, this common scenario would put the patentee in the catch-22 of having to prove direct infringement as a prerequisite to showing indirect infringement, without having access to the information needed to make out its case for direct infringement.

Finally, this provision aptly illustrates the adage “the devil’s in the details” and the need for a deliberative process—both of which counsel against rushing. A “covered customer”, however defined, will almost never be in precisely the same situation as its “covered manufacturer” such that it would be appropriate for a covered customer to be fully and simply bound in all respects by a judgment against its covered manufacturer. Instead, one party will almost certainly have different license agreements in place that will affect defenses to infringement, or will have been put on notice at a different time than the other. For these or any other of the myriad of ways parties are almost never in precisely the same position, legitimate patentees, covered manufacturers, and covered customers will all find themselves embroiled in more, not less litigation. To avoid this result, more clarity will be needed around binding parties to litigation outcomes of others.

I am optimistic that all of these issues can be addressed with further input from a broad range of stakeholders and with further deliberation. But as with any complex set of issues, multiple rounds of input will be required, first-order and second-order effects will need to be considered at each round, and patience will be a premium asset.

Moving USPTO IPR and PGR Proceedings to District Court Standard of Claim Construction

H.R. 3309's mandate for USPTO to move from its current claim construction standard of "broadest reasonable interpretation" to "ordinary and customary meaning to one of ordinary skill in the art" during post-grant proceedings carries pros and cons. I mention it not to support or oppose the provision, but to ensure there is clarity as to the implications. On the one hand, the speed mandated for post-grant procedures is leading to greater interaction between court interpretations and USPTO interpretations of the same patent claims, and having the USPTO apply a different standard than the courts is leading, and will continue to lead, to conflicting decisions. Moving the USPTO to a consistent standard with that of the courts would resolve such conflict. On the other hand, because the patentee has the ability to amend claims during post-grant processes in the USPTO, the Agency is justified in applying a broader standard. This broader standard requires patentees to define their claims clearly over the prior art during proceedings in the Agency, which is undoubtedly in the best interests of the public

So while this provision presents valid arguments on both sides, it is critical for this Committee to understand that moving the USPTO to the district court "ordinary and customary meaning" standard will invariably force the USPTO to endorse and issue broader and more generally defined claims in important post-grant proceedings (excepting Section 18, which is excluded from the provision) – the very same kinds of claims that form the basis of inappropriate assertions this legislation is aimed at reducing. Thus, while the provision may make sense on balance, it must be appreciated that it cuts in the opposite direction from the stated purpose of this legislation.

Conclusion

Mr. Chairman, thank you again for this opportunity to share my thoughts. I commend you for introducing H.R. 3309, the Innovation Act, aimed at improving and strengthening the American patent system.

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