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BEFORE THE

UNITED STATES HOUSE OF REPRESENTATIVES
COMMITTEE ON THE JUDICIARY
SUBCOMMITTEE ON INTELLECTUAL PROPERTY

PATENT TROLLS: FACT OR FICTION?

June 15, 2006

I. Introduction and Summary

Chairman Smith, Representative Berman, and Members of the Subcommittee, it is an honor to appear before you today to discuss the issue of patent trolls. Thank you for your leadership and hard work in the important cause of ensuring our nation's patent laws continue to promote progress and innovation in the 21st century as in the past. My name is Chuck Fish, and I am Vice President and Chief Patent Counsel of Time Warner Inc.

With respect, we believe the subject of today's hearing should be somewhat different. In our view, it is neither productive to engage in name calling exercises such as branding certain patent owner plaintiffs as "trolls" nor enlightening to debate definitions of the term – rather we believe that a focus on behaviors and the consequences of those behaviors is essential. In our experience, the behaviors associated with patent litigation abuse are harming consumers and both small and large innovative companies. There is every indication that – whatever we call those responsible for the trend – the harmful trend towards patent speculation and litigation and away from product innovation supported by strong intellectual property rights will continue unless Congress reforms the patent system.

The patent system as it exists today touches Time Warner's businesses in many ways and works well in a variety of contexts. There are several areas, however, where improvements are sorely needed. Patent litigation is one of the most urgent and important. As a large and diverse media company, Time Warner has an enormous and unique interest in the maintenance of strong intellectual property protections in all contexts. Creators and innovators must have the fruits of their intellectual endeavors protected or this country will lose its edge in exporting valuable entertainment and technology products and services of the sort Time Warner (and of course others) provide.

A deep commitment to intellectual property protection and, in particular today, a strong and enforceable patent system, is wholly compatible with repairing that system to ensure it continues to function for the common good. As patent litigation and patent licensing by entities that do not innovate has grown dramatically, it is critical that the remedial aspects of the patent law and their judicial application strike the right balance. In my testimony today, I will describe why these problems are serious and create a strong need for reform.

II. Problems in Patent Litigation Today

Patent litigation in the technology areas Time Warner works in is an extremely costly, often unpredictable breed of federal litigation. It is the subject of massive awards and defensive settlements that often bear no relation to the real value of the patent in the marketplace. There has been a huge increase in cases, many of them brought by former tort lawyers who have found patent litigation more lucrative than traditional tort work. This phenomenon has been given a catchy label: the “PI to IP transition.”¹

Nationwide, the number of patent cases more than doubled between 1991 and 2001² and the number of cases in 2004 was more than 22% greater than the number in 2001.³ In Marshall, Texas, where only seven patent cases were filed in 2003, ten patent cases were filed in the last two weeks of April 2006 alone, and more than 116 were filed in the last sixteen months.⁴

Simply looking at the raw numbers of patent suits filed misses the full story of the drain on the American economy. Patent litigation is extremely costly compared to other types of commercial litigation. Companies spent 32% more on outside counsel for intellectual property litigation in 2003 than in the previous year. Those same companies spent only one percent more for outside counsel on non-IP litigation.⁵ Today, a typical patent litigation costs \$4.5 million through trial.⁶ This is over four times as expensive as a typical copyright case with similar exposure⁷. It seems reasonable to assume that patent cases are more expensive than other types of litigation, in part, because in many jurisdictions summary judgment is rarely granted, there are no interlocutory appeals of claim construction rulings (although parties have found agreed procedural routes to what are essentially interlocutory appeals), and trial courts appear to be

¹ Alan Cohen, *From PI to IP*, IP LAW & BUS., Nov. 2005, at 40.

² William O. Kerr and Gauri Prakash-Canjels, *Patent Damages and Royalty Awards: The Convergence of Economics and Law*, LES NOUVELLES, June 2003, at 83.

³ See Table C-2A Cases Commenced, by Nature of Suit, 2000 Through 2004, Judicial Business of the United States Courts 2004 (2004), available at <http://www.uscourts.gov/judbus2004/contents.html>.

⁴ C. Lindell, *A Litigation Boom*, AUSTIN AMERICAN-STATESMAN, Apr. 16, 2006, at A10; PACER System for the United States District Court of the Eastern District of Texas available at <https://ecf.txed.uscourts.gov/> (identifying ten cases filed between April 13 and April 30).

⁵ *Patent Law Reform: Injunctions and Damages*, 109th Cong. 2 (2005) (statement of J. Jeffrey Hawley, President, Intell. Prop. Owners Ass'n).

⁶ AMERICAN INTELLECTUAL PROPERTY LAW ASSOCIATION, *Report of the Economic Survey I-110* (2005) (median cost for cases with more than \$25 million at issue).

⁷ AMERICAN INTELLECTUAL PROPERTY LAW ASSOCIATION, *Report of the Economic Survey I-110* (2005) (when comparing median costs for cases with more than \$25 million at issue).

reversed at a much higher rate in patent cases than in other commercial litigation -- often requiring a retrial of some aspect of the case.

A Significant Economic Impact from Abusive Litigation. The substantial increase in the economic impact of patent litigation might not be cause for concern if the litigation system were in balance and functioning properly – the cost could be explained as a byproduct of the increased value of intellectual property or some other factor. However, there is abundant evidence that the nature of patent litigation has changed fundamentally in recent years and that a very significant share of the increased cost stems from abusive claims. Of course, not every lawsuit filed by patent enforcement companies is abusive. We are not advocating that innovative patentees be denied relief that they deserve, rather we urge that the system be restored to balance in view of the reality of a new breed of middlemen patent speculators.

As Justice Kennedy explained in the *eBay v. MercExchange* decision, “[i]n cases now arising . . . the nature of the patent being enforced and the economic function of the patent holder present considerations quite unlike earlier cases. *An industry has developed in which firms use patents not as a basis for producing and selling goods but, instead, primarily for obtaining licensing fees*”.⁸

One popular strategy abusive patent enforcement companies employ is to demand substantial sums of money from an entire industry based on shared procedures mandated by regulations or technical standards. For example, Data Treasury has aggressively asserted its patents against the banking industry – claiming that its patents cover technology for various stages of the check archiving process, including image capturing, centralized processing and electronic storage of document and check information. Several financial institutions have entered into very large settlements instead of running the risk with litigation.⁹ Other plaintiffs that pursue this route often assert that their patents cover a technical interoperability standard. Typically, the purported infringement claims are not raised in the standard-setting process and instead are asserted only *after* the standard has been adopted.¹⁰ By the time the purported infringement is discovered, it may be prohibitively expensive to adopt and implement a new standard to avoid the patent.

The economic impact of abusive patent cases is by no means limited to lawsuits that are filed, which are only the tip of the iceberg. For example, it is routine for these patent enforcement companies to send demand letters simultaneously to many companies. Indeed, one

⁸ *eBay, Inc. v. MercExchange, L.L.C.*, 547 U.S. ___, 126 S. Ct. 1837, 1842 (2006) (Kennedy, J., concurring) (emphasis added).

⁹ See Erik E. Larson, *DataTreasury Launches Fresh E-Banking Assault*, I.P. LAW 360, February 28, 2006, <http://iplb.portfoliomedia.com/Secure/ViewArticle.aspx?id=5500>; see also Glen Fest, *Patently Unaware*, BANK TECH. NEWS, April 2006, <http://www.banktechnews.com/article.html?id=20060403T76I25I8>.

¹⁰ See, e.g., *Rambus v. Infineon, AG*, 318 F.3d 1081, 1085-86 (Fed. Cir. 2003) (involving infringement claim by patent owner who had been a member of a standard-setting organization for the computer memory industry); *InterDigital Tech. Corp. v. OKI Am., Inc.*, 845 F. Supp. 276, 281 (E.D. Pa. 1994) (involving claim by patent holder that multiple manufacturers infringed patents by complying with wireless telecommunications standards). Ultimately, there was no finding of patent infringement in these cases.

plaintiff reportedly sent such letters to **75,000** companies.¹¹ The theory seems to be that at least some recipients will agree to pay license fees to avoid the costs and uncertainties of the current patent litigation system – especially after seeing how companies in similar situations have fared – and their contributions will fund actions against those who have refused to pay tribute.

The economic burden of abusive litigation deters innovation and harms our entire economy. The costs associated with abusive litigation sap resources that would otherwise be available for research and innovation. Every dollar spent defending against abusive patent suits is a dollar that could be spent more productively on research and development. Moreover, the risk of patent litigation is a major consideration in deciding whether to engage in research and development. Aware that they cannot afford the time and expense of patent litigation, many smaller companies reduce or alter their research and development efforts.¹² The research and development decisions of larger companies are affected as well. To avoid abusive patent litigation, some larger companies often seek defensive patents that they would not otherwise prosecute, thereby reducing the funds available for additional research and development.¹³ They also forego pursuing smaller innovations because it is safer to use old components and processes that are clearly in the public domain or for which they already own the patents. These consequences effectively turn the patent system on its head, undermining its goal of promoting innovation. Unproductive patent expenditures imposed on large and small companies throughout the economy function as an innovation tax that afflicts some of America's most important and creative firms and their customers.

III. Important Features of Patent Litigation Reform We Hope That the Subcommittee Will Support

We have been following the various proposals to revise the patent system that have been circulating in Congress with great interest and continue to evaluate new ideas to improve the patent system. Like many others, we believe that there are several issues that need to be addressed in order to improve the functioning of the patent system.

Require Meaningful Proof Before Awarding Increased Damages in Patent Suits. We are pleased that there is quite broad agreement across the patent community that the current willfulness doctrine needs to be reformed. Under current law, a finding of willfulness entitles the patent plaintiff to multiply its damages up to treble damages. Willfulness has a very different meaning in patent law than in traditional tort law. It is almost always alleged, and increased damages are routinely awarded in patent cases. In contrast, in other litigation, increased damages are awarded only where parties have clearly acted reprehensibly or egregiously.

¹¹ “ The company E-Data, sent letters to 75,000 companies informing them that they were infringing an E--Data patent and asking them to pay royalties between \$5,000 and \$50,000. The company owns a patent which allegedly covers financial transactions on the Internet. Several high-profile companies agreed to license the patent but most refused. E-Data sued forty-one of the companies for patent infringement.” Meurer, “Controlling Opportunistic and Anti-Competitive Intellectual Property Litigation,” 44 B.U.L. Rev. 509, 517 (2003).

¹² ADAM B. JAFFE & JOSH LERNER, INNOVATION AND ITS DISCONTENTS: HOW OUR BROKEN PATENT SYSTEM IS ENDANGERING INNOVATION AND PROGRESS, AND WHAT TO DO ABOUT IT 15 (2004).

¹³ *Id.* At 58.

To fend off possible willfulness allegations, companies must go to the expense of hiring patent counsel to produce exculpatory opinion letters for potentially hundreds or thousands of patents where a mere license is offered. As courts have noted, such letters are only useful when they are wrong – after a defendant has been found to infringe – despite the letter’s stated belief that there was no infringement. Because willfulness accusations arise in almost every patent case, there is great uncertainty as to the ultimate outcome. Allegations of willful infringement lead to substantial increases in discovery and trial costs, because they are difficult to dismiss at the summary judgment stage, and appear to produce very little benefit to the system.

Moreover, as the FTC noted in its 2003 report, To Promote Innovation, the overbreadth of the willfulness standard in current law introduces unnecessary uncertainty, raises risks, and reduces efficiency because it discourages companies from reading others’ patents and from planning non-infringing business models.¹⁴

We support all proposals that bring patent law into compliance with other litigation standards so that the purpose behind increased damages, to punish those who have acted with disregard for the law, is actually the predicate for willfulness damages being alleged and imposed.

Conform Patent Damages Rules to the Reality of Multiple Patents Covering Products. Current law requires that patentees who succeed in litigation receive damages fully adequate to compensate for the infringement. We support this standard for all owners of intellectual property, but note that in the patent area the elements of damages have been expanded by the courts far beyond the patented contribution to the public. Especially in the areas of complex computer and communication systems, there can be many hundreds of patents covering a product or service.

For example, there are more than 400 patents that are essential to produce a DVD and hundreds of patents are typically related to a computer operating system on a PC. Yet the patent law remains mired in a nineteenth century paradigm of essentially “one patent, one product.” As a result, the courts have been required to create and modify complicated, patent specific damage rules to give effect to the statutory purpose and underlying policy, e.g. *Rite-Hite*¹⁵ and its progeny. Thus, in litigation and negotiation, legitimate patentees, as well as those who would twist the patent litigation system for private advantage despite potential harm to the public, routinely urge that the measure of their damages must encompass any remotely relevant revenue of the defendant.

As members of the subcommittee know, there has been much discussion of patent damages rules in the last year and a half as you have tried to craft balanced and prudent reform. One important principle (universally supported in the patent community) is that whatever damages rules exist should be of general applicability. So, for example, if it is the rare patent which is more than an incremental improvement to a product covered by many patents, then the general rule (the starting point) should not be to treat all patents as if they were fundamental,

¹⁴ FEDERAL TRADE COMMISSION, TO PROMOTE INNOVATION: THE PROPER BALANCE OF COMPETITION AND PATENT LAW AND POLICY Ch. 5 at 28-32 (Oct. 2003).

¹⁵ *Rite-Hite Corp. v. Kelley Co., Inc.*, 56 F.3d 1538 (Fed. Cir. 1995).

pioneering advances. Rather, the exceptional patent should be treated as an exception to the general damages rule.

Time Warner supports reforming patent damages law by explicitly directing the courts to begin their damages analysis by focusing on the incremental value attributable to the difference between the patented invention and the prior art. This approach, we believe, will simplify litigation, reduce costs and allow for fair damages awards. We appreciate the Subcommittee's inclusion of apportionment language in H.R. 2795. However, we believe the key issue to focus on is the situation where the accused product or service involves a complicated system incorporating many public domain and patented contributions. In cases like this, full compensation to the patentee should not usually involve apportioning value unrelated to her invention.

Progress on the Patent Injunction Imbalance. We are pleased that in *eBay v. MercExchange*, the Supreme Court restored the law governing issuance of injunctions in patent cases to reflect the plain language of the Patent Act and traditional equity jurisprudence.

We believe that injunctions are an important and essential part of the patent system, and that only parties who can show actual, irreparable harm should be able to receive an injunction following a finding of patent infringement. We also expect that patent holders will be able to establish irreparable harm easily in many situations.

The holding of *MercExchange* plainly commits to the discretion of the district court the decision of whether to issue an injunction. However, it would be a tragic irony if this holding led to further forum shopping. For this reason, as several leading newspapers have concluded in recent editorials, the *MercExchange* decision makes meaningful venue reform more important.¹⁶

Venue Reform to Stop Forum Shopping. An aggressive patent plaintiff can sue almost anywhere in the U.S. Although the number of patent cases proceeding to a full trial remains low (on the order of 5 %),¹⁷ the number of cases being filed in certain *fora* continues to rise because of the odds of winning in those courts. It seems reasonable to assume that people are filing in certain jurisdictions because they are perceived to be pro-plaintiff. Not surprisingly, the number of cases filed in the Eastern District of Texas, a current hot spot for patent litigation, has skyrocketed --it is now among the top three patent lawsuit filing districts.¹⁸

This sort of blatant forum-shopping cries out for venue reform, and we are pleased that the Subcommittee is considering including venue reform in H.R. 2795. Venue provisions can be

¹⁶ "America has taken a first step toward leveling the playing field in patent litigation. There is no excuse to stop now." *Patents improvement Ebay ruling is just a first step in a much-needed US Reform*, FINANCIAL TIMES (London), May 23, 2006, at 14; "Now that the Supreme Court has started fixing the patent morass, lawmakers need to finish the job." *The eBay Effect*, LOS ANGELES TIMES, May 17, 2006, at B12; The Court's *eBay* decision is "progress," but "isn't going to fix all that ails our patent system." *A Winning Bid for eBay*, WALL ST. J., May 16, 2006, at A14.

¹⁷ Jay P. Kesan & Gwendolyn G. Ball, *How Are Patent Cases Resolved? An Empirical Examination of the Adjudication and Settlement of Patent Disputes* (U. Ill. Law & Econ. Res. Paper No. LE05-027), available at <http://ssrn.com/abstract=808347>.

¹⁸ *Texas Challenges California as IP Litigation Hotbed*, IP LAW BULLETIN, Oct. 21, 2005, available at <http://ip.law360.com/Secure/ViewArticle.aspx?id=4329>.

tricky, and crafting balanced reform which does not produce too many unintended consequences will take careful attention. We are mindful that plaintiffs whose only business is to license and litigate on patent portfolios may choose to incorporate in places like Marshall, Texas to manufacture venue, and hope that any venue provision prevents this and similar gamesmanship and focuses on a real and substantial relationship between permissible fora and the defendant's activities.

Improve Patent Trial Procedures. Due to forum shopping, the intensive demands on judicial resources caused by patent cases, and the flood of patent cases into certain districts, Time Warner agrees with the idea of creating specialized procedures for handling patent litigation (especially at the pre-trial stages) and for increasing the expertise of decision makers in patent cases. We very much appreciate Representative Issa's work on this issue. We are also happy to agree with many, including Mr. Myhrvold,¹⁹ who believe that specialized patent trial courts are an idea worthy of serious consideration. We hope to assist in bringing these ideas to fruition.

Level the Playing Field for Patent Litigants on Validity Issues. Currently, issued patents receive a strong presumption of validity. To invalidate a patent, a defendant must prove by "clear and convincing" evidence that the patent should have never been issued. In practice, this means that a defendant must prove that it is absolutely clear that the issuance of the patent was a mistake, even where prior art is asserted that the Examiner was not aware of and did not review. This standard is impractical and unfair when imposed on patents issued under the current patent system. Although the PTO has made great strides with the extremely limited resources it has been given, the task is an onerous one, and most recent reports still recognize the need for further resources and time for the PTO to address inadequate quality of examination and the resulting poor quality of issued patents. Due to the tremendous workload before the PTO, it is often the case that patents do not deserve a strong presumption of validity.

Given the inefficiency inherent in the increasing numbers of expensive validity contests over increasingly weak patents (especially in the software and business method areas), it is important to level the playing field now. We thus propose that, to invalidate a patent, a party relying on prior art not considered by the PTO must prove by "a preponderance of the evidence" that the patent is invalid — in other words a 51% probability that the patent should have never been issued. This is fair, especially considering that when a patent is in litigation, thousands of hours and millions of dollars may be spent on examining whether it should have been issued. This intense scrutiny should be given at least the same amount of weight as the effort of the PTO to issue a valid patent, especially in light of the fact that on average an examiner is typically given less than 30 hours to decide whether to issue a patent, and very often does not have the best prior art before him or her.

Require the "Loser Pays Rule" for Patent Infringement Suits. Patent litigation is extremely expensive, involving high expert witness fees, attorneys' fees and extensive discovery. However, the cost of such litigation often falls disproportionately on defendants. Even when they win on summary judgment, at the conclusion of discovery defendants will usually pay over three

¹⁹ *Perspectives on Patents: Post-Grant Review Procedure and Other Litigation Reforms*, 109th Cong. (2006) (statement of Nathan P. Myhrvold, Chief Executive Officer, Intellectual Ventures).

million dollars in fees to prove that a single patent is invalid.²⁰ Currently, even with (rarely imposed) Rule 11 sanctions, there is a gap in disincentives to deter a patent owner that wishes to launch a nuisance patent infringement lawsuit because the risks of an injunction, increased damages for willfulness, and a statutory entitlement to six years of damages place the risk of litigating overwhelmingly on the defendant. Even when the patent owner is not justified in his actions, defendants are stuck with the tremendous cost of defending the lawsuit. As patent litigation is almost entirely contested between commercial entities (increasingly commercial entities that exist solely for the purpose of threatening or pursuing patent litigation), we believe there is no justification for continuing a system where the risks are skewed so heavily in favor of plaintiffs. Some type of fee shifting mechanism in the case of plaintiffs' actions that are objectively unreasonable or vexatious would go a long way to ensuring that litigation is a last recourse, rather than a first option, as occurs all too frequently today.

We believe that adoption of our recommendation would provide a stimulus to decrease the incidence of patent litigation, and increase negotiated (and hopefully therefore more efficient) resolution of patent disputes.

Other Proposed Reforms. Other reforms to the patent litigation system, including ending the possibility of world wide damages under Section 271(f) of the Patent Law, providing for interlocutory appeals of claim construction rulings (because they are reversed so frequently and require retrial of cases), and requiring rulings on claim construction within a reasonable period after the start of discovery and before trial (to reduce costs of litigation and provide more information to the parties to encourage settlement) would also be valuable improvements.

Overall, we believe that the goal should be to return patent litigation to the mainstream of business litigation and restore traditional balance to patent-specific rules, while respecting the important role that the patent system plays in our economy and the rights of patent owners. We also believe that patent litigation reform can have a near term impact in alleviating patent quality problems while the resources and processes in the PTO are being upgraded to address the challenges of the 21st century.

IV. Conclusion.

In conclusion, patent litigation imbalances present an imminent and urgent threat. In order to improve the entire patent system for the long term good of the nation we believe the following issues also need to be addressed:

- First, the PTO needs to be adequately and consistently funded. Many criticisms are unfairly directed against the PTO. In the recent past, the PTO has been given an enormous task but highly inadequate funding to do its job. We appreciate the work done to make sure the PTO has the resources it needs in this fiscal year, and urge that adequate funding continue so that the laudable programs of Under Secretary of Commerce for Intellectual Property and Director of the PTO Dudas and the professionals at the PTO can bear fruit.

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AMERICAN INTELLECTUAL PROPERTY LAW ASSOCIATION, *Report of the Economic Survey* I-110- (2005).

- Second, to insure the long term viability of the patent system and the continuation of the benefits it has historically brought to our nation, patent quality needs to be addressed. In this area, improvements we support include limits on abuse of continuation practice, meaningful post grant opposition procedures, publication of all patent applications, and improved ability of the public to submit prior art during prosecution. We recognize that many who support improving the quality of issued patents have concerns about some of the proposals in this area, and agree with them that it is important to retain both substantive and procedural fairness for patentees while fixing the problems.

Thank you for the opportunity to testify. We greatly appreciate the Subcommittee's work on this important issue and believe the proposals I've described are important reforms that would make the U.S. patent system much fairer and more reasonable for all parties. In providing this testimony, we hope to stimulate a discussion regarding the best way to reform problems in patent law, including patent litigation. We know that much remains to be done to turn these recommendations into proper legislative proposals, and would be delighted to work with this Subcommittee to help in any way we can.