

Here We Go Again

Proposed reforms to the patent system promise lawyers more reasons to litigate.

By Thomas F. Holt Jr. and Tara C. Clancy

In the early 19th century, there was considerable sentiment that patents were too easy to come by and that overly aggressive enforcement was burdening the judicial system. Sound familiar?

Today the efficacy of the U.S. patent system is being hotly debated, not only by those who unflinchingly believe that patents are an unwarranted impediment to innovation, but also by the Federal Trade Commission, the National Academy of Sciences, and, most recently, Congress. The goals of these policy-makers, urged on by many in corporate America, are to improve the quality of patents granted and to decrease the costs of patent litigation. And now they have proposed legislation, the Patent Reform Act of 2005.

Certainly, patents should not be issued lightly, and patent disputes can be very expensive for all concerned. But intellectual property litigators need not worry about keeping busy if the pending House legislation passes. With the inevitability of

unintended consequences, lawyers will be back in court, driven by the very legal proposals meant to keep them away.

IN THE EARLY 19TH CENTURY, THE LEGISLATIVE solution to the troubles of the patent system was the Patent Act of 1836. In the 1790s, as the first administrator of patents (and secretary of state), Thomas Jefferson personally examined each patent application. The 1836 act created a Patent Office, a prototypical administrative agency, to examine applications. The fledgling office was given the power to require applicants to distinguish their invention from the prior art and to “particularly specify and point out the part, improvement or combination, which he claims as his own invention or discovery”—the precursor to modern-day claims.

Although the patent law has undergone various amendments since 1836, many of its principal features have remained largely intact. Recently, however, pressure has been building for a vastly more comprehensive rewrite—for a number of reasons.

First among these is the sheer volume of patents being sought each year. In 2004, roughly 376,000 applications were filed, up from 126,000 only 20 years ago.

The number of patent infringement cases has also increased dramatically, as has the cost of patent litigation. All these rising numbers have fueled complaints that the patent system is out of control.

Adding to the calls for reform is corporate America's growing awareness of the value of technology. More and more, companies' law departments are focusing their efforts on inventoring their valuable IP and formulating a more aggressive strategy to enforce and exploit those assets. Furthermore, "patent trolls"—that is, companies organized for the sole purpose of acquiring and asserting patent rights against those who actually produce products—have emerged as a considerable force.

IN THIS ENVIRONMENT, TWO SIGNIFICANT reports evaluating the current system and recommending changes have received much attention. First, in October 2003, the FTC issued "To Promote Innovation: The Proper Balance of Competition and Patent Law and Policy." The report found an IP system fraught with poor-quality patents and anti-competitive effects.

In April 2004, the National Academy of Sciences entered the fray with a report titled "A Patent System for the 21st Century." The NAS report spelled out a number of recommendations to streamline the patent system and promote innovation.

Congress responded by introducing the Patent Quality Assistance Act of 2004, authored by Rep. Howard Berman (D-Calif.). The Berman bill was referred in November to the House Judiciary Subcommittee on Courts, the Internet and Intellectual Property, which in turn issued a "committee print" of the bill this past April.

Then, on June 8, Rep. Lamar Smith (R-Texas), chairman of the House IP panel, and nine co-sponsors introduced H.R. 2795, the Patent Reform Act of 2005. Like the Berman bill, the Patent Reform Act embodies a number of the FTC and NAS recommendations. It also makes some notable changes from the much-debated committee print.

While much has been written about the reform act's technical features affecting patent prosecution (for example, its elimination of the requirement for "best mode" disclosure), its potential impact on patent litigation is no less significant.

SHOULD THE PATENT REFORM ACT PASS AS drafted, the entire balance of power between patentees and accused infringers could shift. Why? Because the proposed legislation would greatly diminish the patent holder's effective right to secure an injunction to exclude a product from the marketplace after a finding of infringement.

A March 16, 2005, decision by the U.S. Court of Appeals for the Federal Circuit, *MercExchange LLC v. eBay Inc.*, highlights the critical role of the permanent injunction in patent infringement disputes. Zeroing in on the centrality of the injunction remedy, the court wrote: "Because the 'right to exclude recognized in a patent is but the essence of the concept of property,' the general rule is that a permanent injunction will issue once infringement and validity have been adjudged."

The Federal Circuit's take is clearly supported by the language of the Constitution indicating that patents should secure to inventors "the exclusive Right to their . . . Discoveries" for the duration of the patent.

In *MercExchange*, the Federal Circuit noted that courts have "in rare instances exercised their discretion to deny injunctive relief in order to protect the public interest"—for example, when the invention must be exercised to make critical medications available. But the word "rare" is key. The court continued that there was not "any persuasive reason to believe this case is sufficiently exceptional to justify the denial of a permanent injunction."

Now look at the House committee print for the Berman bill, which made an ill-conceived proposal to require courts to decline to grant an injunction unless the patentee is "likely to suffer irreparable harm." Since "irreparable" harm—even likely irreparable harm—is a high standard to meet, this proposal could fairly be read as an elimination of the almost-automatic right to exclude an infringing product.

Evidently, widespread criticism of this provision led to a revision in the 2005 proposed legislation. The new Section 7 requires that a court consider the fairness of the injunction remedy in light of all the facts and relevant interests of the parties. Although the new proposal softens the language of

the House committee print, this provision still shifts the balance more toward the infringer and away from the exclusive right of the patent holder. The Patent Reform Act demands a more case-specific analysis, although that analysis will still turn on facts relevant to the showing of harm, irreparable or otherwise.

IF THE REFORM ACT IS PASSED AS DRAFTED, this change to the injunction standard will significantly influence litigation strategy in all future patent cases. Both the patentee and the potential infringer will need to weigh the relevant harms to assess whether a court will grant an injunction. The one thing the change will not do is make patent litigation less burdensome. Courts will have to take the time and parties will have to expend the resources to determine whether the specific facts and circumstances of each case warrant a finding of irreparable harm to the successful plaintiff—and the consequent granting of injunctive relief.

Without the clear threat of an injunction, the patentee will also lose a significant advantage in settlement negotiations. After all, barring “irreparable” harm, the infringer will know that the only immediate threat is monetary damages. And Section 6 of the Patent Reform Act makes it more difficult for courts to award treble damages. Under the current law, the defendant who loses at trial risks an immediate, and possibly devastating, court-ordered shutdown of his production line.

Moreover, the proposed legislation states: “Unless the injunction is entered pursuant to a nonappealable judgment of infringement, a court shall stay the injunction pending an appeal upon an affirmative showing that the stay would not result in irreparable harm to the owner of the patent and that the balance of hardships from the stay does not favor the owner of the patent.” Although some will argue that this has long been the law, the Federal Circuit’s holding in *MercExchange* certainly suggests that staying an injunction is improper. Notably, in the period that an injunction is stayed pending appeal, the infringer will have considerably more time to design around the problem patent. Thus, even if the infringer loses on appeal and the permanent injunction is granted, he may be able to avoid any real business loss.

As a practical matter, accused infringers will have much less to lose by litigating. In cases where

the infringer has certain competitive advantages over the patentee—such as greater size, a ready availability of capital, and more robust sales and marketing capabilities—the infringer may be more likely to roll the dice in court. Perhaps the defendant’s damages expert will prove particularly persuasive and convince the jury that smaller monetary damages are appropriate.

The net result may be to lower the value of all patents, as patent holders lose the power to insist on exclusivity. In practice, we may face a system of compulsory licenses.

Interestingly, the FTC and NAS reports do not address injunctions. The impetus for the proposed change appears to stem from the concerns over patent trolls.

The argument has some appeal: If companies that neither innovate nor produce products, but merely exploit others’ patents, can nonetheless shut down companies that do actually produce products, it might seem as if the system has gone wrong.

The question is whether a few trolls warrant this shift in the bargaining power for all patent holders. Love it or hate it, the proposed injunction provision will undermine the ability of all patentees to exploit their creativity.

SECTIONS 6 AND 7 ARE NOT THE ONLY PROVISIONS in the Patent Reform Act that promise significant ramifications for litigation. Section 9 provides the framework for a more extensive post-grant review of issued patents than permitted in the current re-examination procedure before the Patent and Trademark Office.

Under the post-grant opposition provision, a party may raise essentially any of the statutory requirements for patentability to challenge a patent’s validity. Factual evidence and expert opinions can be submitted via affidavits or declarations. It is possible to obtain a hearing before the three-judge panel, which may include live cross-examination. The parties can settle before a written opinion is issued. The panel will evaluate the question of validity under the lower preponderance-of-the-evidence standard. And the panel must issue its decision within one year of the PTO commencing an opposition proceeding.

To those trying to reduce the cost of patent disputes, as well as those wishing to clear away the underbrush of dubious patents, Section 9 may sound appealing. But it may turn out to be a Trojan horse.

The current proposal includes a “stay of opposi-

tion” that was not included in the House committee print. Under this provision, an infringement suit in federal court is favored over an opposition proceeding before the PTO if the patent owner files the infringement suit within nine months after the patent is granted or within six months after the owner sends out an infringement notice.

Say that Company A files for an opposition proceeding against Company B’s patent. Now Company B has a decision to make: Should it wait for the outcome of the opposition proceeding? Or should it quickly sue Company A for infringement?

The opposition proceeding will essentially separate consideration of the validity issue from any infringement claims the patentee might raise later. So Company B might want to get the full case to court immediately. Indeed, recognizing this threat, Company A, which is likely also to be an accused infringer, may think twice before filing an opposition at all. Either way, we’re right back to an infringement dispute in federal court.

If Company B chooses to wait instead, Section 9 gives new meaning to the cliché “two bites at the apple.” Company A could make all its validity arguments in the opposition proceeding. But recognizing the risk of losing everything at once, counsel may suggest a more prudent course. Company

A may decide to strategically save certain validity arguments for a later infringement trial—presumably ones that are less technologically abstruse and, hence, more jury-friendly. And so both companies will still find themselves in federal court arguing over validity.

Moreover, because the PTO’s three-judge panel must address claim construction issues in determining validity, potential litigants will have to evaluate the impact this claim construction decision may have on an overburdened federal judge in a subsequent infringement suit. Depending on whether a litigant wants to overturn the panel decision, strategic forum selection may prove critical.

In short, the Patent Reform Act, in seeking to improve the IP system, will also undermine patent holders (in some cases) and create more work for litigators (in some cases). The question is whether these risks are ultimately justified. Will the Patent Reform Act “promote the Progress of Science and useful Arts”?

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