NATIONAL VENTURE CAPITAL ASSOCIATION
Funding innovation. Empowering entrepreneurs.

March 31, 2014

The Honorable Patrick J. Leahy
Chairman
Committee on the Judiciary
United States Senate
Washington, DC 20510

The Honorable Chuck Grassley
Ranking Member
Committee on the Judiciary
United States Senate
Washington, DC 20510

Dear Chairman Leahy and Ranking Member Grassley,

On behalf of the National Venture Capital Association (NVCA), I am writing to express our views on several critical issues included in the various patent litigation related bills currently pending in the Committee on the Judiciary that impact investment in the start-up ecosystem. As the voice of the venture capital industry, NVCA represents 90 percent of U.S. venture capital under management. Venture capitalists work closely with entrepreneurs to transform breakthrough ideas into emerging growth companies that drive U.S. job creation and economic growth.

Almost all venture capital investing involves risk, and usually the more innovative the breakthrough, the greater the risk. The primary task of venture capital investors centers on analyzing and assessing these risks. Therefore, the greater the perceived risk is in an investment, the greater must be the projected return to justify going forward. NVCA believes it is critical that Congress should take a carefully measured approach in making changes to the patent system because almost any such change is likely to alter the risk/benefit equation in ways that affect individual companies and specific industries in different ways. While some innovative companies have business models in which intellectual property does not play a significant role, for other companies' patents and legal protection against well-established incumbent competitors are essential to survival. A "one-size fits all" approach to patent enforcement is likely to have unintended and unforeseeable consequence for some small companies and could have a significant impact on others to the point that incentives to invest are diminished or extinguished. However, NVCA also recognizes that abusive practices in patent enforcement need to be addressed, either by the courts or through statutory or regulatory changes.

NVCA proposes the following suggestions for legislative solutions that we believe will address the key problems with the patent litigation system without inflicting undo damage on the need for strong patent protection.

The demand for the shifting of fees and costs: NVCA believes that proposals for mandatory fee shifting are an overly simplistic responses to the patent troll problem, premised on the mistaken belief that trolls are going to lose most of the cases that they bring. Well-funded trolls, however, know how to select the patents that they assert, thus undercutting the fundamental premise of the idea. Since the impact of a mandatory "loser pays" rule will be bidirectional, it is likely to affect defendants as much as plaintiffs, perhaps more so.

NVCA believes the biggest problem of the loser pays rule is that fee shifting will raise the risk level associated with patent litigation for BOTH parties, which places small companies actually using the patent system at a significant disadvantage against their larger competitors. This will be the case irrespective of whether the small company is the plaintiff or the defendant in the patent case.

Suggested alternative: NVCA would support an increase in the **discretionary** use of fee shifting, where either party has behaved in a manner that is abusive of the litigation process. NVCA would also support giving the trial judge greater leeway to assess fees where one party or the other asserts claims or position with little or no legal support, even though they may not be so frivolous as to require sanctions under current law. Rather than adopting some blanket provision that automatically shifts fees, NVCA would focus on the existing Patent law that allows the trial court, in its discretion, to require the losing party to pay the fees and costs of the winner. Although it is possible that the Supreme Court, when it decides the pending *Highmark* and *Octane* cases in the next few months, will give proponents of fee shifting at least some of what they want.

If Congress is determined to provide for some kind of fee shifting, the existing mechanisms of Section 285 of the Patent Act already provide a workable approach. Currently, that provision states that the trial court "in exceptional cases may award reasonable attorney fees to the prevailing party." Although the Federal Circuit has been highly restrictive as to what constitutes an "exceptional" case, Congress could mandate greater leeway for the trial judge to make such findings. For example, Congress might include in Section 285 language along the following lines:

> "In making a determination as to the exceptionality of a case, the district court may exercise sound judicial discretion appropriate to the specific parties and facts before the court. The district court may take into consideration: (a) whether the nonprevailing party asserted positions during the pendency of the litigation that had little likelihood of success; (b) whether the nonprevailing party persisted in asserting losing positions after it became apparent that the court had rejected such positions; (c) whether the nonprevailing party was candid and truthful with the court and with the other parties during the pendency of the litigation; (d) whether the prevailing party engaged in the same types of conduct set forth in subparts (a) – (c); (e) the relative size and access to resources of the parties, (f) whether the nonprevailing party was substantially engaged in any business other than the acquisition and enforcement for monetary damages of the patent or patents being asserted, and (g) whether the timing of infringement suits, claims and demands for royalties was calculated to coincide with periods of extreme vulnerability of the alleged infringer, such as, for example, the occasions on which an alleged infringer was trying to raise equity capital.
>
> "In making the determination of exceptionality, no one of the foregoing considerations need be dispositive; all should be weighted in the sound discretion of the district judge based on the circumstances of the particular litigation.
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> "Determinations under Section 285 are reviewed on appeal for abuse of discretion."

Although some of the foregoing factors (except for (e), (f) and (g)) are likely to be addressed by the Supreme Court in *Highmark* and *Octane*, if Congress were to endorse the need for more fee shifting in this fashion, it would probably lead to greater scrutiny by the courts of the conduct of the parties and the assertion of frivolous positions. In addition, parts (f) and (g) would actually be specific to patent trolls in a balanced and fair-sounding way that could give specific effect to the underlying policy objectives of the legislation.

Transparency and joinder: These two issues are critical issues for NVCA's membership. Because of the amount of risk venture capitalists take in the investment of a start-up company, they need certainty that this will be the full extent of the investment until they decide otherwise. Although the venture capital community, for the most part, would have no real problem with the simple identification of the ultimate owners of portfolio companies (*i.e.*, transparency), when that transparency is linked to possible joinder anytime a portfolio company needs to assert a patent, it may become a significant problem. Put differently, if there is to be any provision allowing a defendant in a patent case to pierce the corporate veil and allow a successful defendant to look to shareholders for litigation expenses, it is likely to be devastating to venture

capital investment. It would also be a bizarre distortion of a principle of corporate law that is validated by centuries of experience.

Nevertheless, if joinder provisions are to be included in any legislation, NVCA believes the language suggested below could be a workable approach. The proposed language would focus on the entity that puts up funds used to **acquire** previously issued patents from third parties for the **purpose** of enforcing them for patent damages or royalties. Both of the emphasized words are important – they require the acquisition of a previously issued patent and a purpose to enforce only for money damages. This approach would address the majority of those perceived as patent trolls and would still carve out an exception to the transparency requirement for most of the situations involving venture backed companies acting as patent plaintiffs.

Suggested alternatives: The transparency and joinder provisions in the pending legislation are premised on the belief that many patent trolls create elaborate ownership structures designed to conceal the true identities of those who control the litigation and will profit by it. The fundamental problem with the approaches taken in the pending legislation to transparency and joinder is the difficulty in differentiating a small LLC troll seeking to enforce a patent from a small venture-backed company seeking to enforce a patent. In terms of the transparency of ownership, both can be small companies whose principals and owners are not publicly known; both may have ultimate parent owners that are not interested in disclosing their identities; both may be unable to satisfy an award of litigation costs in the event that they lose the litigation.

One major difference between the two, however, and one that should be exploited, is that a patent troll normally seeks only money for a patent license and a venture backed company enforcing a patent is usually seeking to preserve or balance market access or to counter the threat of a patent suit from a competitor. Therefore, if it becomes clear that Congress is going to create joinder for some "ultimate parent companies" based on mandatory disclosure of all those who have an equity interest in the patent owner, one way to contain the adverse impact of such a provision on the venture community would be to frame the disclosure requirement in terms of:

> "persons or entities that provide funds to acquire previously owned patents and patent applications (including follow-on patents that trace their priority dates to previously issued patents that were acquired from a third party) for the sole purpose of asserting monetary demands for royalty revenues or damages for infringement, irrespective of the form of the financial transaction leading to the acquisition (*i.e.*, equity, debt or other financial obligation)."

NVCA does not believe that many venture backed companies acquire patents for the sole purpose of enforcing them for money; such companies would more likely be acquiring patents for defensive purposes to build an arsenal for counterattacking a competitor or to go after a competitor for stealing their technology; or simply to enhance the company's overall enterprise value.

As an alternative to having legislation, NVCA could support the PTO's recently circulated potential change in the Rules of Practice in Patent Cases as set forth in 37 Code of Federal Regulations, Part 1, as long as it is not linked to joinder provisions or used as the basis for ascertaining when to pierce the corporate veil.

Elimination of the estoppel provisions in the Post Grant Review procedures: NVCA is opposed to the modification of the estoppel provisions in the post grant review procedures. That estoppel was an iron clad requirement on which our support for the AIA was based and it would damage the credibility of Congress to now take that away. Without the estoppel, competitors of patent owners would have the right to take a free swing at their patents without any offsetting risk to the competitor; this puts small companies who need their patents for survival at a real disadvantage.

Suggested Alternative: NVCA understands that there is some objection to the estoppel language in 35 USC § 315(e)(2) in current statute which was included in the passage of the AIA. It is our understanding that the principal concern to this language is that the window for initiating a PGR proceeding is insufficient to explore all of the potential grounds for invalidity and that the estoppel would be extended to include later discovered grounds for invalidity that were not apparent or known to the petitioner at the time the PGR proceeding was filed. Although NVCA believes that the word "reasonably" in the current version of the statute is adequate protection against that eventuality, we would support the addition, after the word "review," of the words "based on information actually known or in the possession of the petitioner at the time of the review sufficient to support a challenge." We believe this would fully address the concerns of needing additional time to develop a case for invalidity but would prevent challengers from bringing forth some known grounds for invalidity while holding back other or even better known grounds for assertion in court.

Bad Faith Demand Letters: NVCA supports legislation that would provide the Federal Trade Commission the legal authority to challenge bad faith or deceitful demand letters that are sent out on a mass mailing basis.

Extending the Covered Business Method Procedure. NVCA opposes any effort to extend CBM review to all "software" patents, in part because no one has any idea as to the limits on that distinction. Software is a component of a large percentage of all patents on new technology. The CBM review provision was put in place as an experiment because of objection to the notion that financial products should be eligible for patent coverage at all. Whether or not the special challenge opportunity should be continued after the current law expires is highly questionable, but there is no justification whatever for extending it to patents on other types of inventions that otherwise meet the statutory requirements of Title 35.

Provide Full Protection of User Fees Paid to the U.S. Patent Office: NVCA supports the Patent Fee Integrity Act, which would provide full protection of user fees paid to the U.S. Patent and Trademark Office and which would prevent the continued withholding or diversion of such fees. The practice of fee diversion is especially burdensome for the innovative start-up companies.

Thank you for your leadership on these complex issues. We look forward to working with you and the other members of the Committee on legislation that balances the need to curb patent litigation abuses with the need to maintain strong protection for patent-dependent startups.

Sincerely,

Bobby Franklin

Bobby Franklin
President & CEO

Cc: Senate Judiciary Committee members