

**Submission for the Record
Statement of Robert P. Taylor
House Subcommittee on the Courts, Intellectual Property, and the Internet
February 12, 2015**

My name is Robert Taylor. I am the founder and owner of RPT Legal Strategies PC, an intellectual property consulting firm in San Francisco and Silicon Valley. For more than 30 years, I have been heavily involved in patent litigation, serving as lead trial and appellate counsel for both patent owners and companies accused of infringement. My clients have included companies of all sizes from Fortune 100 companies to start-ups, and my cases have dealt with a wide spectrum of technologies and industries. For the past 10 years, I also have counseled venture capital firms and many of the start-up companies in which they invest with respect to patent and litigation issues.

I am appearing here on behalf of the National Venture Capital Association (“NVCA”), which represents approximately 400 venture capital firms accounting for a large percentage of all venture capital invested in this country each year. NVCA wishes to express its thanks for an opportunity to be heard with respect to the pending patent legislation. One of NVCA’s most important roles is to assist Congress in understanding how new legislation is likely to affect the venture capital industry, emerging growth companies, and the process of innovation in America.

Throughout the American economy, innovators large and small ranging from universities and non-profit foundations, to start-ups and small businesses, to manufacturing, technology, and life science companies, are critically dependent on patents to protect and recoup their investments of time, money, and other resources in research and development. These organizations understand that domestic job growth and our competitive advantage in the global economy depend on a strong patent system that creates incentives for invention and protects inventors from unfair copying and imitation by others.

Let me say frankly at the outset, we are concerned that H.R. 9, if enacted as written, will have a chilling effect on investment in patent intensive companies, which in turn will have a depressing effect on innovation in general. At the very least, the legislation will make it far more difficult, risky and expensive for emerging companies to enforce their patents, which is an essential part of the patent right. Equally important,

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H.R. 9 also will raise the cost and risk confronting smaller companies trying to defend against patent litigation brought by their larger, incumbent competitors.

Many argue, correctly we believe, that much of the perceived need for legislation to address abusive litigation practices already is being dealt with effectively by the Supreme Court, U.S. Patent & Trademark Office (“PTO”) and Federal Trade Commission (FTC), all of which are discussed in greater detail below. Nevertheless, if Congress still sees a need to address the problem of abusive behavior by certain patent litigants, NVCA strongly believes that any new legislation should focus on specific behavior, not on the procedural aspects of enforcing patents.

Innovation does not take place in a vacuum. It requires entrepreneurs willing to devote time and resources to pursue visions and new ideas. It requires investors willing to invest time and money in developing those innovative new ideas. Venture capitalists work closely with entrepreneurs and innovators 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 and disruptive a breakthrough idea, the greater the risk facing those who would commercialize it. For thousands of companies across the United States, patents are the *only* way to ensure a return on investment sufficient to justify the risks involved in making such investments.

NVCA recognizes that some companies have business models in which intellectual property, such as patents, does not play a particularly significant role. For many older and well-established companies, for example, their size alone may provide better protection for their markets and investments than do their patents. For thousands of other companies, however, patents are the only way to insure a return on investment sufficient to justify the risks involved. This group includes companies developing digital technologies that employ innovative hardware and/or software, energy technologies, communication technologies, new polymers and metallurgical materials, information technologies, medical devices, biologics and pharmaceuticals. For these companies, a highly structured and rigid approach to patent enforcement is likely to have unintended and unforeseeable consequences.

Enforceability is the essence of the patent right. A patent that cannot or will not be enforced is useless. A patent that others believe will not be enforced has no deterrent

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effect on imitation of innovative products by incumbents. In this light, making it more difficult and costly to enforce patents in order to combat abusive litigation will have the unintended consequence of diminishing—if not extinguishing—the only true incentive that thousands of innovators presently have to invest the necessary time, money and other resources needed to create a new company from scratch. Put differently, the patent-backed right to own and profit from innovative ideas has been a major driving force for the American economy for 200 years, and that right requires that valid patents be fully enforceable in court at reasonable expense and without undue risk to the patent owner or its investors.

The Resurgence of Patent Cases at the Supreme Court.

In recent years, the Supreme Court has rekindled its interest in patent law. After a period of relative neglect following the 1982 creation of the Court of Appeals for the Federal Circuit, the Supreme Court in the last few years has begun tackling some of the most important issues defining the patent system. We are only halfway through the present decade and the Court already has decided more patent cases since 2010 than in the entire 1980s and 1990s combined.¹ The Court heard six patent cases last year and will hear more this year. The Court has plainly recognized the important role that patents play in our technological driven economy.

As a result of Supreme Court's decisions and the America Invents Act that became law in 2011, the patent landscape looks far different today than it did five years ago or even last year. New patent case filings in 2014 dropped 18 percent from 2013, as the full impact of judicial decisions and administrative developments began to be felt.

Fee Shifting.

Perhaps the most significant rulings of the past year were the two Supreme Court decisions in *Octane Fitness v. ICON Health & Fitness*² and *Highmark v. Allcare Health*

¹ Dennis Crouch, Supreme Court Patent Cases per Decade, <http://patentlyo.com/patent/2014/07/supreme-patent-decade.html>.

² 134 S.Ct. 1749 (2014).

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*Management System*³, wherein the Court construed Section 285 of the Patent Act and allowed prevailing parties in patent litigation to recover their costs and their lawyer and expert witness fees from the losing party. In the two rulings, the Supreme Court was critical of the restrictive approach to fee shifting taken by the Federal Circuit, particularly in cases where the district judge had made a determination that the prevailing party seeking fees had met the existing statutory standard for what constitutes an “exceptional case.”

The Supreme Court held that whether to shift fees under Section 285 is a matter that resides in the sound discretion of the district judge and is reviewable by the Federal Circuit only for abuse of discretion, not the *de novo* review the Federal Circuit had been using. Further, the Court held – contrary to the Federal Circuit rule – that a prevailing party need not establish its entitlement to fees by “clear and convincing” evidence, but only by a “preponderance of the evidence,” a significantly reduced burden to meet in this context.

Finally, and perhaps most importantly, the Supreme Court overturned the Federal Circuit rule that a case is exceptional only if the position of the nonprevailing party is both objectively and subjectively baseless, holding instead that a “totality of circumstances” test should be used to determine exceptionality. The Court held that the baselessness tests were too rigid and that district judges should have the discretion to award fees in a case that simply “stands out” from other case in terms of its substantive strength.

These rulings have already had a significant impact on the use of fee shifting to force the parties in patent litigation to take positions that have some probability of success. It is likely to have particular impact in cases where nonpracticing entities attempt to assert weak or frivolous patents.

Patent-Eligible Subject Matter.

One of the major complaints about patent litigation affecting the business community has centered on the large number of so-called “business method” patents in

³ 134 S.Ct. 1744 (2014).

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which the claimed “invention” was no more than the use of a computer to carry out a long established commercial practice. In *Alice Corporation v. CLS Bank*⁴, the Court held that a computer implementation of a well-established commercial practice is not patentable. The case involved a patent claiming a computerized method for settling financial transactions using a stakeholder. The decision casts considerable doubt on the validity of dozens of business method patents that were issued by the PTO during the last 15 years.

In the aftermath of *Alice Corp.*, there has also been a significant increase in the number of patents that have been invalidated in the lower court for lack of patent-eligible subject matter. In the four months following the *Alice Corp.* decision, 18 federal court rulings have relied on that decision to decide patentability cases, and in 14 of such cases (*i.e.*, 78 percent), the court invalidated the patent claim in question.⁵ Moreover, the lower courts appear to be reading *Alice Corp.* to hold that subject matter eligibility can be decided at an early stage of litigation, without the need for costly discovery or claim construction.⁶

We are already seeing evidence of this. In 2014, more than a dozen motions to dismiss and motions for judgment on the pleadings were granted finding that the patents-in-suit were not directed to patent-eligible subject matter. Such motions are being granted in districts across the country, including such traditionally plaintiff-friendly venues as the Eastern District of Texas. Therefore, a motion for an early determination that a patent is not directed to patentable subject matter will likely prove to be a powerful new tool to dispose quickly and cheaply of meritless, abusive lawsuits.

Nor is *Alice Corp.* the only effort by the Supreme Court to narrow the range of subject matter that may be patented. Three other cases since 2004 have also dealt with patent eligibility, each of them narrowing the scope of what is patentable: *Bilski v.*

⁴ 134 S.Ct. 2347 (2014).

⁵ B. McCall, Lessons from 4 Months of Post-Alice Decisions, LAW360, Oct. 31, 2014, available at <http://www.law360.com/articles/590465/lessons-from-4-months-of-post-alice-decisions>.

⁶ See *I/P Engine, Inc. v. AOL Inc.*, 576 Fed. App'x 982, 996 (Fed. Cir. 2014) (Mayer, J. concurring).

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*Kappos*⁷, *Mayo Collaborative Services v. Prometheus Laboratories, Inc.*⁸, and *Association for Molecular Pathology v. Myriad Genetics, Inc.*⁹ *Bilski* was another business method patent involving the use of computers to hedge risk; the Court held that the method was not patentable subject matter. In *Myriad*, the Court held that naturally occurring DNA sequences are not patentable. In *Mayo*, the Court held that a diagnostic process that merely measured the human body's response to a drug was ineligible for patent protection.

Collectively, these cases are refocusing the entire federal judiciary on the basic objective of the patent system to protect specific categories of subject matter and nothing else. They are having a clear impact on the types of patent cases that are likely to be brought in the future.

Indefiniteness.

Another significant complaint that defendants have raised about patents in recent years has been that the claims are vague and therefore the "invention" was too difficult to identify. In *Nautilus, Inc. v. Biosig Instruments, Inc.*¹⁰, the Supreme Court addressed the proper test for determining whether claim language is "indefinite" to the point that it fails to satisfy 35 U.S.C. § 112, ¶ 2. That statutory provision requires a patent owner to set forth claims that "particularly point out and distinctly claim" the invention, thus requiring patent applicants to differentiate their own inventions from the prior art and from the public domain so that members of the public are properly apprised as to what areas of endeavor are foreclosed by the patent.

Prior to the ruling in *Nautilus*, the Federal Circuit provided that a claim is indefinite only if it is "not amenable to construction" or "insolubly ambiguous."¹¹ The Supreme Court, in a unanimous opinion, held that such test does not adequately inform the public as to the boundaries of a patent claim. Noting that a patent draftsman may

⁷ 561 U.S. 593 (2010).

⁸ 132 S.Ct. 1289 (2012).

⁹ 133 S. Ct. 2107 (2013).

¹⁰ 134 S. Ct. 2120 (2014).

¹¹ *Datamize, LLC v. Plumtree Software, Inc.*, 417 F.3d 1342, 1347 (Fed. Cir. 2005).

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have a compelling incentive to write claims that are ambiguous and that the draftsman also is in the best position to avoid such ambiguities, the Court held that patent claims will be held invalid for indefiniteness if persons skilled in the art, after reading the patent specification and the claims, is unable to know with reasonable certainty what the invention is.

Nautilus will have a significant impact on the ability of patent owners to assert casually that a product or service is covered by a patent merely because a claim can be read in that fashion without regard to what it actually was intended to cover. Equally important is that *Nautilus*, when combined with the fee-shifting rules laid out in *Octane* and *Highmark*, will make it far more risky for patent owners to take absurd positions in litigation merely to promote unfair settlements.

Pleading Standards.

Notice pleading has been the normal practice in this country for decades. A complaint was required to put the defendant on notice of the general nature of the claims asserted and little else. An answer to a complaint needed only to apprise the plaintiff of the general nature of defenses likely to be asserted. Independently of patent litigation, that practice is being replaced with a more demanding form of complaint and answer. In *Bell Atlantic Corp. v. Twombly*¹² and *Ashcroft v. Iqbal*,¹³ the Supreme Court imposed a higher pleading standard in most civil cases. A complaint “must contain sufficient factual matter ... to ‘state a claim to relief that is plausible on its face.’”¹⁴

The Federal Circuit has held that *Twombly* and *Iqbal* do not apply to cases alleging only direct patent infringement,¹⁵ reasoning that Form 18 appended to the Federal Rules of Civil Procedure is controlling. Form 18 requires little more than that the plaintiff identify the patents-in-suit and a broad category of products that are alleged

¹² 550 U.S. 544 (2007).

¹³ 556 U.S. 662 (2009).

¹⁴ *Iqbal*, 556 U.S. at 678 (quoting *Twombly*, 550 U.S. at 556).

¹⁵ *R&L Carriers v. Driver Tech LLC*, 681 F.3d 1323 (Fed. Cir. 2012).

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to infringe.¹⁶ The Federal Circuit has, however, expressed its disapproval of Form 18 and has urged its removal from the Federal Rules. In response, the Judicial Conference has proposed amendments to the Federal Rules that would do so. The amendments are currently pending before the Supreme Court. The amended rules, assuming they are approved, will take effect in December, at which point *Twombly* and *Iqbal* will apply to all patent cases.

***Inter Partes* Review (IPR) Under the America Invents Act.**

Another of the complaints about patent litigation is the high cost of getting to a final resolution, which is particularly significant where the patent is ultimately held to be invalid in light of prior art that was not before the PTO. An alternative procedure for determining patent validity in such cases was created by the Leahy-Smith America Invents Act (AIA), which became law in late 2011. The *inter partes* review procedure allows a challenger to contest the validity of a patent within the PTO, which is a much faster and cheaper way to test its validity than doing so in court. Although the AIA took a couple of years for full implementation, its impact is now clear and significant. Since its implementation in 2013, more than 2400 IPR petitions have been filed. The PTO has initiated a review in approximately 80 percent of the cases where one was requested. Among the cases that reached a merits decision, the PTO has rejected some or all of the challenged claims approximately 75 percent of the time.

IPR reviews have greatly reduced the burdens on courts. When a defendant files an IPR petition against a patent that has been asserted in litigation and the PTO agrees to initiate a review, the district court will often stay the case, depending on the stage of the litigation. Regardless of outcome, the *inter partes* review will usually simplify the issues for trial. If the patent claims are rejected on review, then the IPR may dispose of the litigation entirely. Moreover, where the claims survive the review, the petitioner is estopped from further challenging the invalidity of the patent at trial on any ground that was raised or reasonably could have been raised as part of the IPR.¹⁷

¹⁶ Fed. R. Civ. P. Form 18.

¹⁷ See 35 U.S.C. § 315(e)(2).

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Inter partes review has proven to be especially effective against nonpracticing entities, because such proceedings are faster and far cheaper than litigation to get resolution of the same essential issues a court would otherwise decide. *Inter partes* review is therefore an effective means for an accused infringer to defend itself against an abusive lawsuit.

Federal Trade Commission and Demand Letters

Another complaint that surfaces about the current state of patent litigation is that some patent owners have sent abusive or deceptive letters to companies that they believe are infringing their patent rights. The FTC and some state attorneys general have weighed into this practice, using the power of their offices protect small businesses and consumers from what they consider to be improper practices.

Abusive demand letters is one area where additional legislation may be useful. The Targeting Rogue and Abusive Letters (TROL) Act, which passed the House Energy and Commerce Subcommittee on Commerce, Manufacturing, and Trade in July, would strengthen FTC and state authority to combat abusive demand letters.

Conclusion.

Innovation has been a fundamental driving force for the American economy for decades, but at no time has this been truer than in the past 25 or 30 years – a period in which our economy has literally exploded with innovative machines, tools, chemicals, drugs, medical devices and procedures, forms of communication and much, much more. It is no coincidence that this most dynamic period in the growth of American economic strength has occurred at a time when respect for patents and patent enforcement was at its highest point in nearly a century. Patents are critical to innovation in many industries and a company's ability to enforce its patents at reasonable expense and risk is an essential element of such rights.

If this Congress chooses to move forward with legislation, NVCA hopes it will bear in mind the strong correlation between patents and investment so that innovative start-ups and emerging companies in all sectors of our economy will continue to thrive. In assessing the need for legislation, we encourage Congress to consider carefully the impact of recent developments in the federal courts, at the PTO and at the Federal Trade

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Commission, all of which collectively have reduced significantly the number of new patent cases and promise to reduce them even further as the full impact of those developments begins to be felt. NVCA looks forward to working with this Committee and other members of the Congress on any such legislation.