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ABUSIVE PATENT LITIGATION: THE ISSUES IMPACTING AMERICAN COMPETITIVENESS AND JOB CREATION AT THE INTERNATIONAL TRADE COMMISSION AND BEYOND

HEARING

BEFORE THE

SUBCOMMITTEE ON
COURTS, INTELLECTUAL PROPERTY,
AND THE INTERNET

OF THE

COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES

ONE HUNDRED THIRTEENTH CONGRESS

FIRST SESSION

APRIL 16, 2013

Serial No. 113–24

Printed for the use of the Committee on the Judiciary

Available via the World Wide Web: http://judiciary.house.gov

U.S. GOVERNMENT PRINTING OFFICE

80–459 PDF WASHINGTON : 2013

For sale by the Superintendent of Documents, U.S. Government Printing Office
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ABUSIVE PATENT LITIGATION: THE ISSUES IMPACTING AMERICAN COMPETITIVENESS AND JOB CREATION AT THE INTERNATIONAL TRADE COMMISSION AND BEYOND

TUESDAY, APRIL 16, 2013

HOUSE OF REPRESENTATIVES

SUBCOMMITTEE ON COURTS, INTELLECTUAL PROPERTY, AND THE INTERNET

COMMITTEE ON THE JUDICIARY

Washington, DC.

The Subcommittee met, pursuant to call, at 2:25 p.m., in room 2141, Rayburn Office Building, the Honorable Howard Coble, (Chairman of the Subcommittee) presiding.

Present: Representatives Coble, Goodlatte, Marino, Chabot, Poe, Chaffetz, Farenthold, Collins, DeSantis, Watt, Conyers, Chu, DelBene, Jeffries, Nadler, Lofgren and Jackson Lee.

Staff present: (Majority) Vishal Amin, Counsel; Olivia Lee, Subcommittee Clerk; and (Minority) Stephanie Moore, Minority Counsel.

Mr. COBLE. The Subcommittee on Courts, Intellectual Property, and the Internet will come to order. Without objection, the Chair is authorized to declare a recess of the Subcommittee at any time.

We welcome all our witnesses today.

Before we get into the hearing as such, I want to convey our condolences to our New England friends who were the victims of the inexcusable and indefensible tragedy that struck Boston yesterday. I know the victims are all in our thoughts and prayers.

I will give my opening statement now.

It is clear that abusive patent litigation serves as a drag on our economy and our future competitiveness. The America Invents Act of 2011 was the most substantial reform to the U.S. patent system since the 1836 Patent Act. Though the America Invents Act set our patent system on solid footing, there are still a number of patents that have been issued or are currently being reviewed under the old system. Many, if not most, are good patents, but there are a number that probably never should have been granted in the first place. Though these patents will eventually work their way out of the system as they expire, that does not mean that they are not causing real harm to American entrepreneurs and job creators today.

Today's hearing builds on the Subcommittee's March 14th hearing regarding abusive patent litigation, and on the July 18, 2012 hearing on the International Trade Commission. The ITC has a long history, but in the last few years it has become an attractive forum for patent cases. In fact, the average number of ITC complaints filed annually during the past decade is nearly triple the average for the previous decade. Some may say that the situation is starting to get out of control.

Recent decisions at the ITC to expand the domestic and industry requirement have led to more cases migrating to the agency. When a patent holder brings a case at the ITC, the alleged infringer faces the ultimate punishment, the exclusion order. The ITC serves a narrow role. It is not meant to be an alternative to district court, and it is not equipped to deal with the complexities of today's various technologies.

When it is one patent to one product, the decision may be clear. But when you are talking about a product with thousands of patents spread across hardware and software, the issues become much more complex. Patent assertion entities, PAEs, have increasingly been using the ITC to drive litigation settlements. With unlimited discovery and a punishment that is absolute, a PAE knows that it will just make economic sense for an infringer to simply pay up. And even when the case is litigated at the ITC, since it is just a Federal agency, the PAE can go to the ITC, lose, and still go to the district court and sue again.

Clearly, the ITC has veered away from its statutory mandate into uncharted waters. The ITC can still fix the problem that they have created by taking several simple steps which include narrowing the domestic industry requirement and conducting their public and economic interest tests upfront when deciding whether or not to even allow a case to proceed at the ITC before discovery begins.

American innovation cannot be held hostage to frivolous litigation from weak or over-broad patents. To ensure that the American economy does not suffer legal gamesmanship that is currently taking place by patent assertion entities, or patent trolls, it is important for us to consider ways to remedy the situation. I hope we will hear today what potential steps can be taken to promote America's innovation economy and create jobs.

I again thank the panel for your presence here today, and I am now pleased to introduce the gentleman from North Carolina, the Ranking Member, Mr. Mel Watt, for his opening statement.

Mr. WATT. I thank the other gentleman from North Carolina, our Chair, and join him in expressing my shock and condolences to those who were injured and the families of those who were killed yesterday in Boston also.

Today we continue our examination of litigation abuses in the patent arena, turning our focus for the first time in this Congress to the International Trade Commission. I am very pleased that we have before us the immediate past chair of the Commission, Ms. Okun, and I would like to thank her publicly for accepting the invitation to testify today.

Last Congress, then Chairman Smith, Ranking Member Conyers and I wrote a letter to Chairman Okun expressing our concerns

about the policy implications of companies using the ITC to seek exclusion orders on standard essential patents. We noted that, "The ability to leverage standard essential patents to obtain an exclusion order may result either in these products being excluded from markets altogether or in companies paying unreasonable royalty rates to prevent an exclusion."

Although today's hearing does not focus specifically on standard essential patents, it does touch on the issue of whether certain companies that are often called "patent trolls" unfairly wrestle unreasonable royalties from legitimate U.S. manufacturers with threats of obtaining exclusion orders. More precisely, we are seeking to evaluate whether the practices and procedures before the ITC, including the domestic industry requirement, invite abuse by those seeking to extract unjust settlements from manufacturing and production companies that employ thousands of Americans.

It is for that reason that it is very valuable to have Chairman Okun at our witness table today. That, of course, is not designed to minimize the importance of the presence and testimony of our other expert witnesses on today's panel.

Mr. Chairman, let me make four brief points. First, I think it is evident that there is no satisfactory definition based on business models of what constitutes a troll. The fact that an entity, whether a university, an independent inventor, or a patent aggregator does not exploit its patents in the same manner in which a production company may use the patented devices or technology does not mean that the entity is a troll, or that it stifles innovation, or is otherwise non-essential to the patent ecosystem. The existence of a robust secondary market in patents is vital to the patent system, and responsible non-practicing entities often play an important role in that market.

Second, there are multiple players with distinct purposes operating in this space that we all must be cognizant of. I hope that I need not remind members of the Intellectual Property Subcommittee that the principal objective of the patent system is to promote the progress of science and the useful arts by providing incentives to innovators to keep innovating.

I also hope I need not remind members of the Judiciary Committee that the judicial system exists to provide a civil forum for the unbiased resolution of disputes between private parties, and is largely premised upon the principle of open access to all litigants with standing to sue, with particularized sanctions for misuse or abuse of the system.

And the ITC, which exercises in rem jurisdiction, is a trade forum whose core task is to protect U.S. industries from unfair trade practices. It would be foolhardy to dismantle any of these players, even at the margins, or unhinge their foundational underpinnings to solve a particular perceived problem, including the problem of trolls.

Third, I think there is a need for substantially more information to avoid uninformed or precipitous action by this Committee. While I don't discount the costs that abusive non-practicing entities inflict on the marketplace, or the concern of production companies about the number of settlements they enter into. Because most settlements are confidential, it is impossible to assess whether the num-

bers reflect that extortion is taking place or, on the other hand, whether some of these settlements might actually reflect fair compensation for infringed property rights.

If infringement is taking place, we certainly don't want to turn a blind eye to it simply because we don't like the plaintiff or can conveniently categorize that plaintiff as a troll.

Finally, although this Subcommittee does not have specific jurisdiction over the inner workings of the ITC—we do have a jurisdictional interest in how intellectual property is impacted by its investigations. In that vein, I would caution those who advocate for solutions directed at ill-defined entities as opposed to specific abusive conduct to examine carefully the implications of those proposals.

For example, isn't it possible that the Shield Act's loser pay requirement in patent litigation in Federal court of a bond for non-practicing entities to initiate suit could have the unintended consequence of driving even more patent enforcement activity to the ITC, the very complaint we are here trying to address today? In other words, if we erect overly onerous barriers to access the Federal courts, wouldn't non-practicing entities that can meet the requirements at the ITC likely migrate to that forum?

As I have indicated in our previous hearings, I continue to believe that focusing on the activity as opposed to the actor would yield better results.

With that, Mr. Chairman, I yield back the balance of my time and look forward to hearing the testimony of our witnesses today, and again welcome Ms. Okun and all of the witnesses.

Mr. COBLE. I thank the gentleman from North Carolina.

The Chair now recognizes the distinguished gentleman from Michigan, the Ranking Member for the full Committee, for his opening statement.

Mr. CONYERS. Thank you, Chairman Coble. I welcome all of the witnesses, particularly the former chair of ITC and the chairman of the legislative committee of the trial lawyers.

Now, it can't be disputed, and Mel Watt has done an excellent job of this, that there has been an increase in the number of new Section 337 investigations over the years. But we should examine whether the increase in the number of these investigations is really due to abusive behavior by the non-profits or is there some other reason. For my part, let me just say that these incredible increases of challenges tripled over 10 years is not good. Sixty-five percent of them proceed simultaneously in the Federal district court, and I remain skeptical of current proposals to abuse patent litigation by reforming ITC legislatively.

There is not as much abuse as I first suspected, but this is what we are holding the hearing for. I want to find out from our experts. We know that these cases are being watched closely. Any proposed change must not adversely impact American innovators.

Now, the patent law is not efficient, the other reason that we are here, 700,000 backlog. And although they are shrinking, they are not shrinking fast enough. So let's find out what is going to be revealed at this hearing.

I thank the Chairman, and I return my unused portion of time.

Mr. COBLE. I thank the gentleman from Michigan for his comments.

I think Chairman Goodlatte was on his way, but I see he has not arrived as yet.

We have a very distinguished panel of witnesses today, as I previously indicated. Each of the witnesses' written statements will be entered into the record in its entirety. I ask that each witness summarize his or her testimony in 5 minutes or less. To help you stay within that time frame, there is a timing light on your table. When the light switches from green to yellow, that is your indication that you have 1 minute to remain and the ice upon which you are skating is thin. [Laughter.]

No one will be keel-hauled. But if you can keep it within 5 minutes, that would be appreciated. When the light turns red, that does signal that the 5 minutes have expired.

I will begin by swearing our witnesses in today before introducing them. If you would, please, rise.

[Witnesses sworn.]

Mr. COBLE. Let the record reflect that all answered in the affirmative.

Now I will introduce each witness, and then we will proceed with the testimony.

Our first witness today, Mr. Kevin Rhodes, Vice President and Chief Intellectual Property Counsel, 3M Innovative Properties Company. In his position, Mr. Rhodes manages 3M global intellectual property assets in its worldwide affiliates. Mr. Rhodes joined 3M in 2001. Prior to that, he was a partner at Kirkland & Ellis in Chicago, specializing in intellectual property and litigation. Mr. Rhodes is a member of the Board of Directors of the Intellectual Property Owners Association Educational Foundation.

Mr. Rhodes received his J.D. magna cum laude from Northwestern University, and his B.A. in Chemistry from Grinnell College.

Our second witness, Mr. Jon Dudas, former Undersecretary of Commerce for Intellectual Property and Director of the U.S. PTO. Mr. Dudas was appointed as Director in 2004 and served in this position until 2009. He also served 6 years on the House Judiciary Committee, including time as counsel of this Subcommittee in the area of intellectual property, having worked on major company patent rights and trademark policies and laws. After leaving the U.S. PTO, Mr. Dudas joined the law firm of Foley & Lardner as a partner and became President of FIRST, For Inspiration and Recognition of Size and Technology. Mr. Dudas currently serves on the Board of Directors of MOSAID Technologies, Inc.

Mr. Dudas received his J.D. degree from the University of Chicago and his B.S. in Finance summa cum laude from the University of Illinois.

I understand that our third witness, Professor Colleen Chien, is a constituent and friend of Congresswoman Zoe Lofgren, and Ms. Lofgren has asked for the opportunity to introduce Professor Chien, and I am now pleased to yield to her for that purpose.

Ms. LOFGREN. Well, I appreciate that very much, Mr. Chairman, and it is an honor to introduce Professor Colleen Chien. She is a Professor of Law at the University of Santa Clara, my alma mater, and where I serve on the Board of Visitors. She is nationally known for her research and publications about patents, and espe-

cially domestic and international patent law and policy issues. She is an expert on the International Trade Commission and has authored many articles about it, and is a co-author of the practice guide, the Section 337 Patent Investigation Management Guide.

She is an engineering graduate of Stanford University, got her juris doctorate from Boalt Hall. Before serving as a professor, she prosecuted patents with Fenwick & West in San Francisco, and also did stints as a consultant at Dean and Company, a spacecraft engineering company at NASA Jet Propulsion Lab. She is the inaugural Eric Yamamoto Emerging Scholar at Santa Clara University Law School, and she is one of Silicon Valley's Women of Influence, and I think all of the Santa Clara University community is proud that she is a witness here today.

I yield back, Mr. Chairman.

Mr. COBLE. Thank you, Ms. Lofgren, and it is good to have Ms. Chien with us as well.

Our fourth witness, Mr. Russell Binns, is Associate General Counsel in IP law and litigation with Avaya. In his role, Mr. Binns is responsible for all aspects of Avaya's worldwide intellectual property legal operations, including IP litigation and patent procurement. Prior to joining Avaya, Mr. Binns worked as an IP litigator with Goodwin Procter in New York and in Boston. He also serves as board member for the Intellectual Property Owners Association.

Mr. Binns received his J.D. from the Franklin Pierce Law Center and his Bachelor of Science in Electrical Engineering from Clarkson University.

Our fifth witness is Ms. Deanna Tanner Okun, about whom we heard earlier, a partner at Adduci, Mastriani & Schaumberg, and former Chairman of the U.S. International Trade Commission. Ms. Okun served two terms as chairman during her 12 years of service at the ITC. Ms. Okun also served as counsel for international affairs to Senator Frank Murkowski, associate attorney and member of the International Trade Group at Hogan & Hartson, and research associate specializing in trade at the Competitive Enterprises Institute.

Ms. Okun received her J.D. with honors from Duke University School of Law and her B.A. with honors from Utah State University.

Our final witness, the sixth and final witness is Mr. David Foster, Chairman of the Legislative Committee at the U.S. International Trade Commission Trial Lawyers Association, also known as U.S. ITCTLA. He is also a partner at Foster Murphy Altman & Nickel, where he focuses on international intellectual property matters, particularly international licensing and litigation. Mr. Foster has worked extensively on Section 337 of the Tariff Act beginning in 1974 while working at the ITC's General Counsel office, and then as the Trade Counsel for the Senate Finance Committee, and now represents complainants and respondents litigating patent disputes at his firm.

Mr. Foster received both his law degree and his bachelor's degree from Arizona State University.

Welcome to all of you.

Mr. Rhodes, if you will kick it off, and keep a sharp eye on the time clock, if you will. Thank you.

TESTIMONY OF KEVIN H. RHODES, VICE PRESIDENT AND CHIEF INTELLECTUAL PROPERTY COUNSEL, 3M INNOVATIVE PROPERTIES COMPANY

Mr. RHODES. Thank you. Chairman Coble, Ranking Member Watt and Members of the Subcommittee, thank you for the opportunity to testify today. Because of the importance of a well-functioning patent system to 3M's business model, which is based on bringing innovative new products to its customers, 3M has been engaged with Members of this Subcommittee and other stakeholders for many years as we have discussed issues of patent law and policy. We appreciate the opportunity to continue that dialogue today.

3M brings a balanced perspective to the question of patent litigation abuse. We have litigated patent disputes in district courts across the country and in many ITC investigations. 3M is a plaintiff as often as it is a defendant, and we recognize that abusive litigation practices can be perpetrated by defendants as well as plaintiffs, and by practicing patent owners as well as non-practicing patent owners. It is the abuse that should be targeted, not particular types of patent owners.

Any legislation to curb litigation abuse should ensure that a patent owner's right to enforce against infringement—a core value of the patent grant, the right to exclude others—is not unduly weakened by overly broad reactions to litigation abuse by a few patent owners.

Regarding calls for legislative action at this time, there are a lot of moving parts right now in the patent system. Many of them will impact patent litigation outcomes and procedures, including the reforms just now fully being implemented by the Leahy-Smith America Invents Act. Until the combined impacts of these changes become clear, 3M urges caution in making major changes that may risk unintended consequences or otherwise upset the balance of the patent ecosystem as a whole.

Now, against that background and call for caution, I will turn to the ITC. The ITC is an important venue for 3M and other U.S. patent owners to protect their inventions against infringing imports. The ITC is too important to weaken unless and until a compelling case is made that it is broken and that it cannot fix itself. I do not believe that case has been made.

Just yesterday, the ITC released updated caseload statistics. I encourage you to review them. People look at these statistics and the caseload data in different ways, but what is telling to me is that the ITC itself has looked at its data and it has concluded that the increase in its caseload has not been caused by so-called patent assertion entities who seek exclusion orders. And to the extent that there are legitimate concerns, which there are, the ITC already has the tools and the authority to guard against abuse. It has shown awareness of the concerns being expressed, sensitivity to those, and it has taken action to address them. I will give you a few examples of the most recent actions it has taken.

In 2011, the ITC, in a case, clarified the elements needed to establish a licensing-based domestic industry, and that is how PAEs, patent assertion entities, seek to prove they have established a domestic industry through licensing. Since that time, only one party has been successful in establishing a domestic industry through li-

censing investments, and that case was in July of 2012. In that case, the ITC held that the party, in establishing the domestic industry, could not rely on money it had spent on purchasing patents, on patent litigation, and on patent reexamination proceedings.

Just last month, in an investigation brought by a PAE, the ITC ordered the judge to issue an expedited initial determination within the first 100 days solely on the threshold issue of whether that PAE can show a domestic industry through licensing. The investigation will not proceed unless this threshold showing is made. So this is a great example of active case management identifying when domestic industry is a key threshold issue, accelerating that determination to the front of the investigation, and if that showing isn't made, the investigation won't continue.

The ITC recently issued new rules that provide for a more complete record on public interest considerations. These have to be considered even before an investigation is begun, and they must be taken into account before issuing any exclusion order.

Finally, just last week, the ITC published new rules of practice and discovery rules, and it has also proposed new rules for E-discovery that are based on the Federal circuit's recently issued E-discovery model order. So the ITC is looking at all facets of its law and its practice to address the concerns that have been expressed.

We believe it is prudent to monitor and assess the impact of these efforts the ITC already has underway before considering what, if any, further legislative changes may be warranted.

As always, 3M remains committed to working with Congress and all stakeholders to find fair and balanced solutions to curb abusive litigation practices in patent cases. I will be pleased to answer any questions or to supply any additional information for the record. Thank you very much.

[The prepared statement of Mr. Rhodes follows:]

Statement of

Kevin H. Rhodes

Vice President and Chief Intellectual Property Counsel of 3M Company

To the

Subcommittee on Courts, Intellectual Property and the Internet
Committee on the Judiciary
United States House of Representatives

On

"Abusive Patent Litigation: The Issues Impacting American Competitiveness and Job Creation at the International Trade Commission and Beyond"

April 16, 2013

Chairman Coble, Ranking Member Watt and Members of the Subcommittee:

Thank you for the opportunity to testify on the subject of "Abusive Patent Litigation: The Issues Impacting American Competitiveness and Job Creation at the International Trade Commission and Beyond." I am a Vice President and the Chief Intellectual Property Counsel of 3M Company and the President and Chief Intellectual Property Counsel of 3M Innovative Properties Company. At 3M, I am responsible for managing the global intellectual property assets of the company and its worldwide affiliates.

Although I testify today on behalf of 3M, I am also a member of the Steering Committee of the Coalition for 21st Century Patent Reform, which recently submitted testimony to the Subcommittee on the subject of abusive patent litigation.[1] I concur with the views expressed in that testimony and build on those views here.

Based in St. Paul, Minnesota, 3M is a global, diversified technology company with sales totaling nearly $30 billion in 2012. As a company based on bringing innovative new products to its customers, a well-functioning patent system is an issue of intense interest to 3M. In 2012, 3M invested over $1.6 billion in R&D, and was awarded 527 U.S. patents. In total, 3M's patent portfolio includes approximately 10,000 issued and pending patents and patent applications in the U.S., and approximately 40,000 patents and patent applications worldwide.

[1] *See Abusive Patent Litigation: The Impact on American Innovation & Jobs, and Potential Solutions*, Hearing Before the House Subcommittee on Courts, Intellectual Property and the Internet, 113th Cong. (prepared statement of Philip S. Johnson, Johnson & Johnson) (Mar. 14, 2013).

3M's business interests are extremely diverse. 3M sells over 50,000 products in five different business groups. Those groups range from industrial products like abrasives, adhesives and automotive components; consumer products like Post-it® notes and Scotch® tape; safety and graphics products like RFID tags and readers, respirator masks, optical films for computer screens and reflective sheeting for road signs; electronics and energy products like fiber optic connectors, window films and components for solar energy generation; and health care products like stethoscopes, dental implants and medical billing software.

With business interests in so many different industry segments, 3M has experience with many different aspects of patent infringement litigation in district courts and before the International Trade Commission ("ITC" or "Commission"). At any given time, 3M may be involved in dozens of patent infringement lawsuits or pre-litigation disputes in the U.S. In roughly half of those cases, 3M is enforcing its patent rights against unauthorized uses by competitors. Whether 3M is seeking injunctive relief in U.S. district court, an Exclusion Order from the ITC, or licensing royalties, 3M enforces its patents to protect its enormous investments in research, development and commercialization of its innovations. By protecting those investments, 3M can continue to invest in the costly and uncertain R&D efforts it takes to bring new technology, products and innovation to companies, homes and lives in the U.S. and around the world.

On the other hand, with so many products on the market, 3M also has a steady docket of cases in which 3M is defending itself against charges of patent infringement. As an integral part of its new product development process, 3M reviews thousands of third-party patents each year in an effort to ensure that 3M is not infringing the patent rights of

others. Nonetheless, disputes inevitably arise and 3M finds itself on the receiving end of patent assertion letters and infringement lawsuits from non-practicing entities (NPEs) and patent assertion entities (PAEs), as well as competitors.[2]

Thus, 3M is familiar with the concerns expressed by those stakeholders calling for legislation to address abusive patent litigation practices. 3M understands from first-hand experience the costs involved in defending itself in an ITC investigation alleging infringement by software and components of products with hundreds of other components, like 3M's RFID readers, tags and software used for electronic toll collection and parking management. Likewise, 3M appreciates the challenges involved in defending against a patent infringement lawsuit brought by a PAE alleging infringement by components of products we did not design or develop, and source from other manufacturers, like components of 3M's digital projector and display units. Finally, 3M knows how difficult it can be to defend against patent infringement allegations brought by a PAE and based merely on 3M's use of products or services provided by others, such as allegations made against 3M when our marketing and sales organizations use social media platforms or third party software for live chat services.

[2] Although the terminology is not well-defined, clear or subject to accepted, shared or even common understandings, as I understand the term, a non-practicing entity (NPE) is a patent owner who does not make or sell a product embodying its patented invention. NPEs thus may include a wide variety of patent owners, including not only so-called "patent trolls," but also universities, individual inventors, startup firms, R&D or engineering entities, patent holding companies, patent aggregators, companies not practicing noncore patents, and even companies that have not yet commercialized a particular patent, but which may in the future depending on their resources, business plans and customer demands. Patent assertion entities (PAEs), as I understand the term, are a subset of NPEs that acquire patents for the sole purpose of obtaining settlement payments by asserting them against alleged infringers. *See* Fed. Trade Comm'n, The Evolving IP Marketplace: Aligning Patent Notice and Remedies with Competition, at p.8 n.5 (2011) (available at http://www.ftc.gov/os/2011/03/110307patentreport.pdf).

Given the diversity of 3M's interests with respect to patent litigation, 3M approaches the question of litigation abuse from a balanced perspective. As a party to patent infringement litigation, 3M is a plaintiff about as often as it is a defendant, and many of the latter cases involve 3M defending itself against infringement allegations brought by NPEs or PAEs. Thus, 3M supports balanced, measured reforms to curb the litigation abuses that undeniably currently exist, balanced against the need to ensure that a patent owner's ability to enforce its patent rights against infringement – a core value of the patent grant – is not unduly undermined by unbalanced, overly-broad reactions to litigation abuses by some patent owners.

I. The Need for Balanced, Measured Reforms That Build Upon Those Already in Progress and that Focus on Curbing Litigation Abuse, Not on Penalizing Certain Types of Patent Owners.

Much of the discussion of abusive patent litigation misses the mark because it is focused on certain types of patent owners who do not commercialize their patented inventions, rather than on the perceived abuses of the system and how those abuses may be curtailed. Not only does such labeling of patent owners run the risk of penalizing independent inventors, universities, startups, technology licensing firms and others legitimately seeking to exploit their patent rights through litigation of entirely meritorious claims, but it also distracts from fair and comprehensive solutions that would deter abusive litigation practices by all litigants.

Some of our nation's most visionary and productive inventors do not manufacture or market their own inventions. Among these are America's independent inventors, university and government-based inventors, and many small businesses and start-ups. NPEs serve as

important sources of technology that is developed and brought to market by others, including 3M.

That said, it is an unfortunate reality that some patent owners have abused the litigation system by making overly-broad infringement assertions, often against an entire industry or against many different participants in a manufacturing/supply/distribution/retailer/end-user chain, intending to extract windfall settlements from multiple defendants seeking to avoid the cost and disruption of litigation. Non-meritorious litigation positions, espoused by patent owners to force settlements in the face of the staggering costs of litigation, have no place in patent cases. But non-meritorious litigation positions are no more acceptable coming in the form of specious infringement defenses or counterclaims pled by an accused infringer, and no more acceptable coming from a patent owner that practices its patent than from a non-practicing entity. Yet some proposed reforms, which single out non-meritorious litigation positions only when taken by certain non-practicing patent owners, while ignoring bad litigation behavior by others, represent thinly-disguised efforts to devalue certain types of patents, to make infringement a less risky business decision, or to use patent law to pick winners and losers among different industries. Reforms designed to curb litigation abuse should be applied in a balanced, principled manner, targeting litigation misbehavior on the part of any litigant, to avoid unintended consequences that may upset the balance of the patent ecosystem as a whole.

I urge Congress to proceed cautiously when considering further changes that may impact the balance between plaintiffs and defendants in patent infringement cases, when so many changes are currently underway already. The ITC, for example, is in the process of

developing its jurisprudence and practice to respond to concerns expressed regarding PAEs seeking unwarranted Exclusion Orders and to improve its management of patent infringement investigations. As discussed below, I do not believe the case has been made for more radical changes to ITC law or practice at this time; even if the ITC's current efforts do not go as far as some have sought to make it more difficult for PAEs to obtain Exclusion Orders, it is prudent to monitor and assess the impact of the ITC's efforts currently underway before considering what, if any, further changes may be warranted.

With respect to district court patent litigation, it is equally important to monitor closely the impact of the numerous reforms already enacted and currently being implemented by the Leahy-Smith America Invents Act, judicial decisions on substantive issues of patent law, district court local rules, Federal Circuit model rules and the Patent Pilot Program.[3] The combined impact of these changes is far from clear at this time, so I urge caution in making further changes without fully considering the possibility of unintended consequences that would make reliable patent enforcement substantially less certain, and risk undermining the value of patent rights and chilling innovation. Provided that such caution is exercised, however, I believe that several of the current proposals designed to curb litigation abuses in district court patent cases do have merit and warrant further consideration. Specifically, I believe that proposals in three areas, each of which I discuss

[3] *See Abusive Patent Litigation: The Impact on American Innovation & Jobs, and Potential Solutions*, Hearing Before the House Subcommittee on Courts, Intellectual Property and the Internet, 113th Cong. (prepared statement of Philip S. Johnson, Johnson & Johnson) (Mar. 14, 2013), at pp. 8-15 (discussing steps that have already been taken, or are in the process of being taken, by courts, Congress and the PTO to counteract abusive patent litigation).

further below, hold promise for curbing the most egregious abusive litigation practices and thus deserve further discussion and consideration:

- More frequent fee-shifting in favor of prevailing parties in patent cases;
- More proportional and uniform discovery in patent cases; and
- Codification of the right to stay patent suits against customers and end users.

As always, I and the Coalition for 21st Century Patent Reform remain committed to working with Congress and all stakeholders to find fair and balanced solutions to curb abusive litigation practices in patent cases.

II. Abusive Patent Litigation at the ITC.

Concerns have been raised regarding certain types of complainants which seek ITC Exclusion and Cease and Desist Orders to prohibit the importation into, and the sale within, the United States of imported articles that infringe a valid and enforceable U.S. patent, and for which there exists a so-called "domestic industry."[4] The issue is whether the ITC should issue Exclusion and Cease and Desist Orders, or even institute Section 337 investigations, on behalf of PAEs – that subset of NPEs who acquire patents for the sole purpose of obtaining settlement payments by asserting them against alleged infringers. PAEs cannot establish a "domestic industry" through manufacture of the patented articles in the United States and have no intention of establishing such an industry by manufacturing or marketing any articles covered by their patents. Rather, PAEs seek to show a "domestic industry" through

[4] The ITC's authority to undertake such investigations and to issue Exclusion and Cease and Desist Orders arises from Section 337 of the Tariff Act of 1930, 19 U.S.C. § 1337 ("Section 337").

investments in "licensing" their patents, with such licensing investments primarily consisting of litigation fees and costs associated with enforcing the patents against alleged infringers. Even though they seek to license their patents, not to exclude others from practicing them, PAEs are said to be turning to the ITC to seek Exclusion Orders solely to obtain negotiating leverage to extract larger royalties from accused infringers, because they are less likely to obtain similar leverage in the form of injunctions from U.S. district courts following the U.S. Supreme Court decision in *eBay, Inc. v. MercExchange, L.L.C.*, 547 U.S. 388 (2006).[5]

Under Section 337, a domestic industry relating to articles protected by the patent for which an Exclusion Order is sought is considered to exist if there is, in the United States and with respect to those patented articles:

> (A) significant investment in plant and equipment;
>
> (B) significant employment of labor or capital; or
>
> (C) substantial investment in its exploitation, including engineering, research and development, or licensing.[6]

It is important to note that not all NPEs fall into the category of PAEs. There are many NPEs – *e.g.*, universities, engineering firms, research-based institutions – that expend considerable resources on the research and development of new inventions that they seek to commercialize indirectly through the sale and/or licensing of patents covering those

[5] *See eBay*, 547 U.S. at 391 ("A plaintiff must demonstrate: (1) that it has suffered an irreparable injury; (2) that remedies available at law, such as monetary damages, are inadequate to compensate for that injury; (3) that, considering the balance of hardships between the plaintiff and defendant, a remedy in equity is warranted; and (4) that the public interest would not be disserved by a permanent injunction.").

[6] 19 U.S.C. § 1337(a)(3).

inventions. These NPEs do not based their claims of domestic industry solely on licensing; indeed, they may satisfy most or all of the criteria set forth in subsection (a)(3)(C) of Section 337. In this sense, these NPEs have many of the same attributes as firms that manufacture patented products, which likewise must make investments in such things as plant and equipment, labor or capital, and engineering, research and development before they begin to manufacture the patented product.

I believe there is widespread consensus – as there should be – that such NPEs need access to the ITC and the remedies available under Section 337 to exclude the importation of infringing products. Just as with patent owners who manufacture patented products, for these NPEs, the availability of the ITC, with its *in rem* jurisdiction over the imported infringing articles themselves, may be essential to prevent the importation of infringing products by manufacturers who are beyond the reach of U.S. district court infringement actions or who may be located in countries where it is not feasible to obtain or to enforce effectively a local patent.

The stated goal of the current calls for changes to ITC jurisdiction and practice is to address the perceived problem of PAEs, that subset of NPEs who seek to use the ITC not to exclude infringing imports, but rather to extract larger royalties from companies that are manufacturing products by the threat of an Exclusion Order to block the importation of necessary components. There may be PAEs that seek to misuse Section 337 remedies in this manner, but before legislative changes to ITC jurisdiction or practice are made to address such misuse, proponents of those changes should show (1) that the ITC is incapable of distinguishing between PAEs who are misusing the ITC and those NPEs who should be

entitled to Exclusion Orders, and fashioning its procedures and remedies accordingly; and (2) that the proposed changes are narrowly tailored to avoid unintended negative consequences for NPEs and other patent owners who should be entitled to Exclusion Orders. I do not believe that the case has been made for (1), or that the proposed "fixes" are narrow enough to satisfy (2).

A. Has the Case Been Made That the ITC Cannot, Or Is Not, Applying Section 337 To Prevent Misuse by PAEs?

ITC statistics are being used to support the claim that PAEs seeking Exclusion Orders are a problem, but those statistics do not support claims that PAEs have flooded the ITC with requests for Section 337 investigations. While it is undoubtedly true that the number of ITC Section 337 investigations, and the number of respondents in those investigations, have increased over the past several years,[7] the data do not indicate that PAEs, or even NPEs, are the cause of the increase. The most recently-available ITC statistics indicate that since May 15, 2006, when the *eBay* decision was issued, through the first quarter of 2012, NPEs and PAEs together accounted for only 18% of Section 337 investigations instituted – 10% for NPEs and a mere 8% for PAEs.[8]

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[7] *See* http://www.usitc.gov/press_room/337_stats.htm. Like any court, however, the ITC's caseload varies from year to year. The steady increases in the number of Section 337 investigations over the past several years reversed itself in 2012, with the number of new investigations dropping substantially as compared to 2011. *See* http://www.usitc.gov/intellectual_property/documents/cy_337_institutions.pdf (69 Section 337 investigations instituted in calendar year 2011; 40 instituted in calendar year 2012).

[8] *See* "Facts and Trends Regarding USITC Section 337 Investigations," June 18, 2012, pp. 2-3, available at http://www.usitc.gov/press_room/documents/featured_news/337facts.pdf. The ITC uses the nomenclature "Category 2 NPEs" to refer to what I term PAEs in this Statement.

Nor is there evidence that PAEs are very successful in the ITC. The ITC's statistics show that since 2006, only three NPEs have obtained Exclusion Orders: Tessera (Inv. No. 337-T A-605); UNeMed Corporation, the technology transfer office of the University of Nebraska Medical Center (Inv. No. 337-TA-679); and Rambus (Inv. No. 337-T A-661). Of these three NPEs, the ITC classified only Rambus as a PAE, and all three (including Rambus) conducted the research and development that led to the patent involved in the investigation. Thus, none of these NPEs fit the definition of a PAE offered by proponents of changes to ITC practice and remedies – a patent owner whose business model primarily focuses on purchasing and asserting patents – and it is far from clear that any of these NPEs was seeking an ITC Exclusion Order because it would have been unsuccessful in obtaining a permanent injunction from a district court applying the *eBay* factors.

Likewise, there is no evidence that the ITC is incapable of properly sorting out PAEs seeking to obtain unwarranted Exclusion Orders. In an ITC investigation where the complainant is a PAE, it must try to meet the domestic industry requirement through its investments in "licensing," since by definition a PAE cannot show that any of the other statutory bases for a domestic industry exists. In 2011, the ITC clarified the elements that a complainant must prove to establish a licensing-based domestic industry.[9] Since then, only one complainant has been successful in establishing a domestic industry through licensing investments; and in that case, the ITC held that the complainant could not include in such

[9] *In re Certain Multimedia Display & Navigation Devices and Sys.*, Inv. No. 337-TA-694, Comm'n Op. at 7-8 (Aug. 8, 2011) (complainants who base domestic industry on licensing must meet three threshold requirements: (1) investments exploit the asserted patent; (2) investments relate to licensing; and (3) investments are made in the U.S.).

licensing investments the money it had spent on purchasing patents, litigation and patent reexamination proceedings.[10]

Moreover, both the ITC and the Federal Circuit have held that patent infringement litigation expenses alone, *i.e.*, patent infringement litigation activities that are not related to engineering, research and development, or licensing, do not create a domestic industry under the term "licensing" in Section 337(a)(3)(C).[11] As the Federal Circuit explained, "[w]e agree with the Commission that expenditures on patent litigation do not automatically constitute evidence of the existence of an industry in the United States established by substantial investment in the exploitation of a patent."[12] In October, the Supreme Court denied *certiorari* of the Federal Circuit's decision.[13]

Although it is true that the ITC and the Federal Circuit have not foreclosed any possibility that litigation expenses could be recognized as creating a domestic industry, there is no basis to suggest that the ITC is incapable of effectively distinguishing between genuine licensing investments and sham activities designed solely to create a basis for being in the ITC. The ITC assesses whether licensing or litigation expenses establish a domestic industry on a case-by-case basis, based on the nexus between litigation expenses and efforts to license

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[10] *In re Certain Liquid Crystal Display Devices, Including Monitors, Televisions, Modules, & Components Thereof*, Inv. No. 337-TA-741/749, Comm'n Op. at 108-125 (July 6, 2012).

[11] *In re Certain Coaxial Cable Connectors and Components Thereof and Products Containing Same, Inv. No.* 337-TA-650, Comm'n Op. at 44-51 (Apr. 14, 2010) ("*Coaxial Cable Connectors*"), *aff'd, John Mezzalingua Assocs., Inc. (d/b/a PPC, Inc.) v. Int'l Trade Comm'n*, 660 F.3d 1322 (Fed. Cir. 2011).

[12] *John Mezzalingua*, 660 F.3d at 1328.

[13] *John Mezzalingua Assoc., Inc. (Doing Business As PPC, Inc.) v. Int'l Trade Comm'n*, ___ U.S. ___, 133 S.Ct., 422, 184 L.Ed.2d 255 (Oct. 9, 2012).

the asserted patent, and whether there has been "substantial investment in the exploitation of the patent."[14] This is a factually-specific inquiry which may vary depending on the nature of the industry and the resources of the complainant.[15]

Indeed, the Commission is showing a willingness to devote focused and early attention to the domestic industry issue in appropriate cases. On March 22, 2013, the ITC instituted a Section 337 investigation sought by Lamina Packaging Innovations LLC, a PAE. The ITC's Notice of Institution of Investigation ordered Administrative Law Judge Theodore R. Essex to issue an initial determination, within 100 days, on the issue of whether Lamina Packaging Innovations has satisfied the economic prong of the domestic industry requirement of Section 337.[16] The procedure set forth in the Notice mandates an expedited fact and expert discovery period, pre- and post-hearing briefing, a hearing on the merits, and the issuance of an initial determination, all solely on the issue of whether the complainant has satisfied the economic prong of the domestic industry requirement. If Judge Essex finds

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[14] *Coaxial Cable Connectors* at 43-44 ("Depending on the circumstances, [licensing activities] may include, among other things, drafting and sending cease and desist letters, filing and conducting a patent infringement litigation, conducting settlement negotiations, and negotiating, drafting and executing a license. The mere fact, however, that a license is executed does not mean that a complainant can necessarily capture all expenditures to establish a substantial investment in the exploitation of the patent. A complainant must clearly link each activity to licensing efforts concerning the asserted patent.").

[15] *See In re Stringed Intstruments*, Inv. No. 337-TA-586, Comm'n Op. at 25-26 (May 16, 2008) ("There is no minimum monetary expenditure that a complainant must demonstrate to qualify as a domestic industry under the 'substantial investment' requirement of [19 U.S.C. § 1337(a)(3)(C)] . . . . [S]howing the existence of a domestic industry will depend on the industry in question, and the complainant's relative size. . . . [T]here is no need to define or quantify the industry itself in absolute mathematical terms.").

[16] *In re Certain Prods. Having Laminated Packaging, Laminated Packaging, & Components Thereof*, Inv. No. 337-TA-874, Notice of Institution of Investigation, at 2 (Mar. 22, 2013), available at http://usitc.gov/secretary/fed_reg_notices/337/337_874_notice03222013sgl.pdf.

that Lamina Packaging Innovations has not satisfied the economic prong of the domestic industry requirement, the investigation will be stayed and the complainant can petition the Commission for review of the initial determination. This example of active case management shows that the Commission has the tools and authority it needs to address the concerns that have been expressed regarding PAEs who seek Exclusion Orders, and is actively engaged in responding to those concerns.

Moreover, Section 337 requires the ITC to consider the effect of any contemplated Exclusion Order upon the public health and welfare, competitive conditions in the United States economy, the production of like or directly competitive articles in the United States, and United States consumers.[17] These public interest factors provide the ITC with considerable discretion to decide whether to deny or limit an Exclusion Order in an investigation initiated by a PAE. The ITC recently issued new rules that provide for a more complete record on public interest considerations and that enable the Commission to assess if development of public interest information early in the investigation would be helpful, much like the early determination of the economic prong of the domestic industry requirement discussed above.[18]

In sum, the ITC has ample authority and discretion to prevent PAEs from abusing Section 337 investigations. The ITC has used this authority and discretion appropriately and the case has not been made that sweeping changes to Section 337, changes that would

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[17] 19 U.S.C. § 1337(d)(1).

[18] *See Section 337: Building the Record on the Public Interest*, available at http://www.usitc.gov/press_room/documents/featured_news/publicinterest_article.htm.

impact all patent owners and risk unintended consequences, are needed because the ITC has allowed PAEs to abuse Section 337 investigations for negotiating leverage. Given that all types of U.S. patent owners, including small and large companies, universities, and individual inventors, routinely license and litigate their patents, it is entirely appropriate that the ITC determine whether licensing or litigation expenses establish a domestic industry on a case-by-case basis, rather than enacting legislation that might risk the unintended consequence of cutting off the ITC as a forum where patent owners who have licensed their inventions can seek to prevent infringing imports from destroying their investments.

B. Do the *eBay* Factors Belong in ITC Investigations?

Some proponents of changes to ITC law and practice intended to prevent PAEs from obtaining Exclusion Orders have proposed that the issuance of Exclusion Orders be made subject to the same traditional four-factor equitable test that the Supreme Court held should be applied in deciding whether to issue a permanent injunction against patent infringement. In *eBay*, the Court listed four factors that a patent owner must demonstrate to obtain a permanent injunction:

(1) it has suffered an irreparable injury;

(2) remedies available at law, such as monetary damages, are inadequate to compensate for that injury;

(3) considering the balance of hardships between the plaintiff and defendant, a remedy in equity is warranted; and

(4) the public interest would not be disserved by a permanent injunction.[19]

[19] *eBay*, 547 U.S. at 391.

Unlike these equitable factors, the ITC's decision whether to issue an Exclusion Order is based on the statutory criteria set forth in Section 337. Accordingly, the ITC has held that the *eBay* test does not apply when deciding whether to issue an Exclusion Order because Section 337 "represents a legislative modification of the traditional test in equity . . . [and] it is unnecessary to show irreparable harm to the patentee in the case of infringement by importation."[20] The Federal Circuit has affirmed that the ITC's remedies are governed by statute and not by equitable principles.[21]

In my view, the *eBay* factors are simply inapplicable to the determination of whether an Exclusion Order should be issued in a Section 337 proceeding. These factors arise from the traditional test in equity, where the issue is whether remedies at law, such as monetary damages, are adequate to compensate the plaintiff. When applied in patent infringement actions in U.S. district court, the judge is deciding whether a permanent injunction should issue in addition to whatever damages have been awarded to compensate for the infringement. In contrast, the only remedies available in an ITC Section 337 investigation are in essence injunctive relief – Exclusion and Cease and Desist Orders. Damages are not available and thus there is no determination of whether damages are an adequate remedy, as when a district court applies the *eBay* test. Thus, applying the *eBay* factors in Section 337 proceedings would mean that whenever the ITC determines that a complainant has not made an adequate showing that they are met, the patent owner would be left with no ITC

[20] *In re Certain Baseband Processor Chips and Chipsets*, Inv. No. 337-TA-543, Comm'n Op. at 62-3 n.230 (2007).

[21] *Spansion, Inc. v. Int'l Trade Comm'n*, 629 F.3d 1331, 1359 (Fed. Cir. 2010).

remedy whatsoever to prevent the continued importation of products that were found to infringe a valid and enforceable U.S. patent.

A short discussion of each of the four *eBay* factors will show how inapposite they are to the question of whether the ITC should issue an Exclusion Order to prevent the continued importation of products found to infringe a valid and enforceable U.S. patent. The first three factors are simply inapplicable when taken out of their context in equity and grafted into Section 337's statutory framework, and the fourth factor is already part of the ITC's determination.

With respect to the first *eBay* factor – whether the patent owner has suffered an irreparable injury – the question of whether an injury is irreparable boils down to whether or not it can be repaired with money damages. In district court patent infringement actions, a prevailing patent owner has a statutory right to recover damages "adequate to compensate for the infringement but in no event less than a reasonable royalty for the use made of the invention by the infringer, together with interest and costs as fixed by the court."[22] The traditional four-factor test in equity that the Supreme Court applied to patent infringement actions in *eBay* determines whether the patent owner also is entitled to a permanent injunction. In other words, the *eBay* factors were never intended to determine whether the patent owner would obtain any remedy when infringement has been proven. Thus, the question of whether the patent owner's injury is "irreparable" – *i.e.*, repairable with a damages award – makes little, if any, sense in the ITC, where the patent owner either gets an Exclusion Order or goes home empty-handed.

[22] 35 U.S.C. § 284.

For the same reasons, the second *eBay* factor – whether remedies available at law, such as monetary damages, are inadequate to compensate for the injury – is equally inapplicable to ITC proceedings. The ITC cannot award money damages, which moots the question.

The third *eBay* factor – whether, considering the balance of hardships between the plaintiff and defendant, a remedy in equity is warranted – also becomes inapt when it is taken out of its context for determining whether relief in the form of both money damages and a permanent injunction is an equitable remedy. There can be no meaningful balancing of hardships between the owner of a patent found to be valid, enforceable and infringed who would receive no relief whatsoever without an Exclusion Order, versus an infringer who would merely be denied the ability to benefit from importing only those products found to infringe into the United States before the U.S. patent expires, while retaining the ability to make and sell them anywhere else in the world.

It is not a satisfactory answer to argue that U.S. patent owners could mitigate any hardship from failing to obtain an Exclusion Order by seeking relief in U.S. district court. As discussed already, foreign defendants may not be subject to personal jurisdiction in the United States. Nor is it persuasive to argue that U.S. patent holders should file infringement actions against offshore manufacturers in the countries where the infringing products are made. Not only would it be exorbitantly expensive to seek patent protection in every country where products that infringe a U.S. patent could be made, but effective patent coverage, and especially effective enforcement of those patents that can be obtained, is simply not possible in many jurisdictions where infringing products originate.

Finally, regarding *eBay's* public interest factor, the ITC already must consider four public interest factors when determining whether to issue an Exclusion Order: (1) the public health and welfare, (2) competitive conditions in the U.S. economy, (3) the production of like or directly competitive articles in the U.S., and (4) U.S. consumers.[23] As the ITC has observed, these public interest factors "are not meant to be given mere lip service," but rather "public health and welfare and the assurance of competitive conditions in the United States economy must be the overriding considerations in the administration of this statute."[24] The Commission has cited these factors in limiting Exclusion Orders to accommodate the public interest.[25] There is no need to graft *eBay*'s public interest factor onto the requirements for issuing Exclusion Orders, when it is already there.

For these reasons, the *eBay* factors should not apply in determining whether to issue Exclusion Orders. Such an approach would take the factors out of their proper context in determining whether it is equitable to issue an injunction in addition to an award of money damages in a patent infringement case. The result would be greater uncertainty for all U.S. patent owners, especially those who are not manufacturers, such as universities, research-

[23] 19 U.S.C. § 1337 (d)(1).

[24] *In re Certain Inclined Field Acceleration Tubes and Components Thereof*, Inv. No. 337-TA-67, USITC Pub. 1119, Comm'n Op., at 22 (Dec. 1980), quoting S. Rep. 93-1298, at 197 (1974), reprinted in 1974 U.S.C.C.A.N. 7186, 7330.

[25] *See, e.g.*, *In re Certain Personal Data & Mobile Communications Devices*, Inv. No. 337-TA-710, Comm'n Op. at 68 (Dec. 29, 2011) (delaying effective date of Exclusion Order by four months); *In re Certain Erasable Programmable Read Only Memories, Components Thereof, Products Containing Such Memories, And Processes For Making Such Memories*, Inv. No. 337-TA-276, Comm. Op. at 125-26 (Mar. 16, 1989) (discussing "EPROM" factors designed to consider public interest in exclusion of downstream products), *aff'd sub. nom.*, *Hyundai v. U.S. Int'l Trade Comm'n*, 899 F.2d 1204 (Fed. Cir. 1990).

oriented engineering firms and independent inventors, as to the availability of Exclusion Orders to prevent imported infringing products from flooding the U.S. marketplace.

Moreover, the proposal to introduce the *eBay* factors into Section 337 would impose added burdens and complexity on all patent owners seeking to use the ITC. It is not just PAEs, or even NPEs, who would be forced to prove that the *eBay* factors justify issuance of an Exclusion Order to prevent infringing importation. Particularly when the evidence is at best arguable for claims that the ITC is being abused by PAEs, making this sweeping limitation to the ITC's authority, in all investigations sought by all patent owners, is neither warranted nor wise.

C. <u>Does the Definition of "Domestic Industry" Need To Be Changed?</u>

Another proposal which has been discussed as a possible approach for limiting the ability of PAEs to obtain ITC Exclusion Orders is to restrict those "licensing" investments eligible to support a domestic industry. Some have proposed that a domestic industry may be established through licensing only when that licensing takes place prior to the alleged infringing activity and promotes the adoption of the patented invention.

This proposal would generate undue uncertainty and risk for U.S. patent owners, particularly research-oriented American universities and engineering firms, that their investments in licensing, even if substantial, would be disregarded for purposes of establishing a domestic industry if the infringement began before a license was offered, negotiated and executed. Indeed, limiting access to Section 337 to those licenses that were granted prior to infringement would benefit importers who "infringe first, ask for a license second," as they could argue that licensing investments incurred by the U.S. patent owner

after the infringing importation began cannot be counted for purposes of establishing a domestic industry.

The limitation that licensing only qualifies to support a domestic industry if it "promotes the adoption of the patented technology" adds further uncertainty. One can envision extended collateral disputes over whether this limitation is satisfied by the patent owner's licensing activities. Given the unresolved debates over the definition of what exactly constitutes an NPE, and a PAE, it is not difficult to imagine similar debates over whether the licensing activities of such firms actually promote the adoption of the patented technology or represent a tax on innovation and technology adoption.

Given that the ITC has made a number of changes already to its law and practice in an effort to address perceived abuses of the ITC by PAEs, I think that further changes, including a change to the definition of "licensing" for purposes of establishing a domestic industry, should not be made unless and until a need for such changes has been clearly demonstrated, and only then if such changes can be tailored narrowly to avoid the specter of unintended consequences that would unduly undermine the enforceability of patent rights against infringing imports.

III. Abusive Patent Litigation Beyond the ITC.

Notwithstanding the many efforts currently underway to address the costs, disruption and uncertainty of patent infringement litigation, concerns remain that not enough is being done to address the most egregious abusive litigation practices by PAEs. Although I have urged caution against making further changes while the combined impact of the changes currently underway is not yet known, I do think that several recent proposals warrant further

discussion and consideration. The three concepts I discuss below could, with balanced, measured and thoughtful implementation, curtail some of the abusive litigation practices in patent cases that have raised the greatest concerns.

A. <u>More Frequent Fee-Shifting in Patent Cases</u>.

The assertion of non-meritorious litigation positions in patent litigation is, unfortunately, neither new nor limited to NPEs or PAEs. Frivolous assertions in litigation should be no more acceptable by an accused infringer than by a patent owner, and no more acceptable by a practicing patent owner than by an NPE. If applied in a balanced, principled manner, targeting misbehavior on the part of any litigant, fee-shifting can encourage meritorious litigation behavior and can discourage litigation abuse.

Unfortunately, the recently-introduced "Shield Act"[26] misses the mark because it focuses on the litigant and not litigation abuse that should be discouraged. The focus of fee-shifting should be on curbing litigation abuse, rather than on deterring meritorious suits by patent owners who have not commercialized their patents. The Shield Act tilts the playing field against such patent owners by making it riskier for them to assert their patents, even when their infringement allegations are well-founded. The proper role of fee shifting is as a tool to curb litigation abuse, not a penalty against certain types of patent owners.

Currently, section 285 of the Patent Act[27] provides that a court may, in "exceptional cases," award reasonable attorney fees to the prevailing party. However, the Federal Circuit

[26] Saving High-tech Innovators from Egregious Legal Disputes Act of 2013, H.R. 845, 113th Cong., 1st Sess. (introduced Feb. 27, 2013).

[27] 35 U.S.C. § 285.

has set the bar so high for a finding that a case is "exceptional" that Section 285 is invoked too rarely to serve as an effective deterrent against litigants who assert specious infringement claims or defenses. A case lost by the patent owner may be "exceptional," for example, if it is found to be "objectively baseless" and brought in "subjective bad faith."[28] Other grounds for fee-shifting under Section 285 require similarly-difficult findings of, for example, inequitable conduct, willful infringement or vexatious litigation misconduct.

A relaxation of the "exceptional" case standard to permit fee-shifting in more cases would encourage both plaintiffs and defendants alike in patent infringement actions to assert only meritorious positions. One alternative is simply to loosen a court's ability to award fees under Section 285; for example, by requiring the court to make the award to the prevailing party unless the position of the losing party was "substantially justified" or special circumstances would make the award unjust. More frequent fee-shifting under such a relaxed standard would encourage meritorious litigation behavior and discourage litigation abuse by all litigants, provided it is applied in a balanced, principled manner, targeting misbehavior on the part of any litigant.

B. <u>More Proportionality and Uniformity in Discovery Rules.</u>

The costs and burden of discovery can be enormous in any patent case. But in cases brought by NPEs or PAEs, the asymmetry of such costs and burdens increases the risk of litigation abuse. Such patent owners typically have few documents and witnesses, so they may propound extremely burdensome discovery to corporate defendants without fearing

[28] *Checkpoint Sys., Inc. v. All-Tag Security S.A.*, No. 12-1085, ___ F.3d ____, 2013 WL 1188940 (Fed. Cir. Mar. 25, 2013).

that they will be on the receiving end of corresponding burdens. Coupled with the growth of electronically stored information that is an easy target for burdensome discovery requests, the costs of litigation can mushroom out-of-control and force defendants to settle simply to avoid intrusive discovery.

Many district courts have adopted local patent rules to help standardize and streamline pre-trial procedure in patent litigation. Similarly, the Federal Circuit Advisory Council recently adopted a Model Order governing e-discovery in patent cases.[29] These rules help promote an efficient discovery process in patent cases, but they are not a substitute for early engagement by the court in structuring and streamlining patent litigation, and customizing the case schedule to prioritize early resolution of the most significant issues. Perhaps the most impactful way courts may keep patent cases in check and moving forward is through active early engagement in narrowing issues and setting an orderly pre-trial schedule. The Patent Pilot Program, launched in 14 district courts in 2011 and continuing for 10 years, recognizes the importance of providing district court judges with adequate resources to engage in active management of patent cases.[30]

In addition to these ongoing efforts, more proportionality in discovery burdens and costs should be encouraged as a way to lessen the asymmetry that currently exists in patent infringement cases brought by PAEs. One proposal that merits further consideration would

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[29] Model Order Regarding E-Discovery in Patent Cases (announced Sept. 27, 2011) (available at http://www.cafc.uscourts.gov/images/stories/announcements/Ediscovery_Model_Order.pdf).

[30] *See* Patent Cases Pilot Program, Pub. L. No. 111-349, 124 Stat. 3674; District Courts Selected for Patent Pilot Program, Admin. Office of the U.S. Courts (Jun. 7, 2011) (available at http://www.uscourts.gov/News/NewsView/11-06-07/District_Courts_Selected_for_Patent_Pilot_Program.aspx).

allow discovery of a core set of documents and witnesses in patent cases, with each party bearing its own costs for such core discovery, as under the present system. Beyond that core discovery, however, a party seeking additional discovery would be required to bear the opposing party's reasonable costs associated with providing it.

Conceptually, this proposal would add much-needed proportionality to the discovery obligations in patent cases. Caution should be exercised, however, to ensure that such a concept is in fact used to manage discovery costs and burdens in all patent cases, and not just as a way to make patent enforcement more difficult for some patent owners. First, any such discovery cost-shifting should apply in all patent cases, not just those brought by PAEs. Second, the scope of what constitutes "core" discovery – *i.e.*, discovery for which each party bears its own costs of providing – must be reasonably broad and comprehensive to encompass the bulk of discovery that is appropriate in most patent cases. The proposal should be tailored to discourage abusively broad and costly discovery in patent cases, not as a way to deny or discourage a litigant from obtaining documents, witnesses and other information reasonably required for a fair and just adjudication of a patent dispute.

The Federal Circuit Advisory Committee's Model E-Discovery Order represents a welcome effort to balance these dual interests in ensuring that litigants have access to the information they reasonably need to litigate patent disputes, while at the same time discouraging the overbroad and expensive email production requests that have become routine in patent litigation. Federal Circuit Chief Judge Randall Rader has explained that "litigation costs should not be permitted to unduly interfere with the availability of the court to those who seek to vindicate their patent rights—the enforcement of such rights is both an

obligation of the legal system and important to innovation. Likewise, disproportionate expense should not be permitted to force those accused of infringement to acquiesce to non-meritorious claims."[31]

Under the Model Order, parties are required to disclose "core documentation concerning the patent, the accused product, the prior art, and the finances" before they can request further e-discovery. Email production requests must be directed towards specific issues in the case and are presumptively limited to five custodians per producing party and five search terms per custodian per party. Finally, the Model Order shifts the costs for "disproportionate" discovery requests.

Disclosure obligations and limited additional discovery similar to that permitted under the Model Order, but applying to all forms of discovery in patent cases, could provide the basis for defining the "core" discovery a party could obtain without cost-shifting. Beyond such core discovery, a party would bear the costs of obtaining additional discovery, subject to a sufficient showing of good cause as to why the costs should not be shifted. The judiciary is in the best position to define the scope of such rules and their implementation, but Congress might encourage the courts to pilot such concepts designed to ensure more proportionality of discovery costs in patent cases, perhaps by providing guidance and recommendations to the Judicial Conference to promulgate model rules, and/or through the Patent Pilot Program.

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[31] Model Order Regarding E-Discovery in Patent Cases (available at http://www.cafc.uscourts.gov/images/stories/announcements/Ediscovery_Model_Order.pdf), at pp. 2-3.

More generally, it is worth considering ways to provide more uniformity in how patent cases are handled by district courts across the country. Through the use of local patent rules, many best practices have been identified already, but their adoption and implementation varies among the various district courts. A single set of Federal Rules of Patent Litigation Procedure, which would apply in patent infringement cases in all district courts, would be a way to capture and implement nationwide the best practices that have been developed through local patent rules in various judicial districts. Although uniform federal rules for patent cases might be controversial among some district judges, a single set of rules could address abusive litigation practices comprehensively and prevent forum-shopping by litigants who wish to engage in such practices. Given that patent litigation already is subject to unified appellate practice, it would seem logical also to have nationwide district court patent litigation rules. As a starting point, perhaps uniform rules could be adopted by those courts participating in the Patent Pilot Program, which would ensure their use in a large percentage of district court patent litigation.

C. Stays of Patent Suits Against Customers or End Users.

Some PAEs make it a practice to file infringement suits against customers, retailers or end users of a product accused of infringement, rather than the manufacturer or primary supplier of the product. By targeting multiple customers or end users, a PAE may create increased settlement opportunities, particularly when the customers or end users lack sufficient technical knowledge of the accused product or sufficient resources to litigate. Under current law, the stay of a customer suit, in favor of a suit against the manufacturer or supplier of the accused product, is not automatic, but rather is committed to the discretion

of the district court. Unfortunately, courts have been inconsistent in their willingness to stay such customer suits, thus encouraging their filing by some PAEs.

Codification of the right for a manufacturer or supplier to intervene in actions against customers or end users, or to proceed in a separate action against the patent owner, and to stay the actions against the accused customers or end users pending the outcome of the infringement suit between the patent owner and the manufacturer or supplier, would curtail the practice of filing customer and end user suits to proliferate litigation and spur settlements with downstream entities. Once the real party in interest has intervened as a party to an infringement action, the action would proceed against that party and would be stayed against non-manufacturing defendants. Moreover, a customer suit would be stayed in favor of a separate declaratory judgment or infringement action instituted by or against the manufacturer or supplier. This proposal thus would promote resolution of patent disputes by the manufacturers or suppliers of the products accused of infringement, or the parties practicing methods alleged to infringe – *i.e.*, the real parties in interest.

Some proposals go a step further, suggesting that customers or end users should enjoy immunity from patent infringement suits. In my view, such proposals go too far and risk unduly undermining the value of certain types of inventions. It may be the case that, due to the nature of the patented invention, infringement depends on how a customer uses, installs or integrates a product with other products. Because legitimate infringement claims may arise from acts beyond the mere use of the manufacturer's product as sold, it may be that litigation between the patent owner and the manufacturer does not resolve all issues of infringement. In such cases, it may be appropriate to lift the stay following adjudication

between the patent owner and manufacturer, and to allow a customer or user suit to proceed. Moreover, user immunity might run the risk that would-be infringers could game the system, with the manufacturer stopping just short of selling an infringing product so that the customer who is immune from infringement can complete the assembly of what would otherwise be an infringing device. An end user stay, rather than immunity, avoids such unintended consequences and balances the interests of deterring suits against end users, on one hand, against ensuring that patented inventions directed toward end uses are not made valueless, on the other hand.

Finally, another important safeguard is provided by making intervention by a manufacturer or supplier voluntary, as it would not be appropriate in all cases. Because infringement allegations may involve multiple potentially responsible parties or real parties in interest, intervention may not be practical in multi-supplier markets with non-linear supply chains. Moreover, voluntary intervention would ensure that this proposal does not have the unintended consequence of impacting contractual obligations that may exist between suppliers and purchasers and that may allocate the risks of infringement or the costs of defending against infringement allegations. But when a manufacturer or supplier is truly the real party in interest, it would have the voluntary right to defend its products against infringement accusations, rather than being made to stand on the sidelines as windfall settlements are forced upon its customers.

* * *

Chairman Coble, Ranking Member Watt and Members of the Subcommittee, I thank you for the opportunity to appear here today and to offer my views on the subject of "Abusive Patent Litigation: The Issues Impacting American Competitiveness and Job Creation at the International Trade Commission and Beyond." As explained above, I believe that the case has not been made for changes to ITC law or practice at this time, and the changes that have been proposed are not sufficiently tailored or focused to address the perceived problems while avoiding unintended consequences detrimental to patent owners who need access to the ITC to prevent infringing imports from undermining the value of their inventions. With respect to the district courts, although I have urged caution in making further changes that would alter the substance or procedure of patent litigation before the full impact is known of the many recent changes already made and in the process of being fully implemented, I do believe that several of the proposals I have discussed above warrant further consideration and discussion among stakeholders. As always, I and the Coalition for 21st Century Patent Reform remain committed to working with Congress and all stakeholders to find fair and balanced solutions to curb abusive litigation practices in patent cases.

I will be pleased to answer any questions or to supply additional information for the record.

Mr. COBLE. Thank you, Mr. Rhodes.
Ms. Chien?

TESTIMONY OF COLLEEN V. CHIEN,
SANTA CLARA UNIVERSITY SCHOOL OF LAW

Ms. CHIEN. Thank you so much, Chairman Coble. Thank you so much. It is really an honor and privilege to be here, Chairman Coble, Members of the Subcommittee, and especially thank you to Representative Lofgren for your wonderful remarks.

It is my privilege and honor to be here today, and I commend you Members for your close attention to the abuses that plague our patent system.

I have two points to make today. First, I believe that we are spending too much time and money fighting about patents. I believe this fighting is a problem because it drives companies to settle even if their case is weak. That means that the profits that come from patent assertion get increased, and this breeds more fighting and more filing, even for weak patents.

Second, I believe Congress and agencies can stop this abuse by reducing waste and duplication, and by helping companies help themselves to resist patent demands over weak patents.

Point One: We are spending too much time and money fighting about patents. I am talking here about campaigns of companies like Lodsys against app developers that make the terrific applications that we have on all of our smartphones. Many of them have received demands based on implementing functionality that is basic. These patents are in litigation. Apple says it already has rights to them, and Google has placed these patents into reexamination. Still, the letters and suits continue to plague hundreds of app developers. I am talking about the filing of cases in the ITC and district court at the same time.

Earlier, the statistic of 65 percent of overlap was cited. When we went back and checked for 2012, we found that over 90 percent of cases in the ITC that were patent cases also had a district court counterpart, which has different remedies and procedures but much overlap otherwise.

Does it make sense to make litigants go to both venues? If litigants can get exclusion orders in one place but not the other, or if SHIELD applies in one place but not the other, this invites forum shopping and abuse.

I am talking about small companies that call me and don't have the resources to send their own representatives to these hearings. Companies that make $10 million or less in revenue are the majority of unique defendants to PAE suits.

Startups are crucial sources of new jobs, but patent demands hinder their ability to hire and meet other milestones, cause them to change their products and shut down lines of business, according to a survey that I conducted. Forty percent of them were targeted because of technology they did not make but implemented or used.

Why is this happening? My sense is it is because the market is impatient, and now the market is driving patent assertion, because for all the epithets that are thrown at patent assertion entities, they have very compelling economics. They sell the market need by making patent enforcement affordable and less risky. In fact, the

economics are so compelling that there are now over 15 publicly traded companies that bankroll patent lawsuits. Intellectual property funds generate returns between 10 and 20 percent, reports Julie Steinberg in her Wall Street Journal article entitled, "Stocks, Drugs, Rock 'n Roll."

Foreign governments are getting into the game: Korea's Intellectual Discovery Fund, France's Brevets, and the Innovation Network Corporation of Japan are examples. It is only in this context that we can understand the filing of a complaint by Swiss investor-backed PAE Beacon Navigation GmBH against U.S. car companies that employ thousands of people at the International Trade Commission, a venue that is designed to protect domestic industries.

As PAEs increase, so do the burdens on our courts and the public. Last year, PAEs filed over 50 percent of patent cases in district courts and, according to my estimates, about 30 percent of ITC cases. These cases are complicated. They are time-consuming. They can be torturous for jurors, and they clog our dockets. But they also are rightful vindications of patent rights. How can we streamline litigation to reduce the over-incentive for enforcement but still allow for meritorious claims to go through? In this testimony, I provide three suggestions for consideration.

First, I believe we should look carefully at the duplication in our patent system by trying to improve coordination between patent entities. It makes no sense to have more than one entity simultaneously decide a patent's validity or whether the same act constitutes infringement. PAEs are now suing multiple users of goods rather than single suppliers or manufacturers of that good. Congress should reduce the duplication that results by immunizing or eliminating liability for innocent end-users or implementers that use the invention.

As I mentioned before, 90 percent of patent litigation in the ITC were also filed in District Court. While that interface is regulated by Section 1659, Congress should look carefully at this overlap and make sure that there is no unnecessary duplication between these efforts. We should also reduce waste in our patent system, following the example of the Federal Circuit Advisory Council's Model Order Initiative. Congress should facilitate the benchmarking of courts trying innovations in the patent pilot program so that the best practices for reducing waste can be observed and disseminated.

Finally, I believe that we should reduce the government's role in deciding patent disputes. The government should give members of the public, and in particular the members of the public that are not patent-savvy or well-funded, information from which they can help themselves rather than going to a court or lawyers. Courts should require governmental data storehouses to provide data on patent litigations, reexaminations, ITC actions and ownership information either by themselves or to third party providers who promise to consolidate and make it available to the public in an accessible form. The FTC or PTO should provide authoritative information about patents and options for responding to demand letters. Many people now are getting a demand letter and don't have anything to do or know about the patent system. They need basic information about their options.

The duplication, redundancies, and lack of access to information in our patent system invite abuse and forum shopping. They clog our docket and consume our precious judicial resources. They create lucrative opportunities for patent assertion that is attracting financing and more suits.

I would be happy to take your questions in a question-and-answer period.

[The prepared statement of Ms. Chien follows:]

Reducing Litigation Abuse by Reducing the Government's Role in the Patent System[1]
Testimony of Colleen V. Chien,[2] Santa Clara University School of Law
Subcommittee on Courts, Intellectual Property and the Internet
April 16, 2013

A "patent troll" does not make money by manufacturing, innovating or transferring technology, but by holding patents and suing those who do. Patent trolls demand money to use products they did not create. Patent trolls are so notorious that they have been accused of "hijack[ing] someone else's idea and see[ing] if they can extort some money." And worse.

But demonizing patent "trolls" overlooks their compelling economics. Using economies of scale and contingent fee lawyers, patent assertion entities (PAEs) have dismantled traditional obstacles to suit. For years, patent holders couldn't monetize their patents because it was too risky and large companies ignored their demands.

But things have changed. Instead of ignorance, enforcement is now the new normal. PAEs paved the way, by showing how powerful the threat of prolonged litigation can be in getting companies to pay settlements. Following their lead, large companies are monetizing and asserting their patents at a greater rate as well, e.g. through the smartphone wars. Those who aren't are being pressed to think about making money off their patents by their CFOs, including by partnering with PAEs.

The freedom of PAEs to litigate has created serious issues for the patent system. Scads of entities that have nothing to do with the patent system – e.g. retailers, bakeries, funeral homes, advertising firms, and even politicians –are getting sued and receiving demand letters. While large tech companies capture most of the patent headlines, last year, more non-tech companies were sued. Companies that make $10M or less in revenue are the majority of unique defendants. Startups are particularly vulnerable. Although startups are a crucial source of new jobs, PAE demands have impacted their ability to hire and meet other milestones, caused them change their products, and shut down lines of business, according to a survey I conducted. 40% were targeted because of technology that they did not make, but implemented or used.

Yet the economics of patent assertion are so favorable that over 15 publicly traded companies now use the stock market to bankroll patent lawsuits. Intellectual-property funds generate annualized returns between 10% and 20%, reports Julie Steinberg in her Wall Street Journal article of earlier this year, "Stocks, Drugs, Rock 'n' Roll." You can bet on individual patent litigation events. Foreign governments are getting into the game: Korea's Intellectual Discovery Fund, France's Brevets, and the Innovation Network Corp of Japan for example. It is only in this context that the filing of complaint by Swiss-investor backed PAE Beacon Navigation GmBH against US car companies that employ thousands an International Trade Commission (ITC), a venue designed to protect domestic industries, makes any sense.

[1] Due to time constraints, this testimony is being submitted without footnotes, however I will post a version with footnotes to SSRN (http://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=362060).

[2] Assistant Professor, Santa Clara University Law School © 2013. colleenchien@gmail.com. I am indebted to my research assistants, in particular Wesley Helmholz, as well as Nicole Shanahan, Coryn Millslagle, Teri Karobonik & John Neal. I thank the many small and large companies who have talked to me and taken my surveys as well as Professors Michael Risch, David Schwartz, Mark Lemley, Brian Love, and James Yoon for their insights and research, and Julie Samuels, Ann Fort, Alan Shoenbaum, Tim Wilson, Andrew Pierce, Stefani Shanberg, Brad Burnham, Brad Feld, Jason Mendelson, and Dan Ravicher for sharing their experiences supporting small companies and startups. I am grateful, as always, to Dirk Calcoen.

As PAEs increase their footprint, they increase the burdens on our courts and the public: last year PAEs filed over 50% of patent cases in district courts, independent sources have found. Patent cases are complicated and time-consuming. They can be torturous for jurors. They clog our dockets. Yet, some of them are rightful vindications of patent rights. How can we streamline litigation to reduce the over incentive for enforcement but without limiting meritorious claims? In this testimony I provide three suggestions for consideration:

First, we should reduce duplication in our patent system by improving coordination between patent entities. It makes no sense to have more than one court simultaneously decide a patent's validity or whether the same act constitutes infringement. Yet this is what we do now –more than 90% of patent litigations in the ITC last year were also filed in district court. Congress should reduce the overlap by making ITC jurisdiction exclusive of district court jurisdiction or reducing the incentives to file in both. Similarly, many administrative reviews in the PTO involve pending litigation at the district court. The PTO and courts should implement post-issuance administrative reviews in a coordinated fashion that eliminates the overlap. PAEs are now suing multiple users of goods, rather than the single supplier or manufacturer of the good. Congress should reduce the duplication that results, by immunizing or limiting liability for innocent end-users or implementers that use the invention as intended and notice the suppliers of the use.

Second, we should reduce waste in our patent system, following the example of the Federal Circuit Advisory Council's model order initiative. Courts should focus the key issues, hold early, pre-discovery claim construction, and consider early damages contentions. Courts should encourage dispositive motions, e.g., concerning standing, section 101 patentability, or whether the patentee's rights have been exhausted via license, to be heard and ruled on early in the case, if they have merit. Congress should facilitate the benchmarking of courts trying these innovations in the Patent Pilot Program so that best practices for reducing waste can be observed and disseminated. Congress should also discourage lawsuits on weak claims by increased fee-shifting, and wasteful discovery by requiring parties to pay for it beyond core documents.

Third, we should reduce the government's role in deciding patent disputes. The government should give members of the public, and in particular the public that is not patent-savvy or well-funded, information from which they can help themselves, rather than going to court or lawyer. Congress should require governmental data storehouses to provide data on patent litigations, reexaminations, ITC actions, and ownership information to third party providers who promise to consolidate and make information available to the public in an accessible form at no or low cost. The FTC or PTO should provide authoritative information about patents and options for responding to demand letters for the many companies that are receiving demand letters to rely upon. Congress should also authorize a study, to be taken by the government or a respected institution like the National Academy Sciences, to pave the way towards real-world determinations for establishing the value of patents, outside the theatre of patent litigation. Patentholders and licensees should be able to know ahead of time the range of a patent's worth. And they should be able to reach determinations on their own rather than having to remain at the mercy of courts and juries.

The duplication, redundancies, and lack of access to information in our patent system invite abuse and forum shopping. They clog the docket and consume our precious judicial resources. They create lucrative opportunities for patent assertion that is attracting financing, and more suits. As a result, we are spending far too much time and money fighting about patents.

In the following paragraphs I suggest ways to reverse these trends by reducing duplication, waste, and the role of the government in resolving patent disputes.

Reducing Duplication

The ITC-District Court Interface

Patentholders can enforce their rights at District Court and through a Section 337 action at the ITC. Although the ITC was created as a special solution to the special problem of foreign piracy, its jurisdiction has become as mainstream as overseas manufacturing. Yet the convergence of jurisdiction has been accompanied by a divergence in procedures and remedies. The ITC takes about half as much time to decide cases, is four times more likely to adjudicate its cases (44 percent vs. 11 percent), and more readily awards injunctions to prevailing patentees (100 percent vs. 79 percent) than district court. But the ITC cannot award damages, and its decisions do not bind district courts. The relief it provides is thus neither complete nor final.

This creates incentives for litigants to file in both venues. By our count, over 90% of 337 patent cases were filed in 2012 had a counterpart in the district court. This implies that the ITC is not being used for its original intended purpose – to reach litigants that district court can't. Just as with district court, PAEs are also using the ITC – by our count more than a quarter of patent investigations and nearly half of PAE defendants are there due to a PAE. Because of the expense of bringing an ITC action, these entities tend to be well-capitalized companies rather than individual inventors. Many of them are seeking the increased leverage that accompanies the threat of an injunction, which they are frustrated they can no longer get in district court post-eBay.

A 90% duplication rate is wasteful. It could be eliminated by stripping jurisdiction from the ITC by limiting it to cases where the district court lacks jurisdiction, or the need for the ITC's special remedies can be demonstrated (e.g. because of the evasive behavior of a counterfeiter). This proposal has the advantage of freeing up the ITC to focus more on the types of piratical infringement it was originally intended to address.

As an alternative, the incentive to file in both venues could be reduced by harmonizing them. If one venue offers only injunctions, and the other only damages, parties will naturally want to file in both. The differences between ITC and district court law, procedures, and remedies would need to be reconciled, in particular the law of the domestic industry requirement and remedies. The district court could adopt exclusion orders, or the ITC could adopt eBay; if the latter, it should be given damages authority.

Section 1659 regulates the interface between the ITC and district court, allowing the 337 case go forward first. However, stays aren't mandatory and apply only 60% of the time when the cases are overlapping in time. Neither does it make sense for the 337 case to go first unless the party is seeking the ITC's unique remedy of an exclusion order, rather than settlement. That is because 337 cases don't bind district court, it's the other way around. In addition, ITC cases go to trial four times more than district court cases – the natural settlement points of claim construction and summary judgment are missing due to the tight timeframe. Although the ITC has promulgated new ESI rules, discovery at the ITC is necessarily more expansive and more expensive– according to industry estimates about 50% more.

Congress should streamline the ITC-District Court interface by making their jurisdiction exclusive or harmonizing the venues. At the very least, it should rethink the ITC-District court interface and consider resolving parallel cases in favor of the district court, to eliminate duplication and gamesmanship.

The PTO- Court Interface

Following the AIA, up to five different forms of administrative review are available for issued patents. Fortunately, the PTO has the authority to streamline and coordinate different administrative proceedings under the AIA, by consolidating diverse challenges involving a single patent into one proceeding.

The big challenge will be to minimize duplication by the PTO and district court. Right now many perhaps most of 100+ inter partes reviews (IPR) filed to date have been on patents in litigation. It doesn't make sense for the IPR and district court cases to proceed in parallel as the district court case may resolve with the PTO's outcome.

Yet, courts are not convinced that stays will further the efficient resolution of a case. Furthermore, the AIA creates some uncertainty by allowing six-month extensions for good cause. Even those judges willing to grant a stay wonder how long it will be until the PTO rules (and appeals are completed). Justice delayed is justice denied.

The PTO must do all it can to bolster confidence that its reviews are being handled timely. It should make the status of administrative proceedings transparent and accessible. It should publish target dates for the completion of its proceedings, like the ITC does. It could also consider creating a "fast track" for high impact patents that have been asserted against more than a threshold number of targets. The potential gains for the system are high in these situations –the elimination of large numbers of disputes and parties.

The courts should stay cases in deference to the PTO, particularly in cases where no market harm is threatened. A party that undertakes administrative review without confidence that the court will pause costly discovery and wait for the PTO will not be able to afford the risk even if with strong invalidity arguments. Justice accelerated may lead to injustice.

The court should also suspend enforcement activities while administrative challenges are pending. It doesn't make sense for new complaints based on the patent to be named and settlements to be demanded, as they have been for example in the Lodsys case. If the patents are ultimately narrowed or invalidated, settlement fees should be returned or the fees shifted. Certainly, parties named during this period should not be able to be found willful when they have taken notice of the reexamination challenge.

Customer-Supplier Suits

A troubling PAE tactic is to sue or threaten customers in order to wrest small settlements from unsophisticated parties - for example $1,000 per employee for use of a scanner or $1,000 per node for use of Wi-Fi. While businesses don't usually sue their customers, PAEs can do this because they have no customers. But this sort of tactic is not unique to patent law, in this very Committee, on the day before its last hearing on patent litigation abuses, the Constitution Subcommittee heard from a small business trade association about a scheme of "fleecing small business owners," in which an unscrupulous attorney received hundreds of settlements of $1,000 or more from "mom and pop" stores throughout the state after suing them for minor violations of the state business code.

In PAE customer disputes, the right party is the supplier of the technology who is more knowledgeable about patents and has better access to the relevant documents and witnesses. Yet the PAE may choose customer defendants over manufacturers because they are unsophisticated, and it's cheaper to pay the nuisance value settlement sought than to fight.

To reduce the duplication and ensure that the right party is named, Congress should limit or immunize end users from liability. In particular when the invention is embodied in a staple article or commodity of commerce that the end users uses in the intended form, the end user lacks specific knowledge of the patent, and when there is jurisdiction and a cause of action available over a supplier who has been noticed. An outright immunity, or limiting remedies to injunctions, or damages to the cost of product acquisition, would go far in reducing the *in terrorem* impact of patent demands on the most vulnerable targets, like municipalities, non-profits, and small businesses who have no idea what their exposure might be. Although the amount of money at stake in each individual case is relatively small, it can devastate the target in unanticipated ways –one small company I talked to offered physical therapy services to autistic kids. A suit would jeopardize its ability to accept government funding for services, a core source of revenue. A startup I talked to lost key customers because of technology it had implemented led it to be sued. These companies which employ people, are casualties of an inefficient system that is being exploited for financial gain.

But the government can end this practice through an immunity or providing certainty about exposure. At the very least, an end-user should generally not be liable for treble damages liability when they give notice to the supplier. Even a basic fact sheet from a trusted source explaining that the receipt of a demand letter or even suit does not legally obligate the recipient to pay the demander could help.

When suits involving end-users and manufacturers are pending that involve the same basic facts, they should be consolidated or the customer suit stayed. But it would be more equitable and simpler to limit the liability of end users, particularly for using the tools of modern day commerce like Wi-Fi and scanners. In some European and Asian countries this is the law in certain contexts. Allowing suits against customers as we currently do puts small suppliers in a difficult position–as others have said, they make small suppliers unattractive, because of their inability to indemnify large companies.

Reducing Waste

Waste can be reduced by paring down to the essentials and taking high impact, low-cost interventions. As applied to patent cases, this means focusing issues and discovery. It also means that dispositive motions deserve prioritized attention.

E-Discovery Model Order

The cost and complexity of patent litigation can be staggering. I therefore join the chorus of those that applaud the efforts of the Federal Circuit Advisory Council including Chief Judge James Ware (ND Cal), Judge Virginia Kendall (ND Ill), Magistrate Judge Chad Everingham (ED Tex), Tina Chappell, Richard "Chip" Lutton, Joe Re, Edward Reines, Steve Susman, and John Whealan, led by Chief Judge Randall Rader (Fed. Cir.) to streamline and limit the cost of patent litigation through their model e-discovery order.

Focusing and Prioritizing Issues

Considerable savings could also be captured by focusing issues. The number of claims and terms in claim construction is one example. Another is to hear dispositive motions early. For example, in the Lodsys case which involves app developers, Apple has asserted an exhaustion defense that would immunize its implementers from liability. Deciding this issue early could dismiss scores of demands and litigants from the challenge. Other dispositive motions such as 101 patent eligibility and standing present low risk high reward propositions for the court. If the motion is successful, the case goes away, and if it is denied, the case proceeds. To avoid waste, it makes sense to know whether or not the patent actually passes these basic screens. The ITC's recent innovation of ordering a domestic industry determination

within the first 100-days of a case is a great example of how such prioritization may align the parties' and courts' interests. By setting aside a period of time to hear dispositive motions, as the ITC did, unnecessary delays and abuse are reduced.

Whatever can be done to support and encourage best practices should be done. Congress can help by facilitating the benchmarking of courts trying innovations in the Patent Pilot Program so that what works, and what doesn't, can be observed and disseminated, e.g. through the model order instrument.

Fee Shifting

Congress should encourage courts to use fee-shifting as a tool to discourage wasteful litigation and litigation practices. A one-way shift such as is found in the SHIELD Act can help fund meritorious defenses in the same that one-way fee shifts in civil rights contexts have funded meritorious cases. A bond requirement, with the normal exceptions for indigency and related conditions, would prevent circumvention of the rule. Just as in the medical malpractice contexts in which bonds also appear, PAE suits have the potential to significantly impact the livelihood of small defendants. Fees would still be available to prevailing plaintiffs under the existing statute.

Congress should also consider authorizing more liberal fee-shifting prior to the resolution of a case as few small companies have the ability to "go all the way" in litigation. Requiring parties to pay for discovery beyond core documents, as has been proposed by SAS, for example, would correct the asymmetries that produce unfair leverage.

Reducing the Government's Role in Deciding Patent Cases

Consolidated Information

The government should give the public, and in particular the public that is not patent-savvy or well-funded, information from which they can help themselves, rather than going to court or a lawyer. Congress should require the Secretary of States, EDIS, PACER and the PTO to provide data e.g. on patent litigations, reexaminations, ITC actions, and to third party providers who promise to consolidate and make information available to the public in an accessible form at no or low cost and allow public interest groups to monitor implementation. Google Patents and Patent Bulk downloads would be a natural choice for a partner. Or Congress should empower and fund one of the agencies to provide this information. This information can inform market initiatives to provide defense service offerings. So much of the litigation landscape is opaque, but sunshine can reduce returns to information arbitrage. In this regard, I commend the FTC/DOJ's recent efforts and urge the FTC to conduct a 6(B) study.

It needs to be easier for the courts to understand the status of parallel litigations, reexaminations, and previous cases involving the patent in order to reduce duplication. A court may stay a case if another body is handling the same or a related dispute. A member of the public needs to be able to find, by patent number, the status of the patent, who owns it, whether it has been reexamined, and other litigations involving the patent and what other patents are owned by entities with interests in the assertion. Such records can reveal that the patent has already been licensed, through a different name, the other assets of the patentee that might be asserted against the target, and other basic information which can now be hidden behind obfuscatory name changes such as have been engaged in by scanner PAEs, frustrating information sharing efforts. While this information should ideally be available for all patents, if it's not, it should be made available upon proof of a demand letter to the information supplier.

Patent Demand Letter Information Website

The FTC or PTO should provide authoritative information about patents and options for responding that the many companies receiving demand letters can rely upon. Increasingly people who have little to no familiarity with the patent system need basic information like what is a patent is, what infringement is, where to get information, what kind of lawyer might be needed, and what options for responding are available need to be disseminated. This kind of information can be powerful for helping unsophisticated targets know their rights, and that receiving a letter, even when it has a potential complaint attached to it, does not obligate them to pay. This simple and inexpensive intervention could go far in reducing fear, uncertainty, and doubt as well as unnecessary payments. The FTC experience with educating consumers can go far in making such an initiative effective.

Damages Study

Congress should also authorize a study, to be taken by the government or a respected institution like the National Academy Sciences, to pave the way towards real-world determinations for establishing the value of patents, outside the theatre of patent litigation. This study should consider real-life ex ante negotiations for determining a patent's technical and economic value. Patentholders and their targets should know ahead of time what the range of a patent's worth, instead of relying on courts to do so.

Identifying High Impact Patents and Connecting Small Defendants

Not all patent campaigns are created equal. For example, in the Innovatio case, 13,000 letters were sent to users of Wi-Fi routers. Where a dispute impacts so many members of the public the sheer numbers of relevant parties transform the case from a private dispute into a public concern. The FTC or PTO should accept information from members of the public who have received a demand, much like a "We the People" petition so that social impact can be gauged and appropriate interventions, by the public or public interest agencies, can be prioritized. The agency should also serve a coordinating role between small defendants who may want to band together and form common defenses. The inability of these parties to find each means that they cannot access the same options available to larger parties. But if they band together, they may be able to. Public interest agencies like EFF who are experienced with serving small companies and individuals can help as well but the agencies are in a better position to handle certain aspects of such an effort.

Conclusion

Subcommittee members, I thank you again for the honor of testifying before you today on ways to reduce litigation abuse in our patent system. I look forward to responding to your questions

Colleen V. Chien

Mr. COBLE. Thank you, Ms. Chien.

Mr. Dudas?

TESTIMONY OF JON DUDAS, FORMER UNDER SECRETARY OF COMMERCE FOR INTELLECTUAL PROPERTY AND DIRECTOR OF THE UNITED STATES PATENT AND TRADEMARK OFFICE

Mr. DUDAS. Thanks very much, Mr. Chairman, Ranking Member Watt, and all the Members of the Committee. It is a real opportunity and an honor to testify before you today.

While I am not an ITC subject-matter expert, I do offer my perspective as former undersecretary and a former staffer of this Subcommittee.

For the last year, I also served on the Board of Directors of MOSAID Technologies, Inc. In addition to holding 1,450 issued and pending patents from its own R&D, MOSAID Technologies has a core expertise in managing high-quality patent portfolios.

In my government role, I was honored to promote the United States system of intellectual property throughout the world. Nothing has given me more professional satisfaction and pride than to explain our system and its economic benefits and growth to officials from other Nations. Is it a perfect system? Certainly not. But it is the best in the world, and its tremendous value makes it worth your efforts to improve it.

This is an important point, because in an effort to advance a particular point of view or an effort to advance a particular model, our entire patent system has often come under attack. Many have essentially claimed that the strength and value of innovation lies not in the invention itself, not in the idea or the model, but in who owns it. There is a growing lexicon of ad hominem names for entities that own intellectual properties but do not make products: "troll," "privateer" are among the most common. Name-calling is a distraction and plays no role in addressing the actual problems facing our system, and there are real problems.

It turns out there are many entities that own intellectual property and do not make products, but they add tremendous value to the system. It is not who owns the property that matters but what they own and how they conduct themselves in their ownership. There are certainly individuals or entities that own patents, do not make products, and engage in abusive and inappropriate practices. Likewise, there are those who own patents, do make products, and engage in abusive and inappropriate practices.

The solution will be to address abusive and inappropriate practices, not to discriminate against certain business models. Focusing on conduct allows judges to fashion remedies that fit particular circumstances.

One example of focusing on conduct occurred just last week. District Judge Scola noted of two companies locked in a patent lawsuit, "The parties have no interest in efficiently and expeditiously resolving this dispute. They instead are using this and similar litigation worldwide as a business strategy that appears to have no end. That is not proper use of this court." The judge did not discriminate against the companies based on whether they made a product or did not, but because of what he described as obstreperous and cantankerous conduct, Judge Scola ordered the parties

to narrow the case or he would put it on hold, a remedy to the actual conduct.

As the Committee considers proposals for potential additional modifications to patent law, please consider the following principles.

Do no harm. The solution we seek should not cause more harm than the problem—something that this Committee has looked at many times in patent law.

Do not discriminate. The intellectual property is what matters, not who owns it.

Please consider being conduct focused. Root out bad behavior regardless of the actor, and make sure proposed change will actually address the targeted conduct. That is one thing I worry about, is are we going to actually resolve the issue, or if there are really bad actors out there, and we know there are, are they just going to find another way around the law?

Respect the role of the Federal judiciary and recognize that some measure of judicial discretion will be necessary and that the Federal judiciary already has the toolkit.

I will close my oral testimony with a story I find particularly compelling. To me, it is an example of how the U.S. innovation and intellectual property system has proven to be an inspiration to the world. The head of the State Intellectual Property Office of China, Tian Lipu, is a brilliant man. He understands how strong intellectual property laws will benefit China and any other country. He was one of the partners we had to build, try to build a stronger intellectual property system in China. In a symposium 2 years ago, Commissioner Tian noted that Chinese manufacturers paid $19.70 in patent royalties for each DVD player they produced. His quote, "This is 10.2 times their profit, which is only $1.93 for each DVD player. In the year 2007 alone, the patent royalties charged by multinational companies from Chinese manufacturers amounted to $2.85 billion."

His point is clear and well understood. What matters is not so much who made the product but who had the innovation and who had the idea. There is much more to be done in China, for certain, on the intellectual property front, but it was a great moment for me to see a leader of China make that point, that the ideas are what are important. I would hate to sit across the table and explain why in the U.S. system we treat different patent owners differently from other patent owners when we are negotiating with the Chinese to make certain that they treat our innovators in China with the same respect that we demand through international treaties.

In closing, allow me to thank you again for the chance to share my views and answer any questions you may have. Please know I welcome the opportunity to participate in the process going forward. I am also certain that the company where I serve as a corporate director, MOSAID Technologies, would welcome the opportunity to participate as well.

The only professional regret I have, I just want to say at this moment, was when I was on this Committee, I often sent really hard questions up to Members of Congress to hassle the witnesses, and I don't sleep at night now knowing that I did that. [Laughter.]

Thank you very much.
[The prepared statement of Mr. Dudas follows:]

United States House of Representatives
Committee on the Judiciary
Subcommittee on Courts, Intellectual
Property and the Internet

Hearing on *Abusive Patent Litigation: The Issues*
Impacting American Competitiveness and Job Creation
at the International Trade Commission and Beyond
April 16, 2013

Testimony of Jon Dudas
Former Under Secretary of Commerce for Intellectual Property
and Director of the United States Patent and Trademark Office

Thank you for the opportunity to testify on these important issues. Today, I offer my perspective as a former Under Secretary of Commerce for Intellectual Property and Director of the United States Patent and Trademark Office (USPTO) from 2004 to 2009. Including my two years as Deputy, I spent seven years representing the United States and advocating for our intellectual property system throughout the world. I also spent another six years staffing this Committee and Subcommittee, supporting Members to craft sound intellectual property policies and laws. I can also add a business perspective. For the last year, I have served on the board of directors of MOSAID Technologies Inc., a privately owned company that identifies and maximizes the value of intellectual assets.

Legislative Review Based on Conduct and Not on Labels

In my government role, I was honored to promote the United States' system of intellectual property throughout the world. Nothing has given me more professional satisfaction and pride than to explain our system and its benefits for economic growth to officials from other nations. Is ours a perfect system? Certainly not, but neither is it fundamentally broken, as some have claimed.

Our intellectual property system is the best in the world, and its tremendous value makes it worth your efforts to improve it. This is an important point because in an effort to advance a particular point of view or a particular model, our patent system has come under constant attack. While the licensing of owned assets is a model we celebrate for bringing more efficiency and liquidity to markets, some forms of patent licensing are being particularly misrepresented and vilified.

Many have essentially claimed that the strength and value of an innovation lies not in the invention itself, the idea or the model, but who owns it. There is a growing lexicon of ad hominem names for entities that own intellectual property but do not make products: "troll" and "privateer" are among the most common. This name calling is a distraction that plays no role in addressing the problems facing our system.

Indeed, the very label of a "patent troll" is a red herring. The definition easily shifts depending upon the speaker, the audience, and the attractiveness of the patent holder. Universities, independent inventors, and research and development shops were once solidly in the troll category. As their models became more easily understood and recognized as beneficial, they become either implicitly or explicitly exempted.

However, it turns out that there are many entities that own intellectual property, do not make products and add tremendous value to the system. It is not *who* owns the property that matters but *what* they own and *how* they conduct their ownership. There are certainly individuals or entities that own patents, do not make products and engage in abusive and inappropriate practices. Likewise, there are those who own patents, make products and engage in abusive and inappropriate practices. There are also doctors, lawyers, and bus drivers who engage in abusive and inappropriate practices. The solution will be to address the abusive and inappropriate practices – not in discriminating against certain types of licensing entities, producers, doctors, lawyers or bus drivers.

Importance of Patents and Licensing

As the United States transitions from a manufacturing-based to a knowledge-based economy, the importance and value of intangible assets to U.S. businesses and investors has increased. Some have asserted that currently over half of the value of publicly listed companies stem from their intangible assets. Patents constitute the most important of these intangible assets because of the exclusionary rights they provide to their owners and because of the monetary impact they can have from licensing royalties.

In short, American inventors have built a reserve of intellectual property rights that is every bit as strategic as our domestic energy resources. Yet, in recent years, the American patent system, long one of our greatest institutional strengths, has come under increasing attack, with some advocates urging that this strategic reserve should

has been focused on licensing practices and has been voiced by companies who manufacture products outside the US.

Many inventors do not manufacture or market their own inventions. Inventors who are not in a position to develop or market their own inventions should not be deprived of the value of their patents, and treating non-practicing entities (NPEs) differently under the law would do just that. The free trade in patent rights that allows technology developers to combine many different inventions to create products is the DNA of NPEs.

It should also be noted that many operating companies depend on licensing companies to help them generate revenues from their patent portfolios, enabling further reinvestment in R&D.

By creating more demand for patent assets, NPEs increase the monetary value of those assets and makes them more liquid. These characteristics are important to lenders that take patents as collateral in financing arrangements.

Accordingly, as Congress studies how to improve the patent system, please consider viewing the overall picture. Legislation targeting certain patent owners based on their status, rather than on activities that are economically detrimental such as nuisance level suits, could have negative ramifications that we cannot fully anticipate.

Framing the Approach to Legislation

The Committee went through a long and thoughtful process to comprehensively review the entire patent system as a whole in the passage of the "Leahy-Smith America Invents Act." You recognize it is a long procedure that includes or can include inventing, application, examination, possible reexamination and post-grant review, administrative bodies and the Federal courts. For every step of the process, quality is fundamental. We should support all reasonable efforts to ensure patent quality from the

time an application comes in the office through issuance and beyond. I welcome the opportunity to discuss the great work the women and men of the USPTO do and how we can support them even further.

In addition to giving some direction about patent quality, Congress has done a great deal to address the issues of patent litigation abuse with the passage of the America Invents Act. The AIA created a vigorous post-grant review system, among other things, and enacted new joinder requirements and venue reforms.

The fundamental issue the Committee appears to be grappling with is how to advance modest reforms – notwithstanding the fact that the AIA is only now being implemented – to deal with those whose motivation is simply to profit from the high costs associated with litigation. How do we do this without harming US interests domestically and internationally?

As the Committee considers proposals for potential additional modifications to patent law, I would urge that it consider the following ideas:

- Do No Harm – the solution should not risk causing more harm than the problem
- Do Not Discriminate – the intellectual property is what matters, not who owns it
- Be Conduct Focused – root out bad behavior regardless of the actor, and make sure a proposed change will actually address the targeted conduct
- Respect the role of the Federal Judiciary – recognize that some measure of judicial discretion will be necessary, and that the federal judiciary already has a toolkit

With respect to the Committee's consideration of matters affecting the jurisdiction of the ITC, it is important to consider the ITC mission to safeguard American industries from unfair trade. A domestic industry that is protected by US patents should be safeguarded regardless of whether the patents are owned by or licensed to the industry. Licensing US intellectual property strengthens the US economy and improves our trade

balance. Weakening the ITC's jurisdiction over intellectual property could have an adverse effect on the US economy.

Importers of foreign made products – both US based and foreign companies – have appealed to Congress for several changes to Section 337 that would, in effect, limit access to the ITC or weaken the powers of the ITC to deal with cases of unfair trade practices. Diminishing the ITC's authority over IP could benefit foreign economies, foreign competitors, and other foreign manufacturers to the detriment of the US industries. I would urge the Committee to consider the expertise and resolve the ITC has continued to demonstrate to apply the law and address some of the issues being examined by the Committee.

Business Adapts to Changing IP Landscape

After leaving the USPTO, I continued to stay focused on promoting innovation. I counselled clients on intellectual property matters at Foley & Lardner, and I was president of *FIRST®*, a non-profit that inspires more than 300,000 kids a year to get interested in technology, science and innovation through robotics programs. I also continued to stay interested in the ways markets and business models have been changing to acknowledge and better understand intellectual property as an asset class. About one year ago, I joined MOSAID Technologies, Inc. as a member of the board of directors. MOSAID is a leading company in identifying and maximizing value of high quality and high impact patent portfolios. As a corporate director, I am compensated and have a fiduciary duty to the company. More importantly, I believe in MOSAID's business model. I welcome the opportunity to advance that model and to discuss it with you today.

MOSAID is a compelling company because it has consistently demonstrated both technological leadership and the ability to adapt to changing business conditions. The company was founded in 1975 as a semiconductor design services firm. In the 1980s, MOSAID invented circuit technology that is used in virtually all dynamic random access memory, or DRAM, the main type of data memory still used in computers. It

was also a leader in building test equipment for de-bugging prototype memory chips. By the mid-1990s, MOSAID realized that its DRAM inventions were being widely used in the market without permission. Its innovations were being appropriated. MOSAID responded by adding a licensing program to its business operations, requiring the company to develop expertise in identifying and asserting its patents. Today, the company has about 1,450 patents issued or pending from its own R&D, and has signed patent license agreements with over 60 leading international electronics companies.

MOSAID's R&D now focuses on Flash memory, which is widely used for data storage in computers, cellphones, and other electronics products. MOSAID's HLNAND® Flash memory technology improves the performance of solid state drives that are replacing hard disk drives in many applications, particularly enterprise and data center storage systems that are the backbone of the Internet and "cloud" computing. The company has about 700 patents issued and pending as the direct result of its R&D in this cutting-edge technology. This R&D has been funded for many years from the revenues earned from MOSAID's licensing activities.

Through its R&D, MOSAID developed an extensive portfolio of semiconductor intellectual property. By learning to license its own technology, the company also developed expertise in identifying and valuing high-quality, high-impact patent portfolios. In 2007, this led to MOSAID expanding its licensing model and to begin licensing other companies' patented electronics technologies.

Today, I would characterize MOSAID as a patent management and intellectual property development company. It forms and operates patent licensing partnerships with other patent owners. It acquires patents from other companies and works to improve the quality of those patent portfolios. In 2011, MOSAID attracted international attention when it acquired Core Wireless, which holds a major portfolio of wireless patents and applications originally invented by Nokia. MOSAID now has multiple patent licensing programs and is considered a leader in maximizing intellectual asset value. And the company continues to innovate, develop and promote new technology, such as HLNAND

MOSAID has also attracted the attention of investors who realize that managing intellectual property assets is an engine for economic and job growth. Sterling Partners, a leading US private equity firm with approximately $5 billion in assets under management and major investments in over 30 companies in the health care, education and the general business sectors, clearly recognized the value of investing in MOSAID as a specialized intellectual property company. In late 2011, Sterling Partners led a $600 million transaction to acquire MOSAID. Since then, MOSAID has grown its employee base by over 25 percent, adding high-paying jobs in the Dallas area and Ottawa, Canada.

Conclusion

One of the greatest things about representing the United States government on intellectual property policy was knowing the world was always watching. Our system has produced massive economic benefits for our nation, and thankfully many nations recognized it and worked closely with the US government to adopt a similar system. However, there are also many countries seeking the benefits associated with adopting improved intellectual property laws and working to undermine those principles to maintain an advantage for their domestic companies. In other words, they are focusing on *who* owns the intellectual property (domestic rather than US or other inventors) rather than the property itself. It is an attempt to discriminate against US inventors and companies. The US is the international leader in intellectual property, and it leads by example. If we make such a distinction in our law, it would harm innovation in the US. I believe it would also become the basis to attempt to justify treating certain entities in their nations differently. Improving the law for the US is the primary focus, but we must be mindful of both its domestic and international effects.

I will close with a story that I find particularly compelling. To me, it is an example of how the US innovation and intellectual property system has proven to be an inspiration to the world, and it is particularly relevant to the current debate. The head of State Intellectual Property Office in China, Tian Lipu, is a brilliant man who understands how strong intellectual property laws will benefit China and any other country.

In a symposium two years ago, Commissioner Tian noted that Chinese manufacturers pay $19.70 in patent royalties for each DVD player they produce. This is 10.2 times their profit, which is only $1.93 for each DVD player. In the year 2007 alone, the patent royalties charged by multi-national companies from Chinese manufacturers amounted to $2.85 billion, Commissioner Tian said.

His point is clear and well understood. It does not matter nearly so much who makes the product but who has the innovation. His nation as the product maker did not benefit nearly as much as did the innovators who had the ideas. This is a fundamental principle of *intellectual* property and one that allows for greater fairness for US companies operating in China. There is much more to be done in China for certain, but it was a great moment to see a leader advocate the point.

In closing, allow me to thank you again for the chance to share my views and answer any questions you may have. Please know that I welcome the opportunity to participate in the process going forward. I am also certain that the company where I serve a corporate director, MOSAID Technologies, would welcome the opportunity to participate as well. We all want to make the greatest economic and engine in the world even better.

Mr. COBLE. Good to have you back on the Hill, Mr. Dudas. Thank you, sir.

Mr. Binns?

TESTIMONY OF RUSSELL W. BINNS, JR., ASSOCIATE GENERAL COUNSEL, IP LAW AND LITIGATION, AVAYA, INC.

Mr. BINNS. Mr. Chairman and Members of the Committee, thank you for convening this hearing and for the opportunity to testify about the impact of abusive patent litigation today. I am the head of intellectual property law at Avaya, a leading provider of business and government communication systems worldwide, with approximately 7,000 employees in the United States and over 3,000 U.S. patents and patents pending. Avaya has a long history of innovation that traces its roots back to Alexander Graham Bell and Bell Labs. Avaya has been the victim of substantial abusive litigation and believe we are representative of many U.S. companies facing these issues.

Despite the best efforts of Congress and the courts, patent assertion entities continue to have a deeply damaging effect on the U.S. economy and consumers through both Federal court litigation and the ITC. These abuses cost U.S. companies billions of dollars that could be used to create jobs, invest in R&D, and bring new products to consumers. The abuses are even more clearly evident at the ITC, where patent assertion entities are frequently bringing cases against companies with operations in the U.S. seeking remedies that they don't want—namely, exclusion orders. Yet exclusion orders go contrary to the very business model of patent assertion entities.

A typical patent case costs millions through trial, and ITC actions are much more expensive and compressed. Regardless of the merits of the patents at issue, defendants are put in the position of rolling the dice in this system. These complex cases often coerce settlements that are out of line with the value of an asserted patent that represents a miniscule part of a targeted product. Patent assertion entities use their profits from one suit to file additional suits, and as the cycle continues and expands, no businesses are furthered, no jobs are created, and progress of science or the useful arts are not promoted. All of these costs are eventually shouldered by consumers.

I think there are unintended consequences caused when licensing was added in 1988 as a former domestic industry for standing at the ITC without envisioning how 25 years later a cottage industry of patent assertion entities would develop and burden the patent system and U.S. operating companies. The ITC was not created as a patent court for everyone but is a trade court with limited jurisdiction. It should only be used by those that need an exclusion order. The question everyone should be asking is why should licensing entities that are only seeking money have access to the ITC? From my experience, licensing entities use it for ulterior motives, to coerce settlements for more than what they could obtain in Federal court.

Avaya, along with several other major U.S. companies, recently faced an ITC dispute against a patent assertion entity that was only seeking licensing revenue on products that we had developed

and had been commercializing for many years. Its patent had nothing to do with communications, but was seeking to exclude essentially all of our phones and gateways. Knowing that its patent was for a small feature within a system and did not justify the large damages in Federal court, it filed an ITC action threatening an exclusion order.

During the case, settlement demands were based on a disproportionate share of the entire revenue of these products, and due to the cost of litigation and the chance of an exclusion order issuing, Avaya settled for a substantial sum of money. I believe the harm caused to companies such as Avaya by even a few of these cases is problematic enough to warrant change, and there are several ways Congress can improve the system.

First, institute a hearing into the equities of each 337 investigation in an early stage of the proceeding. It is not rocket science to determine if a complainant is using the ITC for an exclusion order to prevent harm or rather using it to obtain licensing revenue to support its business model. The hearing should be the first matter undertaken by an ALJ and would allow the ITC to prevent abusive patent assertion entities from initiating non-trade-related investigations. The inquiry could be similar to that used by the courts in applying eBay before awarding injunctive relief.

Second, Congress should amend Section 337 to change the domestic industry requirements by limiting qualification to those who engaged in production-based licensing and not allow complainants to rely on revenue-based licensing to satisfy domestic industry. This can be accomplished and is appropriate as licensing entities are seeking only money and the ITC cannot award damages. These changes will preserve legitimate uses of the ITC while constraining patent assertion entities that have an adequate remedy at law in the Federal courts, where they belong, thus protecting U.S. industry, jobs, and technology from abusive and damaging litigation in ITC.

Thank you for holding this hearing and addressing this problem that is harming American companies. I would be happy to discuss these issues further with any of you at your convenience, as these are critically important issues to Avaya. Thank you.

[The prepared statement of Mr. Binns follows:]

ABUSIVE PATENT LITIGATION: THE ISSUES IMPACTING AMERICAN COMPETITIVENESS AND JOB CREATION AT THE INTERNATIONAL TRADE COMMISSION AND BEYOND

HEARING

BEFORE THE

SUBCOMMITTEE ON COURTS, INTELLECTUAL PROPERTY, AND THE INTERNET

OF THE

COMMITTEE ON THE JUDICIARY HOUSE OF REPRESENTATIVES

ONE HUNDRED THIRTEENTH CONGRESS

APRIL 16, 2013

Testimony of

Russell W. Binns, Jr.
Associate General Counsel – IP Law & Litigation
Avaya Inc.

Written Testimony of

Russell W. Binns, Jr.,
Associate General Counsel of Intellectual Property Law & Litigation
Avaya Inc.

Before the
House Judiciary Subcommittee on Courts, Intellectual Property, and the Internet

"Abusive Patent Litigation: The Issues Impacting American Competitiveness and Job Creation at the International Trade Commission and Beyond"

April 16, 2013

Mr. Chairman, and members of the committee, thank you for convening this hearing and for the opportunity to testify about the impact of abusive patent litigation today. I'll speak to abuses with patent litigation in general, and then more specifically with respect to the International Trade Commission.

Despite the best efforts of Congress and the courts, patent assertion entities continue to have a deeply damaging effect on the U.S. economy and consumers, through both federal court litigation and the ITC. These abuses cost U.S. companies billions of dollars that could be used to create jobs, invest in R&D, and bring new products to consumers. This problem in the past few years has expanded far beyond Avaya and technology industry colleagues. Today, we see the problem plaguing small business, traditional retailers, venture back startups, and many more. The abuses are even more clearly evident at the ITC, where Patent Assertion Entities ("PAEs") are frequently bringing cases against companies with operations in the U.S. seeking remedies that they don't want, namely an exclusion order – the only remedy available at the ITC – yet one that goes contrary to the very business model of PAEs. This is by its nature a misuse of the system.

PAEs take advantage of lopsidedness in our litigation system. PAEs typically have very little in discovery costs but at the same time they have the ability to make defendants like Avaya spend a lot of resources responding to very broad and burdensome discovery requests. The cost to defend against a PAE suit far exceeds the PAE's cost to assert the patent. By stretching the interpretation of the claims of the patent beyond the intended invention, an aggressive PAE is able to target a large number of potential defendants and increase its potential windfall. PAEs then use their profits from one suit to file additional suits and buy additional patents, which are then similarly monetized with more settlements. As this cycle continues and expands, no businesses are furthered, no jobs are created, and progress of science or the useful arts is not promoted.

Introduction to Avaya

I am the head of intellectual property law & litigation for Avaya. Avaya is a leading provider of business and government communications systems worldwide with approximately 7000 employees in the United States across 10 states, and about 16,000 employees worldwide. Avaya traces its roots back over a century ago to Alexander Graham Bell, beginning as part of Bell Labs. The business unit that became Avaya today was once part of AT&T and then spun out of Lucent in 2000. In 2009, Avaya purchased the Nortel Enterprise business assets out of bankruptcy. The role our company has played in revolutionizing how people communicate is well documented in U.S. history and our engineers are at the forefront of American leadership in this field. Avaya has a long outstanding culture for innovation, and currently invests about 17% of its product revenue in research and development, about $464M dollars in the last year.

Avaya is a strong supporter of the U.S. patent system having more than 3200 issued and pending U.S. patents. But when it comes to patent litigation, we believe our system has room for improvement, particularly with respect to PAEs, and abusive litigation.

Avaya is now the target of a growing number of legal claims as a result of a patent system that still has many questionable issued patents and legal uncertainty. As a result, rather than investing in innovation and more jobs, Avaya diverts valuable resources to fighting unwarranted threats of exorbitant liability and baseless claims. The cost is not merely in dollars, but in time spent defending claims. Engineers are spending time in depositions and in extensive discovery exercises, instead of creating the next great invention. Prior to 2008, Avaya had no PAE lawsuits, but since 2008, Avaya has been sued 25 times by PAEs, with numerous more demand letters and lawsuits against customers. Avaya, as well as many other technology companies, is increasingly becoming risk averse in this environment, hedging against the risks of innovation to avoid the additional costs that result from an abusive patent claim.

The Patent Assertion Entity Problem

Patent Assertion Entities are becoming widely recognized as a problem to the U.S. economy. The Federal Trade Commission has confirmed that patent assertion entities "deter innovation by raising costs and risks without making technological contribution."[1] As Supreme Court Justice Anthony Kennedy explained in the *eBay* 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." The Supreme Court further recognized in curbing injunctive relief in federal court actions brought by patent assertion entities that PAEs use the threat of an injunction simply for undue leverage in negotiations, and that in such situations legal damages are sufficient to compensate for any infringement and an

[1] FTC, *The Evolving IP Marketplace, Aligning Patent Notice and Remedies with Competition*, 9 (Mar. 2011).

injunction may not serve the public interest.[2]

Patent Assertion Entities use of litigation to tax and deter innovation is contrary to the public policy set forth in the Constitution. Article 1, section 8 of the Constitution authorizes Congress "To promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries." Promotion of innovation through the patent system is a fundamental value of our society. Patent Assertion Entities subvert the public policy promoted by the Constitution, namely the promotion of innovation. They do not use granted patents to promote the progress of the useful arts but instead lay traps with their rights to siphon the progressive efforts of others. For example, a patent owner who actively promotes their new idea through efforts to manufacture or offers to license to encourage manufacture are promoting innovation, and are not the type of patent owner that causes problems with abusive patent litigation. But a patent owner who passively waits for others to step on or near their rights in order to threaten them with a toll is exactly the type of patent assertion entity that causes problems in our litigation system and should further not be using the ITC as a forum for its disputes. The patent owners that acquire or set up companies for the sole purpose of litigation and nothing else, are the most problematic and place the greatest burden on U.S. companies and the economy.

The ITC has also previously recognized, that in amending Section 337 in 1988, "Congress intended to cover 'licensing activities that encourage practical applications of the invention or bring the patented technology to the market.'"[3] PAEs seeking revenue licensing income do not encourage practical applications of the invention nor do they bring the patented technology to market. The entire business model of PAEs, and particularly their use of the ITC, goes directly against the public interest, controlling Supreme Court precedent, and the purpose of section 337.

Abusive litigation in both federal court and the International Trade Commission are driven by the current economics of what can be obtained by PAEs. The current system encourages patent owners to seek settlements that far exceed the value of the patent's contribution. The amount of money potentially at stake in litigation as a result of this approach creates huge pressure on defendants to settle regardless of the strength of the infringement claim. If the economic incentives and leverages are reduced so PAEs do not treat patent litigation as winning lottery tickets, then there will be fewer abuses.

Abusive Patent Litigation

Federal court proceedings have their issues that lead to abuse. As discovery is still too expensive and asymmetrical with respect to PAEs, invalidity is a challenge and extremely costly, even when you have good evidence of invalidity, such as Avaya often has because we are a treasure

[2] *eBay v. MercExchange LLC*, 547 U.S. 388, at 396-97 (2006).
[3] *Certain Multimedia Display and Navigation Devices and Systems, Components Thereof, and Products Containing Same*, Inv. No. 337-TA-694, Comm'n Op. at 25 (Jul. 21, 2011)

trove of prior art going back to some of the greatest work done in Bell Labs that we have and are often incorporated into our products long before the filing of patents being asserted by a PAE. Unfortunately, it still often requires a defendant to go through trial at a cost of approximately $4M to prove that the patent is invalid. With this type of patent litigation system, PAEs have an advantage and defendants will often settle for amounts less than litigation even when a patent is most-likely invalid, because most defendants, like Avaya, do not have the resources to be spending millions of dollars on every patent that is asserted against us to prove that it is invalid. We are not alone here, and many similarly situated companies need these issues to be addressed.

There has been a steady stream of cases correcting past imbalances in patent law, including on critically important issues such as damages, injunctions, venue, and the scope of patentability. These changes, along with the American Invents Act, have vastly improved the landscape of patent law from where it was just a few years ago. Today, the increasing trend of abusive litigation is a challenge for our industry. From my experience, rarely in a PAE suit is the accused product or system the same as the invention described in a PAE's patent specification, but PAEs based on a broad reading of its claims will assert infringement against similar but different innovations independently developed. The cost of defending a PAE suit is asymmetrical with the PAE having little discovery costs, and the PAE knowing that it will cost at least $2M and often more around $4M to prove that there is no infringement or that the patent is invalid. This puts all defendants and particularly defendants with limited resources at a distinct disadvantage.

Patent assertion entities exploit the current system to coerce high settlements from productive companies, such as Avaya. A typical patent case costs over $4 million through trial. This is more than four times as expensive as a typical copyright case with similar liability exposure. Regardless of the merits of the patents at issue, defendants are put in the position of rolling the dice in a system that ill serves inventors and producers of products alike. These complex cases not only cost millions in legal bills, but often coerce settlements that are out of line with the value of a claimed inventive contribution that represents a miniscule part of a targeted product. All of these costs result in wasted capital, fewer jobs, and less innovation, and are eventually shouldered by consumers buying products in the form of a hidden innovation tax.

In our industry, one device may have thousands of patents encompassed within it. Some of those patents pertain to voice communications features. We have experienced numerous instances in which a patent assertion entity buys a patent that superficially touches on one of many features in the hopes that it can collect a large sum of money on the allegation that we have infringed upon its patent. Speculating on patents in the hope of a large recovery based on an allegation of infringement has become a cottage industry in this country. Although some recent caselaw helps make progress in appropriately limiting damages, there is still uncertainty with respect to when damages can be calculated based on the entire market value of a device, or merely on the value provided by the patent that has been found to be infringed upon. Instead of focusing on what is the smallest saleable unit representing the patented invention, these patent assertion entities often

seek damages on the entire product. The uncertainty in damage calculations drives up risk and the cost of litigation, and coerces settlements.

Further, patent assertion entities subvert productivity and innovation. PAEs acquire patents with the express intent to extract money from as many companies as possible. They do not use their patents to promote innovation, but instead lay traps with their patent rights to siphon the progressive efforts of others. This differs greatly from a patent owner such as Avaya who actively promotes its new ideas by obtaining patents and through efforts to manufacture products or offer licenses for others to manufacture products. The efforts that derived from Alexander Graham Bell, and later from our Bell Labs, and now Avaya labs has spawned entire industries from our innovation. Patent assertion entities passively wait for others to step on or near their patent rights in order to threaten them with a toll. This cottage industry threatens Avaya's and the U.S.'s long history of continued research, development and innovation efforts.

Prior to the American Invents Act, the last comprehensive revision of U.S. patent law took place in 1952, a time when typewriter correction fluid was the new technology, highly integrated global markets were not the norm, and the networked interoperable devices on which our economy now relies were more science fiction than everyday reality. In addition, the number of patents issued annually in the early '50's was less than one-quarter of today's volume. And then, patent litigation was a tool of last resort, not first resort. The AIA made improvements to the patent system, but more needs to be done in litigation reform and with respect to the ITC.

As many members of this committee may be aware, many PAEs file numerous lawsuits seeking settlements that are under the cost of litigation knowing that most defendants will settle to avoid costly litigation. Further many PAE lawsuits target mature industries and products and processes that operate in accordance with various standards that were developed in cooperation for the betterment of consumers and the economy as a whole without any contribution by the PAE to promote the useful arts. Something is terribly wrong when patents are being used, not to further innovation but instead to tax innovation by others, costing companies dollars that could have been used to create new jobs, fund R&D, and create the next great technology.

I don't believe the patent system was intended to be a playground for trial lawyers and assertion entities to use as a lottery ticket at the expense of U.S. companies by diminishing what they can contribute to the overall economy through capital spending, job creation, manufacturing, and selling of products.

ITC abuse

Neither the America Invents Act nor recent court rulings apply at the ITC, making it fertile ground for the exact type of abuse Congress has sought to eliminate. We welcome Congress addressing abusive patent litigation, and want to make it clear that any truly effective effort to stop the corrosive impact of patent assertion entities must address ITC abuse as well.

We believe that Section 337 of the Tariff Act is an important tool for the protection of American jobs and intellectual property. Section 337 is a US trade law, enacted in 1930. It was designed to protect U.S. manufacturers from unfair foreign competition, and empowers the U.S. International Trade Commission (ITC) to exclude products from the U.S. market. The statute is particularly useful in intellectual property enforcement cases because it sometimes is difficult to enforce a patent against foreign infringers in the U.S. courts due to jurisdictional issues. Section 337 permits direct action against the infringing products, whether or not the maker of the products is subject to the U.S. courts.

Increasingly, Section 337 is being abused by PAEs that acquire and hold patents for the purpose of litigation. PAEs don't produce goods – they don't actually use technology to create products or jobs in the United States. Their goal is to threaten other businesses with patent litigation in the hope that those other businesses will agree to pay royalties rather than face continuing legal claims.

The intensity and fast pace of ITC litigation creates an atmosphere where a respondent in the ITC must divert extensive resources quickly to its defense or face a rapid, adverse and unfair result. Even if a company is confident that its imported products do not infringe a patent, the costs of litigation, the uncertainty of litigation, and the risks of an interruption of business are so great that the company often will settle avoiding the unfair discovery process where PAEs have minimal discovery.

While a PAE may have a claim in federal court, it should have no place in the ITC, which is intended to protect U.S. industries and jobs, not to allocate existing value among claimants by awarding damages. The current domestic industry test in Section 337 does not specifically distinguish between production-based licensing and revenue-based licensing. PAEs were not contemplated, and did not exist in their modern form, when Congress last updated the ITC's statute in 1988. And so, under current practice, almost any patent owner, even foreign based PAEs with virtually no presence in the U.S. and licensees with limited capacity, can bring an action against an entire U.S. industry.

This is happening because the 1988 Congressional amendments to Section 337 of the Tariff Act of 1930 have been interpreted to require the ITC to accept complaints from entities that invest in ***any*** kind of domestic licensing, including "revenue-driven licensing."

"Revenue-driven licensing" is licensing or attempted licensing that occurs ***after*** another company has already developed and sold products allegedly using the patented technology. Generally, the targeted products were independently developed without knowledge of the patent, and it is not uncommon for the patent claims to be drafted after the targeted product has already been sold. This is not "production-driven licensing" activity, where licenses encourage the development and sales of new products that Congress intended would satisfy the ITC's jurisdiction requirement when it amended the Tariff Act.

Use of the ITC by PAEs has become more prevalent in recent years because the remedy the ITC may issue – an exclusion order that bars a U.S. company from importing its products for sale in the U.S. – has been unavailable to patent assertion entities in federal court since 2006, when the Supreme Court decided *eBay v. MercExchange*[4]. In that case, the Supreme Court held that injunctive relief may only be awarded to patent holders who satisfy a traditional four prong equitable test for an injunction by proving, among other things, that their patent claims cannot be adequately satisfied by an award of money damages. Patent assertion entities, which by definition are looking for money, have no standing to seek injunctive relief in federal courts. Because of this, they have turned their sights on the ITC as a preferred venue for asserting their patents against U.S. operating companies, in order to threaten them with the prospect of exclusion orders that they would not be able to receive in a federal court. By filing in the ITC, these entities hope to extract more than the true value of the patented technology from U.S. operating companies. This is particularly unfair and abusive where the allegedly infringing component is: minor to an overall product and doesn't drive consumer demand, yet is enough to have the ITC grant an exclusion order on the entire product. This is a result that would not be available in federal court.

The use of the ITC in this manner should not be allowed. Patent assertion entities do not engage in the kind of domestic licensing activities that should qualify them to use the ITC. Congress did not intend for its trade statutes to allow patent assertion entities who target existing products for licensing revenues to bring their claims in the ITC. The ITC is a trade forum intended to protect U.S. industry and U.S. consumers. It was not intended to be a forum for a few individuals to extract settlements far beyond what they would be entitled to receive if they sued in a federal court.

Claims by patent assertion entities can be and are adjudicated in federal district courts empowered to award money damages where appropriate. The ITC is an international trade forum intended to protect U.S. industry. Yet under current ITC practice, it is being used with increasing frequency by patent assertion entities to harm U.S. industry.

PAEs have discovered that the much lower bar for obtaining exclusion orders at the ITC gives them tremendous leverage to demand outrageous licensing fees – even as they pursue cases in federal court. This often leads to companies being left with little choice but to give-in to PAE demands, resulting in truly wasted capital, higher costs for consumers, and barriers to American innovation.

With respect to the ITC, the system is clearly broken when a Patent Assertion Entity that relies only on revenue licensing (as opposed to production licensing) seeks a remedy that it doesn't want and would actually hurt its business, which is based on generating licensing revenue from the sale of products. It is a perversion of our legal system when a party seeks a remedy that it doesn't want in order to create leverage for an award of money that isn't available to it. The federal courts are the proper venue when monetary damages are sufficient to remedy any harm. At least in the

[4] *eBay Inc. v. MercExchange LLC*, 547 U.S. 388 (2006)

federal courts, a defendant can present arguments on reasonable damages based on recent case law. In the ITC, a respondent does not have that opportunity and is forced to settle for unreasonable amounts rather than face the possibility of an exclusion order.

Some argue that there isn't a problem in the ITC because the ITC isn't issuing exclusion orders for revenue licensing PAEs. That argument misses the point, and actually argues against PAEs being granted access to the ITC. The fact that PAEs are instituting these proceedings, but seek and prefer monetary settlements over an exclusion order further evidences that the ITC is not the proper forum for them, as the federal courts can more than adequately address the PAE concerns.

The bottom line is that a Patent Assertion Entity wants and needs licensing revenue. The ITC does not offer damages as a remedy and if it granted an exclusion order, it would actually be detrimental to the PAE. In such a situation, the system is clearly being misused.

PAEs like to bring their cases against prominent U.S. companies, because their goal is not to exclude foreign products from the United States or to protect American manufacturers; it is to negotiate a royalty stream by placing the respondent in a state of duress. Pay a royalty or face an exclusion order. U.S. manufacturers, and others, operate on a global basis. They sell their products globally, and they ensure their products are internationally competitive by purchasing parts and materials globally as well. Exclusion of critical parts or components from the U.S. market can lead to a disastrous shut-down of U.S. operations.

Example of ITC abuse

Avaya, along with several other major U.S. companies, recently faced an ITC dispute against a PAE that was only seeking licensing revenue on products that we had developed and been commercializing for many years incorporating a standard. The PAE waited for an industry to mature then asserted its patent against the products practicing the standard. The PAE's specific embodiment of what it had invented was not the same as the standard, but the PAE asserted that the claims of its patent were broad enough to encompass the standard and that it deserved royalties. Knowing that its patent was at best just applicable to a powering feature of an overall communication system – and therefore not justified to large damages in a federal court proceeding – it filed an ITC action threatening an exclusion order for essentially all of our phones and gateways. During the case, settlement demands were based on a disproportionate share of the entire revenue of these products, and due to the cost of litigation and the chance of an exclusion order issuing, Avaya settled for a substantial sum of money. During the ITC mediation, the PAE admitted that it never wanted an exclusion order, but only licensing revenue. They were using the ITC as leverage to maximize licensing revenue that quite frankly would not be justified under current damages law in any federal court proceeding. The PAE subsequently withdrew its ITC complaint, but not before costing the respondents tens of millions of dollars in defense fees.

We believe if a patent owner wants only money that it should be limited to the federal

courts, which are more than adequately prepared to address patent damages. In an ITC proceeding, Respondents do not have the opportunity to present damages arguments or any rationale of what reasonable damages should be. And, respondents are not able to establish the importance of the allegedly infringing component and whether it really drives consumer demand, or is it merely an insignificant feature in a larger product. Respondents are therefore subject to either paying above what is legally required as damages to avoid the possibility—even when they don't believe they infringe or they believe the patents are invalid—the possibility of an exclusion order that would be devastating to their business.

PAE cases demonstrate the extent to which 337 investigations have strayed from their intended purpose. PAEs should not be allowed to initiate a 337 investigation because they have no real trade grievance – they are only seeking money damages. They do not make products and do not promote adoption and production of new innovations through licensing others. They, therefore, do not have the capacity to supply even a fraction of the industry that they seek to exclude. Nonetheless, PAEs are able to proceed because they claim domestic industry under the licensing clause in Section 337, and because there is no procedure to challenge the reasonableness of an ITC remedy at the beginning of an investigation.

Solutions to the Problem

The federal court system, particularly the Federal Circuit Court of Appeals, is making progress in recognizing the PAE problem and fashioning judicial policy within their authority to put appropriate limits on abusive PAE practices. Congress also deemed it necessary to correct some of these practices in the recently enacted America Invents Act (AIA), which in part, limits a PAE's ability to include unrelated defendants in a patent lawsuit. Unfortunately, the adjustments made by the courts and Congress to limit PAEs do not apply to the ITC. And the ITC is not bound by Supreme Court precedent that requires a thorough equitable evaluation prior to the grant of injunctive type relief.

The ITC is not able to adequately remedy the problem without statutory change. The ITC is constrained by statute, which has resulted in an application of the law which has ultimately led to many examples of PAE abuse in the ITC.Some believe that the ITC has the ability to fix this problem without statutory change. There is no evidence, however, that it will do so. To the contrary, the ITC has stated that it will not distinguish between entities that claim domestic industry based on particular licensing activities. That is, any entity that can show it has licensed a patent to another party, even if it is revenue-based licensing, qualifies as a "domestic industry" under current ITC law. And while recent decisions and proposed rule changes indicate that the ITC may genuinely be trying to address the problem in limited respects, these attempts will likely fall far short of eliminating PAE activity from unfairly burdening productive US manufacturers that employ thousands of American workers.

There are several ways Congress can improve the system. We believe the following

suggestions, if implemented, would make a significant difference at each of these suggestions, if implemented, would make a difference toward American competitiveness and curbing ITC abuses.

First, institute an inquiry into the equities of each 337 investigation at an early stage of the proceeding, or even before an investigation is begun. The inquiry preferably would be the first matter undertaken by an ALJ. An initial determination by an ALJ on this issue should be immediately reviewable by the Commission, and a Commission determination should be reviewable by the Federal Circuit Court of Appeals. This inquiry will allow the ITC to use its discretion in preventing abusive PAEs from initiating non-trade related investigations. The inquiry could be similar to that used by the courts as set forth by the Supreme Court in *eBay* before awarding injunctive relief. This would align the ITC with the equitable principles it was founded upon.

Second, Congress should amend Section 337 to change the domestic industry requirements by limiting qualification to those who engaged in production-based licensing, and not allow complainants to rely on revenue based licensing to satisfy domestic industry.[5] This is appropriate as licensing entities are seeking money and the ITC cannot award damages.

Patent assertion entities would still have federal courts available to them and could still pursue fair monetary damages if they showed ownership of a valid and infringed patent and an entitlement to damages. And domestic manufacturers, and technology licensing companies and universities would continue to benefit from the ITC's protections. What patent assertion entities would lose is the ability to use the ITC to threaten companies with the prospect of an exclusion order, and the certainty of an expensive patent litigation, to obtain settlements far in excess of the true value of the patented technology. This litigation tactic does not benefit any U.S. industry.

These changes will preserve legitimate uses of the ITC while constraining PAEs who have an adequate remedy at law in the federal courts, thus protecting U.S. industry, jobs and technology from abusive and damaging litigation in the ITC.

If PAEs are allowed to continue to use the ITC as a forum to extract licensing revenue, we will eventually see a PAE assert a patent that tangentially covers a minor aspect of a system and demand an exorbitant rate that a respondent won't be able to pay forcing the respondent to risk getting an exclusion order against it, and face being put out of business costing thousands of jobs and losses of products that can't be replaced by the PAE. We should not wait for such a senseless outcome to occur before taking action. Allowing a PAE to misuse the ITC for a remedy that is of no use to it, solely as leverage should not be tolerated. The system should not force U.S. companies to face such choices through misuse of the ITC.

Conclusion

[5] The Federal Trade Commission has made a similar recommendation in its March 2011 Report, *The Evolving IP Marketplace: Aligning Patent Notice and Remedies with Competition.*

Avaya supports common sense measures to modernize and bring balance to the patent system. We should stop abuse of the ITC by not allowing the forum to be misused for ulterior motives. Only parties needing an exclusion order should be in the ITC. A party that uses a forum for a remedy that it doesn't want and in fact will hurt it, just to use it as leverage for what they can't get under the law in federal court is an abuse that cries out for statutory reform to correct it.

Thank you for holding this hearing and addressing this problem that is harming American companies. I would be happy to discuss these issues further with any of you at your convenience, as these are critically important issues to Avaya.

Mr. COBLE. Thank you, Mr. Binns.
Ms. Okun?

TESTIMONY OF DEANNA TANNER OKUN, PARTNER, ADDUCI, MASTRIANI & SCHAUMBERG, LLP, FORMER COMMISSIONER, U.S. INTERNATIONAL TRADE COMMISSION

Ms. OKUN. Thank you, Chairman Coble, Ranking Member Watt, and Members of the Subcommittee. Thank you for the opportunity to testify. It is an honor to engage in this important discussion with you today and to appear on this panel of distinguished witnesses.

Mr. Chairman, thank you for your introduction. Let me reiterate that I appear in my individual capacity and not on behalf of the firm or any of its clients, nor do I speak for the U.S. ITC or my former colleagues. My purpose is to share my perspective based on my recent experience as commissioner and chairman. I will focus my oral remarks on a few key points for consideration by the Subcommittee. I will refer Members to my written statement, and I will be pleased to answer questions.

First, the ITC is an expert trade agency that, in administering Section 337, provides an effective remedy to combat the pervasive problem of infringing imports, thereby providing essential protection to U.S. IPR owners and fostering U.S. competitiveness and innovation.

Second, through its decisions and administrative actions, it is my view that the ITC has sent a strong message that only entities with substantial domestic ties will succeed under Section 337. The data demonstrate that PAEs are not succeeding at the ITC.

Third, the ITC, perhaps because it is small, non-partisan, and quasi-judicial, has been nimble in addressing litigation issues by pursuing case management and rules changes to reduce the cost and burden of litigation.

Allow me to elaborate briefly on those three points.

As this Committee knows well, innovation is a primary driver of U.S. economic growth and competitiveness. IP licensing is one of the few industries in which the United States enjoys a significant trade surplus. Unfortunately, the infringement of IPR is a pervasive problem that harms companies and consumers.

The advantages of Section 337 include expeditious adjudication, experienced ITC judges, in rem jurisdiction, and effective remedies. The prevalence of high technology products with short life cycles underscores why these attributes make the ITC an attractive venue for domestic industries battling infringing imports. I respectfully submit that Section 337, by serving as a mechanism for protecting U.S. IPR, promotes American competitiveness and domestic job creation.

Critics claim that NPE's are easily satisfying the domestic industry requirement through dubious investments in licensing activities. To the contrary, since August 2011, only one NPE has proved the existence of a licensing-based domestic industry. In addition, and I want to underscore this really important administrative development, the Commission, in a recent case with an alleged PAE complainant accusing 15 respondents of patent infringement, ordered the presiding ALJ to hold an early evidentiary hearing, find

facts, and issue a decision within 100 days as to whether the complainant had established a domestic industry.

The Commission's decision to order an early hearing demonstrates that PAEs must be prepared to prove their domestic industry before addressing other aspects of the case. This puts significant pressure on the PAE and reduces its leverage to extract a settlement. Moreover, the expense to respondents is potentially reduced as the case could be dismissed on domestic industry grounds early on.

Next, I would like to focus on the data regarding NPEs at the ITC. I want to note, yesterday the ITC posted on its website an update on facts and trends regarding U.S. ITC Section 337 investigations. According to the fact sheet, from May 2006, when eBay was decided, through the first quarter of 2013, the U.S. ITC instituted 301 investigations. Of these, Category 1 NPEs accounted for 33 investigations or 11 percent, and Category 2 NPEs, which would resemble a PAE under many definitions, accounted for just 27 investigations or 9 percent.

The second data issue concerns results, are PAEs obtaining exclusion orders. Again, the facts do not support the hype. The Commission has issued over 50 exclusion orders since 2006, only four of them on behalf of NPEs, and those NPEs developed the technology, or their affiliates.

Let me briefly touch on public interest issues. Before issuing any remedial order, the Commission is required by statute to consider the effect of such relief on the public health and welfare, competitive conditions in the U.S. economy, the production of like or directly competitive articles in the U.S., and consumers. The ITC has tailored remedies based on legitimate public interest concerns. In the most recent example, the Commission delayed enforcement of remedial orders by 4 months to provide network carriers time to replace the infringing smart phones and permitted the respondent to import replacement parts to be provided to customers under warranties and insurance contracts. In addition, in 2011, the ITC issued new rules allowing ALJs to develop the factual record on how a complainant's request for relief would affect the public interest.

Finally, I want to call the attention of the Committee to the rulemaking initiatives of the Commission to increase the efficiency and reduce costs for all litigants. While I was chairman, the Commission initiated new rules and pilot programs governing discovery, including e-discovery, inspired in part by Chief Judge Rader's efforts to encourage courts and the ITC to adopt rules that reduce the cost of litigation. The first set of new rules, including limits on depositions and interrogatories, issued last week, and new rules on e-discovery are expected soon. These changes are additional evidence of a nimble agency finding reasonable ways to best address the matters under its jurisdiction.

Thank you, and I look forward to your questions.

[The prepared statement of Ms. Okun follows:]

Written Statement of Deanna Tanner Okun

Partner, Adduci, Mastriani & Schaumberg, LLP
Former Commissioner, United States International Trade Commission

Before the

United States House of Representatives Committee on the Judiciary
Subcommittee on Courts, Intellectual Property and the Internet

"Abusive Patent Litigation: The Issues Impacting American Competitiveness and Job Creation at the International Trade Commission and Beyond"

April 16, 2013

I. Introduction and Executive Summary

Chairman Coble, Ranking Member Watt, and distinguished members of the Subcommittee: thank you for the opportunity to testify. It is an honor to engage in this important discussion with you today.

I have been privileged to be part of the international trade and intellectual property community for a number of years. I spent a good portion of my early career on Capitol Hill and served on the U.S. International Trade Commission for twelve years, including two terms as Chairman. I am now with Adduci, Mastriani & Schaumberg, LLP, an international trade law firm based in Washington, DC, but appear today in my individual capacity, and not on behalf of the firm or any of its clients.

As you know, the ITC is a small, independent, nonpartisan administrative agency that was established by Congress in 1916. The ITC administers U.S. trade remedy laws in a fair and objective manner, provides Congress, the President, and the U.S. Trade Representative with information and support on matters relating to tariffs and international trade and competitiveness, and maintains the Harmonized Tariff Schedule of the United States.

The trade remedy law we are discussing today is 19 U.S.C. § 1337, commonly known as Section 337. This statute authorizes the ITC to investigate unfair methods of competition and unfair acts, including infringement of intellectual property rights ("IPR"), in the importation of articles into the United States. In other words, the purpose of this law is to assure that competition from overseas goods respects U.S. property rights, especially those protected by statute.

The number of Section 337 cases has increased in recent years. Perhaps as a result of that increase, some commentators have argued that the statute is inappropriately, and disproportionately, serving the interests of so-called non-practicing entities ("NPEs") and patent assertion entities ("PAEs"). Respectfully, I disagree with such contentions.

In my capacity as a former member and Chairman of the ITC, I offer a few key points for consideration by the Subcommittee. First, the ITC is an expert trade agency that, in administering Section 337, provides an effective remedy to combat the pervasive problem of infringing imports, thereby providing essential protection to U.S. IPR owners and fostering U.S. competitiveness and innovation. Second, through its decisions and administrative actions, the ITC has sent a strong message that only entities with substantial domestic ties will succeed under Section 337. The data demonstrate that PAEs are not succeeding at the ITC. Finally, the ITC has pursued rules changes to reduce the cost and burden of discovery.

II. Importance of Protecting Intellectual Property to the U.S. Economy

There is a direct link between the protection of U.S. IPR and American competitiveness and job creation. I respectfully submit to the Committee that Section 337, by serving as a

mechanism for protecting U.S. IPR, promotes American competitiveness and domestic job creation.

Innovation is a primary driver of U.S. economic growth and competitiveness. IP-intensive industries accounted for more than $5 trillion in value added, or 35 percent of U.S. gross domestic product, in 2010.[1] In the same year, IP-intensive jobs accounted for 19 percent of total U.S. employment.[2] IP licensing, it should be noted, is one of the few industries in which the United States enjoys a significant trade surplus, delivering billions to the U.S. economy every year.[3]

Acknowledging that development of IPR had become an increasingly critical source of value for the U.S. economy, and that some manufacturing had moved overseas, Congress amended Section 337 in 1988 to explicitly authorize NPEs to bring complaints. Congress modified the statute so that companies making a "substantial investment in [a patent's] exploitation, including engineering, research and development, or licensing," could establish the existence of a domestic industry and obtain relief under this statute. Congress expressly recognized that large and small U.S. companies, developing and utilizing IPR that is being infringed by unfair imports, should be afforded protection under Section 337.

Infringement of IPR is a pervasive problem that harms companies, consumers, and all levels of government.[4] The purpose of Section 337 is to combat infringing imports. China is the number one source of infringing products seized at the border. More than half of Section 337 investigations instituted since 2006 have involved Chinese imports; in 2012, the figure was 90 percent. Section 337, by helping to combat this infringement, strengthens U.S. competitiveness.

Equally important, the ITC administers Section 337 in a prudent and judicious manner. Through its decisions and administrative actions, the ITC has sent a clear message that it is not a friendly forum for complainants whose U.S. activities do not merit the protection of this statute as intended by Congress.

III. Responses to Criticisms of Section 337

Advantages of asserting IPR under Section 337 include expeditious adjudication, expert ITC judges, *in rem* jurisdiction, and effective remedies. While the spectrum of products,

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[1] Economics and Statistics Administration and U.S. Patent and Trademark Office joint report, "Intellectual Property and the U.S. Economy: Industries in Focus," at 45 (Mar. 2012).

[2] *Id.*

[3] *Id.* at 56-59. *See also id.* at 2 (stating that IP licensing helps drive the U.S. economy forward by "[c]reating a platform for financial investments in innovation" and "[e]nabling a more efficient market for technology transfer and trading in technology and ideas".)

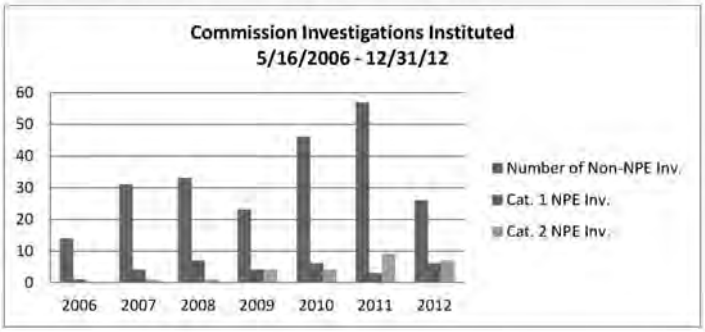
[4] *See* U.S. Congress Joint Economic Committee, "The Impact of Intellectual Property Theft on the Economy," at 1, 4 (Aug. 2012).

industries, and types of IPR considered by the Commission is broad, the prevalence of high-technology products with shorter life cycles underscores why these attributes make the ITC an attractive venue for domestic industries battling infringing imports.

Against a backdrop of increased filings in the last decade, including a number of high-profile cases involving smartphone and tablet technology, a few companies have sought to diminish the powers of the ITC. The foundational argument of such critics is that the Section 337 docket has been flooded by an exponential increase in NPE and PAE filings. Data, however, suggest otherwise.

- According to an ITC factsheet, from May 2006 through June 2012, "Category 1" NPEs—entities defined as manufacturers whose products do not practice the asserted IP, research institutions, start-ups, and individual inventors—accounted for just 10 percent of Section 337 investigations. Over the same period, "Category 2" NPEs—entities whose business model focuses on purchasing and asserting patents (essentially PAEs)—accounted for just 8 percent of investigations.[5]

- New Section 337 complaints decreased from 69 in 2011 to 40 in 2012 (a 30 percent drop), while the number of filings by NPEs remained the same. Thus, there was an increase in the *percentage* of NPE-based cases in 2012, but no change in the *actual number* of NPE cases. Of the 40 investigations instituted during 2012, six were based on a complaint filed by a Category 1 NPE and seven from a complaint filed by a Category 2 NPE. Notably, there was a decline, from nine to seven, in the number of Category 2 (PAE) investigations from 2011 to 2012.[6]



[5] *Facts and Trends Regarding USITC Section 337 Investigations* (Published on the Commission's website, June 18, 2012).

[6] The data for full year 2012 is based on the author's individual assessment of Section 337 filings. As of April 12, 2013, the ITC had not yet issued a new factsheet providing data on NPE filings through December 2012.

Some have also criticized the Commission's handling of Section 337 investigations, particularly as to the issues of domestic industry, remedies, and public interest. An analysis of ITC data, including recent decisions, demonstrates that the Commission is, in fact, appropriately analyzing these issues and making reasoned determinations on a case-by-case basis.

A. Domestic Industry

- Critics claim that NPEs are easily satisfying the domestic industry requirement through dubious investments in licensing activities. To the contrary, the ITC is thoughtfully interpreting the statute's "substantial investment" standard where an alleged domestic industry is based on licensing. Since August 2011, only one NPE has proved the existence of a licensing-based domestic industry (and that complainant did not succeed in obtaining an exclusion order).[7] In 2012, two NPEs *which had in previous investigations satisfied the domestic industry requirement* failed to prove that their licensing investments were sufficient to meet the test as currently applied.[8] Already in 2013, another NPE has failed to establish a domestic industry based on its licensing investments.[9]

- In the seminal case involving a complainant attempting to establish a domestic industry based on licensing, the Commission held that such a complainant must meet three threshold requirements: (1) the investments must constitute an exploitation of the individual asserted patent; (2) the investments must relate to licensing; and (3) the investments must be domestic, i.e., occur in the United States.[10] If these requirements are satisfied, the complainant must then prove that its investments are substantial. Factors assessed in the substantiality analysis include the number of licensees, the amount of revenue generated from license agreements, and the number of U.S. employees involved in the relevant licensing efforts.[11] Litigation expenses, alone, are insufficient to satisfy the test.

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[7] *Certain Liquid Crystal Display Devices*, Inv. No. 337-TA-741/749, Comm'n Op. (Pub. Version) (Jul. 6, 2012).

[8] *Certain Semiconductor Chips*, Inv. No. 337-TA-753, Comm'n Op. (Pub. Version) (Aug. 17, 2012); *Certain Integrated Circuits*, Inv. No. 337-TA-786, Comm'n Op. (Pub. Version) (Oct. 10, 2012).

[9] *Certain Microprocessors*, Inv. No. 337-TA-781, Initial Determination (Pub. Version) (Dec. 14, 2012) (domestic industry finding vacated by the Commission in a Feb. 15, 2013, notice, without reaching the merits, because the finding was nondispositive in view of the Commission's adopted claim constructions).

[10] *Certain Multimedia Display & Navigation Devices & Systems*, Inv. No. 337-TA-694, Comm'n Op. (Pub. Version) (Aug. 8, 2011).

[11] *Id. See also Certain Short-Wavelength Light-Emitting Diodes*, Inv. No. 337-TA-640, Initial Determination (Pub. Version) (June 10, 2009).

- The Commission has, through its application of these carefully crafted standards, denied relief to multiple complainants based on their failure to establish the required domestic industry. And in an attempt to remain faithful to the legislative history of Section 337, the ITC has concluded that "revenue-driven licensing"—as opposed to "industry-creating, production-driven licensing"—is entitled to less weight in the domestic industry analysis.[12]

- The U.S. Court of Appeals for the Federal Circuit has reviewed the Commission's approach under the statute and affirmed its correctness—both where licensing activities were deemed sufficient to establish a domestic industry, and where such allegations failed to establish a domestic industry.[13]

- The Commission recently instituted an important new procedural mechanism regarding the question of domestic industry. In *Certain Products Having Laminated Packaging*, the complainant, a PAE, accused 15 respondents of patent infringement. The Commission, for the first time, ordered the presiding Administrative Law Judge ("ALJ") to hold an early evidentiary hearing, find facts, and issue an expedited decision as to whether the complainant has established a domestic industry.[14] The ALJ was given just 100 days to issue his decision. A finding that the complainant's U.S. activities are insufficient to meet the test will effectively end the litigation, unless the Commission orders otherwise.

- The Commission's action in *Laminated Packaging* shows that NPEs must be prepared to prove their domestic industry before addressing other aspects of the case. This puts significant pressure on the NPE and reduces its leverage to extract a settlement. Moreover, the expense to respondents is potentially reduced, as the case could be dismissed on domestic industry grounds early on.

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[12] *Certain Multimedia Display & Navigation Devices & Systems*, Inv. No. 337-TA-694, Comm'n Op. (Pub. Version), at 25 (Aug. 8, 2011).

[13] *See InterDigital Communications, LLC v. Int'l Trade Comm'n*, 690 F.3d 1318 (Fed. Cir. 2012) (affirming Comm'n Op. in *Certain 3G Mobile Handsets*, Inv. No. 337-TA-613); *John Mezzalingua Assocs., Inc. v. Int'l Trade Comm'n*, 660 F.3d 1322 (Fed. Cir. 2011) (affirming Comm'n Op. in *Certain Coaxial Cable Connectors*, Inv. No. 337-TA-650).

[14] *Certain Prods. Having Laminated Packaging, Laminated Packaging, & Components Thereof*, Inv. No. 337-TA-874, Notice of Institution of Investigation (Mar. 22, 2013).

B. Remedies

- Critics claim that, prior to issuing a remedial order, the Commission should be required to conduct an *eBay* injunction analysis.[15] Such arguments do not make policy sense.

- As the Federal Circuit has noted, "[t]he difference between exclusion orders granted under Section 337 and injunctions granted under the Patent Act, 35 U.S.C. § 283, follows 'the long-standing principle that importation is treated differently than domestic activity.'"[16] Moreover, unlike the patent laws, Section 337 is a trade statute that does not provide monetary damages and whose effectiveness relies entirely on its power to exclude unfair imports. Applying the four-factor *eBay* test would thus impose unnecessary hurdles and expenses for all U.S. IPR owners—operating companies and NPEs alike—seeking to protect their rights against foreign infringers.[17]

- Additionally, the Commission's examination of statutory public interest factors (*see infra*), and the required Presidential review on national economic and policy grounds, provide a safeguard equal to, if not greater than, the *eBay* injunctive factors.

- Critics also claim that NPEs are disproportionately benefiting from ITC remedial orders compared to manufacturing companies. This is false. The Commission has issued over 50 exclusion orders since 2006, only four of them on behalf of NPEs (and each of those four NPEs, or their affiliated companies, actually developed the patented technology).[18]

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[15] *eBay Inc. v. MercExchange*, LLC, 547 U.S. 388 (2006). The *eBay* decision held that patent holders must satisfy the traditional four-part test for equitable relief before being granted an injunction against an infringer. The test requires a plaintiff to demonstrate that: (1) it has suffered an irreparable injury; (2) remedies available at law are inadequate to compensate for that injury; (3) considering the balance of hardships between the plaintiff and defendant, a remedy in equity is warranted; and (4) the public interest would not be disserved by a permanent injunction.

[16] *Spansion, Inc. v. United States Int'l Trade Comm'n*, 629 F.3d 1331, 1359 (Fed. Cir. 2010).

[17] In addition, the *eBay* factors simply do not translate to the Section 337 context. The ITC only offers equitable relief, so the second and third *eBay* factors have no relevance to Section 337. The fourth factor is superfluous, as Section 337 already requires the Commission to examine public interest considerations. As to the first factor—the requirement to show irreparable injury—in 1988 Congress removed the injury requirement of Section 337 because it viewed the importation of an infringing product as *per se* harmful in the patent, trademark, and copyright context.

[18] *Facts and Trends Regarding USITC Section 337 Investigations* (Published on the Commission's website, June 18, 2012).

C. Public Interest

- Before issuing any remedial orders, the Commission is required by statute to consider the effect of such relief on the public health and welfare, competitive conditions in the U.S. economy, the production of like or directly competitive articles in the U.S., and U.S. consumers.[19]

- The ITC has recently tailored some of its remedial orders based on legitimate public interest concerns. In *Certain Baseband Processor Chips*, Inv. No. 337-TA-543, the Commission provided carve-outs from the exclusion order in view of the then-developing 3G wireless network and the need for first responders to use that network. In *Certain Personal Data & Mobile Communications Devices*, Inv. No. 337-TA-710, the Commission (a) delayed enforcement of the remedial orders by four months to provide network carriers time to replace infringing smartphones, and (b) permitted the respondent to import replacement parts to be provided to customers under warranties and insurance contracts.

- In addition, in 2011 the ITC issued new rules allowing ALJs to develop a factual record on how a complainant's requested relief would affect the public interest. Over 20 new investigations have entailed public interest fact-finding.

- The new rules are resulting in even greater attention being paid to public interest concerns. In *Certain Microprocessors*, for example—an investigation in which the complainant sought relief against Hewlett-Packard, Intel, and Apple—the presiding ALJ found that an exclusion order could result in product shortages, U.S. job losses, and price increases. Accordingly, the ALJ recommended that, if the Commission finds a violation of Section 337, it should tailor any exclusion order to mitigate these potentially adverse effects upon the public interest.[20]

- The Commission's handling of investigations involving another controversial area, standards essential patents, also demonstrates its sensitivity to matters of public

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[19] *See* 19 U.S.C. § 1337(d)-(f).

[20] The Commission ultimately terminated the investigation with a finding of no violation. *See Certain Microprocessors*, Inv. No. 337-TA-781, Notice of Commission Determination (Feb. 15, 2013). ITC staff attorneys have also recently advocated for tailored remedial orders on account of public interest concerns. *See, e.g.*, *Certain Reduced Ignition Proclivity Cigarette Paper Wrappers*, Inv. No. 337-TA-756, Initial Determination (Pub. Version) (Feb. 1, 2012) (arguing for a stay of any exclusion order for a commercially reasonable period of time to allow cigarette manufacturers to obtain the FDA approval and fire-safety recertifications needed to legally sell redesigned cigarettes in the United States); *Certain Microprocessors*, Inv. No. 337-TA-781, Initial Determination (Pub. Version) (Dec. 14, 2012) (arguing, consistent with the ALJ's conclusion, that the public interest factors weigh against issuance of any exclusion order, but that if the Commission determines to issue an exclusion order, the order should be limited to mitigate harmful effects on consumers and the U.S. economy).

policy. In 2012 alone, the Commission received and considered comments from the public on this issue in three high profile cases.[21] In 2013, the Commission has continued to seek outside input on such issues, and has delayed issuance of a highly anticipated decision in order to consider more carefully viewpoints from diverse interests.[22]

- Finally, critics of the ITC fail to appreciate the additional public interest protections built into Section 337. Remedial orders are not final until the conclusion of a 60-day period for Presidential review, and the President can disapprove any remedy "for policy reasons."[23]

The facts above demonstrate that the ITC is appropriately adjudicating Section 337 investigations. It has become more difficult to establish a domestic industry, remedies have been tailored based on economic factors, and due consideration is being given to public interest and policy concerns.

The Commission has also instituted creative procedural mechanisms to streamline investigations. In addition to the domestic industry and public interest procedures discussed *supra*, the Commission has issued new rules governing discovery, inspired in part by the efforts of Chief Judge Randall Rader of the Federal Circuit to get courts and the ITC to adopt rules that reduce the cost of litigation.[24] The purpose of the adopted changes is "to reduce expensive, inefficient, unjustified, or unnecessary discovery practices."[25] The new rules should decrease the expense and burden that parties, particularly respondents, face in Section 337 investigations.

All of these decisions and initiatives will make the ITC an even more challenging forum for complainants who have a questionable basis for utilizing Section 337.

IV. Uniqueness of Section 337 and the ITC

Three additional points help demonstrate the important purposes served by Section 337 and the ITC. First, Section 337 is a trade, not a patent statute, aimed at protecting domestic

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[21] *See Certain Wireless Communication Devices*, Inv. No. 337-TA-745; *Certain Gaming & Entertainment Consoles*, Inv. No. 337-TA-752; *Certain Electronic Devices*, Inv. No. 337-TA-794.

[22] *See Certain Electronic Devices*, Inv. No. 337-TA-794, Notice of Comm'n Determination to Extend the Target Date; Requesting Additional Written Submissions on Remedy and the Public Interest (Mar. 13, 2013).

[23] 19 U.S.C. § 1337(j). The President has delegated this authority to the U.S. Trade Representative.

[24] *See* USITC Final Rule, "Rules of General Application and Adjudication and Enforcement," Docket No. MISC-040 (Apr. 11, 2013).

[25] 77 FED. REG. 60952-60956 (Oct. 5, 2012).

industries from infringing imports. Although, in conducting investigations under Section 337, the ITC can make a patent-related determination, it is not administering patent statutes. Indeed, Commission findings on infringement and invalidity have no *res judicata* effect.

Because Section 337 is directed at unfair practices in import trade, ITC complainants face evidentiary requirements distinct from, and in addition to, those of a plaintiff in district court. A complainant must prove, *inter alia*, that the infringing articles have been imported into the United States and, as explained above, must establish the existence of a domestic industry relating to the asserted IPR. Further, because the remedies available under Section 337 are directed at the infringing articles themselves, these proceedings involve trade and economic analyses that do not occur in district court patent litigation.

Second, the ITC exercises *in rem* jurisdiction that is different from the *in personam* jurisdiction exercised by federal courts. *In personam* jurisdiction empowers a court to make judgments against a person or an entity that has legal standing, such as a corporation. *In rem* jurisdiction, by contrast, permits a tribunal to rule "against a thing," and therefore against the rights of persons or entities generally with respect to that thing. Section 337 provides the ITC with *in rem* jurisdiction over articles imported into the United States.

These jurisdictional distinctions are manifest in the types of relief afforded by federal courts and the ITC. Plaintiffs asserting IPR in district court typically seek monetary damages. Section 337 complainants, on the other hand, may only obtain remedial orders that direct U.S. Customs and Border Protection to block the importation of infringing goods (an exclusion order), or prohibit the sale of domestic inventories of such goods (a cease and desist order). The U.S. Court of Appeals for the Federal Circuit has explained that the *in rem* relief afforded by Section 337 "follows the long-standing principle that importation is treated differently than domestic activity."[26]

Third, the relief afforded by the ITC is often essential to ensuring meaningful protection of U.S. IPR. A U.S. company cannot easily obtain relief in district court against an infringing foreign manufacturer. Such a plaintiff must first establish personal jurisdiction over that manufacturer, which is typically accomplished through the company's U.S. affiliate. Where a foreign manufacturer does not have a domestic affiliate, therefore—and many do not—it may be impossible to establish jurisdiction in federal court. Sometimes it is impossible even to identify foreign manufacturers. In such circumstances, the ITC's *in rem* jurisdiction ensures that U.S. companies harmed by infringing imports can obtain effective relief.

Indeed, as the Commission has stated, "Congress enacted Section 337 because in many instances foreign individuals or firms committing unfair acts to the detriment of an American industry are beyond the *in personam* reach of the U.S. courts and not amenable to a suit for

[26] *Spansion, Inc. v. U.S. Int'l Trade Comm'n*, 629 F.3d 1331, 1359 (Fed. Cir. 2010).

money damages or injunctive relief."[27] The following examples demonstrate the practical significance of the relief afforded by the ITC.

- In *Certain Electronic Paper Towel Dispensing Devices*, Georgia-Pacific of Atlanta, Georgia, sought relief against imports that infringed its U.S. patents. The Commission found that: (a) there was interchangeability of manufacturers; (b) the products were easy and inexpensive to manufacture; (c) there were many well-established distribution channels and internet retailers actively selling the articles; and (d) many of the infringing products were being sold unlabeled. Accordingly, the Commission concluded it was extremely difficult to identify the sources of the infringing articles. The Commission issued a general exclusion order prohibiting the importation of all electronic paper towel dispensers that infringed the asserted patents.[28] Given the nature of the supply chain, Georgia-Pacific could not have obtained any such meaningful relief in district court.

- The pioneering computer company Hewlett-Packard of Palo Alto, California and Houston, Texas, has recently benefitted from the unique remedies available at the ITC. In *Certain Inkjet Ink Cartridges with Printheads*, Hewlett-Packard obtained a general exclusion order against products that infringed its U.S. patents relating to inkjet printers.[29] Evidently satisfied with the results it obtained, Hewlett-Packard returned to the ITC in *Certain Inkjet Ink Supplies*, in which it obtained a general exclusion order relating to imports that infringed other patents.[30] In each instance the ITC noted that it was difficult to identify the origins of infringing products, in part because the imports were generically packaged and there were numerous, unnamed contract manufacturers—primarily in China—involved in the production of infringing goods.

- Another iconic American company, Caterpillar of Peoria, Illinois, has availed itself of Section 337 protection. In *Certain Hydraulic Excavators*, Caterpillar sought relief against the importation of gray market excavators that infringed its trademarks. A pattern of violation was shown by the identification of thousands of gray market excavators within the United States. Caterpillar proved that it could not establish the sources of these infringing products and that multiple foreign manufacturers were

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[27] *Certain Steel Rod Treating Apparatus & Components Thereof*, Inv. No. 337-TA-97, Comm'n Act. & Order at 139 (Jan. 1982).

[28] *See Certain Electronic Paper Towel Dispensing Devices & Components Thereof*, Inv. No. 337-TA-718, Comm'n Op. on Remedy, the Public Interest, and Bonding (Pub. Version) (Jan. 20, 2012).

[29] *See Certain Inkjet Cartridges With Printheads & Components Thereof*, Inv. No. 337-TA-723, Comm'n Op. (Pub. Version) (Dec. 1, 2011).

[30] *See Certain Inkjet Ink Supplies & Components Thereof*, Inv. No. 337-TA-730, Comm'n Op. (Pub. Version) (Feb. 24, 2012).

involved in the supply chain. The Commission issued a general exclusion order prohibiting the importation of the infringing excavators.[31]

- In *Certain Hair Irons*, Farouk Systems of Houston, Texas, sought relief against the importation of hair irons that infringed its trademarks. The Commission noted that Farouk had litigated 21 district court actions seeking to stop the importation and sale of infringing products. The Commission also cited findings that the infringing manufacturers were improperly marking the country-of-origin of their products in an effort to increase confusion as to the actual source of the articles. Additionally, the Commission found that the infringing hair irons were primarily distributed over the internet, "a method that lends itself to anonymity and makes it difficult to determine the source of the infringing products."[32] The Commission issued a general exclusion order, the type of robust relief Farouk could not obtain from its 21 lawsuits in various federal courts.

- In *Certain Energy Drink Products*, Red Bull Energy Drinks of Santa Monica, California, sought relief against imports that violated its trademark and copyrights. The Commission found that numerous unidentifiable entities were producing and importing gray market energy drinks. The Commission noted that Red Bull had filed multiple cases in federal courts and had identified 250 suspected parties, in 2009 alone, who were engaged in gray market activities across the United States.[33] The Commission issued a general exclusion order, providing Red Bull with relief it could not attain from its district court actions.

These examples demonstrate that the ITC is an indispensible forum for protecting U.S. IPR from infringing imports.

V. Conclusion

The ITC is an expert trade agency that, in administering Section 337, is providing an effective remedy to combat the pervasive problem of infringing imports. This relief is often essential to ensuring meaningful protection of U.S. IPR, an important source of this country's economic growth. Section 337 therefore promotes U.S. competitiveness and innovation.

The ITC is interpreting Section 337 in a judicious manner. It has become more difficult to establish a domestic industry, NPEs are rarely obtaining exclusion orders, the Commission is

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[31] *See Certain Hydraulic Excavators & Components Thereof*, Inv. No. 337-TA-582, Comm'n Op. (Pub. Version) (Feb. 3, 2009).

[32] *Certain Hair Irons & Packaging Thereof*, Inv. No. 337-TA-637, Comm'n Op. on Remedy, the Public Interest, and Bonding (Pub. Version), at 4-5 (Jul. 20, 2009).

[33] *See Certain Energy Drink Products*, Inv. No. 337-TA-678, Comm'n Op. on Remedy, the Public Interest, and Bonding (Pub. Version) (Nov. 23, 2010).

Mr. COBLE. Thank you, Ms. Okun.
Mr. Foster?

TESTIMONY OF F. DAVID FOSTER, CHAIRMAN, LEGISLATIVE COMMITTEE, U.S. INTERNATIONAL TRADE COMMISSION TRIAL LAWYERS ASSOCIATION

Mr. FOSTER. Thank you, Mr. Chairman and Ranking Member Watt, and Members of the Committee. The U.S. International Trade Commission Trial Lawyers Association appreciates the opportunity to appear today. Many of the comments I was going to make have been made by Mr. Rhodes and Ms. Okun, so I won't repeat those, but I will focus on just a few issues.

One is that, as has been noted, while NPE use of Section 337 has increased, the development of the Commission's practice and jurisprudence is addressing their use of Section 337, and in particular their access to Section 337 and perceived excessive leverage, the very issues that are addressed by some of the proposed legislative changes that are being made.

The Commission, as administrator of the law, is well suited to developing the application of Section 337 to NPEs and PAEs and the issues raised thereby. Given that this process involves the application of expertise and very complex fact and law situations, we believe that thought should be given to according the Commission deference in this process prior to amendment of the statute.

The second point I would like to make, in addition to the points that have already been made, is that in considering amendments to Section 337, we would urge great caution, and I will just reference one particular proposal and some of the implications of that proposal.

Under one proposal, the Commission would be required to apply in Section 337 investigations the same equitable principles required by the eBay Supreme Court case to be applied in district court patent cases when the court must determine whether an injunction should be issued or whether monetary relief only should be made available. The differences, however, between Section 337 investigations and district court cases dictate that such a proposal should be carefully evaluated as to its appropriateness given the consequences that would likely result. Unlike district courts, the Commission does not have the ability to award damages if a violation is found.

Section 337 is a trade, a border enforcement statute. It operates in addition to any other provision of law, but it has at its disposal only one remedy, the exclusion order. Congress determined that only the remedy of exclusion should be applied in Section 337 cases subject to consideration of the public interest, which the Commission has to undertake in every case when it is considering whether or not to issue an exclusion order.

The House report on the 1988 act specifically noted a temporary right to exclude others was the essence of the patent right, citing Article 1, Section 8, Clause 8 of the Constitution, and it was this 1988 act that amended Section 337 in significant fashion.

In Section 337 investigations, if no exclusion is issued, no relief would be given even though infringement is occurring. This effectively makes the eBay criteria of adequacy of legal—that is, mone-

tary—relief simply inapplicable to Section 337 investigations. The consideration of equity in these circumstances is totally different than in district court cases, where relief is always available, at least in the form of damages.

So again, this is sort of an example of potential unintended consequences or potential effects that would happen with proposed amendments. And again, the Association would urge Congress that in considering potential amendments, they take into account the fact that you may have unintended consequences, and also to allow the Commission to further develop the jurisprudence which, in our view, is addressing many of the issues that are raised by NPEs and PAEs.

Thank you for your consideration. I will be happy to answer any questions.

[The prepared statement of Mr. Foster follows:]

WRITTEN TESTIMONY OF F. DAVID FOSTER ON BEHALF OF THE U.S. INTERNATIONAL TRADE COMMISSION TRIAL LAWYERS ASSOCIATION

BEFORE THE SUBCOMMITTEE ON INTELLECTUAL PROPERTY, COMPETITION AND THE INTERNET OF THE HOUSE COMMITTEE ON THE JUDICIARY

April 16, 2013

I. INTRODUCTION

The U.S. International Trade Commission Trial Lawyers Association ("TLA") is pleased to participate in this hearing. We hope our participation will aid the Subcommittee in its consideration of how Section 337 of the Tariff Act of 1930, as amended (19 USC §1337) ("Section 337") works in patent-based cases, and in particular the practice under Section 337 as it relates to so-called non-practicing entities ("NPEs").

The TLA is an association of private practice, corporate and government lawyers concerned with practice under Section 337. The TLA has over 300 members worldwide. It provides input and advice to the U.S. International Trade Commission ("Commission" or "ITC"), which administers Section 337, and to U.S. Customs and Border Protection, the Administration, and Congress regarding the procedures and substance of Section 337 practice to improve the efficiency and effectiveness of the statute.[1]

Recently, there has been increased attention focused by U.S. technology companies, academics and the U.S. Congress on the activities of NPEs under Section 337 in cases based on alleged infringement by imports of U.S. patents owned by such NPEs. The principal concern expressed by those focusing increased attention on NPEs' use of Section 337 is that because there is a possibility in a Section 337 investigation that an NPE may succeed in establishing that

[1] The comments and observations made in this testimony are presented as part of the educational and advisory function of the TLA and do not necessarily represent the views of any individual member.

imports infringe one or more of its asserted patents, and thereby secure an order excluding such imports from entry into the United States, those who are named as respondents (defendants) in Section 337 investigations (e.g., the U.S. importers or users of the infringing imports, or foreign manufacturers or exporters thereof) feel compelled to settle with the NPE at unreasonably high royalty rates in order to avoid the risk of exclusion from the U.S. market. This is often referred to as the "hold-up" effect of NPEs' actions under Section 337. This has led to suggestions from some companies and legislators representing them that Section 337 be amended to restrict access to Section 337 by NPEs and to make securing exclusion orders by NPEs more difficult, in particular by amending the criteria which must be met to qualify as a U.S. industry that can cause a Section 337 investigation to be undertaken, and by requiring in Section 337 investigations the application of the same equitable principles used in the U.S. district courts to determine whether an injunction should issue in patent litigation.

The analysis presented in this written testimony largely reflects a "White Paper" prepared recently by the TLA, entitled "Section 337 and Its Uses by Non-Practicing Entities" (February 2013). The analysis briefly considers the current law and practice under Section 337 as it relates to certain provisions in the law which some suggested legislative amendments address. The analysis suggests that great caution is in order before making legislative amendments to Section 337 to address perceived NPE issues, and counsels deference for permitting the continued development of the law by the Commission, which development is already manifestly affecting NPE use of Section 337.

II. SECTION 337 OF THE 1930 TARIFF ACT

Section 337 is a trade statute under title 19 of the U.S. Code. The statute, administered by the U.S. International Trade Commission, declares unlawful unfair methods of competition and unfair acts in the importation of articles into the United States that injure a U.S. industry.

Since the 1930s, infringement of U.S. patents (and other intellectual property rights) by imports has been held to constitute a violation of Section 337; in amendments to Section 337 made in 1988, patent infringement by imports was expressly recognized as unlawful when a U.S. industry existed which exploited the patent(s) asserted, and the need to prove injury to such industry was dropped as a requirement for a finding of violation. Patent-based actions have constituted, and continue to constitute the large majority of cases filed and instituted under Section 337. Section 337 proceedings are considered government investigations. *See USITC v. Jaffee*, 433 BR 538 (E.D. Va. 2010). Similar to most trade statutes, Section 337 has in rem jurisdiction; its actions are against the articles being imported and no personal jurisdiction is needed for relief to be given.

Patent-based Section 337 investigations are instituted upon a complaint by a holder of a U.S. patent right. Section 337 investigations are trial-type proceedings conducted under the Administrative Procedure Act before an Administrative Law Judge ("ALJ"), and in patent-based cases, the trial is very much like a patent trial in a U.S. district court in terms of both procedures and substantive law. One distinction between a district court patent proceeding and a Section 337 patent investigation is that in order to be eligible for relief under Section 337, the complainant must show that a U.S. industry exists which exploits each of the patents being asserted. This is usually done by the complainant proving that there is U.S. production of a product practicing the patents asserted.

Following the trial, the ALJ issues an initial determination, followed by review by the Commission in most cases and the issuance of a final determination on violation by the Commission. The Commission's determinations on infringement and validity of patents are not binding on U.S. district courts, but are made to carry out the Commission's function under

Section 337. On the other hand, U.S. district court determinations on validity and infringement are binding on the Commission.

The remedy for violation of Section 337 is exclusion from entry into the United States of infringing articles. This remedy, like those of most trade laws, is directed against the article and not against a company or person, and is to prevent the unfair practice from continuing. No damages or compensation are provided to the U.S. IP rights holder under Section 337. The Commission may also issue a cease and desist order directed to a person violating Section 337, enjoining continued infringement; unlike an exclusion order, the Commission has required personal jurisdiction over the respondent before it will issue a cease and desist order. Before issuing a remedy, the Commission will determine whether the public interest requires that no remedy issue, i.e., whether the effect of the remedy on the public health and welfare, competition in the United States, U.S. production, or U.S. consumers is such that no order or something less than full relief should issue. Public interest considerations rarely have prevented issuance of an order.

Any remedy issued by the Commission is subject, for a period of 60 days, to disapproval by the President (delegated to the U.S. Trade Representative) on the basis of the national economic interest; disapproval rarely occurs. Final actions and determinations of the Commission are subject to review by the U.S. Court of Appeals for the Federal Circuit.

As a trade border enforcement remedy, a Commission exclusion order is enforced by U.S. Customs and Border Protection ("CBP"). While CBP has direct enforcement authority in the case of registered trademarks (e.g., knock-off products that are falsely branded), CBP has no comparable authority to enforce patents at the border except based on a Section 337 order. Consequently, if a U.S. patent owner seeks to enforce its patent rights at the border to physically

block infringing articles before they enter the stream of commerce within the United States, its sole remedy is to first go through the ITC under Section 337 and obtain an exclusion order. If an exclusion order (or cease and desist order) is violated, no damages are provided to the U.S. IP rights holder.

A Commission cease and desist order issued against a person is enforced by the Commission. Violation of a cease and desist order may result in a substantial monetary penalty and the issuance of an exclusion order if not already ordered.

While Section 337 goes back to 1930, Congress radically amended Section 337 in the Trade Act of 1974 to make it more effective in fighting imports of articles which infringe U.S. Intellectual property rights, particularly U.S. patents. This was an early recognition by the trade committees of Congress and, indeed, the entire Congress, that as U.S. competitive advantage lessened in terms of labor, capital and natural resources, it was critically important that the U.S. competitive advantage in intellectual capital or property be preserved and indeed encouraged, not only to continue U.S. production activities but to itself become a critical source of value for the U.S. economy as some U.S. production moved off-shore.

In 1988, Congress again amended Section 337, recognizing that as some manufacturing increasingly left the United States and became more dispersed around the world, it was important to encourage not only U.S. production, but also U.S.-based engineering, research and development and licensing associated with U.S. patents and other IP. The amendments added engineering, research and development, and licensing activities, i.e., the activities in which some NPEs engage, to U.S. production as equally appropriate bases to establish that a U.S. industry exists so as to justify the use of Section 337 to stop trade in infringing imports. 19 U.S.C. §1337(a)(3)(C). The amendment is in part also a recognition that imports which infringe U.S.

intellectual property rights are not less unfair or damaging to the U.S. economic interest because the rights owner does not itself or through licensees engage in U.S. production.

Parties use Section 337 in lieu of or in addition to U.S. district court patent actions for a variety of reasons. The speed of Section 337 investigations is one of the primary reasons. Typically Section 337 investigations are completed within 16-18 months, while district court cases can often take twice as long or more. If a violation is found in Section 337 investigations, the remedy, an exclusion order, is effective and implemented by CBP, while a district court injunction requires enforcement by contempt proceedings initiated by the plaintiff. Being an *in rem* proceeding at a national tribunal, personal jurisdiction and venue issues are not present in Section 337 investigations like in district court cases. The absence of juries and the experience of the Commission's ALJs may also be draws relative to district court cases. Within two years of being at the ITC, ALJs will have handled more patent trials than the vast majority of U.S. district court judges. ITC decisions on the merits are sound; as Federal Circuit review confirms, the affirmance rate is at least as high as for U.S. district court patent cases. These factors have caused the number of Section 337 cases filed to triple in the last decade. In FY 2011, a total of 70 cases were instituted.

III. CALLS FOR AMENDMENTS TO SECTION 337: THE NPE ISSUE

A. The "Problem"

Some assertions have been made that amendments are needed to Section 337 because NPEs (persons or companies that seek to enforce a U.S. patent that they own but which do not manufacture or market a product covered by the patent), or a subset of NPEs, so-called patent assertion entities ("PAEs") (entities focused on purchasing patents and seeking the enforcement of them if licenses are not agreed to) are turning to Section 337 in greater numbers. NPEs and PAEs usually gain access to Section 337 if their licensing activities in the United States are

sufficient to constitute a licensing industry in the United States under the 1988 amendment to Section 337.

Some assert that NPEs' and PAEs' newfound interest in Section 337 may be because they are less able to receive injunctive relief in the district courts than in the past, while they can continue to receive an exclusion order or cease and desist order (hereinafter, collectively referred to as an "exclusion order") under Section 337. The argument is made that they then can use the threat of an exclusion order to "hold-up" respondents accused of infringement in license negotiations for higher than warranted payments because the accused infringers cannot afford to take the risk of being excluded from the U.S. market by an exclusion order.

The basis for asserting the difference between district court cases and Section 337 investigations as to injunctive-type relief is the 2006 Supreme Court case, *eBay v. MercExchange,* 547 U.S. 388 (2006). There, the Court said that injunctive relief should not be virtually automatic, but required district courts to apply "traditional equitable principles" (i.e., the traditional four-factor test of irreparable harm, inadequacy of legal remedies, balance of hardships, and the public interest) when determining whether to grant permanent injunctive relief. This decision was consistent with the patent statute's provision that district courts may issue injunctions in accordance with "the principles of equity." The Federal Circuit subsequently rejected this approach of using traditional equitable principles in Section 337 investigations, however, finding that *eBay* did not apply because Section 337 had "different statutory underpinnings for relief", including that injunctive relief was the normal remedy and that irreparable harm need not be shown to receive it. *Spansion, Inc. v. U.S. Int'l Trade Comm'n,* 629 F.3d 1331 (Fed. Cir. 2010).

B. A Purported Solution

In order to address this perceived problem, some have argued that Section 337 should be amended to change the definition of what constitutes a U.S. or domestic industry under the statute to make it more difficult for NPEs to qualify as such, and to require that the Commission apply the *eBay* decision in determining whether to issue an exclusion order, which would presumably have the effect of making exclusion orders far less available to NPEs/PAEs in Section 337 investigations.

The most often referenced exemplar of the proposed amendments to Section 337 was draft legislation being considered by Representative Devin Nunes in the last Congress, which is similar in scope and direction to a proposal from some in private industry. The draft legislation would provide in the most relevant part:

> (1) that the required domestic industry, when based on licensing (which is a principal basis for the ability of many NPEs, and almost the exclusive basis for the ability of PAEs, to use Section 337), should be found to exist only when the NPEs' licensing activity, or activities of any of its licensees, is prior to, and promotes, the adoption of the claimed patented invention in articles for sale in the United States; and
>
> (2) that the principles of equity set forth in the *eBay* decision should be applied in Section 337 investigations by the Commission in deciding whether to issue any relief.

C. The Extent of the Asserted Problem

In the six (6) years since *eBay*, there have been only three exclusion orders issued on behalf of an NPE (in Investigation No. 337-TA-605 (Tessera); Investigation No. 337-TA-661

(Rambus); and Investigation No. 337-TA-679 (UNeMed)). U.S. International Trade Commission, Facts and Trends Regarding USITC Section 337 Investigations, pp. 2, 3, June 18, 2012, http://www.USITC.gov/Press-room/documents/featured_news/337facts.pdf. According to the Commission, only one of these orders involved a PAE (Rambus), and in each of these cases, it happens that the NPE itself had developed the technology leading to the patent. Based on those facts, it is difficult, at best, to say whether injunctions would or would not have issued in a district court if these cases had been brought there.

Supporters of the changes to the Section 337 say that despite the low number of NPE exclusion orders, problems with NPE use of Section 337 exist whether an exclusion order issues or not. They assert that the existence of a Section 337 case and the risk of possible exclusion from the U.S. market result in settlements at "hold up" rates, which risk would not exist to the same extent in district court cases because the application of *eBay* would result in many fewer injunctions being imposed when a NPE was the plaintiff.

There is no question that the number of new Section 337 investigations instituted has increased since 2006; Commission statistics indicate an irregular but upward trend to where about twice the number of cases were instituted in FY 2011 compared with FY 2006. *Id.*, p.1 (chart).[2] While the number of investigations instituted involving NPEs has increased comparing 2006/2007 to 2010/2011, it is clear that investigations involving NPEs are not the major cause of the overall increase in Section 337 cases; NPEs and PAEs together accounted for some 18% of the 258 investigations instituted from May 2006 through the first quarter of 2012, with PAEs

[2] It should be noted that the number of cases instituted in FY 2012 declined over 40% from 2011 levels, but is still well above FY 2006 levels.

accounting for only 8 percentage points of this total. *Id.*, pp.2-3.[3] Perhaps relevant to the question of "hold up", in terms of settlements, non-NPE investigations settled at a rate of 50.62%, while investigations involving NPEs actually settled at a lower rate of 47.06%. *Id.*[4]

IV. DEVELOPING COMMISSION PRACTICE AND JURISPRUDENCE ARE ADDRESSING THE NPE/PAE ISSUE

While NPE/PAE use of Section 337 has increased, the development of the Commission's practice and jurisprudence is addressing their use of Section 337, and in particular their access to Section 337 and perceived excessive leverage, the very issues addressed by the proposed legislative changes. The Commission, as administer of the law, is well suited to developing the application of Section 337 to NPEs and PAEs and the issues raised thereby. Given that this process involves the application of expertise in complex fact and law situations, thought should be given to according the Commission deference in this process prior to amendment of the statute.

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[3] These percentages may be somewhat higher in FY 2012 compared to FY 2011, but NPEs still constitute less than one-third of cases instituted under Section 337 and the absolute number of NPE cases instituted declined in FY 2012 compared to FY 2011. Colleen V. Chien, "Patent Trolls by the Numbers", Legal Studies Research Paper Series, Santa Clara University School of Law (working paper no. 08-13. March 2013) (downloaded from http://ssrn.com/abstract=2233041). This is in contrast to NPE filings in U.S. district courts, which increased sharply in 2012 over 2011 in both absolute and percentage terms (id.), which should be noted seems to undercut assertions of a rush by NPEs to Section 337.

[4] Whether "hold up" occurs in settlement negotiations in either NPE investigations, or, for that matter, in non-NPE investigations, while certainly having a logical basis, is ambiguous based on available empirical evidence. The financial terms of settlements in ITC investigations are often confidential. It is not a question which has been rigorously studied. Further, even if a respondent may pay more to settle than it may think warranted, that does not mean that it pays more than the technology is worth, nor that it pays more to an NPE than a non-NPE; indeed, a counter-argument exists that an NPE which receives a return on its IP only if it settles a Section 337 investigation is less likely to insist on an unreasonably high settlement amount compared to a non-NPE, which receives a return on its IP from its own sales activities and therefore is not as dependent on reaching a settlement to receive a return. Ultimately, however, the financial motivation of any particular complainant is likely to be unique to that complainant.

A. Licensing as a Domestic Industry

As noted above, NPEs usually, and PAEs always, seek to establish the domestic industry required for access to Section 337 relief by reliance on licensing activities to show that a U.S. licensing industry exists related to the patents being asserted, as the 1988 amendments to Section 337 permit. 19 U.S.C. §1337(a)(3)(C). The Commission's practice with respect to licensing industries has, over the last several years, revealed rigorous analysis of claims that a licensing industry exists, including perhaps most importantly requiring greater tying of claimed licensing activities to the particular patents being asserted. The Commission is insisting on a case-by-case basis that each asserted licensing industry be shown by substantial proof, and as a result, there is no indication that questionable licensing industries have been found to exist, nor will be in the future.

For example, in 2010, in *Certain Coaxial Cable Connectors, Components Thereof, and Products Containing Same ("Coaxial Cable")*, Inv. No. 337-TA-650, Comm. Op. (Apr. 14, 2010), *aff'd, John Mezzalingua Assocs., Inc. v. Int'l Trade Comm'n* (Fed. Cir. 2012)), in finding that no domestic licensing industry existed, the Commission considered whether expenses incurred in prior patent litigation could be considered investments in licensing and, thus, help establish a domestic industry under §1337(a)(3)(C). The ITC determined that litigation expenses, on their own, could not establish a domestic industry under §1337(a)(3)(C). However, the Commission also held that, if prior litigation expenses exhibited a clear nexus to the complainant's concerted efforts to license the asserted patent, they could be considered as one factor, among others, as to whether there was substantial investment in exploiting the patent via licensing efforts. The Commission also held that the design and history of the statute favor licensing activity that furthers the development and commercialization of technology. Because

of this, the Commission indicated it will give greater weight to such activity over activity that merely monetizes patent assets in determining whether an industry exists.

The ITC further honed its interpretation of §1337(a)(3)(C) in *Certain Multimedia Display and Navigation Devices and Systems, Components Thereof, and Products Containing Same ("Navigation Devices")*, Inv. No. 337-TA-694, Comm'n Op. (Aug. 8, 2011). In *Navigation Devices*, the Commission again found that no domestic licensing industry existed. The primary issue was whether a complainant could establish a domestic industry based upon its investment in licensing its entire patent portfolio without allocating expenditures to licensing the asserted patents. Despite public comments advocating this broad approach, the ITC determined that Congress did not intend Section 337 to encompass such a liberal interpretation. Instead, the Commission stated that the test is governed by the "strength of the nexus between the licensing activity and the asserted patent." *Id.* at 9.

Specifically, the Commission analyzed the complainant's patent portfolio and related activities in three areas to determine whether a "substantial investment" had been made to exploit the patents at issue, namely: (1) "the relative importance or value of the asserted patent within the portfolio"; (2) the extent to which activities are "*solely* related to licensing" versus "serv[ing] multiple purposes"; and (3) "the extent to which the complainant conducts its licensing operations in the United States, including the employment of U.S. personnel and utilization of U.S. resources in its licensing activities." *Id.* at 9-15. Consequently, the ITC determined that the burden is on the complainant to "present evidence that demonstrates the extent of the nexus between the asserted patent and the complainant's licensing activities and investments." *Id.*[5]

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[5] Similarly, in *Certain Semiconductor Chips and Products Containing Same*, Investigation No. 337-TA-753 (2012), in which Rambus Inc. was the complainant, the Commission, in reversing the ALJ's Initial Determination that Rambus had established a licensing industry, held that Rambus's reliance on its total

(footnote continued on next page)

More recently, in *Certain Liquid Crystal Display Devices, Including Monitors, Televisions, Modules, and Components Thereof ("Liquid Crystal Display Devices")*, Inv. Nos. 337-TA-741/749, Comm'n Op. (Jul 6, 2012), where the complainant had purchased a substantial patent portfolio covering a broad array of technology and subsequently filed parallel suits in the district court and the ITC against a number of respondents, the Commission was tasked with determining which of the complainant's activities and investments related to its efforts to license the patents at issue in the suit and ultimately determined that only the "activities relating to [complainant's] LCD licensing program, including employee time, facility use, travel, and product acquisition," qualified as "substantial investment" under Section 337(a)(3)(C). *Id.* at 110. The Commission began its analysis by reiterating the guidance laid out in *Navigation Devices*, that "the complainant must demonstrate that a particular activity: (1) relates to the asserted patent; (2) relates to licensing; and (3) occurred in the United States." *Id.* at 109. Importantly, the Commission determined that expenses and activities related to the purchase of patent portfolios, litigation of underlying Section 337 investigations and parallel district court actions, and reexamination of the patents at issue did not qualify as exploitation through licensing. *Id.*

(footnote continued from previous page)
investment in its entire licensing program, the amount of licensing revenue received for patent portfolios that included the patents in issue, and the number of licenses for each of the patent families did not provide sufficient evidence of a nexus between the portion of its overall licensing investment and the patents being asserted, and also made impossible a determination of the substantiality of the licensing investment in the asserted patents. *Id.*, pp. 45-47. It should be noted that this effectively overturned the existence of a domestic industry of Rambus in Investigation No. 337-TA-661, *supra*, to the extent that existence was based on the same patents Rambus asserted in Investigation No. 337-TA-753; the Commission decision in TA-661 was the only investigation in which the Commission had held that a PAE satisfied the requirements for a licensing domestic industry and had issued relief. *See also, Certain Integrated Circuits, Chipsets, and Products Containing Same Including Televisions*, Investigation No. 337-TA-786 (2012).

Most recently, the Commission indicated its continued focus on the domestic industry requirement in cases where a licensing industry is asserted by issuing a Notice of Investigation calling for an early determination on whether a domestic industry existed. In Certain Products Having Laminated Packaging, Laminated Packaging, and Components Thereof, Investigation No. 337-TA-874 (March 22, 2013), the ALJ was directed to determine within 100 days (with a possible limited extension) whether the Complainant satisfied the domestic industry requirement. 78 Fed. Reg. 19007-008 (March 28, 2013). The Commission indicated that a determination of no industry by the ALJ would likely result in a stay of the investigation, presumably so the Commission could review the determination, with the implication that affirmance of a no industry determination would end the investigation. *Id.*

The preceding discussion illustrates that the ITC has appeared to balance its obligations under Section 337. In investigations which are heavily fact dependent, harnessing its administrative expertise, its decisions have conveyed an effort to remain mindful of the 1988 amendments' intent to liberalize Section 337 while also remaining vigilant in not allowing an expansion of the domestic industry test beyond the intent of Congress.

B. Public Interest Considerations and the Availability of Relief

In determining the remedy in a Section 337 investigation, the Commission is required to consider the effect any exclusion order will have upon "the public health and welfare, competitive conditions in the United States economy, the production of like or directly competitive articles in the United States, and United States consumers." 19 U.S.C. §1337(d). These are referred to as the public interest factors. The Commission, in determining whether to issue a remedy, need not consider public interest issues other than the four public interest factors enumerated in the statute. As noted previously, in *Spansion v. U.S. Int'l Trade Comm'n*, the

Federal Circuit held that, in determining whether to issue a remedy, the Commission was not required to apply the traditional four-factor test set forth in *eBay Inc. v. MercExchange*. The Federal Circuit explained that the legislative history of Section 337 "indicates that Congress intended injunctive relief to be the normal remedy for a Section 337 violation and that a showing of irreparable harm is not required to receive such injunctive relief." 629 F.3d at 1358. In particular, the court noted that Congress did not include monetary remedies when passing the original Tariff Act of 1930 (nor has it subsequently), which shows that the Commission is not to consider whether the complainant could be made whole through monetary remedies in deciding whether to issue a remedy. 629 F.3d at 1359 (citing 35 U.S.C. § 283).

Over the last several years, as the issue of NPE use of Section 337 has drawn increased attention, the Commission has been addressing the statutory public interest factors even more intently than it had done in the past. The Commission amended its rules in November 2011 to gather information on the public interest from the filing of the complainant (which now must be accompanied by a public interest statement, to which respondents may reply), and not just at the conclusion of an investigation. 76 Fed. Reg. 64803 (October 19, 2011). Since October 2011, in approximately 40% of cases the Commission has also asked the ALJ to develop specific evidence regarding the public interest, something rarely done in prior practice.

Further, recent Commission decisions show not only increased attention to the public interest, but flexibility in providing relief, all of which indicates that the Commission can adequately address issues of improper leverage by NPEs. One such case is *Baseband Processor Chips*, a case where complainant sought an exclusion order against all downstream products that included within them the chips of respondents that had been found to infringe, which potentially could have affected the availability and development of "3G" cell phones. ITC Inv. No. 337-TA-

543. After extensive comments and a lengthy hearing on public interest, the Commission declined to issue such a broad remedy. *Id.*, Comm. Op. at 116-30 and 148-54 (July 7, 2007). Instead, the Commission issued an exclusion order that excluded the downstream products containing the respondents' infringing chips, except for models of products that had been sold in the United States on or before the date of the final Commission determination, which models include some that used a type of chip from the respondent that was generally not available from other sources. The Commission found that the exemption was warranted because of the magnitude of the economic harm from lack of product that the third parties (such as network providers, like Verizon and Sprint) would suffer without the exceptions. ITC Inv. No. 337-TA-543, Comm. Op. at 116-30.

In another example, the Commission addressed the public interest factors in *Personal Data and Mobile Communications Devices and Related Software,* Inv. No. 337-TA-710 (Dec. 2011). Although the Commission issued an exclusion order in that investigation, it provided in the order that the infringing articles could be imported for a transition period of four months. The Commission found that an exclusion order with immediate effect would have had a substantial impact on competitive conditions in the wireless service, and that a "transitional" exclusion order was within its discretion and addressed the concerns about the impact on competitive conditions.

This development of Commission practice relating to the public interest plainly demonstrates that the Commission has the flexibility to deal with the perceived undue leverage that NPEs may seek to assert, and to take into account effects on consumers and competition when it sees fit to do so. The development of the practice is also consistent with recent calls for careful public interest consideration and a flexible approach to the exclusion order remedy when dealing with

NPEs/PAEs. *See* N.Y. Times, Postscripts Appended, Colleen Chien and Mark Lewley, December 13, 2011.

V. THE CONSEQUENCES OF ANY AMENDMENT TO SECTION 337 SHOULD BE CAREFULLY CONSIDERED

A. Application of *eBay*

As noted, one principal proposal has been put forward for amendment of Section 337 to address the perceived issue of use of Section 337 investigations by NPEs to gain leverage over respondents and achieve settlements at "hold-up" rates. Section 337 would be amended so that in determining whether an exclusion order should be issued when the Commission finds a violation under Section 337, the Commission would be required to apply in Section 337 investigations the same equitable principals required by *eBay* to be applied in district court patent cases when the court must determine whether an injunction should issue or whether monetary relief only should be made available. The differences, however, between Section 337 investigations and district court cases dictate that such proposal should be carefully evaluated as to its appropriateness given the consequences that likely result.

Unlike district courts, the Commission does not have the ability to award damages if a violation is found. Section 337 is a trade/border enforcement statute. It operates in addition to any other provision of law, but has at its disposal only one remedy -- an exclusion order. Congress determined that only the remedy of exclusion should be applied in Section 337 cases, subject to consideration of the public interest. The House report on the 1988 Act specifically noted that the temporary right to exclude others was the essence of the patent right, citing Article 1, Section 8, Clause 8 of the Constitution. U.S. House of Representatives, "Trade and International Economic Policy Reform Act of 1987", Report of the Committee on Ways and Means, Rept. 100-40 at 156 (April 6, 1987). In Section 337 investigations, if no exclusion order

issued, no relief would be given even though infringement is occurring. This effectively makes the *eBay* criterion of adequacy of legal (i.e., monetary) relief simply inapplicable to Section 337 investigations. The consideration of equity in these circumstances is totally different than in district court cases, where relief is always available in the form of damages. Thus, applying district court equity standards to determine if an injunction should be available in addition to damages, is problematic at best for Section 337 investigations where only one remedy is available.

In any event, the Commission's examination of the public interest and the Presidential review of national economic interest likely provide safeguards against a decision not in the public interest at least as great as those provided by *eBay*. For example, when the Commission has limited or denied relief based upon the public interest, it has been in the context of a complainant not being able to demonstrate that non-infringing alternatives exist that can supply the demand in the U.S. market. *See Baseband Processing Chips, supra*; *Fluidized Supporting Apparatus*, Investigation Nos. 337-TA-182/188. Thus, NPEs not able to show that there are sufficient alternative products to meet demand will likely have a difficult time receiving relief and this will certainly mitigate any leverage such NPEs may have in negotiations for settlement, as well as the effect of any such leverage on consumers and the economy. Further, as noted in the discussion below of current Commission considerations of the public interest in determining whether to issue relief, the Commission can tailor remedies, including exclusion orders, and in doing so does not focus on the narrow interests of an infringer as much as *eBay* would require (the four factors under *eBay* include harm to the infringer by an injunction, and whether the infringer is causing irreparable harm to the IP holder). Instead, the Commission focuses more on the larger public interest, which is perhaps appropriate in a trade statute which values the

importance of U.S. intellectual property as a national public interest and encourages rejection of infringing imports.

Application of *eBay* would also reintroduce an injury test (irreparable harm, one of the *eBay* four factors) into Section 337, despite proof of injury specifically being eliminated in the 1988 legislation as necessary to establish a patent-based violation, and would reintroduce it after the ITC was specifically admonished not to do so: "The Committee does not intend that the USITC reintroduce these requirements [including injury] in making their public interest determinations." House Ways and Means Rept., *supra*, p. 156. This again reflects the different foundations between Section 337 and district court patent cases.

Layering the *eBay* standard on top of the Commission's public interest standard also would likely engender confusion and uncertainty. For example, besides the presence of criteria in *eBay* which do not seem applicable and would be difficult at best for the Commission to address (e.g., the availability of monetary relief), where the *eBay* factors and the Commission's current public interest factors do seem to overlap in part, is the Commission supposed to change its approach to mirror that of a district court if the Commission practice varies from district court practice?

Additionally, because application of *eBay* would apply to all Section 337 investigations, not just those involving NPEs, it would increase the cost and likely the length of all Section 337 investigations as parties would be required to undergo additional steps to prove their cases, and in particular to prove irreparable injury. This would be particularly detrimental to smaller entities, universities, research facilities and inventors, and is directly contrary to the express intent that Section 337 investigations be conducted expeditiously and efficiently.

B. Suggested Changes to Domestic Industry

As noted above, the principal proposal, other than the application of *eBay* to Section 337 investigations, that is made by those that seek to limit the access of NPEs to relief under Section 337, is to amend the domestic industry requirement as it relates to licensing industries. In particular, some have suggested a licensing domestic industry should be found only when the licensing relied upon to show the existence of an industry is prior to, and promotes, the adoption of the patented invention.

Adding a requirement to Section 337 to the effect that U.S. licensing activity will only be counted in determining whether a U.S. licensing industry exists if the activity occurs prior to, and promotes, the adoption of the patented invention in products in the U.S., introduces a host of issues, including a temporal limitation that may well incentivize behavior that stifles innovation, rather than promoting it. To avoid the limitations of this proposed language, some inventors may avoid publishing prior to issuance of a patent in order to give time for licensing before an industry springs up based on a disclosure in a publication. Also, some infringing parties could be rewarded for dilatory tactics during license negotiations because the temporal restriction could be interpreted as cutting off consideration of licensing activities done after the "adoption" of the patented invention. This would imply that only the first license involving the patent which results in a product sold in the U.S. is relevant to the domestic industry analysis. Thus, if a company starts small with a licensing program, and eventually licenses an entire industry, only the initial license may be considered, rendering meaningless the subsequent and true extent of the complainant's licensing activity. This will eliminate an inappropriately large number of cases based purely on the vagaries of timing.

It should also be noted that the use of "promotes" and "adoption" in the proposed language will introduce uncertainty into the statute as the Commission determines what those words actually mean in the context of the "patented invention". The terms are open-ended and subject to many different interpretations: what constitutes "adoption"; what "promotes" such adoption; what is the "patented invention"? Such vague terms will result in years of unnecessary litigation and uncertainty.

Further, dependent on the interpretation, the requirement that an article based on the patent be "sold in the United States" may largely read licensing industries out of the statute, or at least make them redundant, contrary to Congress's plain intent to include them as a distinct, separate basis for satisfying the domestic industry requirement. Does "sold" mean also produced in the United States; if not, why is this term used, because the importation requirement under Section 337 almost certainly already means that sales are occurring, making the term largely redundant absent a broader meaning. Licensing activities directly tied to certain intellectual property, without a corresponding product produced in the United States, should satisfy the domestic industry requirement. To hold otherwise would make redundant the long established ITC precedent that recognizes the U.S. production activities of licensees that practice the patent as satisfying the domestic industry requirement and eliminate access to the ITC of the universities and other research facilities that were expressly of concern when the statute was changed in the Omnibus Trade and Competitiveness Act of 1988.

VI. CONCLUSION

It is not clear that any amendments to Section 337 are needed to address perceived issues of use of Section 337 by NPEs/PAEs. The extent of the actual issues is unclear, and the development of Commission jurisprudence appears to be addressing the issues in a measured fashion consistent with the Commission's existing statutory authority. In any event, any changes

to Section 337 should be undertaken with caution, as perhaps unintended, negative consequences of such changes may far outweigh any perceived benefit from them.

Mr. COBLE. Thank you, Mr. Foster.

Ladies and gentlemen, thank you all again for your contribution today.

We try to comply with the 5-minute rule as well, so we will be appreciative if you all could keep your responses as terse and as brief as possible.

I will start with you, Mr. Rhodes. Do you believe that the patent assertion entities, PAEs, or those that accumulate large numbers of patents for purely offensive purposes should be subject to antitrust scrutiny?

Mr. RHODES. Thank you for the question, Chairman Coble. I think that it is difficult to generalize the business models for patent monetization. I think there are a lot of different approaches to the market by a lot of different entities. I don't think that the business model of acquiring patents to exploit them, whether it be by licensing with litigation or in conjunction with litigation, because sometimes litigation is needed to reach licensing agreements, ought to receive any special antitrust scrutiny. I don't think that is in the nature of the patent rights that have been granted. I don't think it automatically should confer special scrutiny.

Mr. COBLE. Thank you, sir.

Ms. Chien?

Ms. CHIEN. Thank you for the question. I believe that scrutiny is appropriate. I don't know if the antitrust actions are the right ones to regulate PAEs. I am not an antitrust expert, but I think that exposing and understanding the business model more fully is something that is within the antitrust authorities, and I commend the FTC for considering instituting a 6B investigation. We just don't know enough about these entities. They have different names. They have different organizations. We don't know enough about who is behind certain suits, and these types of practices can be exposed through scrutiny.

Mr. COBLE. Mr. Dudas?

Mr. DUDAS. All industries should be subject to antitrust scrutiny as long as it is based on conduct and they are doing something wrong. As a licensing company, some of the revenues that have come out of patent licensing have led to 700 patents in research and development for a new product that might start a new industry. That is not anticompetitive. But even some of the companies that engage in certain licensing agreements with each other to keep people out, anything that looks like it is really violating antitrust laws should be scrutinized. But I don't think a particular industry, licensing or any other, should be subject because of what it is to antitrust laws.

Mr. COBLE. Thank you, sir.

Mr. Binns?

Mr. BINNS. Yes. I am not an antitrust expert, but I would think that, as Mr. Dudas has said, that there should not be any entity that is exempt from antitrust laws. If they are conducting actions that are in violation of antitrust laws, they should be susceptible to those, and that could be a possible course of conduct against them.

Mr. COBLE. Thank you, sir.

Ms. Okun?

Ms. OKUN. I am not an antitrust expert, so I would prefer not to answer the question.

Mr. COBLE. All right.

Mr. Foster?

Mr. FOSTER. I could say exactly the same thing, but I will at least comment that I echo the comments of Mr. Dudas, that there is no exemption from the antitrust law, but I don't think that categorizing somebody as an NPE means that they should be subject to any particular scrutiny other than based on their particular conduct and the conduct of that group.

Mr. COBLE. Thank you, sir.

This is for all witnesses again. I think we all understand the value of having a strong patent system, but do we see operational inefficiencies in the current patent litigation system where the cost to defend far outweighs the cost to accuse? How can we better improve our patent litigation system to get it on a par with a newly modernized post-AIA patent system?

Mr. RHODES. Thank you for the question, Chairman Coble. I suggested three possible areas of exploration in my testimony. One is to encourage more fee shifting against non-meritorious behavior in patent cases; two, to look at ways to impose more discovery, rationality, proportionality, and cost shifting in appropriate circumstances; and three, to provide for a codification of the right to stay downstream cases against customers or end-users in favor of the manufacturer or primary supplier of the product having the battle with the patent owner in the first instance.

In addition to that, I would add that there are a few follow-up actions from the AIA that I think would be appropriate. One is to fix the estoppel provision that could have raised from post-grant review, to lessen that to what it was intended to be without the could-have-raised estoppel.

Mr. COBLE. Thank you, sir.

Ms. CHIEN. I agree with Mr. Rhodes. One other point I would like to make is that I think that the interface between the PTO and the district court should be carefully monitored. As I mentioned before, these overlaps between the different entities in the patent system need to be looked at, but in particular with respect to staying cases, the district court judges that I talked to want to give their litigants relief, and so they are reluctant sometimes to stay cases. But it doesn't make sense to have the PTO going on one course that could potentially invalidate a patent and still have parties spend millions of dollars on discovery. So I urge that there be a closer look at that interface.

Mr. COBLE. Thank you.

Mr. Dudas?

Mr. DUDAS. I would just make one point, that companies that are excellent portfolio management companies, they are not litigation companies, they are licensing companies, and I am not sure that their litigation costs aren't as high as defendants, because they are there to really license. I think the big problem is those companies—and there are many of them out there that are abusing the situation—if they are there for the cost of litigation, I think that is what we are talking about. If they are frivolous suits to begin with and they want to settle out on costs of litigation, then yes, we really do

need to identify that, and I agree with some of the statements made by other witnesses. Well, I would say my own, which is that attorneys' fees, rule 11, more transparency in the system, there are ways to address that so that we can root out the frivolous bad actors.

Mr. COBLE. Thank you, sir.

Mr. BINNS. Thank you. The costs are very asymmetrical between a patent assertion entity and an operating company that gets sued, whether it be in Federal court or the ITC. A licensing entity typically doesn't have very many employees. It doesn't have a terribly large number of documents. It usually has all the documents prepared on a CD before they even start the suit, and the defendant has to usually spend a tremendous amount of time not just on lawyers but on internal resources, devoting people that should be doing R&D and other functions at the company full-time on discovery efforts. These cost differences are a big problem, and I think that the judges need to act as better gatekeepers on discovery. There should be more sanctions offered when things are disproportionate or when plaintiff is being just abusive with the discovery to try to force a party into settlement.

Mr. COBLE. Thank you, sir.

Ms. OKUN. Yes. I think it is very important for the ITC to continue to address lowering the cost to all litigants, and I think the rulemaking that was begun and is continuing where companies, such as the ones you are hearing from today, can comment but they have limited interrogatories at the Commission now, limited depositions, and then the other administrative action I mentioned earlier of holding a 100-day hearing on a threshold issue of domestic industry can reduce costs to respondents as well. So I encourage the Commission to continue that and to look, I would say, on the sanctions side where there is frivolous or abusive litigation, to use that as a tool as well. Thank you.

Mr. COBLE. Thank you, Ms. Okun.

Mr. Foster?

Mr. FOSTER. I would just echo the comments of former Chairman Okun and indicate that I think the Commission and its judges are making increased efforts to try to control costs and try to penalize dilatory and inappropriate behavior, and motions for sanctions are on the increase, and the Commission and judges are not shy about imposing fees for abusive discovery, for example. I think that is likely to continue and hopefully will help to control some of the costs.

Mr. COBLE. Thank you, sir. I see my red light has illuminated, so I will recognize the gentleman from North Carolina, Mr. Watt.

Mr. WATT. Thank you, Mr. Chairman. Ms. DelBene, one of our new Members, has made me aware of an irreconcilable conflict she has, so I am going to yield my time to her and go all the way at the end of everybody else.

Ms. DELBENE. I would like to thank the Ranking Member for giving me the time, and thank you all for being here and for your testimony.

Ms. Okun referenced the fact sheet that the ITC just put out, and in it it talks about the number of cases from non-practicing entities, and in particular talks about entities that do not manufac-

ture products that practice the asserted patents and whose business model primarily focuses on purchasing and asserting patents. In this data, 9 percent of the cases are of those types of non-practicing entities, and I think, Professor Chien, you said maybe 35 percent of the cases were from non-practicing entities. I just wondered how you calculated your data and whether you agree or think of it differently.

Ms. CHIEN. I haven't seen this data sheet, but I know of their methodology from before, and they separate patent assertion entities into two types, or two types of NPEs. The data you cited also is over the 2006 to 2013 period, and what I cited was 30 percent from the last year alone. So I wouldn't expect there to be very many cases in earlier years, but now as patent assertion entities have become prevalent in district court litigation, just in that way they are also coming to the ITC.

Ms. DELBENE. And, Ms. Okun, I just wanted to ask for your response on that because I am trying to get an idea of what the numbers actually are.

Ms. OKUN. Sure. So, Ms. Chien is correct in terms of the fact sheet references the period post-eBay since there was a lot of discussion of was there a flood after eBay was decided, and I think these numbers would show no. In an individual year, if you look at—2011 was a high point in cases filed at the ITC altogether, so all cases went up. In 2012, the caseload at the ITC went down by 30 percent. The number of NPEs, total NPEs, remained about the same. So the percentage is higher in 2012 than in 2011, but the overall caseload is down, and down again.

Ms. DELBENE. And so you think that trend is consistent even though that 1 year is slightly different?

Ms. OKUN. I think over time looking at this, it is just not a large portion of the caseload given that most of the other cases that are brought are more traditional.

Again, it is there, and I think that is the reason you have seen the Commission, both through its decision-making on the cases that have come before it and in these administrative actions, look for even these few cases that have been filed as ways to say are they meeting the domestic industry requirement as a threshold issue. They have to show substantial ties. Litigation expenses alone are not enough, according to the ITC. The ITC in its case law has said it looks to productive versus revenue-driven licensing even though all of it is looked at. But it is very case specific. If you read the cases that have dealt with PAEs and NPEs, I think that has been a very fact-specific inquiry to make sure that the ITC is administering the statute consistent with what Congress intended when it was amended in 1988.

Ms. DELBENE. Thank you.

Professor Chien, you look like you had something else to say.

Ms. CHIEN. Right. No, I agree with the remarks of Chairman Okun, especially that the ITC is paying more attention to domestic industry.

One thing in terms of just statistics to be aware of, though, is that not only the number and share of cases is important, but also the number of defendants and the share of respondents. So because the ITC does not apply the rules that were enacted as part of the

AIA, you can still name a lot of defendants there. So the number of defendants, when you count by that, we counted that to be about 50 percent of defendants in 2012.

At the same time, I do want to acknowledge that the ITC is evolving its domestic industry case law, and I think this 100-day case management that was just proposed is a great development. I think it also provides an example for the rest of the court system. Earlier the question was asked how do we reduce waste and duplication in the system. One way is to have early disposition of dispositive motions heard, whether it be about standing or about whether or not the patent is subject-matter eligible. For example, if Apple can say, well, we actually have exhaustion doctrine that would cover all the people here, why should we go on with the case. So those types of things in terms of spacing out and ordering the cases properly can result in great efficiencies.

Ms. DELBENE. Thank you. And again, I would like to thank the Ranking Member, and I yield back my time.

Mr. COBLE. I thank the gentle lady.

The gentleman from Pennsylvania, Mr. Marino.

Mr. MARINO. Thank you, Chairman, and welcome, members of the panel.

Mr. Foster, I want to start with you, if you would, please. Should Congress try to define PAEs in order to limit their activity, or instead try to define abusive behavior and limit that?

Mr. FOSTER. Well, I am not certain that Congress needs to do either. I think at least in terms of what the Commission is doing, the Commission has its statute, has its requirement for domestic industry, and the law permits a licensing industry. And whether it is a PAE that is just an aggregator and has nothing but patents, or whether it is an NPE that has production of one type but has additional patents that it is trying to monetize, the Commission looks at the statute and makes a determination of whether there is an industry. It really doesn't look, so to speak, and try to define the complainant as either an NPE or not. It simply says whoever you are, what are your assertions as to what your domestic industry is, and then it applies its regulations, its rules, the statute to that and makes a determination as to whether or not there is a licensing industry.

So from that perspective, what the Commission is doing is really not just sort of focusing on NPEs and saying we are going to address the NPE issue. They are simply saying if you come here, you have to have a recognizable industry as required by the statute. If you don't, you won't get relief.

Mr. MARINO. Ms. Okun, please.

Ms. OKUN. Yes. If I could just add that I really think the focus on abusive behavior is the correct one, particularly for the Commission or the court, because that is something that helps all litigants. Again, I don't think it is based on who the litigant is. There can be abusive behavior whether you are a PAE or a regular litigant. But the Commission should care about that, and reducing the cost of litigation, and finding ways to help its judges do these things more expeditiously. I think it is good for the system. So I think that is where the focus properly should be.

Mr. MARINO. Professor, you look like you want to say something.

Ms. CHIEN. Well, I think a lot of comments here have been about focusing on the behavior and not the entity, and I do endorse those sentiments. But I think that they are linked together, because a lot of the asymmetries and advantages from PAEs flow from the business model, which is if you don't have customers, they don't make anything, they are not in the market. Normal companies don't sue their customers, but PAEs don't have customers, so they can't sue end-users, and they do so. Normal companies have a reputation to defend. They don't start fights unless they really believe it is important for the competition. PAEs don't have to worry about their reputation. They are not in the marketplace. They don't have to worry about people thinking that they are engaging in litigation just for the sake of the litigation. That is their business. They don't have to worry about the threat of retaliation in terms of a countersuit, or about production of documents.

So the business model itself is set up in a particular way, and it is very compelling. It is not something that I think—I am not saying that the people that are working in it are bad actors. There are legitimate investors and different entities that are investing in PAE activities. Even large companies sometimes are partnering with them. So it is the business model itself which can lead to abuses.

Mr. MARINO. So with that thought in mind, what would you do concerning the PAEs and the entities that do not produce?

Ms. CHIEN. Well, I would look carefully at their behavior, but I would really focus on these things that they do that normal companies don't and just be aware that some of these asymmetries, for example, which could be fixed by fee shifting, for example, are related again to this model. So I think, again, looking at the behavior, but also the model and just being aware, and understanding the model very deeply is what will lead to narrowly tailored interventions that will actually work.

Mr. MARINO. Mr. Dudas, would you please, if you want to respond to that, but I also want an explanation from you as to what is the intent, why do we need PAEs.

Mr. DUDAS. So responding to that, I would just say that MOSAID is a company that does want everyone to know about their licensing, about their technology, about how they have 1,450 patents. So they do care about that. I think there are some points that are correct about how the model works, but that is one of the things I think can be a difference.

How can we address that? More transparency. For those who don't want anyone to know who owns the patents, whether it is in litigation or whether it is before the Patent and Trademark Office, let's make sure they do know. Addressing abusive practices in litigation itself, again, a "loser pays" model that applies to everybody is something to really consider.

And, I'm sorry, your next question was about why do we need them at all?

Mr. MARINO. Yes.

Mr. DUDAS. I think because we are becoming a much more knowledge-based economy, the idea that actually owning the ideas is something that we celebrate in every Nation, the idea that we transfer to a knowledge-based economy. There is more efficiency.

The reason there are companies that come to MOSAID—MOSAID started out as a company that had a lot of research and development and found out that their patents were being infringed. They developed a licensing model because they had to. Otherwise, they weren't getting paid for any of their R&D. They developed an expertise in that. Some companies don't have as deep of an expertise. If a company can license its IP really well in-house, that is fantastic. But a number of companies have come to MOSAID to say you can do a better job of developing this technology.

And another that was just raised as well, it doesn't subject itself to traditional cross-licensing type of thing, where I won't sue you if you don't sue me.

Mr. MARINO. Thank you. I see my time has expired. I yield back.

Mr. COBLE. I thank the gentleman.

The Chair recognizes the gentleman from Michigan, Mr. Conyers.

Mr. CONYERS. Thank you, Chairman Coble.

I am wondering what the thought is about the SHIELD Act. I am wondering whether the statute is disproportionately applied by NPEs and PAEs. And finally, I am wondering if ITC should not have jurisdiction if the infringer is not subject to the Federal court's jurisdiction. What do you think?

Mr. RHODES. Thank you for the question, Representative Conyers. First of all, I think that the SHIELD Act is a flawed approach to litigation abuse reform. I think it suffers from the flaw that we just discussed, and that is it targets the actor and not the bad action. It is not truly a fee shifting. It is just a "loser pays" for certain types of patent owners who are penalized, as compared to other litigants who might be engaging in exactly the same behavior and not be challenged.

I have put in my written statement and I have said this afternoon that I do believe a relaxation of "loser pays," or I should say to have more "loser pays" is an appropriate approach to remedy some of the abuse, but only if it is applied equally and targeted at behavior and not litigants.

As to your second question about ITC jurisdiction if there is also Federal court jurisdiction, for us I think it is important to point out that these are complementary procedures and they really do work in conjunction with each other. If we have a situation which we have had many times in the past where there is infringing importation that we want to remedy, we are willing to go to the ITC. We are not looking for every remedy. We are not looking for damages. But we can get a fast, very efficiently run proceeding with knowledgeable ALJs and well-defined procedures to see if we can stop that importation from occurring, and we have done that on everything from canary yellow Post-it notes to lithium ion batteries in the past, and it has been very effective, and I think it is an essential tool when a U.S. patent-holder wants to prevent infringing imports. It is not designed for everything. It is not commensurate with the district court, but it is complementary in my view.

Mr. CONYERS. What do you think, former chairman, about the statute being disproportionately applied to NPEs and PAEs?

Ms. OKUN. Thank you for the question. I think the statistics that I mentioned earlier and most recently in the official statistics released by the Commission indicate that it is not disproportionately

being used by NPEs, that they are a small portion. Yes, the caseload has grown generally at the ITC.

On that point, I would note that if you look at our trade balance, what you find at the ITC is if you have a lot of imports coming in, you have more infringing imports, and so we think we have seen growth in the caseload because of that. But I don't think it is disproportionate, and it is not only not disproportionate in terms of their filings, they certainly are not succeeding at the ITC. Out of 50 orders that the ITC has issued, only four were for NPEs, and those NPEs were—either the NPE or their affiliate developed the technology. So it is not even in this other category of a PAE.

So I think the statistics don't support that it is disproportionate. I don't think the results support that. Therefore, I think that the Commission, through applying the statute—and for those of you who have had a chance to read the Commission's decisions on licensing, again, it is a high threshold. You have to show ties to the domestic industry. It is substantial, and most NPEs don't make it, only one since 2011.

So all those things I think support that it is not disproportionate. Thank you.

Mr. CONYERS. Should the patent disputes be limited to infringers not in the Federal court jurisdiction?

Ms. OKUN. Sorry, I forgot the second part of your question about the jurisdiction. I think Mr. Rhodes is an example of explaining why there is a trade statute designed to stop infringing imports. It is an unfair competition statute. It is not a patent statute. Yes, a lot of patent holders use it, but they use it to stop infringing imports. So at its base, it is a trade statute and was set up by Congress to be in addition to other provisions.

So, yes, you can bring a case, but I think, as Mr. Rhodes pointed out, and what I saw when I was at the Commission, is where you have technology that needs to come to market and you have infringing imports, your ability to stop that allows you to get your product to market. If you are forced to stay the ITC, as some have suggested, and go through the district court first, with all due respect to district courts, they have a lot on their plate. They don't get to these things quickly. It is not an expeditious forum, and the IPR holder whose rights are being infringed sits there. Yes, he might get damages at the end, but he may not succeed in the market if the infringing imports are allowed to go through during that time period. Thanks.

Mr. CONYERS. Thank you, Mr. Chairman.

Mr. COBLE. Thank you, Mr. Conyers.

The Chair recognizes the Chairman of the full Committee, who has now arrived, Chairman Goodlatte.

Mr. GOODLATTE. Thank you, Mr. Chairman. I appreciate you holding this hearing, and I wish I had been here earlier to read my great statement into the record, but instead I will just ask unanimous consent that it be put in the record so I can ask some questions of these great witnesses.

Mr. COBLE. Without objection.

[The prepared statement of Mr. Goodlatte follows:]

Prepared Statement of the Honorable Bob Goodlatte, a Representative in Congress from the State of Virginia, and Chairman, Committee on the Judiciary

U.S. House Judiciary Committee Chairman Bob Goodlatte Subcommittee on Courts, Intellectual Property and the Internet Hearing on: "Abusive Patent Litigation: The Issues Impacting American Competitiveness and Job Creation at the International Trade Commission and Beyond" Statement Submitted for the Record

During the last Congress we passed the America Invents Act (AIA). That bill was the most significant reform to the patent system in my lifetime. The AIA modernizes our patent system and sets it on the right path for decades to come.

The AIA included a number of provisions that went directly to addressing the issues surrounding patent quality. The PTO has new programs in place to ensure higher quality patents that can stand up to review, setting the bar higher so that quality control starts on the front end rather than relying on the federal courts system to fix problems.

The U.S. patent system is designed to be fair, meeting our international obligations and not discriminating against any field of technology. The strength of the U.S. system relies on the granting of strong patents, ones that are truly novel and non-obvious inventions, those that are true innovations and not the product of legal gamesmanship.

While the AIA paved the way for higher quality patents on the front end, there were a few issues that were left on the cutting room floor during the last Congress that could help go more directly to the immediate issues surrounding patent assertion entities (PAEs) or patent trolls.

Abusive patent litigation is a drag on our economy. Everyone from independent inventors, to start-ups, to mid and large sized businesses face this constant threat.

Many of these lawsuits are filed against small and medium-sized businesses, targeting a settlement just under what it would cost for litigation, knowing that these businesses will want to avoid costly litigation and probably pay up. And it is this type of tactic that has now made the International Trade Commission (ITC) an attractive venue for patent cases.

The ITC has at its disposal the ability to issue exclusion orders that block the importation of "infringing" products into the United States. Since the ITC is a federal agency and not an Article III court, it makes sense that it is limited to this single remedy.

In recent years, however, PAEs have used the Commission as a forum to assert weak or poorly-issued patents against American businesses.

It is evident that there are cases that have come before the ITC that probably should be litigated exclusively in our U.S. District Courts. Nowhere is the disharmony between patent law and Article III court precedent more on display than the application of exclusion orders in technology cases at the ITC.

For example, Congress established an important counter-balance to the blunt sanction of the exclusion order in the public-interest test provided under Section 337. The statute requires the ITC to consider public health and welfare, and the impact of an exclusion order on competition in the marketplace before issuing an exclusion order; yet the ITC rarely exercises its responsibility to apply the public-interest test. This failure to follow the law has particularly damaging results in today's technology markets in which products are often reliant on hundreds or thousands of patents. The ITC has the ability to take certain immediate steps within its statutory authority to correct these problems.

Three key adjustments that the ITC should consider undertaking include: A return to a pre-2010 domestic-industry standard that does not allow legal expenses, airplane flights, and the like to satisfy the domestic-industry requirement.

Second, application of the public-interest test and economic-interest test at the beginning of a Section 337 review for purposes of determining claims consideration as well as the issuance of exclusion orders.

And third, based on the public-interest and economic-interest test analysis, articulation of standards that clarify which patent disputes should be adjudicated by the ITC and those which are more properly addressed by U.S. district courts.

The patent system was never intended to be a playground for trial lawyers and frivolous claims. We need to work on reforms to discourage frivolous patent litigation and keep U.S. patent laws up to date. Abraham Lincoln once said that "the patent system added the fuel of interest to the fire of genius." Well I for one would not want to see the spark of innovation and job creation go out because of a few folks who are adding water to the proverbial gas tank.

Abusive patent troll litigation strikes at the very heart of American innovation and jobs. That is why Congress, the Federal Courts and the PTO should continue to take the necessary steps to ensure that the patent system continues to be one that lives up to the vision of our Founders, truly promoting the progress of science and the useful arts.

I look forward to hearing from all of our witnesses on the issue of abusive patent litigation and potential solutions to this growing problem, in order to ensure that we continue to promote American ingenuity, innovation and jobs.

Mr. GOODLATTE. Thank you, Mr. Chairman.

First, I will direct a question to several of you. I'll start with you, Mr. Rhodes.

When it comes to the patent system, especially patent ownership, do you believe that it is appropriate for entities to assert a patent far beyond the value of its contribution to the art? Are there or should there be limits to asserting patents in litigation?

Mr. RHODES. Well, thank you for the question. That is a very difficult question, of course. Certainly, we all would hope that patents would be asserted commensurate with their contribution to the art, but those are the disputes of which Federal court litigation is made, what is their contribution. I think it is a problem that has existed but one that the courts are looking at and working on, primarily in the area of the development of damages jurisprudence.

So if you look at some of the decisions that have come out of the Federal circuit, in the Lucent case for example, that really dealt with the entire market value rule and how components of a larger product should be valued for purposes of infringement determinations and damages, the *Uniloc* case which talked about the rules of thumb that the Federal circuit threw out, I think that issue is being addressed, and I think we all have the same goal—to try to measure what the contribution is—and we are working in that direction.

Mr. GOODLATTE. Professor Chien?

Ms. CHIEN. Damages and settlements should be driven I think precisely as you say, by the economic value of that patent and its contribution to that product. Right now, however, what is happening instead is that the cost of litigation avoidance is a big factor, as well as what a jury might be persuaded to value the patent as.

I actually endorse in my testimony doing a study that can help us bring damages calculations down to earth and actually inject a real-life ex-ante negotiation for what is this patent actually contributing to this product in its decision, when I am making a product and I am deciding between alternative technologies, what is the value of this technology over another technology. Those types of analyses should be done. We should understand what is happening in the real world for the evaluation of patents.

Mr. GOODLATTE. Let me ask another question since you are all giving good answers, but they are long and I have a couple of other questions.

Let me ask Mr. Dudas, do ITC patent investigations complement or conflict with patent litigation in the U.S. District Court? Should the ITC's jurisdiction over patent cases be limited to disputes in which the accused infringer is not subject to the court's jurisdiction? I think the Ranking Member just asked something similar to that. I don't think you had an opportunity to answer.

Mr. DUDAS. I still look at them as two different remedies. A way over-simplification of this is if someone stole your car, I wouldn't want the police officer to tell me, well, just sue them in court. You want to make sure that person doesn't get your car.

Mr. GOODLATTE. True, but you wouldn't sue them in two different courts.

Mr. DUDAS. Right. But I guess my point is that I think, again, as long as it is applied equally and there is fairness to it. When I was at the Patent and Trademark Office, one thing I was concerned about when we did reexaminations is if there was something parallel in court while we are doing something there. I know there are different standards, there are different notes, but we tried to talk about that in this Committee as well.

I guess what I am getting at is, on intellectual property, if you have someone importing goods and they are infringing your property, you want that to stop. That is a completely separate remedy. You don't want anybody selling anything that is your intellectual property. Separately from that, you want damages to collect.

Mr. GOODLATTE. Mr. Binns?

Mr. BINNS. Thank you. This brings me back to my key point, which is that there are parties that go into the ITC that don't want an exclusion order. An exclusion order would actually hurt their business because they don't participate in the market. They are not selling products. They don't have anything to protect. All they want is money. Almost I would say 100 percent of the time, when a true patent assertion entity files an ITC action, they are filing a district court action at the same time. They should be just in the district court.

Mr. GOODLATTE. Thank you.

Ms. Chien, let me ask you this. Do you believe that there is a perception that the ITC provides a friendly forum for those engaging in patent troll type behavior? Is there more that the ITC could do to prevent abuse?

Ms. CHIEN. I think the ITC is evolving its case law, and I don't think that there is greater activity at the ITC than district court with respect to patent assertion entities.

Mr. GOODLATTE. And what are some of the ways that Congress can ensure that patent rights are able to be enforced while discouraging abusive entities from shaking down? We know there are some bills out there, but what would be some of the things that you would favor the most? What could we do that would be the most productive?

Ms. CHIEN. I personally recommend in my testimony that the overlap and the duplication in the system be reduced, because that is what invites abuse, forum shopping, and——

Mr. GOODLATTE. So what Mr. Binns just said.

Ms. CHIEN. Yes.

Mr. GOODLATTE. Mr. Dudas, what would you do?

Mr. DUDAS. I would focus on transparency and who owns the patents, and I would also focus on what I think is litigation abuse. So I think the idea, from a personal standpoint——

Mr. GOODLATTE. So let me ask you about the litigation abuse, because there is litigation abuse, but the Federal courts have been loath to impose Rule 11 sanctions. Some of the legislation that has been proposed would add new statutory provisions like "loser pays" on parties that abuse the process. You may or may not be abusing the process with "loser pays." But what kind of litigation sanctions would you suggest that we can count on being enforced, as opposed to just being on the books?

Mr. DUDAS. When I was the counsel on the Subcommittee for Courts and Intellectual Property, we looked at expanding Rule 11 and we looked at "loser pays" rules, abusive practices and fines, and I even think of the amendment when it was in a different context. If the Department of Justice pursued you frivolously, vexatiously or in bad faith, there is the opportunity to recover fees. I think there are a number of models out there that would get at that.

Mr. GOODLATTE. Very good.

Thank you, Mr. Chairman.

Mr. COBLE. Thank you, Mr. Chairman.

The gentlelady from California, Ms. Chu.

Ms. CHU. Thank you, Mr. Chair.

Mr. Binns, I would like to get your view as to why the patent assertion entities are filing in the ITC. In your testimony you state that they are looking for money. Then why are the patent assertion entities using the ITC to adjudicate patent infringement cases if the ITC can't award damages? Why would they want an exclusion order from the ITC?

Mr. BINNS. That is a good question. They actually don't want an exclusion order, but they use it as a hammer to drive up settlements that they couldn't get otherwise in Federal court. My experience is that no company, an operating company that is selling a significant amount of product in the United States, would ever want to risk having those products excluded. I think as the injunctions have been taken away from patent assertion entities in the district court, they now have moved over to the ITC because there is only one remedy, the exclusion order, and they wave that over your head, demanding large settlement amounts.

Typically, we have patents that cover just a very small—every patent assertion entity case I have had has covered a miniscule component of an overall system, and they want damages on the overall system. They can't get that, as Mr. Rhodes pointed out, under the current case law in the Federal circuit. They go into ITC and they try to get an exclusion order on the entire system. These cases almost always settle, which is one reason why I disagree with Ms. Okun, because she talks about success.

I think that a patent assertion entity succeeds by getting a settlement in the ITC. They don't succeed by getting an exclusion order. They succeed by getting settlements. If you only measure

patent assertion entities by getting an ITC all the way through to completion, you are measuring the wrong thing.

Ms. OKUN. May I have an opportunity to respond to that, Ms. Chu?

Ms. CHU. Yes, please.

Ms. OKUN. In terms of settlement rates, the ITC fact sheet that was referenced today goes through the settlement rates, and it shows that for Category 2, most like PAE, the settlement rate is not much different for all settlements at the ITC. So again, about 50 percent settle, and the numbers are somewhat consistent.

From Mr. Binns' perspective about what you should measure, that raises a point, and that is why I highlighted one of the recent Commission actions of ordering a 100-day hearing, because I think if there is a questionable PAE who has to come to the Commission and prove the domestic industry within 100 days and their case goes away if they can't do it, and their ownership is not enough, litigation expenses are not enough—the test is tough—that has to reduce the ability to force a large settlement.

Now, I think it also helps if they are not successful at the ITC. So I think all these things—and then finally, just to go back briefly, you also need to lower the cost, because if it is so expensive for these companies that they are forced to settle, then the Commission should be looking for additional ways to lower the costs, reduce depositions, reduce discovery. Thank you.

Ms. CHU. And, Mr. Binns, how do you respond to that?

Mr. BINNS. No, I think the ITC is taking some steps in the right direction. I think having an early hearing—I think 100 days is probably longer than you need to do. District courts are able to do preliminary injunctions in much shorter amounts of time, typically. During that 100 days, you are still under the full burden of ITC discovery, as I understand.

Once a case has been initiated, the damage is already done because you are going to be spending millions of dollars. You are paying your attorneys $750,000 an hour for that 100 days, and all the internal resources that go to bear. I mean, it is a step in the right direction. I don't think it is enough, but it is a step in the right direction.

Ms. CHU. Professor Chien, your testimony stated that the ITC was originally created as a solution to the problem of forum piracy, and yet these patent cases are growing as a proportion of the overall caseload. And what about the ITC's ability to investigate effectively if this problem persists? What impact does this have on the agency's ability to investigate overseas competition, and should we be worried that the ITC may not be able to pursue other intellectual property violators?

Ms. CHIEN. I think that is a great question. I think it looks into the future a bit because—and actually related to the 100-day idea that has been mentioned before. The judge in that case said I am going to have to put off my other cases so I can concentrate on this issue.

So, as we see more cases of piracy come in or we think about using the ITC for other reasons, as has been contemplated by the OPEN bill, for example, I think we do need to think about what is the ITC really good at. They are good at exclusion orders. If they

are not giving those in most cases, those cases probably shouldn't be there.

Ms. CHU. Thank you. I yield back.

Mr. COBLE. I thank the gentlelady.

The gentleman from Texas, Mr. Poe, is recognized.

Mr. POE. Thank you, Mr. Chairman.

Thank you all for being here. I admire the study of patents that you have all done. Being a prosecutor and a judge, spending time at the criminal courthouse for 30 years, it is a lot easier to understand bank robberies, stealing, pillaging, and auto theft than it is patent law. So, God bless you for your work there, and all those judges and lawyers that work in that area. It is highly important, but it is complicated.

As a general rule—I want everybody to answer this—as a general rule, are you in favor of the concept of "loser pays?"

Mr. Rhodes, I will start with you. Just yes or no.

Mr. RHODES. Yes.

Mr. POE. Professor?

Ms. CHIEN. I think the devil is in the details.

Mr. POE. Okay.

Mr. DUDAS. Yes, as long as it is applied on both sides.

Mr. BINNS. Yes.

Ms. OKUN. Yes, as it is applied.

Mr. FOSTER. I am afraid that is beyond my brief and I will have to decline.

Mr. POE. Okay. So we have five yeas and an abstention.

Mr. Dudas, you mentioned in your testimony, you gave four solutions that may be helpful. If Congress gets involved, we don't want to make things worse. Sometimes that actually does happen when we pass laws. We make it worse. You mentioned your respect for the Federal judiciary and judicial discretion. Of course, judges love the word "discretion." I am a former judge. I love that word. Do you think really, though, judicial discretion would help in the area of figuring out bogus cases, legitimate cases, the troll problem? Do you think that that would help, and if so, how? Explain to me what judicial discretion you are talking about.

Mr. DUDAS. Personally, I am a fan of it, the reason being that if a judge has had the case, the judge has the opportunity to see the case and a judge can see certain behavior that is problematic, I would like the judge to have the discretion to fashion a remedy that works.

I will use a context that is well outside of patent law that I mentioned earlier to Chairman Goodlatte. I had the pleasure to work with Congressman Hyde on an amendment that said if the Department of Justice pursues you frivolously, vexatiously and in bad faith, you are exonerated on all claims, you at least have the opportunity to seek attorney's fees from the Department of Justice, and that relied entirely on the judge. It was more efficient because the same judge could look at it. The judge knows what the conduct was in the case.

So I don't mean carte blanche judicial discretion but the opportunity to say I have seen what this is, and I think attorney's fees as a possible remedy, or the possibility to sanction plaintiff or defendant.

Mr. POE. Attorney fees, sanctions, either side a sanction?

Mr. DUDAS. Yes.

Mr. POE. Okay. Does anybody else want to weigh in on that? Professor, I can see you want to.

Ms. CHIEN. I think we want to give judges as much help as we can. These are very complicated cases, and they have a lot more on their docket as well. So where it is possible to help them understand what the dynamics might be, I think that is helpful, either through transparency or other fee shifting where we have certain behaviors that are identified. We just want to make it as easy for the judiciary to do its job as we can.

Mr. POE. Mr. Rhodes?

Mr. RHODES. Yes, just to echo a couple of points. I think the fee shifting proposal has merit if it is applied equally and is really targeted toward abusive behavior. I think beyond attorney's fee shifting, the cost of discovery shifting beyond a core set of discovery is a concept that has some merit. I know it is somewhat of a challenge for Congress to get in the middle of how discovery is managed in courts, but in my testimony I recommend maybe some suggestions to the Judicial Conference or through the patent pilot program on ways that discovery cost shifting could level out some of the asymmetries that a number of us have talked about this afternoon.

Mr. POE. All right. Talk about briefly standard essential patents. Is the ITC moving to more standard essential patents, about the same, less? Where is the ITC moving on that issue of standard essential patents?

Ms. CHIEN. Actually, I had my research assistant look at that number in terms of the number of standard essential patent cases that have been filed, and it is growing, and I think that issue highlights one of the design flaws or issues that we need to be concerned about. We have been talking about patent assertion entities a lot today and how there is a different standard for injunctions at the district court and within the ITC, but standard essential patents is another area potentially where the district courts seem to be moving toward not entering injunctions. But if you can go to the ITC and get an injunction on your standard essential patent, that invites mischief.

Mr. POE. Last question. Do you think a PAE should have equal footing with a traditional patent holder in Federal court or before the ITC? I would just like your opinion on that.

Ms. CHIEN. In Federal court, I think they do have the same footing. They don't have under eBay the same ability to get an injunction. I think that is appropriate.

Mr. POE. So you think it is appropriate in the current system that it is the way it is now, or in Federal court they should or should not have equal footing?

Ms. CHIEN. I think that the Federal courts right now are treating PAEs appropriately.

Mr. POE. All right. Does anybody else want to comment on that? Mr. Binns?

Mr. BINNS. I think patent assertion entities should have the same footing in Federal court as other patent holders. I think there

are other reforms that could be done to limit the abuses by patent assertion entities in Federal court, though.

Mr. POE. All right. I am out of time.

Thank you, Mr. Chairman. I yield back.

And God bless you again for what you do. Tough, tough assignment.

Mr. COBLE. Thank you, Mr. Poe.

The gentleman from New York, Mr. Jeffries.

Mr. JEFFRIES. Thank you, Mr. Chairman.

I have the great privilege of representing a congressional district entirely within the City of New York, and traditionally New York City's economy has relied on financial services and real estate and insurance, and it served the City of New York well over time. One of the things, however, that became clear in the aftermath of the collapse in 2008, where the collapse of those industries resulted in a decrease in significant revenue that New York City and New York State had been relying upon, is that we needed to diversify our economy, and that has happened, thankfully, to some degree as a result of the growing technology and innovation sector and presence in New York City and Silicon Valley growing even into Brooklyn with the Tech Triangle.

So we are concerned, given the importance and the increased reliance and the significance of technology and innovation, that abuse of patent litigation may be having an impact on growth and entrepreneurship and creativity within this sector.

So I guess my first question, Professor Chien, has there been any study that has been done that really quantifies the impact on economic activity that abusive patent litigation in totality has had on the industry?

Ms. CHIEN. Well, with respect to startups, I have done a survey of about 300 companies in the fall, and I am now enlarging that study to be much larger. But I think the impact on startups was very troubling because when you think about what they have to face in terms of trying to make their milestones, make their products, they don't have a lot of resources to deal with it when it comes in. So when it comes in, they are tending to be more significant in their impact. It may cause them not to be able to hire, not to have to change their product, potentially to actually close the business down, and one of your constituents, Brad Burnham, testified at the DOJ FTC hearings in December about how one of his companies was basically put out by a troll completely.

So I think it is a concern of ours to think about not only the issues of patent assertion entities in general but the distributional equities and how this might be hurting smaller entities more.

Mr. JEFFRIES. Okay, thank you.

Now, Mr. Dudas, is there a distinction, as you understand it, between the cost of discovery and litigation in district court and the cost of discovery and litigation in the patent space before the ITC?

Mr. DUDAS. There is, as I understand it. I don't have a deep expertise or really a lot of expertise on ITC. But, yes, my understanding is it's dramatically——

Mr. JEFFRIES. Can anyone on the panel comment as to that distinction?

Mr. BINNS. I can respond firsthand. I have been a defendant in many district court cases, as well as in ITC, and the burden from the ITC's perspective is exponentially worse than it is in the district court.

Mr. JEFFRIES. And is that because the remedy of exclusion is viewed as a more drastic or more severe remedy?

Mr. BINNS. Not for that reason. The reason is because the discovery rules in ITC are so much more draconian. For example, as you guys know, in the district court you get served discovery. Typically, you have 30 days to respond. You can often get extensions. You are able to formulate and not take up too much of your internal bandwidth to respond to discovery. In ITC, you are served with a thousand interrogatories from the day the investigation is initiated, and you have 10 days to respond, and there are really no extensions. It is tremendous.

Mr. JEFFRIES. Thank you.

Ms. Okun, in your view, is the domestic industry analysis as it has recently been set forth in the case that you articulated in your testimony, is that more rigid analysis, can that serve as a significant constraint to preventing or minimizing frivolous litigation in a patent space for moving forward before the ITC?

Ms. OKUN. Yes. It is my view that the application of the statute to the different cases that have come before the Commission involving non-practicing entities trying to establish a domestic industry through licensing has sent a clear message to a questionable PAE that they are not going to meet the domestic industry test of the Commission. Mere ownership is not enough. Litigation expenses are not enough to prove domestic industry. So I think the case law as developed is a very tough test for that.

Mr. JEFFRIES. Thank you. Now, Mr. Binns made the point that if you have burdensome discovery that proceeds simultaneously, that reduces the value of this constraint or this analysis being applied, that may ultimately result in the patent assertion entity being thrown out of court. Can the ITC stay discovery if circumstances dictate while the domestic industry analysis is proceeding? And if they currently don't have that ability, is that something that Congress should consider to minimize the cost of litigation while this analysis is proceeding to see if this is a legitimate entity with standing?

Ms. OKUN. A couple of responses. First, just to be clear, the Commission just adopted, I believe it was last week or the week before, new rules limiting interrogatories, limiting depositions, so a number of the things that Mr. Binns talked about the Commission has recognized and has asked for comments from the parties and had final rulemaking. So there will be limits and a clear message from the Commission to its ALJs and to the parties that these new rules mean that it should reduce the cost and expense. That is one thing.

With regard to the 100-day hearing—and again, I am not at the Commission—and so there may be additional steps they are taking or additional comments they want to hear on whether this is a workable solution about whether you would stay discovery. So I believe there is the authority to do it. It is just for the domestic industry itself, you would have discovery. I mean, that is how you figure out if someone has a domestic industry. That is what the

judge has to hear. So there is discovery going on. Whether the discovery on the rest of the issues in the case are stayed during that 100 days is something that I think parties and others should comment to the Commission on at an appropriate time of what makes more sense.

Mr. JEFFRIES. Thank you.

Mr. COBLE. Thank you, Mr. Jeffries.

The Chair recognizes the gentlelady from Texas, Ms. Jackson Lee.

Ms. JACKSON LEE. Let me thank the Chairman and Ranking Member for the courtesies extended for those of us who had meetings outside this room, and thank the presenters here.

I want to welcome you back, Mr. Dudas, and for your service as well. You have lived both lives with the district court process and the ITC. I guess my line of questioning is just going to be on the parallel route of the district court, the ITC, and the impact it has on either growth and opportunity for businesses or how it provides a dilatory process that does not create that pathway.

In your mind, is the ITC—why don't I ask a very blunt question. Does it perform any role, positive role? And particularly in light of the new legislation that has been passed I think since you have been in the executive.

Mr. DUDAS. Yes. So, I would be clear. I am not a deep ITC expert, but I will tell you that I do think it performs role, and I think it performs an important role for intellectual property. It has been said by some that it is not part of their mission. Because I am not a deep expert on ITC, I went to their website. The Commission also adjudicates cases involving imports that allegedly infringe intellectual property rights. Second page, the primary remedy is an exclusion order that directs Customs to stop infringing imports.

I serve on the board of directors of a company that has a licensing portfolio. They have expertise in that. They also have 1,450 patents pending or issued, including 700 on this. The bottom line on that is it does matter. It is a licensing company, but it does matter to them that they don't want other people infringing their product and selling it throughout the United States. If they have the domestic industry and they have met that burden, it is unfair. This is their property. They don't want other people to do it. If it gives them an advantage that someone else can't take their property and import it into the United States, then so be it. That is okay, and this is me testifying in my personal opinion. It is property.

So I think it serves an important purpose. Federal courts are looking at damages. This is about the property itself. Should you allow infringing property to come into the United States? I think there is a lot of talk about if it is the right valuing. It makes a lot of sense to talk about is it really a domestic industry if people are going to cause those kinds of fees and it is not a domestic industry for a licensing company. But the idea that you are automatically not a domestic industry to me doesn't make a lot of sense. So I think it adds value, yes.

Ms. JACKSON LEE. I am going to expound on the question and ask the rest of you the same question. I will go to Mr. Binns. Is there any problem to grow the domestic industry with a definitive

product that now appears to be under predatory attack and not use the ITC?

Mr. BINNS. If you are making a product and selling a product in the U.S. that is clearly a domestic industry, that should entitle you to the ITC.

Ms. JACKSON LEE. And you would define that as what? Coca-Cola?

Mr. BINNS. It would be any type of operating company that is selling product in the U.S. It would be like my company, Avaya. We sell telecommunications products in the United States. 3M sells many products here in the United States.

Ms. JACKSON LEE. So you are not making the argument that the technology is unique to the United States?

Mr. BINNS. No, not unique, but you have to be selling that product in the United States in order to take advantage of the domestic industry standard for access to the ITC.

Ms. JACKSON LEE. No, and I understand that. Do you think that is valuable? That is what I am asking. Do you think that is a valuable tool that is necessary?

Mr. BINNS. I think the ITC does serve a function. I would not say that you should get rid of the ITC by any means. The ITC definitely does serve a legitimate function.

Ms. JACKSON LEE. I am going to go down to Ms. Okun, and I am going to keep going down as long as I can. Did I pronounce it right? Is it Okun?

Ms. OKUN. Thank you for the question.

Ms. JACKSON LEE. Did I get the pronunciation? I never want to be on the record incorrectly.

Ms. OKUN. Okun.

Ms. JACKSON LEE. Okun. All right. Thank you.

Ms. OKUN. Thank you. Well, certainly, having served on the Commission for 12 years, I think you would expect me to say the Commission serves a valuable role. But the Commission is a creature of Congress. Congress created the ITC, gave it specific rules, and I think the thing to keep in mind with the statute, it is a trade statute. We are talking about the pervasive problem of infringing imports. The ITC is just one tool. There are other tools out there. But I think that is what I hope the Committee can keep in mind. The Commission plays a valuable role. Because of the problem of pervasive infringement of U.S. IPR, we need every tool at our disposal, and the ITC is one tool.

Ms. JACKSON LEE. Professor Chien, you look like you wanted to say something, and I am trying to get in before this red light to get Mr. Foster and Mr. Rhodes. Go ahead, Professor. Thank you.

Ms. CHIEN. I was going to say just about the point of the problem of foreign imports, I think that is an important problem, but I think we need to remember that the ITC now, the patent holders can be foreign. We have, for example, as I mentioned before, a Swiss-backed PAE suing American car companies for their importation, because a lot of things are made abroad. So the distinctions between us and them I think are getting blurry.

I do think the ITC plays an important role. It has a very special remedy, and it is appropriate to be applied in certain cases. But

where the entity is only seeking licensing revenues, I don't think the ITC, it is a good use of their time to be litigating that dispute.

Ms. JACKSON LEE. Mr. Chairman, can Mr. Foster and Mr. Rhodes answer?

Mr. COBLE. Yes, go ahead.

Ms. JACKSON LEE. Mr. Foster? Professor Chien added a little twist to it.

Mr. FOSTER. I thought it was another question.

Ms. JACKSON LEE. Oh, no, no. I am not, I am not. I am just repeating Professor Chien, it is getting blurry. Mr. Foster?

Mr. FOSTER. I am sorry. Yes, I think the ITC does serve a valuable role in helping enforce patents, and I think the evidence is companies, whether they are NPEs or not, are voting with their feet. They are coming to the ITC because they perceive that the speed in which they can get relief, the quality of the judges at the ITC and their ability to comprehend very complex technology, and the remedy that is available is a very valuable tool for them. They have a choice to go to the district court, but they choose the ITC even though potentially it is a more expensive forum. So that, to my mind, is very stark evidence that it serves a very valuable role.

Ms. JACKSON LEE. Mr. Rhodes? Thank you.

Mr. RHODES. I would echo what Mr. Foster said. I think it is not right for every case, but in the case where we are facing infringement by unfair trade practices by virtue of the importation of infringing devices, it is a very important forum to be able to have that option to enforce our IP. But it goes beyond just when we have a product we have already developed and marketed. I mean, this is about protecting innovation. It may be that we are still in the R&D stage. We had a case with our lithium-ion battery where we didn't have much of a product yet, but we were worried that the whole market would be destroyed by these infringing imports before we could actually develop it. We only had a pilot line. We had done the research, but we hadn't really started marketing.

So what we are trying to protect here is innovation, not just products. That innovation may just be at that point in the form of R&D, or we may have exploited it via licensing rather than direct sales, and protecting that licensing revenue that can then go into further R&D to make further innovations is one of the points that I wanted to make. That is important for the ITC to protect as well.

Ms. JACKSON LEE. I thank the Ranking Member and the Chairman. I yield back. Thank you. Thank the witnesses.

Mr. COBLE. I thank the gentlelady.

The gentleman from North Carolina, Mr. Watt.

Mr. WATT. Thank you, Mr. Chairman. I just wanted to ask a few clarifying questions. I think most everybody has covered most of the points.

Let me be clear, Mr. Binns, on what standard would you apply in the ITC to get jurisdiction.

Mr. BINNS. Yes, I would think that you have to apply the domestic industry, and you have to do it early, as ITC is attempting to do in one particular case. We would like to see that become more standard and have those assessments upfront.

Mr. WATT. I guess my question is would you say that a PAE cannot come to the ITC?

Mr. BINNS. No, we would not characterize——

Mr. WATT. Okay. Well, how would you apply the standard to them?

Mr. BINNS. The way I would apply it is that you have to look at whoever the entity is that is taking advantage of the ITC, what is it that they are seeking, and you have to look at the behavior. Are they seeking just money damages to fund their licensing model of being a purely litigation company, or are they seeking to legitimately protect a market by having products excluded? That determination should be done upfront, and that should be done as a standing assessment before the ITC gets into a full-blown investigation.

Mr. WATT. What do you say to that, Mr. Rhodes?

Mr. RHODES. I do not think that legislation should change the 1988 amendments that expanded ITC jurisdiction under domestic industry to include licensing. I think licensing is a way to exploit American innovation that we need to preserve and encourage, and I think the ITC has looked in that 2011 case that has been referenced a couple of times, really does put rigor around is the licensing tied to the patent we are talking about. Does it really represent substantial licensing, and is it taking place in the United States in terms of the revenue generation?

I think with those important safeguards, that is the standard that ought to continue.

Mr. WATT. What do you say to that, Mr. Binns?

Mr. BINNS. Well, there are several problems there. What we have seen recently is that——

Mr. WATT. There seem to be problems on all sides here.

Mr. BINNS. Yes, there are problems on all sides.

Mr. WATT. But you are not saying that you would exclude all licensees if they are not the actual owners?

Mr. BINNS. Not all licensors, but——

Mr. WATT. Okay. How would you draw that distinction, then?

Mr. BINNS. Because there is production-driven licensing, and there is revenue-based licensing. Production-driven licensing is the licensing where you have technology, you have invented something, you want other people to adopt it, incorporate it into their products and bring it to market. That is production-driven licensing.

Revenue-driven licensing is where what you have actually invented isn't actually being used by anybody, but you interpret your claims broadly to try to cover an industry that has already matured and grown up and is making and selling many products in the U.S., and then trying to seek revenue from that. You are not promoting innovation. The U.S. Supreme Court in eBay found that excluding products automatically is not necessarily promoting the useful arts.

Mr. WATT. Ms. Okun, I thought the ITC had already addressed this. I thought you testified that the ITC has already addressed this. Have they not?

Ms. OKUN. Could you repeat which part?

Mr. WATT. The revenue part.

Ms. OKUN. Okay, thank you. The case law, what the case law in interpreting the statute has said—and again, it is very fact specific. So there are cases saying the Commission has given more weight

to production-driven licensing then revenue-driven licensing. The litigation expenses alone are not enough, the mere ownership of the patent is not enough. So the Commission is looking for a very strong nexus between the licensing activity and the patents.

Mr. WATT. So you don't think that they have gone far enough, Mr. Binns?

Mr. BINNS. They have not gone far enough.

Mr. WATT. Mr. Rhodes?

Mr. RHODES. Well, I echo what former Commissioner Okun said. I think they are looking very carefully at very fact-specific questions, putting the appropriate weight. It is in the eye of the beholder, too. One person's production-driven is another person's revenue-generating. So I think it is probably not the stuff of which legislative fixes are as appropriate as case-by-case development. I think the ITC is sensitive. They are engaged. They are looking into this issue, and I think they are moving in the right direction.

Mr. WATT. What do you say to that, Professor?

Ms. CHIEN. I think they are engaged and they are evolving their practices in many of the ways people have talked about. I think the question becomes does Congress need to help them if they feel that they don't have the authority within the statute to change the practices. Just again, by design, the ITC is a completely different remedy and procedure than district court. Do we want to have two forums, 90 percent overlap? Is that something that we want to encourage in our system?

Mr. WATT. Thank you, Mr. Chairman. I yield back.

Mr. COBLE. Thank you, Mr. Watt.

Prior to adjournment, does anyone have any closing statements to make?

Very well. I want to thank not only the panelists but those in the audience who survived the ordeal as well. I appreciate you being with us.

I don't mean that literally. It was not an ordeal.

But today's hearing is concluded. Thanks to all for attending.

Without objection, all Members will have 5 legislative days to submit additional written questions for the witnesses or additional materials for the record.

This hearing stands adjourned.

[Whereupon, at 4:21 p.m., the Subcommittee was adjourned.]

APPENDIX

MATERIAL SUBMITTED FOR THE HEARING RECORD

Statement of the

National Retail Federation

and

Shop.org

submitted to the

United States House of Representatives
Committee on Judiciary
Subcommittee on Courts, Intellectual Property and the Internet

for its hearing on

"Abusive Patent Litigation: The Issues Impacting American Competitiveness and Job Creation at the International Trade Commission and Beyond"

held on

Tuesday, April 16, 2013

David French
Senior Vice President,
Government Relations

On behalf of:

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Chairman Coble, Ranking Member Watt and members of the House Judiciary Subcommittee on Courts, Intellectual Property, and the Internet, on behalf of the National Retail Federation (NRF) and its division Shop.org, I appreciate the opportunity to submit this written statement to the Committee in connection with its hearing entitled "Abusive Patent Litigation: The Issues Impacting American Competitiveness and Job Creation at the International Trade Commission and Beyond" held on April 16, 2013.

As the world's largest retail trade association and the voice of retail worldwide, NRF represents retailers of all types and sizes, including chain restaurants and industry partners, from the United States and more than 45 countries abroad. Retailers operate more than 3.6 million U.S. establishments that support one in four U.S. jobs – 42 million working Americans. Contributing $2.5 trillion to annual GDP, retail is a daily barometer for the nation's economy. Retailers create opportunities for life-long careers, strengthen communities at home and abroad, and play a leading role in driving innovation. Learn more at www.nrf.com.

Comments

Members of the National Retail Federation appreciate the attention the Committee is paying to the issue of abusive patent litigation and the harmful effect on competitiveness and innovation. Many retailers are using capital resources to settle with or fight patent trolls' infringement claims that they would otherwise use to invest in their businesses, including jobs, innovation and refurbishment of their stores.

Retail, at its core, is a highly competitive industry, and many retailers are using innovative technology creatively to expand and grow their businesses. Patent trolls, who are not investing in technological innovation or providing jobs, employ tactics that cut at the heart of this growth and ingenuity.

In recent years, over 200 retailers have contacted NRF about this issue because they have been, or are currently, the target of patent trolls' abusive litigation practices. The threat typically comes from firms whose business model is buying obscure patents which are about to expire and then either licensing the patents to retailers through the threat of litigation or filing lawsuits in an effort to force a settlement. Often retailers will choose to pay the licensing fee because patent litigation is prohibitively expensive.

Patent trolls sued more non-tech companies than tech companies in 2012.[1] Patent trolls employ a strategy that focuses on end-users such as retailers because end-users are more numerous. One manufacturer or vendor may supply a product or service to thousands of retail end-users. Thus, there are many more entities from which to demand a royalty. The end-user retailers are also easy prey because they lack the legal resources and in-house expertise to fight complex patent infringement claims. Compared to high tech companies, retailers typically operate on thin profit margins. Patent trolls, knowing that retailers lack technical expertise, retail stores operate on thin margins, and patent litigation is exorbitantly expensive, will often price a settlement demand (which may still be in the millions) below the cost of litigating, effectively blackmailing a retailer into settlement. This is an abuse of the system.

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[1] Colleen Chien, "Patent Trolls by the Numbers," Patently-O, March 14, 2013. http://www.patentlyo.com/patent/2013/03/chien-patent-trolls.html

Patent trolls assert infringement claims covering the use of technology in all areas of e-commerce and mobile retailing because their claims are based on broad concepts and a general way of doing something rather than specific software innovations. This approach is especially damaging to retailers, who are embracing new technology and groundbreaking innovation to better serve their customers.

For example, MacroSolve Inc. has filed numerous suits related to violating U.S. Patent No. 7,822,816, which is a method patent covering the process that many businesses have used to develop their mobile apps. They have sued technology companies, service providers and end-users, including retailers. Over half of the defendants have settled, and the details have not been released. MacroSolve claims their patent covers thousands of apps as well as those yet to be developed.[2] This is of great concern to the retail community, who increasingly rely on mobile apps as part of their omnichannel presence in the marketplace.

Trolls' claims not only affect e-commerce applications but also affect the operations of traditional "brick and mortar" retail stores. Some examples of the latter are claims that purport to cover the printing of receipts at cash registers, the sale of gift cards, and the connection of any product such as a computer or printer to an Ethernet network.

These cases rarely go to trial because the damages claims are so exorbitant, and the prospect of relief through litigation so time-consuming, that retailers make a business decision to settle, rather than litigate. It has been reported that trolls lose 92 percent of cases that do go to trial, but, as noted, it is infrequent that a defendant has the fortitude to litigate. Smaller retailers may find themselves particularly ill-equipped legally or financially to defend themselves from abusive claims, and dealing with these claims certainly inhibits their ability to innovate and grow.

The exorbitant costs associated with seeing a court case through to final adjudication are startling for retailers, especially small businesses. We have heard from our members that they spend as much as one million dollars or more annually on patent troll-related expenses and settlement agreements. These expenditures and the employee hours diverted to fighting patent trolls are precious capital resources that retailers would rather reinvest in their businesses.

The recent case of *Soverain v. Newegg* demonstrates the many costly steps involved in litigating a patent case and the enormous economic impact that just one patent troll can wreak on an industry. Beginning in 2004 and continuing up through 2012, Soverain has filed numerous suits against dozens of retailers alleging that the basic check-out technology used by nearly all websites infringe its patents[3]. One large retailer is reported to have settled the first suit for $40 million because of the fear of jury verdicts in that era in the Eastern District of Texas. Numerous

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[2] Robert Evatt, "MacroSolve adds Wal-mart to list of patent lawsuits," Tulsa World, February 8, 2012. http://www.tulsaworld.com/site/printerfriendlystory.aspx?articleid=20120208_52_E1_Jsasat255194&PrintComments=1

[3] Joe Mullin, "How Newegg Crushed the "Shopping Cart" Patent Troll and Saved Online Retail" ArtsTechnica.com, January 27, 2013. http://arstechnica.com/tech-policy/2013/01/how-newegg-crushed-the-shopping-cart-patent-and-saved-online-retail/

other settlement amounts are unreported, but in a subsequent suit, an Eastern District of Texas jury awarded damages of almost $18 million against two other national brands.

In 2007 Soverain sued Newegg, which decided to fight back. The case went to trial three years later in April of 2010 and resulted in a judgment of $2.5 million against Newegg. But Newegg decided to appeal to the Federal Circuit, and on January 14, 2013, more than five years after the suit against it was first instituted, it obtained a judgment in its favor, reversing the lower court judgment and declaring the patents invalid due to obviousness. Although Newegg has won, it took more than five years and millions of dollars in attorneys' fees. And the saga is not over yet because Soverain still has pending before the Federal Circuit a petition for re-hearing of the case *en banc* by the full court, as opposed to the panel of three judges that rendered the current decision.

The Newegg case is just one example of the broad infringement claims trolls are asserting against retailers. There are over one million software patents in the United States. Many software patents contain broad concepts dealing with Internet functionality and have extraordinarily vague claims.

Troll cases in federal district court have resulted in the waste of extensive judicial and party resources. NRF is concerned that, fueled by the *eBay* decision and certain portions of the America Invents Act (AIA) of 2011, these abuses will simply be replicated in short order at the ITC.[4] Accordingly, NRF believes that preventative steps should be taken so that this does not occur.

NRF is engaged in discussions with Members of the Committee and Congress to address the abusive litigation practices patent trolls utilize. Retailers support the Saving High Tech Inventors from Egregious Legal Disputes (SHIELD) Act. By requiring the patent troll to pay the defendant's attorneys fees and costs, the SHIELD Act would help deter frivolous litigation.

The AIA, which the President signed into law in September 2011, established a Patent and Trademark Reserve Fund. The United States Patent and Trademark Office (USPTO) is required to deposit all patent and trademark fees collected in excess of the annual appropriation amount into the fund. The provision also provides for authorization to spend all fees deposited in this fund in the USPTO's annual appropriations. The AIA also establishes a provision requiring patent fees to be used only for patent operations, including a share of administrative expenses.[5]

Despite these significant changes to the funding structure of USPTO to alleviate the backlog it faced, we feel USPTO needs more funding so they are able to review patents more thoroughly and expeditiously. Providing the USPTO more resources will reduce the backlog of examinations, produce better quality patents, and help retailers, technology firms and other defendants fight back against patent trolls' broad and baseless claims.

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[4] *eBay Inc. v. MercExchange, L.L.C.*, 547 U.S. 388 (2006).
[5] USPTO.gov

Retailers are also considering a legislative proposal which would limit the scope of discovery requests in patent litigation to "core documents" to help drive down the excessive costs associated with patent trolls' current model of abusive and endless discovery requests. These abusive discovery requests are another expensive tactic used by trolls to drive up the costs of litigation in order to compel retailers into early settlements.

While the proposals are laudable, retailers are also interested in finding a solution that provides immunity from patent trolls altogether. As we stated earlier, patent trolls target retailers and other end-users because they are numerous and are easy prey. But as end-users of much of the technology being disputed broadly and vaguely, they should not be the principal targets of these far-reaching lawsuits.

Conclusion

By papering retailers with broad and vague demand letters and filing an endless series of lawsuits against retail end-users alleging the same patent infringement claims alleged against manufacturers and service providers of a particular device or technology, patent trolls are able to cast a very wide net that hauls in a lucrative catch. They have proven that many of the companies they target will settle given the extraordinarily high demands they make and the costs those companies know it will take to fight even the most frivolous of alleged claims. Addressing this abusive and growing patent litigation problem will help release retailers from the controlling grip on their industry that patent trolls currently enjoy. Because the retail industry contributes $2.5 trillion to our nation's annual GDP, removing or even loosening this grip on retailers will allow innovation and growth to flourish, and undoubtedly benefit the overall U.S. economy.

NRF thanks the Committee for their extensive examination of the impact of abusive patent litigation and is happy to work with Members of the Committee to find effective solutions to curb abusive patent litigation.

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