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**IMPLICATIONS OF PATENT REFORM: WHO WINS, WHO LOSES?  
A STEPTOE AND JOHNSON LLP TELECONFERENCE SEMINAR**

**EXECUTIVE SUMMARY AND UPDATE FROM THE JUNE 28, 2005 TELECONFERENCE**

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**INTRODUCTION**

Under consideration now by Congress are the most sweeping reforms in United States patent law since the 1952 Patent Act. Introduced in the House of Representatives on June 8, 2005, the pending legislation proposes in part to:

- (1) transform the U.S. patent system from the present “first to invent” system to a “first to file” race to the Patent Office;
- (2) create a multi-tiered, post-grant, opposition system in which Administrative Law Judges at the Patent Office would consider validity challenges throughout the life of a patent;
- (3) limit the circumstances in which willful infringement may be found; and
- (4) limit a patentee’s access to injunctions by requiring a likelihood of irreparable harm.

The patent reform movement has gained considerable momentum this year and it has become increasingly important for members of the bar and industry to understand the current political process and the implications of the proposed revisions to patent law.

**THE POLITICAL PROCESS**

***Current leadership in the reform movement.*** Reform has particularly been the goal of the computer and information technologies industries, as well as the financial services industry, who see a particular threat from the so-called “patent troll” – the holding company or patentee with no actual product, but simply a patent deed and thus a license to sue and disrupt business. The software and computer industries feel particularly vulnerable because their individual products such as computer networking systems are potentially subject to hundreds of patents at any given time. The financial services industry is concerned about the surge in recent years in business method patent applications related to their industry.

The Business Software Alliance, including Microsoft, Dell, Hewlett-Packard, Intel, and IBM, claims that its member companies are subject to 200 suits at any given time, and has strongly supported patent reform legislation. Litigation costs and substantial damages awards have been two of the main issues in the background driving the patent reform movement. The concerns of

the reform lobby also focus on a perceived lack of patent quality and a lack of control and fairness in a system that is perceived to promote patent trolls.

The computer and financial services industries have been particularly well represented in recent hearings, while the biotechnology and life science sectors have been less represented and the non-computer, manufacturing sectors have been largely unrepresented. To date, the “small entity” lobby has not been particularly effective in current patent reform discussions, although several groups including the Professional Inventors Alliance USA and National Association of Patent Practitioners have taken positions against some of the proposed reform.

It is clear that lines have been drawn in the reform movement pitting the interests of the computer and software industry against the interests of the pharmaceutical industry.

***Legislative activity in the House of Representatives.*** H.R. 2795, the “Patent Reform Act of 2005” was introduced in the 109th Congress on June 8, 2005. The bill was introduced in the Subcommittee on Courts, the Internet, and Intellectual Property by the subcommittee chairman, Representative Lamar S. Smith, a Republican Congressman from the 21st Congressional District in Texas. His district includes Austin and San Antonio whose major private sector employers include Dell, Freescale Semiconductor (formerly Motorola’s semiconductor sector), IBM, SBC Communications, JP Morgan Chase Bank, and Citicorp.

H.R. 2795 currently has nine bipartisan cosponsors, including 5 Democrats. The cosponsors include four Congressmen from California, two from Virginia, the ranking committee Democrat from Michigan, and one each from North Carolina and Utah: Rep. John Conyers (D-MI-14), Rep. Howard L. Berman (D-CA-28), Rep. Adam B. Schiff (D-CA-29), Rep. Darrell E. Issa (R-CA-49), Rep. Zoe Lofgren (D-CA-16), Rep. Rick Boucher (D-VA-9), Rep. Bob Goodlatte (R-VA-6), Rep. Howard Coble (R-NC-6), and Rep. Chris Cannon (R-UT-3). The pending legislation also has attracted support from a coalition of centrist House democrats from the states of Washington, California, Virginia, Florida, New York, Illinois, Connecticut, Wisconsin, Kentucky.

H.R. 2795 includes provisions previously sought by Reps. Berman and Boucher in a bill introduced during the 108th Congress.

The House Subcommittee held hearings twice in April of this year and again in June when the legislation first was introduced. Testimony has been received from, or on behalf of the Business Software Alliance (BSA), the Financial Services Roundtable, BITS (a nonprofit representing 100 of the largest financial institutions in the United States), the Intellectual Property Owners Association (IPO), the American Intellectual Property Law Association (AIPLA), the American Bar Association (ABA), Genentech, and the U.S. Patent and Trademark Office. Additional testimony has been received from the co-chair of The National Academies panel reviewing patent reform as well as the “small entity,” university, and public interest sectors.

As of the date of this Executive Summary, Subcommittee mark-up of H.R. 2795 has not been scheduled for HR 2795. After mark-up by the Subcommittee, the legislation would be

considered by the full House Committee on the Judiciary for further markup, and then by the full House of Representatives for debate and amendment.

***Legislative activity in the Senate.*** The Subcommittee on Intellectual Property of the Committee on the Judiciary held a hearing on June 14, 2005 on “Patent Law Reform: Injunctions and Damages.” Testimony was received from, or on behalf of Visa and the Financial Services Roundtable, Time Warner, the IPO, the university sector, the life sciences and biotechnology sector, and the university sector. Further testimony was received on July 26, 2005 concerning “Perspective on Patents: Harmonization and Other Matters.” Testimony was received from, or on behalf of General Electric, Microsoft, Barr Laboratories, Amgen, the Association of American Universities, the American Council on Education, the Association of American Medical Colleges, and the Council on Governmental Relations; testimony was also given by a former Commissioner of Patents and Trademarks.

As of the date of this Executive Summary, the Senate has not introduced a companion to H.R. 2795. The Senate now has to make a tactical decision whether to introduce its own bill or wait for H.R. 2795 to first progress through the House.

Congress is scheduled for a recess on August 1 and reconvenes in early September.

## **MAJOR PROVISIONS OF H.R. 2795**

***First to file.*** Under the proposed revisions to the Patent Statute, 35 U.S.C. §§ 100, 102 and other sections relating to interferences, the current system would be transformed from a “first to invent” to a “first to file” system.

### Pros

1. international patent law harmonization, long the topic of interest in foreign negotiations, would be advanced;
2. U.S. patentees already are operating *de facto* in a first to file system if foreign counterpart patent applications are to be filed because of the first to file requirements of foreign countries;
3. early filing of patent applications would be encouraged in such a system thus promoting early disclosure of inventions and potentially faster commercialization of products;
4. the uncertainty inherent to the current interference practice largely would be eliminated in favor of a rapid and highly predictable manner for determining priority for a patent; and
5. applicants would be encouraged to file applications electronically to obtain the earliest possible filing date because electronic filings are permitted 7 days per week including weekends and holidays.

### Cons

1. corporate legal departments will be pressured by a system that favors rapid disclosure and processing of invention disclosures as well as quick decision-making about

- whether to pursue patent protection without complete information on commercialization potential;
2. substantial cost increases may be realized in patent prosecution activities because (a) the system will become a pure “race to the mailbox” to obtain a filing date, (b) there may be a major increase in the number of patent applications filed not only for individual design iterations but also for defensive purposes, and (c) legal fees may increase as firms guard against potential malpractice associated with the complete loss of rights that would result from filing an application just one day “late”;
  3. the limited legal and financial resources of small entities might place them at a substantial disadvantage in a system involving a race to obtain a filing date, and thus these patentees might be discouraged from filing at all;
  4. time pressures may result in a decrease in the quality of patent disclosures which in turn would degrade the quality of the technical knowledgebase made available to the public through the patent system; and
  5. applicants who do not file applications electronically would be disadvantaged because electronic filings are permitted 7 days per week including weekends and holidays.

***Post-grant oppositions.*** During a so-called “first window” opposition period, third parties would be permitted to challenge the validity of an issued patent within nine months following issuance. A “second window” would allow an opposition proceeding to be commenced not later than six months after a notice is received from a patent holder alleging infringement. The proceeding would be commenced before a panel of three administrative law judges, with appeals permitted to the Court of Appeals for the Federal Circuit. The standard of proof to invalidate a claim in an opposition proceeding would be “preponderance of the evidence,” rather than “clear and convincing” as employed in federal court litigation. The opposer would be able to rely not only on patents and printed publications but also on factual evidence or expert opinions through affidavits or declarations. Furthermore, limited depositions would be permitted, and certain estoppel would arise with respect to assertions in future litigations.

#### Pros

1. oppositions would presumably be much less expensive than federal district court litigation;
2. opposition-type proceedings are presently favored by industries that perceive themselves as most susceptible to patent trolls because (a) they provide a means for attacking claims with the lower “preponderance of the evidence” standard and (b) the validity determination would be made by administrative law judges rather than a patent examiner;
3. invalidity arguments would not be limited to patents and printed publications as in reexamination proceedings; and
4. limited discovery would be permitted so that affiants or declarants could be further interrogated.

#### Cons

1. oppositions would be litigation-oriented, with discovery and estoppels, and thus still would be reasonably expensive for example as compared to *ex parte* reexamination;

2. oppositions might not be widely accepted as a legal strategy for high-stakes subject matter; historically, parties have been quite hesitant to initiate proceedings in the Patent Office to review the validity of patent claims, strongly favoring the federal court route with a jury and federal judge for considering “promising” prior art;
3. “second window” oppositions are presently disfavored by industries that place high value on small numbers of patents, e.g., the pharmaceutical industry, because of the perceived need to avoid the creation of clouds on patent validity by the Patent Office as compared to a federal district court;
4. patentees might be discouraged from sending warning letters and resolving matters prior to filing a complaint for patent infringement; fear of provoking an opposition may lead patentees straight to court; and
5. the proceeding is litigation-oriented.

***Willful infringement.*** The current bill substantially curtails a patentee’s ability to allege willful infringement. In particular, H.R. 2795 does not permit a patentee to plead that an infringer has willfully infringed a patent unless a court has first determined that the patent in suit is not invalid, is enforceable, and has been infringed. Moreover, the standard for finding willful infringement would be tightened. And according to the legislation, “reasonable reliance on advice of counsel” is sufficient to defeat a willfulness charge.

#### Pros

1. courts have been loathe to bifurcate liability and damages, but under the new proposal opinions of counsel likely would no longer be subject to discovery prior to a finding of infringement; and
2. the current practice of nearly always alleging willful infringement upon filing a complaint would cease and from the outset the parties will concentrate on infringement and validity issues.

#### Cons

1. discovery on willfulness will be delayed, effectively requiring bifurcation of liability and damages and potentially increasing litigation costs; and
2. by tightening the standard for willful infringement and delaying the time for pleading such a charge, there may be less incentive to settle because from the outset of the trial the “stakes” may appear far smaller to the defendant.

***Injunctions.*** Amendments to Section 283 of the Patent Statute are proposed to decrease the likelihood that an injunction be imposed. In particular, the proposed legislation would require: In determining equity, the court shall consider the fairness of the remedy in light of all the facts and the relevant interests of the parties associated with the invention. Unless the injunction is entered pursuant to a nonappealable judgment of infringement, a court shall stay the injunction pending an appeal upon an affirmative showing that the stay would not result in irreparable harm to the owner of the patent and that the balance of hardships from the stay does not favor the owner of the patent.

This is one of the most controversial sections of H.R. 2795 and most likely to see revision.

***Duty of candor.*** Major new rules are proposed to limit the manner in which allegations of inequitable conduct are handled. In particular, a complex process has been proposed in which all allegations of inequitable conduct would be referred to the Patent Office instead of being handled by a federal court. Patent unenforceability could only be pled by motion to amend a pleading and only if the court has entered a judgment invalidating at least one claim. This provision has received little scrutiny to date, but has major implications for the manner in which patent disputes are litigated. Although the proposed legislation presumably would decrease the focus of the discovery process on vetting out instances of inequitable conduct during patent prosecution, lost would be the ability to place this issue before a jury.

***Best mode.*** H.R. 2795 proposes to eliminate the best mode requirement from U.S. patent law. Presumably, this would allow expedited filing of patent applications but at the expense of less information being disclosed by patentees to the public. This provision also has received little scrutiny to date.

## **CONCLUSION**

The radical changes to United States patent practice contemplated by the first public draft of H.R. 2795 have substantial implications for all who rely on the patent system to protect innovation. Congress continues to debate the merits of these proposed reforms under heavy pressure from the pro-reform lobby. It appears that patent reform legislation will not pass both the House and Senate quickly, but the momentum may increase considerably when Congress returns from recess in September 2005.