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Patent Transparency And Improvement Act Vs. Innovation Act

Law360, New York (January 03, 2014, 12:05 PM ET) -- On Nov. 16, 2013, Sens. Patrick Leahy, D-Vt., and Mike Lee, R-Utah, introduced the latest of a recent series of bills aimed at curtailing patent infringement lawsuits filed by nonpracticing entities, more commonly referred to as "patent trolls." The bill, S.1720 "Patent Transparency and Improvement Act," presents something of a "kitchen sink" approach, throwing out a series of smaller ideas aimed at addressing problems caused by NPEs without significantly increasing the burden on good-faith plaintiffs for recovery; the sections on transparency and customer stay, in particular, seem to be the most realizable and would be at least marginally beneficial to accused infringers.

The Patent Transparency and Improvement Act is less aggressive than the H.R.3309 "Innovation Act," recently passed by the House and currently also before the Senate, which includes provisions for loser-pays, discovery limit, and heightened pleading requirements. The Senate may consider the Patent Transparency and Improvement Act as a counterweight to the more extreme Innovation Act and as an example of reform that does not so drastically change the way all patent infringement lawsuits are conducted. It is less clear, however, whether the Patent Transparency and Improvement Act will be considered as having enough "teeth" to combat real or perceived problems with NPE suits.

The various provisions of the two bills may be broadly classified as belonging to two different categories: a first, narrower set of provisions that targets behavior common to NPEs but would have little or no effect on other patent-infringement suits and a second, broader set of provisions that would potentially affect all patent-infringement suits, regardless of the filer. The Senate will likely take a very hard look at the measures in the second category, which are largely exclusive to the Innovation Act. This article will discuss the measures of each category in turn.

NPE-Specific Provisions

A prominent measure of the first category, versions of which appear in both bills, attempts to address the recent trend in the setting up of shell corporations and entities by plaintiffs; ownership of a parent company's patents are transferred to the shell, and the patent infringement suit is then filed by the shell instead of the parent. Because the shell owns little more than just the patents, this arrangement protects the parent from a counterclaim of infringement of the defendant's patents. For example, if one tech giant directly sued another for patent infringement, the defendant would likely counter-sue the plaintiff for infringement of its own massive patent portfolio. By setting up a shell entity and launching the suit therefrom, a plaintiff hobbles the defendant's ability to counter-sue.

Both bills launch a first salvo against this sort of behavior by requiring transparency of patent ownership. The bills first require that a transfer of ownership of a patent must be

made public to prevent secret transfers (from, for example, a parent entity to a shell entity). The bills further require certain disclosures during an infringement suit: a plaintiff must disclose any party that has a "financial interest" in the patents and the "ultimate parent entity" of any current owner. The Innovation Act more thoroughly defines what is meant by these terms and what sorts of entities fall under their umbrella; the Patent Transparency and Improvement Act is more vague, perhaps opening the door to loopholes in what constitutes a "financial interest."

By knowing who is ultimately behind the filing of an infringement suit, a defendant would be in a better position to defend itself. Defendants often have to spend a considerable amount of time and money to track down the "real" entity behind a suit. The transparency provisions in these bills would eliminate this extra expense, allowing defendants to focus their efforts on other aspects of their defenses. Neither bill, however, requires anything further than mere disclosure; defendants are on their own if they want to file a countersuit against the parent entity and join that countersuit with the first suit.

A second NPE-specific measure, which again appears in both bills, attempts to protect customers from alleged infringing use of a purchased product and shift some or all of the burden of defense to the source of the product (e.g., the supplier or manufacturer). Currently, an NPE may target a great number of businesses (for example) with multiple suits alleging infringement for use of the same product, instead of going after the source of the product in a single suit; the NPE hopes that their ultimate payoff will be greater because each business will settle for a modest amount rather than attempt to fight the suit.

The two bills, therefore, would allow a "customer" to move to stay an action alleging patent infringement if a "manufacturer" has also been sued for infringement (either on the same patent or on the same product). The manufacturer would then be on the hook for running the litigation. The manufacturer, however, must agree to the stay. If this section (or something like it) becomes law, it would, in the best case, provide a certain level of default indemnification to customers and shift a portion of patent-infringement defense to manufacturers/suppliers. This provision seems to contemplate "customers" as individual persons, but it would apply equally to corporate customers (or other entities). The option of the manufacturer to simply opt out of the stay may, however, mean that this section will ultimately not have much "teeth."

A final NPE-specific measure appears only in the Patent Transparency and Improvement Act. A provision therein attempts to limit the sending of bad-faith "demand letters," in which an NPE (or other entity) threatens the filing of an infringement lawsuit but has no factual basis for doing so. The provision sets quite a low bar, however: a demand letter (1) must not "falsely threaten" litigation, (2) must have a "reasonable basis in fact or law," and (3) must not "materially mislead a reasonable recipient."

This section would, hopefully, deter a certain number of patent owners from sending frivolous demand letters in the first place. And if these sorts of demand letters are indeed sent, the section sets up the Federal Trade Commission to enforce this section; such enforcement would, hopefully, come at less of a cost than traditional methods of enforcement (e.g., a lawsuit).

Broader Provisions

The second category of provisions, as mentioned above, are much broader and more aggressive than the narrower, targeted provisions discussed above. These broad provisions are exclusive to the House-passed Innovation Act.

The first of these provisions changes how patent-infringement suits are filed. Currently,

like all suits, a complaint filed for patent infringement need do little more than name the defendant. The Innovation Act raises this standard by requiring that a plaintiff set out specifically which claims are allegedly infringed and identify the alleged infringing activity or systems of the defendant (down to the make and model numbers of alleged infringing products). If this information is not readily available to the plaintiff, the complaint must explain why.

The Innovation Act thus attempts to target NPEs that file infringement suits before doing their homework to determine whether they have a good-faith belief that infringement is, in fact, occurring. The heightened pleading requirements would also give defendants a better idea of their exposure earlier in the process. On the other hand, however, this new standard for pleading could be said to run against the spirit of the US judicial system, which allows a plaintiff to develop its case during discovery, especially when the evidence needed resides solely in the internal documents of the defendant. One might imagine a sole inventor or small business that lacks the funds or information to meet the new pleading standard and that would be denied relief if, for example, its intellectual property were stolen by a larger, more sophisticated entity.

The potentially over-reaching effects of the higher pleading requirement may be amplified by another provision of the Innovation Act that limits the discovery processes available to a plaintiff. The discovery process can be very expensive for a defendant, and an NPE might threaten extensive discovery to force an earlier settlement (and a higher price for that settlement). The Innovation Act attempts to ease the discovery burden on defendants by limiting discovery to only that which is required to interpret the asserted claims and thus preventing "fishing expeditions." Again, however, this limitation on discovery could also harm good-faith, non-NPE plaintiffs who simply do not have access to enough information to prove infringement and rely on the discovery process to provide that proof.

A final provision of the Innovation Act is perhaps the largest change to U.S. jurisprudence and the most controversial part of the act. This provision requires that, by default, the loser of any patent-infringement suit pay the "reasonable fees" incurred by the winner. Such "loser-pays" systems are common overseas but are unusual in the US, where the potential benefit of preventing frivolous suits is deemed less important than deterring legitimate, good-faith plaintiffs from seeking a legal remedy. Again, while switching to loser-pays would very likely reduce the number of "patent troll" suits filed, it may also reduce the number of other patent-infringement suits filed, particularly in cases involving a small, unsophisticated plaintiff and a large, well-funded defendant.

Conclusion

Members of the Senate have already expressed misgivings about the Innovation Act's potential to deprive patent owners access to the courts and have called for further study and debate of the Innovation Act and of the Patent Transparency and Improvement Act. Still, NPE lawsuits are very unpopular with the public, and the losses due to NPE suits are collectively measured in the billions, so the Senate may feel pressure to pass something. Time will tell if we see even the modest reform proposed by the Patent Transparency and Improvement Act (and similar bills) and if the Senate will take things further by passing some or all of the more aggressive proposals of the Innovation Act.

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