

THE IMPACT OF BAD PATENTS ON AMERICAN BUSINESS

HEARING BEFORE THE SUBCOMMITTEE ON COURTS, INTELLECTUAL PROPERTY, AND THE INTERNET OF THE COMMITTEE ON THE JUDICIARY HOUSE OF REPRESENTATIVES ONE HUNDRED FIFTEENTH CONGRESS FIRST SESSION

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JULY 13, 2017
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Serial No. 115-39

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Printed for the use of the Committee on the Judiciary



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

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U.S. GOVERNMENT PUBLISHING OFFICE

32-324

WASHINGTON : 2018

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THE IMPACT OF BAD PATENTS ON AMERICAN BUSINESSES

THURSDAY, JULY 13, 2017

HOUSE OF REPRESENTATIVES

SUBCOMMITTEE ON COURTS, INTELLECTUAL PROPERTY, AND THE
INTERNET

COMMITTEE ON THE JUDICIARY

Washington, DC.

The subcommittee met, pursuant to call, at 10:04 a.m., in Room 2141, Rayburn House Office Building, Hon. Darrell Issa [chairman of the subcommittee] presiding.

Present: Representatives Issa, Goodlatte, Smith, Chabot, Franks, Jordan, Marino, Labrador, Farenthold, DeSantis, Biggs, Nadler, Conyers, Johnson of Georgia, Deutch, Bass, Jeffries, Swalwell, Schneider, and Lofgren.

Staff Present: Joe Keeley, Chief Counsel; Eric Bagwell, Clerk; and Jason Everett, Minority Counsel.

Mr. ISSA. The Subcommittee on Courts, Intellectual Property, and the Internet will please come to order.

Without objection, the chair is authorized to declare a recess of the subcommittee at any time.

We would like to welcome everybody here today to a hearing entitled Impact of Bad Patents on American Businesses.

American businesses, entrepreneurs, inventors all come to this Congress telling us about the effects of patent trolls who seek to abuse the American legal systems to extract money from Americans, to line their own pockets using any method they can, including ingenious ones that have been developed only in the last few years.

Although the AIA was able to immediately stop some of these abuses by creating new procedures at the Patent Trademark Office to weed out bad patents, patent trolls haven't gone away. And let's explore why.

The answer is simple. One, the money is too good. And, two, a good patent can be used by a troll to exert claims that are unreasonable for that patent. Why innovate when it is far easier and more profitable to simply purchase a patent, acquire one, acquire the rights to a patent, perhaps one that has never been licensed, bully businesses into writing a check, go away without ever seriously litigating?

As patent trolls force American businesses to spend money on patent lawyers and settlement checks, business investment by definition—investment money by definition is diverted. Over 80 percent of patent troll litigation focused on small businesses that don't have deep pockets need to pay patent lawyers to defend them, settlement is often the only reasonable option, and every dollar spent in settlement is a dollar not spent in building a business.

For example, Life360 spent over \$1.5 million to take a patent case to trial, and it won it. Unfortunately, \$1.5 million was spent only to prove that it was frivolous by definition. The founders of Life360 could have spent that money improving a product and hiring more Americans.

The testimony that will be provided today by Julie Samuels contains a list of examples faced by American businesses nationwide. Simply put, we should not confuse making America great again with making American patent trolls richer again.

I am happy to see that the Supreme Court has agreed that patent trolling using venues of advantage is contrary to public policy with several unanimous decisions. Much liked by at least this chair in Congress, the Supreme Court hears diverse—sorry—hears diverse issues, yet the Court has repeatedly been in total agreement that the fundamental goal of the American patent system has been—this is one of those days—of the patent system has been perverted by those who would use bad patents or, as I said earlier, good patents in bad ways to strong—arm the rest of America into paying them money. Usually, and I regret to say this, but most often in the Eastern District of Texas before just a handful of judges.

Most recently in the TC Heartland case, the Supreme Court made a major step by trying, and I repeat trying, to stop the overreach of the Eastern District of Texas. However, only 2 weeks ago, Judge Gilstrap interpreted the TC Heartland decision in a way that rejects the Supreme Court's unanimous decision and, at least for the time being, ensures that as many of the cases as possible will remain in his courtroom.

Well, this may be help to the community that Judge Gilstrap represents. To the hotels, to the law firms, it does not serve justice, and is, in fact, an act that I find reprehensible by that judge. It is not common for a Member of Congress to call out an individual judge or a district, but after a long period of enrichment of a community by judges who consider that community's well-being part of their goal, I can reach no other conclusion.

I look forward to hearing from all of our witnesses today, and would like to now recognize our ranking member, the gentleman from New York Mr. Nadler, for, his opening statement.

Mr. NADLER. Thank you, Mr. Chairman.

The United States leads the world in innovation and creativity, which are key drivers of economic growth, but creators cannot safeguard their inventions from infringement, exploit them for profit, or avoid unnecessary litigation without a strong patent system to protect them. The U.S. Patent and Trademark Office does an admirable job, under difficult circumstances, in processing the more than 600,000 patent applications, and growing, that it receives each year.

But no system is perfect, and some poor patents sometimes slip through the cracks. Whether because of pressure to quickly reduce the backlog of applications without having sufficient resources to properly evaluate each claim or because of unclear guidance from the courts in what is eligible to be patented, or even because of simple human error, sometimes the PTO issues a patent that is later deemed to be invalid. This injects uncertainty into the market and imposes potentially huge costs on businesses and small inventors by requiring legal action to resolve claims of ownership.

When bad patents are granted, it also encourages abusive litigation by bad actors known as patent trolls, who purchase these weak patents and use litigation or the threat of litigation as a weapon to extort settlements from innocent defendants. Because litigation can be expensive and time consuming, many defendants determine that it is better to settle even a meritless claim than to endure the significant burdens involved in costly litigation. With a settlement in hand, the patent troll is free to pursue its next victim, and the cycle continues.

Going forward, we must attempt to reduce the number of bad patents that are granted. I support the PTO's patent quality initiative, which has made grade strides in this direction, and I will continue to advocate for the PTO to receive sufficient resources to do its job effectively. But it is also critical that we weed out existing bad patents that continue to plague the system.

The America Invents Act created several mechanisms, such as inter partes review, or IPR, and the Transitional Program for Covered Business Methods to challenge and invalidate patents more efficiently and more cost effectively than pursuing litigation. These are being used widely, and they have successfully eliminated many patents that should never have been granted in the first place.

However, some stakeholders are concerned that too many good patents—that too many good patents are being invalidated at the same time that bad patents are weeded out. They also argue that the standards and procedures used in these programs, which differ from those used in district courts, are unfair and sometimes lead to perverse outcomes in which the same patent is upheld by a Federal District Court but is ruled invalid by the PTO.

Whatever the standard should be, I think most people would agree that the standard should be the same, whether you go to inter partes review or to the Federal Court.

We should be mindful that many companies make business decisions and attract investors in reliance in having been granted a patent. As we work to strip bad patents from the system, we must strike the proper balance to ensure that we do not inject uncertainty and unfairness into the marketplace by throwing away good patents along with the bad.

This hearing offers a good opportunity to examine the impact that poor quality patents have on American businesses and small inventors and to determine how best to weed out bad patents, while protecting legitimate patents from unfair attacks. I look forward to hearing from our witnesses, and I yield back the balance of my time.

Mr. ISSA. I thank the gentleman.

We now recognize the gentleman from Virginia, the chairman of the full committee, for his opening statement. The gentleman, Mr. Goodlatte, is recognized.

Chairman GOODLATTE. Mr. Chairman, thank you very much. Thank you for holding this very important hearing, and I look forward to our witnesses' testimony.

When I became chairman of the House Judiciary Committee, I placed a priority on reducing litigation abuse wherever it occurred. As the committee that oversees our Nation's Federal judicial system, the Judiciary Committee must fight all abuses of our Nation's judicial system, whether abuse occurs in the patent system or elsewhere.

Litigation abuse degrades the confidence of Americans that the judicial branch is there to assist resolving disputes in a fair manner, especially when they are faced with a potential for a business-ending damage award due to a frivolous lawsuit.

Unfortunately, a small number of bad patents that should never have been granted in the first place have been used by some to harass American businesses. Small and medium-sized businesses nationwide have been on the receiving end of demand letters over questionable patents for common technologies long in use, such as podcasting, electronic shopping carts, and document scanners. The demand letters typically include a settlement offer that is lower than the cost of retaining a lawyer to begin litigation.

The patent trolls, as they are known, then move on to their next victim. For businesses that had planned on expanding by hiring new employees, the troll has already ended their ability to expand by diverting money away from the human resources department to the legal department.

Four years ago, I introduced the Innovation Act to address the litigation abuse problems that could not be solved by the America Invents Act. The Innovation Act then passed the House by a vote of 325 to 91, reflecting a bipartisan desire to end such abuse. Although the legislation became stuck in the Senate, the Supreme Court was able to step in to unanimously resolve some but not all of the litigation abuse problems that were to be addressed by the Innovation Act.

Just a few weeks ago, the Supreme Court in its TC Heartland decision concurred with congressional enactment of a patent—specific venue provision in Title 18. This decision was expected to lead to a sharp reduction in cases being filed in one particular district in Texas that seems skilled at attracting patent trolls.

Unfortunately, one judge in this district has already reinterpreted both the law and the unanimous Supreme Court decision to keep as many patent cases as possible in his district in defiance of the Supreme Court and congressional intent. Also unfortunate is that there are some who are now calling to undo much of the progress that has been made on patent litigation reform. Simply put, their efforts and their views of what makes for a strong American patent system are misguided.

A strong patent system is not one that enables patents that should never have been granted in the first place to be used as a weapon against American businesses, destroying American jobs in the process. A strong patent system is one that has robust mecha-

nisms in place to weed out bad patents and to deter abusive patent litigation from happening in the first place, while facilitating the owners of properly awarded patents in seeking the compensation they deserve when their patents are infringed.

As the administration undertakes its search for a new PTO director, I look forward to working with them and their choice of a new director to build up the good work that this committee has done, along with the positive impact of several unanimous Supreme Court decisions. America needs a strong patent system where bad patents are weeded out and litigation abuse is sharply curtailed.

Thank you, Mr. Chairman.

Mr. ISSA. Thank you, Mr. Chairman.

We now go to the gentleman from Michigan, the dean of the House, Mr. Conyers.

Mr. CONYERS. Thank you very much, Mr. Chairman.

We welcome all of our witnesses, particularly the former judge, Paul Michel, former Chief Judge, and we look forward to this hearing. This is a large, important part of our law and economy to consider, because we will examine the current state of patent law and to consider whether Congress should be doing more to promote innovation and protect inventors.

We should also use this as an opportunity to review the procedures at the United States Patent and Trademark Office and how they are impacting American businesses. As we examine these issues, there are several factors I am going to be keeping in mind.

First, one of the most effective steps that we can take in responding to abusive patent litigation is making sure poor quality patents are not issued to begin with. One of the major contributing factors to the problem of abusive patent litigation is the issuance of ambiguous and poor quality patents. Even though getting patents through the system quickly is an important goal, it cannot be done at the expense of quality. Low-quality patents undermine the patent system just as much as lengthy pendency times.

Equally important, patent examiners must have the resources to review and analyze the hundreds of thousands of complex and interrelated patent applications they receive every single year. If the Patent and Trademark Office receives all of its fees and is protected from the unpredictability of the annual appropriations cycle, this will help ensure that the agency's review process remains the envy of the world.

Problematic patents most often are issued as a result of a deficient review process, which in turn, is caused by insufficient resources for the agency. Without question, investing in the Patent and Trademark Office and improving the quality and timeliness of the agency's work has a direct impact on the competitiveness of American businesses and on individual inventors.

The health of our intellectual property system is integral to the health of our Nation's economy. It provides vital incentives that foster innovation, which in turn creates jobs. America's most intellectual property intensive industries generate millions of jobs. According to a Commerce Department report, these industries support at least 45 million United States jobs and account for nearly 40 percent of our Nation's gross domestic product.

In recognition of this fact, I have consistently sought to improve patent protection and have fought to protect American growth and innovation in our increasingly global economy. Congress must ensure that the Patent and Trademark Office has sufficient funding so that it can be truly effective in protecting the integrity of our intellectual property system.

Finally, we must take a cautious approach to any future legislative proposals. Our Nation's economic future depends on the ability of inventors to innovate and create, while at the same time being able to efficiently and effectively protect their products. Even well-intentioned proposals must be thoroughly analyzed to avoid unintended consequences that harm our patent system, discourage innovation, weaken patent rights, or increase patent litigation. Accordingly, we must strenuously reject any legislative proposals that would unbalance the patent system, deprive inventors of full legal protection for their inventions, fuel more rather than less litigation, and weaken patent enforcement protections.

I continue to support reasonable reforms that will improve and strengthen the patent system but reject any changes that even indirectly may undermine our Nation's patent system. And so I congratulate the chairman for holding this important hearing, and I look forward to the testimony from the witnesses. And I thank you.

Mr. ISSA. Thank you, Mr. Conyers.

Without objection, all other members will have their opening statements made a part of the record.

Today, we welcome our distinguished panel of witnesses. If you would all please, pursuant to the rules of the committee, rise to take the oath.

Please raise your right hands. Do you solemnly swear that the testimony you are about to give will be the truth, the whole truth, and nothing but the truth?

Please be seated.

Let the record indicate that all witnesses answered in the affirmative.

Today, our witnesses include Mr. Tom Lee of Mapbox; as previously stated so eloquently by the dean, the Honorable Paul Michel, the former Chief Judge of the United States Court of Appeals for the Federal Circuit; Mr. Sean Reilly, senior vice president, associate general counsel of The Clearing Company; and Ms. Julie Samuels, president of the board at Engine.

For all of the witnesses today, your written statements will be placed in the record in their entirety. This allows you to use the 5 minutes, more or less, to say things that may or may not be in your opening statement or to summarize a longer opening statement.

As most of you know, we work on the standard red, green, yellow system. So green means continue if you please; yellow means hurry like crazy; and red, we understand that there is a cop here that will give you a ticket.

So with that, I will break protocol, Your Honor, and start down the line with Mr. Lee.

The gentleman is recognized for 5 minutes.

TESTIMONY OF TOM LEE, MAPBOX; HON. PAUL MICHEL, FORMER CHIEF JUDGE, U.S. COURT OF APPEALS FOR THE FEDERAL CIRCUIT; SEAN REILLY, SENIOR VICE PRESIDENT AND ASSOCIATE GENERAL COUNSEL, THE CLEARING HOUSE; AND JULIE SAMUELS, PRESIDENT OF THE BOARD OF DIRECTORS, ENGINE

TESTIMONY OF TOM LEE

Mr. LEE. Chairman Issa, Ranking Member Nadler, and members of the committee, thank you for the opportunity to appear before you today to speak about the need for patent reform.

My employer, Mapbox, was founded here in Washington, D.C., about 7 years ago. We produce beautiful and powerful map technology for companies like the Weather Channel and Lonely Planet, and today have grown to over 250 people. Unfortunately, this success is not because of our country's patent system, but in spite of it. Predatory patent litigation has threatened us, generating distractions and roadblocks to growth.

Mapbox has had multiple experiences with patent trolls, non-practicing entities who file meritless lawsuits that are cheaper to settle than to defend. Sadly, this has become an expected cost of business in the software industry and a substantial drag on innovation. Even the decision to testify today was a difficult one for us, as patent trolls use public records to identify targets. It is only thanks to a strongly antitroll board and executive leadership that I am able to be here.

We have seen trolls employ varying tactics, but there are several common themes across these episodes that I would like to highlight today.

The first is the sophistication of the troll industry. Being a troll's target for the first time is a bewildering experience and all the more so when you hear the calmness in the voice on the other side of the phone. This is a steady, routinized business for them, and they are well practiced at it.

When a troll finally names a settlement amount, we have reliably found it to be very slightly cheaper than our counsel's estimate of the cost of proceeding with our best legal remedy. The troll business is extremely well priced, calibrated to individual victims' means and legal situations. These are not rival software firms with whom we have conflicting claims; they are shell companies who keep minimal assets, employ few staff, and produce nothing except legal demands.

The second common theme is venue. Every patent troll we have encountered has filed their claims in remote locations instead of where our business is located. Trolls look for sympathetic venues, like the Eastern District of Texas, to raise the costs of defense, limit choice of counsel, and make impractical several kinds of legal responses.

We were pleased to see the Supreme Court curb venue abuse, but more must be done. Trolls can still sue customers instead of service providers for a venue hook, and it is expensive to file a motion opposing improper venue. Without additional efforts to control the cost of mounting a defense, such as limits on discovery before

early motions are decided, venue will remain an inappropriately important consideration for victims of trolls.

The third theme is the exceptionally low quality of the patents in question. Digital mapping is a complex computer science problem, but the claims we have seen have purported to cover techniques as prosaic as looking for a business on a map or dispatching vehicles from a central location. It is not an exaggeration to say that these techniques have been in use for hundreds or even thousands of years. Unfortunately, invalidating a bad patent is an expensive and risky proposition, and few companies are in a position to gamble their future in this way.

In general, the quality of software patents in our system seems to be very poor. I worked as a programmer for almost 20 years, and in that time I met vanishingly few peers who consider software patents to be beneficial to innovation.

At Mapbox, the desire to create better products drives innovation, not the prospect of patent protection. When we file patents, it is due to other considerations, including defensive ones. Filing patents can be important for individual engineers' career advancement, but for many programmers I know, having one's name on a software patent is, frankly, a personal embarrassment. By saying this I don't mean to question the necessity or importance of our patent system, but it is a sad truth of the system's inability to adapt effectively to the digital age means that a large and increasingly important segment of our economy has lost all faith in it.

Given the prevalence of bad patents, it is particularly galling to see efforts to weaken the inter partes review system. IPR is one of our most important tools for dealing with the many thousands of bad patents that should be invalidated in the wake of the Alice decision, but it is still inaccessibly expensive for small businesses. IPR must be strengthened and made more accessible, not less so.

The weaknesses of the patents used against us have often been matched by the weakness of trolls' claims. In some cases, the patents' claims have no plausible relation to our technology, but getting to the point where a judge can affirm this costs time and money, particularly if the discovery process is allowed to begin. Low pleading standards mean trolls can make vague and unsupported assertions. Amazingly, it can be impossible even to understand their claims against you without incurring substantial costs.

Trolls often withdraw their claims at the first sign of any real resistance. Unfortunately, they usually face no consequences for doing so, and can proceed to targets who are more easily cowed.

Finally, let me encourage you to consider the voices that are not present today. Mapbox has been fortunate to have the resources, will, and luck to defend ourselves against trolls. Others are less fortunate. In researching our trolls' past behavior, we came across many other victims. Big companies who settled and were thereafter legally prevented from discussing their experiences publicly; a father and son software shop who had to watch their business get destroyed every few years when a troll came through making unaffordable demands of their clients, forcing them to move to bigger vendors who could afford to buy protection. And there is no way to count the many failed companies who have been forced to waste

resources that should have been invested in research and development, equipment, or staff instead of paying off trolls.

Your attention to this issue is welcome and sorely needed. I am hopeful that thoughtful reform can eliminate trolls' destructive practices and encourage growth and innovation.

Thank you for the opportunity to speak today. I would also like to express my gratitude to CTA and Engine for their consistent advocacy on this issue, and I look forward to answering any questions you might have.

Mr. ISSA. Thank you, Mr. Lee.

Your Honor, for such time as you need.

TESTIMONY OF HON. PAUL MICHEL

Judge MICHEL. Thank you, Mr. Chairman.

It is an honor to be here. I welcome the opportunity to try to help the committee to stay current on the rapidly changing developments in the patent world. There have been many developments. The TC Heartland decision was mentioned and even a postdecision ruling by one particular judge, so that is a further illustration of how things are rapidly changing.

I would like to stress that I am not affiliated with any company or any coalition or any other commercial entity. I am only interested in the economy of the country and our global competitiveness and in a well functioning patent system. My friends at this table, who are very able advocates and they are also friends, are advocating on behalf of particular interests, of course, and I am not. I don't have to worry about any bottom line pressure or bottom line bias.

It is my judgment that as things have developed in just the last 3 years, the United States patent system is now in a crisis mode. It has been so beleaguered by various forces and reform efforts that it is no longer functioning effectively to incentivize the massive investment repeatedly needed in order to move technology forward. The ranking globally of the U.S. patent system in strength has now fallen to tenth. It was always first in all the prior years. And there are many other indications of problems in the system.

Patent values are down by as much as two-thirds, according to some economists. Patent licensing is down. Patent applications are down. There is greater use of trade secrets, which hides the technology, instead of sharing it with other people the way the patent system does. So there are many warning signs about trouble. The uncertainty in the system is the biggest trouble of all, because that deters the needed investment.

Now, I am a supporter of the AIA reviews. I think they have added a very important second line of defense when improper patents are granted. I do criticize some ways in which the patent board implemented the act and in some ways actually departed from what seems, to me, to be clear congressional intent.

So, for example, you seem to contemplate amendments; they virtually never allow amendments. You seem to contemplate strong estoppel; they hardly ever estop anybody. And the statute, as I read it, suggests that the director and his subordinates should make the institution decision and the Board only make the final written decision on the merits. But it was all sent to the Board in

a massive delegation, so the Board does everything now, and that doesn't seem consistent with the design that was put into the act.

With regard to the eligibility issue, the Supreme Court decisions in *Alice* and *Mayo* have done a lot of good because they allow cases to be thrown out on preliminary motions without discovery, without expensive litigation. The problem part of it is that the standards are so vague and uncertain, there is massive unpredictability, and therefore, there are tens of thousands, maybe hundreds of thousands of patents under a huge cloud of possible invalidity, and therefore, valueless.

The result of all this is investment is now going less into R&D and follow-on commercialization and more into more promising investments, entertainment, and many other things. And there are also signs that, increasingly, it is now going overseas instead of staying here in America. I don't think any of us want that.

So the impact on companies large and small of this uncertainty has been huge. You know, patent litigation is so expensive and now more so because of the way the Board has implemented the procedures for AIA reviews. So we are in a situation where licensing has dried up, investment is drying up.

Now, with regard to abuses, of course there are abuses. They are serious. They need to be combatted. I think the courts of late have made great strides in requiring detailed fact pleading and having eligibility and indefinite decisions made on preliminary motions before discovery, before claim construction, before expensive litigation. Fee shifting has been greatly increased under the *Nautilus* case. It is triple what it was before and rising. Discovery is typically delayed, and in any event, much more limited than it used to be.

If you look at the actual litigated suits, the incidence of frivolous suits is very small. Now, that doesn't cover where there were settlements. It only covers where there was litigation. But that still gives you some sense that, yes, there is a problem of invalid patents and overreach on infringement claims, but it is a limited problem, and I think it is now under way better control than it was even a couple of years ago.

Now, affordability is a consideration that also has to be on the minds of the committee, in my view. I estimate that the vast majority of patent owners can now not afford to defend a valid patent that is actually being infringed because an IPR is so easy to instigate. I looked for, over 29 years of reviewing patents, at several thousand patents. Almost every patent that I can recall had some claims that were clearly valid and rock solid, some that were maybe a little questionable, and a few that were overbroad and probably or certainly invalid. But what that means is that an IPR is easy to instigate, and that adds 2½ years of time delay because stays are routine, and understandably so. And it adds cost of somewhere like a half a million dollars per petition, and many patents are challenged repeatedly by the same challenger or by other challengers so there can be 5 or 10 or more challenges, each one costing hundreds of thousands of dollars.

So now the wags say that patent litigation has replaced horse-racing as a sport of kings. Only the rich can afford to do it. The very rich can afford to do it. So that means most patent owners are

denied the courthouse or denied justice under our justice system, which doesn't seem appropriate.

I think there is a very important role for this committee and the Congress to monitor developments, as you did with the TC Heartland hearing, and to monitor further how that decision is being honored or not. I think there is a role to possibly adjust the statute itself. Beyond that, I hope that the committee will consider forcing the patent office board procedures to conform with what seemed like the legislative intent embedded in the statute. I hope also, as Mr. Conyers mentioned, that the fees that the patent office desperately needs to continue to upgrade its computer systems will be protected from diversion or impoundment.

Mr. Chairman, you instigated a very useful patent pilot program. There are about 80 judges in it now. I think it has been very beneficial. It would be twice as effective if each of those judges was given an additional law clerk with technical training. That should be easy to do. That is a very small cost. It would make a very big difference, in my judgment. And in the same vein the patent pilot districts need additional judges, as do other patent heavy districts.

And I hope, finally, that the Congress will consider trying to clarify the meaning of eligibility in the statute in section 101. The Supreme Court has provided some very good impetus for this, but its standards are too vague to produce consistent and fair results. The Congress has a better capacity as a matter of national economic and innovation policy to state the limits of eligibility, and it should do so, in my opinion, by clarifying 101. Thank you very much.

Mr. ISSA. Thank you, Your Honor.

Judge MICHEL. I appreciate the extra time.

Mr. ISSA. No problem.

Mr. Reilly, I will remind you you are not a Federal Judge. Thank you.

Mr. REILLY. Thank you very much for that, Mr. Chairman.

Mr. ISSA. The Clearing House is recognized.

TESTIMONY OF SEAN REILLY

Mr. REILLY. Chairman Issa, Ranking Member Nadler, and members of the committee, thank you for your time today and the invitation to testify.

Although the financial services industry has an interest in all the issues related to patent reform, today I am going to focus my testimony primarily on the critical importance of the covered business method program, CBM, section 18 of the America Invents Act.

The financial services industry has a balanced perspective on the need for both robust patent protection of actual innovation and also the need to decrease the transaction costs associated with spurious, low-quality patents being asserted in district courts. Financial service firms are innovators, and a functioning patent system is critical to the innovation in this industry, particularly given the fintech convergence and the rapid emergence of new technologies that the consumers are demanding today.

Additionally, the financial services industry is primarily the source of capital for startups of every kind, from companies in the technology sector to the pharma sector. As lenders, it is essential that the intellectual property that we rely on to backstop these

loans be based on strong patents and patents that there is certainty behind.

Due to the industry's role as both innovators and lenders of innovation, the industry is uniquely vulnerable to the assertion of low-quality patents by nonpracticing entities, in particular across the economy of the United States. The CBM program was a landmark effort by Congress to address abusive patent litigation around low-quality business method patents. Thus far, it has operated precisely as Congress has intended.

Seventy-nine percent of the final written decisions issued in CBM proceedings have resulted in an invalid challenged patent in whole or in part. The Federal Circuit has never found that any of those decisions were wrong, when you look at the merits of whether those patents are invalid.

CBM is a narrowly tailored program. It was carefully constructed and preserves and enhances the incentives for innovation by protecting legitimate patents, while also providing an efficient alternative to litigation in district court.

We believe that CBM is necessary because, unlike IPR, it enables a petitioner to raise nearly any invalidity challenge that they could otherwise raise in Federal Court. These include challenges related to subject matter eligibility under section 101, also evidence of prior use or prior sale, and then elements related to drafting requirements under section 112.

The ability to bring these challenges is particularly important in the case of business method patents. If you look at the filings under the CBM program, roughly half of the invalidity findings are based under these sections of the patent code that are not eligible for review under IPR. For these reasons we urge Congress to make the CBM program permanent.

Alternatively, we urge Congress to adjust the inter partes review program to eliminate the current carve-out of that program and allow petitioners to bring all legally recognized invalidity challenges, including the aforementioned subject matter eligibility and evidence of prior use and sale. Not only is CBM effective in combating low-quality patents, but it has been carefully constructed with ample safeguards to prevent the harassment of patent holders.

First, the petitioner must be sued or threatened with a suit. Additionally, only those patents that claim covered business methods and are more likely than not invalid are subject to review. Finally, and perhaps most important, if the patent is a technological invention, it is exempt from the program.

In practice, 34 percent of the petitions filed have been rejected due to this gatekeeping function, so we do believe it is effective. While opponents of the CBM program often urge that it is a special interest handout to big banks, in fact, banks only constitute 8 percent of the filings. As for the rest of the financial service industry filings, such as insurance companies, 17 percent are petitioners there. The remaining 75 percent come from other industries.

Other opponents of CBM have claimed that the threat of CBM review has undermined the perceived value of the assets. We don't believe that this is the case, and one place to look is venture capital funding. Venture capital funding, year over year, has increased since the America Invents Act passed. Furthermore, most of the

criticism come directed towards software patents. Only 5 percent of the petitions at CBM are related to patents in that space. And it is worth noting that none of the petitions are related to patents in the pharma space. And in terms of the patent owners and the patents that are being challenged, 59 percent are owned by NPEs.

We believe the evidence clearly demonstrates that the CBM program has been an overwhelming success in helping eliminate low-quality patents. The evidence also shows that the most frequently raised criticisms of the program do not apply. There are tens of thousands of issue business method patents, many of which continue to be held by NPEs, and we are seeing explosive growth and historic highs in the issuance of CBM-related patents.

I thank the committee today for their time and the opportunity to testify and welcome questions from the committee.

Mr. ISSA. Thank you.

Ms. Samuels.

TESTIMONY OF JULIE SAMUELS

Ms. SAMUELS. Thank you. Chairman Issa, Ranking Member Nadler, and members of the committee, thank you so much for having us today. It is an honor to be here, and I apologize in advance if I cough. I have come prepared with cough drops.

I look forward to discussing how bad patents negatively impact American business, especially because this problem disproportionately harms the community of startups I represent.

As has been much discussed, often before this very subcommittee, patent litigation abuse is a real problem and one that consistently disproportionately targets startups and small businesses. The worst abusers of this system, so-called trolls, are armed with low-quality impossible to understand patents on the one hand, and outrageous costs both in time and money of patent litigation on the other.

For years, the public debate has focused on litigation abuses and how we best close the loopholes that allow those abuses to flourish.

When we would talk to entrepreneurs and engineers, those building companies, creating jobs, developing new technologies, they would always ask, what about the bad patents? And we would have to give an answer that I hated. Politically it is too hard, I would say. The most important conversation, the one about patent quality, involves too many stakeholders, too many powerful interests. I am here today to tell you we were wrong.

For starters, we can fix patent quality. Indeed, we have already seen that start to happen with real success driven by Congress and the courts. Even more, we must fix patent quality for the promise of innovation and the health of our economy.

Today, I am going to briefly talk about where we have been, where we are going, and what we need to get there.

First, where are we? I am going to start with some figures, so bear with me for a second. There are approximately 2.5 million patents enforced today, and 40,000 new software patents are granted every year. Those patents are often next to impossible to understand for engineers and lawyers alike. Many are simply bad, like a patent on filming a yoga class using a computer to count calories and famously exercising a cat using a laser pointer. When those

patents end up in the hands of bad actors, it creates real problems for American business. Eighty-two percent of troll activity targets small and medium-sized businesses who can least afford the \$1- to \$6 million it costs to litigate.

Finally, an important fact, startups, new firms are responsible for all net new job growth in the United States.

Second, the good news: We are headed in the right direction. For starters, the software and high tech industry is thriving, outperforming the market over the last 3 years. R&D spending in software is up. The demand for software engineers continues to increase.

At the same time, I would argue not coincidentally, two trends in patent law have greatly benefited startups and small businesses. The first is section 101 and what we have seen since the Supreme Court decided *Alice* in 2014. *Alice* and its progeny have provided small businesses and startups with a powerful tool. Multiple companies in our network have reported that counsel now often recommend that they fight back against trolls, as section 101 now provides a viable defense to get out of a lawsuit early before costs become unbearable.

These benefits have been most acutely felt in the software industry. More than 70 percent of patents invalidated in whole or part by *Alice* were invalidated because they were abstract ideas implemented on a generic computer. *Alice* has been a lifesaver for many startups and small businesses. I direct you to my written submission for more examples.

The second trend is something we can thank many of you and the patent office for, the inter partes review that was borne out of the 2011 America Invents Act. Since the first IPRs were filed in 2012, it has proven an invaluable tool to clean the system of the most egregiously bad patents. To really understand the success of the process, we must also understand its limitations, meaningful and effective incentives to ensure only the weakest patents are targeted, like a front-loaded process and strong estoppel. Also, they are far from cheap, costing well into the six figures to file.

These limitations have worked. As of the end of 2016, only .002 percent of enforced patents have been challenged, and the vast majority of these are in the high tech space. What is more, not surprisingly, is that trolls were the respondent in the majority of those challenges. Even more, IPRs have been used to stop two of the most notorious patent trolls, MPHJ, the infamous scanner troll, and Personal Audio, the one who targeted podcasters across the country.

Third, I would like to quickly look to the future and talk a bit about what we need to do to rid the system of bad patents. For right now, I would actually say nothing. Nothing. Advances like *Alice* and IPR alone won't weed out all of the bad patents that exist, but they are doing important work to right the ship. The law may move slowly, but for innovators and entrepreneurs across the country, it is moving in the right direction.

The freedom to innovate has always been a central part of the American dream. For the sake of our economy and our identity we must not let bad patents stand in the way.

Thank you for your time, and I look forward to your questions.

Mr. ISSA. Thank you.

It is now my pleasure to recognize the chairman of the full committee, Mr. Goodlatte.

Chairman GOODLATTE. Thank you, Mr. Chairman.

I appreciate the testimony of all the witnesses. I am going yield my time to the chairman of the Science Committee, as he has another pressing obligation, and I know, because of his work on the America Invents Act, that he has some very pertinent questions.

Mr. ISSA. Chairman Lamar Smith is recognized.

Mr. SMITH. Thank you, Mr. Chairman.

Mr. Chairman, I want to thank the chairman of the full committee, and very much appreciate his yielding me time.

Let me address my first two questions to Mr. Lee and Ms. Samuels. And it is this: How have patent trolls specifically adjusted to the America Invents Act and to the recent Supreme Court decisions? And what more needs to be done?

Mr. LEE. I might have to defer to Ms. Samuels, simply because our experience is somewhat limited and spans time both before and after, so I don't think I could answer that systematically.

Mr. SMITH. Okay. Great.

Ms. SAMUELS. I am happy to answer that. So, of course, the cases, we are still kind of seeing where they go, particularly the newer ones, like TC Heartland, which is quite recent.

What we have seen, though, in the past couple of years since the America Invents Act, is that—well, first, the litigation rates went up, and now they have kind of evened out a little bit. But what has been interesting is that the majority of new cases are filed against unique defendants, small companies. So while actually the big defendants, the ones who can probably afford to defend themselves are seeing less litigation, which is good, it is the small guys who are still getting hit. So we have got to figure out what that looks like.

We really think that, systemically, the kind of low-quality patents, particularly in the high tech space are responsible for that, which is why we are so glad to have this conversation today. Also, we are encouraged by what we have seen by the Supreme Court. We do understand, from those of us who are kind of in it but also watching the system, we do understand that those things take some time to work themselves out. I wish it could be quicker, but we are encouraged.

Mr. SMITH. So wait but also watch, and then see what we can do about the small businesses?

Ms. SAMUELS. Wait and watch. There are things in a perfect world I would like, which I am happy to talk about. I would love to expand CBM or extend, you know, as Mr. Reilly so eloquently said, make sure that IPRs do cover more ground. I have got a wish list I am more than happy to discuss at any time.

Mr. SMITH. Good suggestions.

Second question, Ms. Samuels and Mr. Lee, if you feel like you can answer, and I won't take your response personally, but what should we do and what can we do about the Eastern District of Texas?

Ms. SAMUELS. Well, you know, the couple weeks in between TC Heartland and the newer Gilstrap opinion, I felt very excited. And

so now we will kind of see where that goes. I think there is still a lot of potential, and I think, again, the courts are going to work this out. Eastern District of Texas has been an incredibly huge part of the problem, and I would argue too that it is part of the problem that really targeted software, high tech space. So, in fact, there are a lot of graceful solutions there, because there are so many stakeholders in the patent system because we have a one-size-fits-all system, which I hope I can address later this morning. I think we will see where the courts go.

Mr. SMITH. Okay. Thank you.

Mr. Lee, anything to add?

Mr. LEE. Yes. I wouldn't presume to suggest specific remedies, but I can say that our experience is that the Eastern District is deliberately undermining many of the reforms that have been pursued. You know, in one instance, we felt we had a really strong Alice challenge because of the judge we drew, Judge Gilstrap. We were advised by counsel that that was a nonstarter, that if we filed it, we would still be paying discovery costs and that the clock would still be running if we pursued the IPR as well.

You know, both of these are remedies that should be available to people who are being hit with spurious claims, but in this case, they weren't simply because of the venue we found ourselves in.

Mr. SMITH. Okay. I thank you both.

Mr. Reilly, thanks for your suggestions on how we might change the law. And even though you have touched upon this, I was going to ask you to go back and revisit what the direct and indirect costs to financial institutions are as a result of the patent troll litigation.

Mr. REILLY. Yes. Thank you for the question, Congressman, and I appreciate the time. I think most important in financial services we are directly hit and volume drives damage models, at least initially in terms of damage demands. We have tremendous volumes that we flow through our networks, and that creates a huge leverage point for us.

Through CBM and these alternative programs, being able to get out of district court levels the playing field, and we think that that is really the needle mover here. That is what hits us with the costs. Defense costs are there, and, yes, they are high, but we do think they are fairly reasonable in comparison to district court going to the PTO and these alternative proceedings.

We are very focused, as are the other witnesses here today, on the impacts on small business. I think it is crippling to the small business when they are dragged into a district court litigation. And, you know, that impact—we care because that impacts our collateral. We also, of course, care about the U.S. economy and the health of it. Having these viable alternatives to get out of district court is critical and make sure that we maintain the integrity of these programs.

Mr. Chairman pointed out that there is going to be a process to appoint a new director. I think it can be really important that we look closely at the policies that they want to bring to bear. There is a lot of discretion in these programs, and they are quite fragile.

Mr. SMITH. Okay thank you, Mr. Reilly.

Thank you, Mr. Chairman.

Mr. ISSA. I thank you, and I apologize but, Judge Michel, did you have something briefly?

Judge MICHEL. Yes. In answer to Congressman Smith's question, the committee could shape the venue future by more clearly defining the statutory phrase "regular and established place of business." The TC Heartland case settled residency, one-half of the statutory provision, but the other half is the phrase I just quoted. If you defined that in whatever way you saw fit, that would add great clarity and could adjust where a case is going.

Mr. SMITH. Thank you, Judge Michel. By the way, since you are speaking, and not to quibble, but I thought the sport of kings was falconry, not horseracing.

Judge MICHEL. It might depend on the country.

Mr. ISSA. What is it in Texas, Chairman?

Mr. SMITH. Probably horseracing.

Mr. ISSA. Oil drilling? Horseracing, okay.

With that, pursuant to the wishes of the subcommittee chairman, we now recognize the dean of the House for his opening questions.

Mr. CONYERS. Thank you.

I appreciate the testimony of all the witnesses, but let me ask Judge Michel, what do you think the U.S. PTO has as a patent quality problem?

Judge MICHEL. I think the core of the problem, Mr. Conyers, is that most of the 8,300 patent examiners today are not cross-trained in law, as well as in various fields of technology. Patent scope involves claim construction, which means people who understand claim construction case law can do it right. People not trained in that law, can't do it right. So that is an area where the patent office could make huge strides by retraining examiners in relevant parts of claim construction.

The second big area of improvement would be to train and supervise examiners more closely with respect to section 112, where the scope of the protection is supposed to be limited to what the inventor actually invented. But 112 is not well understood by the patent examiners and not well applied by them, and a great effort at retraining and closer supervision about 112 would likewise help patent quality measurably.

Mr. CONYERS. Let me ask you just one more question. What makes a patent high quality, and why does that matter?

Judge MICHEL. I think at the end of the day, patents are either valid or invalid as a legal instrument, and therefore, it is not very helpful to talk about quality or good or bad. They are either valid or not valid. And with respect to someone else using the technology, the patent is either infringed as correctly construed or it is not infringed. They are the two questions that matter. They are legal questions. They have to be sorted out, ultimately, in courts where there are disputes. But the patent office could do a great deal more to help make sure that the issuance of invalid patents is cut way down from where it is today. I think it is better today than it was 5 years ago. It needs to get better still.

Mr. CONYERS. Well, I hope we can satisfy that last desire on your part, and I agree with you.

Turning to Ms. Samuels, how do low-quality patents impact startups and entrepreneurs?

Ms. SAMUELS. Thank you for the question. So first, of course, when a low-quality patent ends up in the hands of a bad actor, that is pretty much the worst-case scenario, and we have seen a lot of that. We have talked a lot about that in front of the full committee, the subcommittee already this morning.

I would argue that, secondarily, when you have got a bunch of low-quality patents out there, and Mr. Lee kind of brushed on this in his opening statement, it harms the whole system. And when it harms the whole system and when it undermines faith in that system, that is really bad for entrepreneurs. That is really bad for engineers. I too have many experiences with software engineers who want nothing to do with patents. They are embarrassed to get them at a lot of tech companies. That is a real thing right now. And that is not—we want a strong system. I am not up here today to be anti-patents, right? We want a strong functioning system.

The last point I will make, and I think this one is incredibly important, is about scalability. It is about the scope and the size of the system. When you have tens of thousands, hundreds of thousands of patents that could potentially apply to a single invention, device, you name it, it becomes nearly impossible to understand the scope of what you are dealing with, particularly for a small company, but also for a large multinational company. So what many in that situation tend to do is put their head in the sand. Better not to know than to try and, you know, address this mountain of patents, and that is not good for the system either.

Mr. CONYERS. Thank you so much.

My last question will go to Mr. Lee, and it is why do you believe the inter partes review is one of the most important tools for dealing with some of the bad patents?

Mr. LEE. Two things come to mind. One is the accessibility of the system. It is, in its ideal form, more affordable for businesses, vastly more affordable compared to the cost of a full legal defense. It is also advantageous in that it can get bad patents out of the system definitively. I think that, you know, we have a lot of particularly bad software patents floating around, and IPR is a potentially really important tool for getting rid of them.

Mr. ISSA. Would the gentleman yield, just to follow up on yours?

Ms. Samuels, Chairman Conyers brought something out that Judge Michel said and then you touched on it. Would you agree with Judge Michel that the 112, in other words, not properly defining the breadth of a patent based on invention, when we most often say bad patents, that is what we are really talking about?

Ms. SAMUELS. I absolutely would agree with that. My notes have 112 circled with exclamation points. In particular, means-plus-function claims, I would say, need a lot of help, but yes. Thank you.

Mr. ISSA. Thank you both.

Mr. CONYERS. Very good. Thank you, sir.

Mr. ISSA. We now got to the gentleman from Texas, who was here at the gavel, Mr. Farenthold.

Mr. FARENTHOLD. Thank you very much, Chairman Issa.

Judge Michel, you—in your written testimony, you talk about how abusers can be punished and deterred by surgical means, and weakening the entire system is surely unnecessary and unwise.

What are some of the surgical means to deter bad actors in the patent system that you were referring to there?

Judge MICHEL. Well, Congressman, first, obviously, fee shifting. If I file a frivolous lawsuit against you, the Federal trial judge should force me to pay your costs and fees, as well as my own, when he throws the case out. That is first and foremost.

Secondly, on motions to dismiss, which now are very, very common, both with regard to eligibility questions under section 101 and indefiniteness questions under section 112, those suits get thrown out at the very start of the process without claim construction, without discovery, without high litigation cost.

People talk about \$1- to \$6 million to litigate a patent case. But that assumes the case goes through the whole gamut. When the case is thrown out, at the very start on a motion to dismiss, a preliminary motion, that is a huge deterrent to anybody else filing a similar case in the future.

Mr. FARENTHOLD. And I don't mean to cut you short. I have only got 5 minutes, and I have got a couple of things that I want to hit.

Does anybody on this panel think fee shifting in a frivolous lawsuit case would be a bad idea?

I see no one objecting to that.

Judge Michel, you also talked about lowering costs, regardless of fee shifting or not. We want an affordable system, especially in an environment where you see some of the greatest inventions in this country coming out of somebody's garage who can't afford massive litigation.

What are some of the other suggestions you might have for lowering costs?

Judge MICHEL. I think the patent office needs to police the intake for the three AIA reviews more carefully and competently than it has so far. As I read the statute, the intent was to have policy officials and their subordinates review the intake part and the Board only make the final written decision. But both have been bucked over to the Board, and I don't think the Board has the ability to focus on the policy considerations that are in the statute, like the health of the patent system, the resources of the office, and other such considerations.

So one way to help would be to better control the intake so the proper cases go in but not excess intake.

Mr. FARENTHOLD. All right. Thank you.

And, Ms. Samuels, I wanted to visit with you for a second. You talked about maybe there being a problem with the one size fits all. I am going to open the door and give you about a minute to talk about what you would propose as an alternative.

Ms. SAMUELS. Thanks. I appreciate that. I would quickly say that we have decided, as a country, that we are a one-size-fits system, international harmonization is important. I would argue it doesn't really work all that well. The fact that we treat pharmaceutical inventions the same as software doesn't actually make that much sense, from an economic perspective.

Mr. FARENTHOLD. Can I stop you there for a second?

Ms. SAMUELS. Yes.

Mr. FARENTHOLD. You see software patents saying a system for e-commerce in ordering something over the internet. Would that

not be the equivalent of a drug company saying a drug to cure cancer?

Ms. SAMUELS. So that is the problem we have seen, right? And, of course, software patents are still fairly new, right? We have just seen them since the late 1990s, early 2000s. We are still, I would say, working it out. But, yes, they are incredibly broad.

Alice has helped narrowing it a little; 112 could do a lot more to narrow them a lot, I would argue. But I think that there are things we can do about a one-size-fits-all system.

A bifurcated system isn't the world's craziest idea, particularly in the current political climate when we are readdressing a lot of our trade deals, maybe we should readdress trips. I know to some people that sounds crazy, but I do think that this doesn't make sense. And we are here to find compromise, and we will, because that is how the system has always worked. But maybe it is easier to take different industries and treat them differently.

Mr. FARENTHOLD. Mr. Reilly, you're in the financial service industry. You do a lot about covered business method patents. Do you think a different treatment for that type of—would be something we should look at?

Mr. REILLY. Thank you for the question. Look, we strongly support a second look on all patents. And the industry has always been advocates of IPR allowing for all invalidity grounds to be challenged. Right now, you only have a subset in CBM. CBM has been highly, highly effective. Out of 358 petitions, you have knocked out over 1,600 litigations in district court saving tens, if not hundreds of millions. So we are a big fan of these post-grant review proceedings.

And we do think on some level—not on some level, but we do think it is important that all grounds can be challenged regardless of the patent.

Mr. FARENTHOLD. All right. Thank you very much. I see my time has expired.

Mr. ISSA. Yes, it has. Thank you.

We now go to the ranking member of the subcommittee, Mr. Nadler, for his questions.

Mr. NADLER. Thank you, Mr. Chairman.

Mr. Lee, particular criticism was leveled at the quality of software patents. They are hardly worth anything. How would you improve the quality of software patents by statute?

Mr. LEE. I think that weeding out bad ones that have already been issued, which would not stand—would stand an Alice challenge is an important consideration. My hope and expectation is that the patent office won't be granting frivolous ones in the future.

Mr. NADLER. Yeah, but that is a hope. What can we do on this subject?

Mr. LEE. You know, a dual system like what Ms. Samuels just proposed is not crazy to me. I think, speaking broadly, by way of comparison, yesterday, I spent some time writing a system to properly capitalize text in Estonian. You know, this was a task that took me a few hours. I did not conduct a patent search in advance of beginning work on that. And there is just no comparison between the amount of investment and thought that goes into it and

the billion dollars that a pharmaceutical company might spend to bring a drug to market.

There needs to be a recognition that software innovation happens too quickly for the patent system to keep up with it, at least in its present form, and also that it enjoys other forms of intellectual property protection. We rely heavily on copyright. We rely heavily on license agreements, trade secrets.

Mr. NADLER. So you wouldn't patent software innovation?

Mr. LEE. My personal opinion is that it would be a better system if we did not patent software and used other forms of IP protection for it. I know that most—many, if not most, software engineers share that opinion.

Mr. NADLER. Judge Michel, what would you say to that?

Judge MICHEL. Mr. Nadler, I think the problem is the category is too broad. It is not true that all software-related patents are bad. It is not true that all business method type patents are bad. Some are very bad, some are borderline, and some are rock solid. So using those categories doesn't get us where we need to go. It has to be better examination, better review under AIA, and better analysis in the courts so these—

Mr. NADLER. And what could we do about that?

Judge MICHEL. Strengthen the patent office along the line that Mr. Conyers mentioned with protecting the fees. And calling to task the patent office implementation of the AIA, which has not been optimal. I think in ways, as I said, it is inconsistent with the statute.

But putting that aside, it hasn't been efficient. And if it got more efficient, everybody would benefit. The people with bad patents would lose fast, and the people with good patents wouldn't be pulled into the process at all.

Mr. NADLER. Okay. I have a couple more questions. Let me ask you, Judge Michel, quickly. Does it make sense that patents are evaluated under different standards in the IPR and in the district courts?

Judge MICHEL. Not to me. I don't see any justification for a legal question, like patent validity, to be decided differently in an administrative agency than it would be decided in a court of law. It is a legal question.

Mr. NADLER. Thank you.

Mr. Reilly, you talk about the necessity of extending the CBMs. CBM was an 8-year temporary program to solve what was regarded as a temporary problem. Why should we extend it? And why shouldn't this be handled in the IPR and the normal patent system, especially assuming we had one standard?

Mr. REILLY. Thank you, Congressman. Simply put, it is not a temporary problem. We are seeing a high number of bad patents issued at the PTO. I am a former patent examiner, and patents are inherently complex. The PTO does a great job. I think there has been significant improvements to the PTO. There is a lot of room for improvement. We strongly support improvements at the PTO.

But at the end of the day, we are looking for a viable alternative in district court from district court. And to get that, you have to have—

Mr. NADLER. Why do you want a viable alternative to district court?

Mr. REILLY. Simply put—

Mr. NADLER. Oh, I'm sorry. The IPR would do that. Go ahead.

Mr. REILLY. Well, the IPR won't do it, though, in the CBM case— or in the case of patents and business method, because you need to have the other invalidity grounds available for petitioners. And you don't have that—

Mr. NADLER. And let's say we did.

Mr. REILLY. Say you did? Then that—we strongly support that. That is a number one move-the-needle solution.

Mr. NADLER. And then we wouldn't need the CBM?

Mr. REILLY. If you modify IPR that way, absolutely.

Mr. NADLER. Okay.

Well, let me ask you, Ms. Samuels. I think we may have—we may have touched on this. You point out in your testimony that low-quality patents often suffer from vague or undefined terms, which make their application scope difficult to understand.

Are there specific procedures that PTO can put in place that would improve how patents are defined or is this something that we in Congress need to address?

Ms. SAMUELS. So the patent office did a glossary pilot program to address this. It recently ended. It was a good pilot, we think. There are things that can be done at the patent office. There are also things that could be done at Congress.

I think this is interestingly a problem that tends to exist, again, in the space of software and high-tech patents. In, for instance, pharmaceuticals, there are more general definitions that apply across patents so that practitioners can read a patent and understand what they are reading. So we would love to see the patent office do more. We would love to see that glossary program expanded. And I think that it could be largely taken care of at PTO.

Mr. NADLER. Without us doing anything?

Ms. SAMUELS. I'm sorry?

Mr. NADLER. Without us doing anything?

Ms. SAMUELS. I think this one we could probably handle at PTO, if they do it. And I think they could. And we saw a lot of great work under Director Lee, and we are optimistic in that whoever comes in will continue that great work.

Mr. NADLER. Thank you.

My time has expired. I yield back.

Mr. ISSA. I thank the gentleman.

We now go to the very patient Congressman Biggs.

Mr. BIGGS. Thanks, Mr. Chairman.

And thanks to each of the members of this panel today. It has been very interesting.

One of the things that I am really interested in, and Judge Michel touched on it when he talked about fee shifting as a deterrent. I am really trying to get at the deterrent. We have talked about IPR. And those are really—those are post-hoc remedies is really what those are.

So my question is, what happens—you know, what is the best way to get a deterrent? So I turn to Mr. Lee first, because one of the things you said in your statement was trolls often withdraw

their claims at the first sign of any real resistance. Unfortunately, there is no consequence for them.

So I guess my question is what do you see as an effective deterrent to kind of slow that down to a—on the front end as opposed to getting yourself and the small business or big business involved in a lengthier process?

Mr. LEE. I think raising the bar to filing an initial abusive claim would be a tremendous help so that companies are able to respond more rapidly. The fee-shifting question is complicated, though, by the fact that trolls are often designed to be disposable corporate entities that don't have assets that can be reclaimed.

Mr. BIGGS. Right. That is a fair comment on the fee shifting. So how would you raise the bar? I don't know. Ms. Samuels, you might have a thought on that.

Ms. SAMUELS. Raise the bar specifically with regard to pleadings? So I think pleading standards—there is a new form 8. I think we could go farther.

I think—I agree with what Mr. Lee just said about fee shifting. There are creative things you can do, like bonding requirements and otherwise to avoid that problem. I would also say I think this is an incredibly important line of questioning, something many of us in this room have worked for years trying to think through and understand. And I believe—I believe it was Judge Michel who talked a little bit about access to the courts for patent holders, which I think is wholly appropriate and important.

I would also argue we need to ensure there is access to the courts for defendants as well, because the current system makes it unaffordable. So you need access to justice on both sides of that equation, and I think that is a really important way to look at this.

Mr. BIGGS. Yeah. Something that you had in your written statement dealing with limitations of IPR. And I guess I would say how have the outcomes been measurable in IPR? I mean, I want to know who is really prevailing there.

Ms. SAMUELS. So like I said—or I think in my—well, at some point I said that a majority of respondents have actually been non-practicing entities. So we have seen IPR being effective in the most egregious situations.

What is interesting about IPR is that, while I and my community are incredibly supportive of these ways to clean out bad patents, they are still really expensive. You know, it is over \$100,000 to file one. Sometimes you have to file multiple. That is something that has come up a bit.

And so a lot of our startups can't afford to file IPRs. I have been involved at least in one case where third parties were able to bring it on behalf—bring an IPR on behalf of an impacted industry of small people who can't afford it. That is incredibly important.

Also, over time, we hope that the IPRs will build a body of case law that implements patent quality that will kind of, you know, move down the system. And, in fact, I would point out that the PTAB has been upheld on appeal I think 78 percent of the time.

Mr. BIGGS. And kind of rifting on that, Mr. Reilly, I guess my question would be, if there remain some barriers to using the IPR, just based on cost alone—and you've talked about a different way of opening up IPR as well—how do you reduce the barrier to use

the IPR to kind of provide an early and equitable and accessible way to resolve these issues?

Mr. REILLY. Thank you, Congressman. I mean, these are tough issues to solve. And IP law is inherently complex and, therefore, high cost. All of the case law that we have seen coming out and some potential fixes in litigation, we don't think ultimately is the answer. We really do think looking at these post-grant proceedings is the answer.

And one of the main things on removing the barriers of fee shifting and litigation, it is still a big fight and still very, very costly when you are in district court. Well, you can't band together in district court. You can't have the masses band together. You can in a post-grant proceeding. And I think one suggestion there is that smaller entities can band together—and we are seeing that—and more coordination there. And this is really private sector action. It starts to eliminate the pricing barriers.

Relatively speaking, though, we are talking about 100- to 200,000 to go through a post-grant proceeding as opposed to potentially millions.

And just triggering off of the former Chief Judge's comments, yes, some of the numbers look at going all the way through litigation. But once you get hit with a complaint, the meter is on. Okay. You are distracting your best and brightest innovators, you are distracting that. You are also flipping the switch on discovery. Discovery is the number one price driver for us. And that is front-loaded in a district court litigation and one of the biggest obstacles. And that is why getting out of district court is really the number one attack vector.

Mr. BIGGS. Thank you. My time has expired.

Thank you, Mr. Chairman.

Mr. ISSA. We now go to the gentleman from Georgia, Mr. Johnson.

Mr. JOHNSON of Georgia. Thank you, Mr. Chairman.

And I am impressed with the testimony of Judge Michel, a seemingly fair and disinterested party in any particular group of stakeholders looking at it from a 40,000-foot level. And his testimony, basically, is that patent enforceability has become less certain. The patent review process is certainly of high importance to the Nation. And, unfortunately, from his point of view, it is no longer viewed as a reliable process, the patent review process.

And he points to the fact that our system has dropped from its customary first place in the annual chamber of commerce global ranking to an embarrassing 10th place, tied with the former Soviet bloc country Hungary. And also the fact that patent values have plummeted by as much as 60 percent, according to several studies by economists, based on public sales and licenses. And I take it from Mr. Lee, Mr. Reilly, and Ms. Samuels that you all believe that, though there should be some tweaking, everything is working as it should.

I might further add that Judge Michel holds the position that we have done a lot of—we have done a lot of patent reform, which has produced this state where it is no longer reliable and our patent system has dropped in world rankings. And he is saying that we base reform on three myths: One is that patents—we have got a

lot of bad patents being issued. The second myth is that lawsuits—most lawsuits are frivolous. We proceeded on reform based on trying to root out frivolous lawsuits, which are not, in fact, a problem in the patent system. And last but not least, the courts are unwilling or unable to deal with the limited number of actual abusers of the patent system.

And I hear from the three of you all that you are not in agreement with Judge Michel. Can you tell me why, Ms. Samuels?

Ms. SAMUELS. Sure. I am happy to. Thank you for the opportunity. First, I would kind of take a look at the premise. And I think that—I would disagree with some of it—much of it. But I think we often, in this country, assume that more patents are good. A lot of times, you will read reports by researchers or economists that look at patents, the number of patents, as if it is somehow related to innovation or the productiveness of the economy. And I would start by pushing back on that notion.

What we have seen, at least in the industry with which I am most familiar that I can speak to, is that that is not always the case.

Mr. JOHNSON of Georgia. Well, how do you account for the chamber of commerce study that shows that the Nation has fallen to 10th ranking?

Ms. SAMUELS. So I would point out that, for starters, when we were first, we were actually tied, I believe, with four countries. And so we have actually—by those rankings. And to be honest—

Mr. JOHNSON of Georgia. So you don't take issue with the fact that we have dropped?

Ms. SAMUELS. I don't. And I am not sure—

Mr. JOHNSON of Georgia. What about you, Mr. Reilly?

Mr. REILLY. I don't take issue with it either.

Mr. JOHNSON of Georgia. Why has it occurred, in your view?

Mr. REILLY. I think when you look at the numbers, we are talking about patents that shouldn't have been issued in the first instance, right? And so just taking the CBM program as a benchmark—

Mr. JOHNSON of Georgia. So you stated—and excuse me for interrupting, but I am getting ready to run out of time.

You stated in your testimony that you think that there are some improvements. There is room for improvement at the patent office. Can you describe what those improvements you would recommend? What improvements you would recommend at the patent office?

Mr. REILLY. Sure. As a former examiner, they still use the same search technology that I used 14 years ago. Improvements on the technology, infrastructure, and accessibility to prior art is probably number one. Sufficient funding, sustainable funding is number two.

Mr. JOHNSON of Georgia. Have we done enough to drive reform at the patent office as opposed to other areas, like limiting lawsuits and trying to get at patent trolls, Judge Michel?

Judge MICHEL. I think the patent office is the place where you are going to get the most improvement. They have made some strides on patent quality. They can make much greater progress under strong leadership, if this committee monitors what they are doing and forces them to continue to upgrade the quality of the examination, supervision of examiners, and the use of section 112

that requires definite claims that are commensurate with the actual invention. That is the place to make the great saving.

And in terms of affordability, the magic bullet here is the motion to dismiss. That doesn't cost much at all. And they are being granted in huge numbers for ineligibility, for indefiniteness, for defective pleadings.

And, in fact, in further answer to Congressman Farenthold's question, if somebody files repeated frivolous lawsuits, the courts can bar them from being able to file any more lawsuits. That is the ultimate deterrence. And it is available, and it is sometimes used, and maybe it could be used more often.

Mr. JOHNSON of Georgia. Thank you. I yield back.

Mr. ISSA. Thank you.

We now go to the gentleman from Idaho, Mr. Labrador.

Mr. LABRADOR. Thank you, Mr. Chairman.

Mr. Lee, I am very proud of the growing tech presence in Idaho. From conversations that I have had with several businessowners throughout the State, it is my understanding that more and more companies are using teleworkers instead of having employees relocate.

In your testimony, you cited one of the common tactics used by trolls is venue. How will the TC Heartland decision impact tech companies who have a presence of teleworkers all around the country?

Mr. LEE. I am afraid I am an engineer by trade and not a lawyer and so probably not qualified to speak to specifics of the Heartland issue.

Mr. LABRADOR. Okay. How about you, Judge Michel?

Judge MICHEL. Congressman, I think that a regular and established place of business—that is a statutory phrase—contemplates a significant physical presence: a laboratory; an administrative office; maybe not the headquarters, but a significant facility. And I certainly—

Mr. LABRADOR. Is there anything we could do in Congress to curb any venue abuse?

Judge MICHEL. I'm sorry?

Mr. LABRADOR. Is there anything that we could be doing to curb venue abuse?

Judge MICHEL. Yes. You can clarify what that phrase is intended to mean.

Mr. LABRADOR. Okay. Excellent. Thank you.

Mr. Chairman, I understand you want a little extra time, so I will yield my time.

Mr. ISSA. I thank the gentleman for yielding.

Judge Michel, you hit a point earlier that I would like to go right back to, and that is the two different standards between the district court hearing a case and ultimately you, when you were at the Fed circuit, and the PTOs. And you said you want to unify them.

Would you please tell me which way you would unify them?

Judge MICHEL. Sure, Congressman. I would make—since their validity is a legal question, I would make the patent office standards and procedures conform to those used in court. So, for example, the patent office would have to use correct claim construction,

the accurate construction, not the so-called broadest reasonable construction, which is hopelessly vague and hopelessly lax.

Mr. ISSA. Let me follow up on that. So we are not talking here about the IPR process. We are talking about original applications. Is that correct?

Judge MICHEL. No. I am talking about in the IPR process.

Mr. ISSA. But let me go through that. If that is the IPR standard, wouldn't you have to use that same standard at the time you are considering it?

In other words, if you were not going to have two standards between granting and elimination, then you would have to look at the patent examiner. And I'll go to Mr. Reilly, perhaps, for that.

Patent examiners today have very little information. Most of it is—much of it is presented by the applicant. And they give the broadest interpretation at the time of the granting, right? So I guess my question to both of you—and I will go between the two of you—Mr. Reilly, is if we went with Judge Michel's suggestion, which I do not disagree with in principle, then don't we have to go back to the PTO and say, now you have to be—you have to use the standard that is anticipated to be used to invalidate it at IPR, at ex parte, and in the court, which means you have to narrow what you are willing to give in the beginning? Is that correct?

Mr. REILLY. I think that is exactly right. And clever drafting is a big challenge that is out there, and I think that is going to perpetuate the problem further if we were to go with that approach.

Mr. ISSA. So going back to Judge Michel—and I respect the years we have worked together—if we were to go with your proposal, in other words, hold the IPR to that standard the same as the court, which many have come to me to say, and if Mr. Reilly's concerns are that it is hard to get the PTO to do that, wouldn't we be creating a new reason to overturn a patent, which is that if the examiner fails to use that narrow standard, then doesn't that come back to you to second-guess the PTO, because they were overly broad in the granting and, thus, that patent is invalid because it is vague?

Judge MICHEL. Chairman, I think the uniformity should be between the PTAB review procedures and the courts, not between the PTAB judges and the examiner.

Mr. ISSA. Well, let's go back to that again for a moment, because that is an extremely important point. And I will probably continue it in a moment. But the—if there is no new information, I might agree with you. But let's just assume for a moment that Mr. Lee brings the evidence of a substantially identical or similar invention—a 102, let's say. Isn't that new information that Mr. Reilly, when he was a patent examiner, didn't have, and wouldn't you prefer, as a judge at the district court level—I realize you were at the Fed circuit—that you be able to consider it de novo since it was not considered by Mr. Reilly and, thus, essentially there but for that knowledge, Mr. Reilly would have likely given a more narrow or no patent at all?

Judge MICHEL. Well, the problem is you don't know in advance what the outcome is on validity. So the question is what standard works appropriately at each of the three stages.

It seems to me, for the examiner, the broadest reasonable construction is the preferable, even though it is laxer, because it gives

the examiner extra leverage to force the applicant to narrow the claims by amendment, to define terms, to explain what he really invented and prove that it fits the scope of what he is trying to get. But once you get with an issued patent—not an application but an issued patent in front of the Board or the court, then you have to use the correct construction. Otherwise, it is just chaotic.

Mr. ISSA. Well, let me go back again.

Mr. Reilly, if the IPR were to be reformed, and let's just say IPR ex parte, the two types of reexaminations—and I personally only went through ex parte reexaminations on my patents, so I don't have the separate experience. As an examiner, is it reasonable to say that you would like to be able to consider the new information, as lawyers say, de novo, consider it as though you were considering the patent anew but now have more information? Is that the standard you would like to see?

Mr. REILLY. Mr. Chairman, I think that is absolutely the point, right? We want to focus on the integrity of the patent system, and a review de novo under that standard is the right way to go.

Mr. ISSA. Ms. Samuels, you would agree with that?

Ms. SAMUELS. I would agree with that.

Mr. ISSA. And, Mr. Lee, I will recognize you as an engineer. You are willing to live with that, that information not known should be considered relative to your patent in this case?

Mr. LEE. Yes. I would say that, in general, engineers' objections to separate patents relies on the invention being obvious.

Mr. ISSA. Okay.

Mr. NADLER. I'm sorry. Would you—

Mr. ISSA. Go ahead and repeat.

Mr. LEE. Sorry. I think that software engineers generally object to patents affecting their work on the basis of the patent being overly broad and not reflecting other innovations that had occurred prior to its granting.

Mr. ISSA. Okay. Now, this actually puts the three of you into a trap set by Judge Michel here. And I don't know if he knows it yet, but I am going to explain—springing a trap. Never a dull moment.

Judge Michel commented in his opening statements that I thought were very profound, and that is that IPR does not grant as though it is a de novo review, as though they simply have new information on a patent. They do not grant what ex parte reexaminations historically would do, which is you strike claim one, the independent claim; claim two, seven, 15, become independent claims on their own. And you essentially may narrow the patent, but you reconstruct it as though the information was available at the time of the examiner.

Ms. Samuels, would you agree that that is not what is happening in IPR to any great extent today?

Ms. SAMUELS. So I actually—I think what is happening with IPRs today is not that simple. I mean, I don't think it is that black and white.

Mr. ISSA. Let me put it this way: Is it, as Judge Michel said, is it something that should happen and routine? In other words, the legislative language that left here would seem to have given them that requirement to use this, as they have in many cases in IPR, to allow the patent holder to essentially argue for what he would

have received had that information been available at the time of the application, which is what historically happened in *ex parte*, and Judge Michel believes doesn't happen enough.

So not arguing does it happen enough. Should it happen? Should that be the intent, thus patent holders can retain the claims they would have had had that information been before them?

Ms. SAMUELS. Listen, I think the reason we have different types—we have *ex parte* and *inter partes*—is because it is presumed that in *inter partes* there will be some back and forth, that you will have—the very structure of the process is different for that very reason. I think that is how Congress—how you all intended in 2011, and I think that is what we are seeing play out.

The processes are different. If they weren't different, we would have one. We don't.

Mr. ISSA. Judge Michel, I have given a lot of credence to your comments. I want to make sure that they are accurate.

Do you believe, both by congressional intent and, if you will, the fairness to the process, to the inventor who is defending his or her claims, that it should be considered in the *inter parte* as though it was knowledge known at the time before the examiner? And I think that is what I heard you say.

Judge MICHEL. Well, it is my view that amendments should be freely allowed during an IPR. That would get you the result that, if all the new information had been known, the original examiner would have acted correctly. If you allow amendments, the end result is the bad claims go out, the good claims stay, everybody goes away better off. But they don't allow amendments. The facts are not in dispute. Out of several thousand decisions, they have only allowed six of them to have amendments.

If I were recommending what—

Mr. ISSA. Your Honor, don't the exceptions prove that they understand the law allowed them to do it, they are simply choosing not to provide what might be reasonable?

Judge MICHEL. Well, I think what it shows is that they have an impossible standard. And the reason is they can't examine it. It is not practical for them to examine. So if they allow an amendment, then they become an examiner, which they are not prepared to do.

What I would recommend to the Congress is allow an off-ramp to go back to reexamination, the way you were explaining it. And if you allowed it to go back for a reissue, reexamination, the patent would not be enforceable in court, because you have to give up the patent in a reissue. It could then be reevaluated with all the new information and allowing free claim amendment, and you would end up with an accurate patent that would benefit everybody.

Mr. ISSA. Not buying completely into one part of what Judge Michel said, but, Mr. Reilly, as a former patent examiner and as somebody interested in, ultimately, patents being good and enforceable, if they are, in fact, good, do you see that as part of where Congress could provide what Judge Michel said was an off-ramp, the ability to avail ourselves of, essentially, an *ex parte* reexamination as part of IPR if that is not reasonable to do at the IPR process?

Mr. REILLY. Mr. Chairman, I would be cautious here. I think the congressional—

Mr. ISSA. What I am asking you is—I am cautious. I want to hear.

Mr. REILLY. Yes. I think the congressional intent was clear here to have an amendment, and I think the PTO has been looking at enhancements there. There is a lot of reasons why patent owners have not been amending. Part of it is potentially the process. But there is other incentives out there. One of them is past damages get wiped away, so they are not incentivized to do so. And I think that is a very important point and a part of this debate.

The vehicle is there. The congressional intent was there. And I think this is a place probably best served for the PTO. We do need to stay focused on the compactness of these proceedings. The reason why we think they are working is because you have got a year-and-a-half fuse and you get to a final result. That certainty is pretty critical to maintain the integrity of the programs.

Mr. ISSA. Thank you.

And I am going to now recognize the ranking member for a round of questions.

Mr. NADLER. Thank you.

Mr. Reilly, what if—and you said—what would it do to your conclusion in what you just said if past violations were not wiped away by an amendment?

Mr. REILLY. Past damages is a factor that I think patent owners look at. And it is just that, a factor. And I am not sure—

Mr. NADLER. No, no. If you went to inter partes review and we changed the standards—or we changed certain factors so that they would allow more amendments, you said one of the things that—why they never do it is that past awards would be wiped away. What if we change that? Would that change the amount of—the number of amendments that would be considered?

I mean, clearly, the congressional intent was that they should consider amendments to that stage. They don't for practical reasons. What if we started dealing with some of those practical reasons?

Mr. REILLY. Well, I think you have to look at the factors as a whole, specifically on past damages. You know, the American public needs notice. Alright? If they are going to be on the hook for damages, someone is going to amend their claim—

Mr. NADLER. Well, you can't give notice to the past.

Mr. REILLY. Right. And that is what I am suggesting. If the scope of the claims changes, you can't go back and have a claw-back on damages—

Mr. NADLER. No, no. That is exactly right. You shouldn't.

Mr. REILLY. Right. And right now, that is the way it is set up. If they do amend, then there are no past damages.

Mr. NADLER. I am suggesting, what if we change that?

Mr. REILLY. I think that is problematic for those reasons, that there is—

Mr. NADLER. No, no. You say it is problematic. But the logic of what you are saying is that it is a good idea. I don't understand that.

Mr. REILLY. I'm sorry. I am not following you, Congressman, as far as the—

Mr. NADLER. You are saying that the people need some certainty, that we can't claw back previous awards. I agree with that. So if we said, all right, we will—and that that is one of the reasons amendments aren't done, even though we have told the IPR that they can do amendments. So what if we change it? In the past, we said if you do an amendment to the IPR grants and amendment, it is like a new application, but only going forward. It doesn't affect prior awards. Now, what is your objection to that? Or is there an objection?

Mr. REILLY. My apologies, Congressman. I think that is the way it is today. And my apologies—

Mr. NADLER. I thought you said—

Mr. REILLY [continuing]. I am not tracking with you.

If they do amend it, right, in the proceeding, and they do avail themselves of that mechanism, then past damages are taken off the table. That is how it stands today.

Mr. NADLER. I thought you said the opposite?

Mr. ISSA. Will the gentleman yield for a second?

Mr. NADLER. Sure.

Mr. ISSA. Maybe I can clarify. If a dependent claim becomes an independent claim and you fall under it, they are not wiped away?

Mr. REILLY. Correct.

Mr. ISSA. Okay. So it is only if, in fact, you have a truly new claim that would assert. But often, what happens in a reexamination, for my colleague and myself to clarify, is that, in fact, you simply strip away, but you modify the patent. And there is a continuity of infringement that often is there.

I agree with you, if it is a brand-new claim that evolves, that is different. But in most cases, they are defending a portion of a patent that survives, even though the independent claim often goes away, which is the most broad of them. Isn't that correct?

Mr. REILLY. That is correct. And I completely agree. If a claim survives, past damages should remain on the table.

Mr. NADLER. Okay. Thank you.

Judge MICHEL, where some of us are upset, as you are, about the two different systems, IPR—two different standards, IPR and ex parte. If you appeal to the courts—you don't start in the courts. You go through the IPR, you appeal to the court from the IPR decision. What is the standard of review?

Judge MICHEL. Well, it is highly differential for fact issues and free review, de novo review for legal issues, as typically is the case. So the fact-intensive nature of IPR reviews means that it is pre-ordained that the Federal Circuit will have to affirm in 90 or 95 percent of the cases whatever the PTAB does. So to me, that is okay, if what the PTAB does is really accurate, really fair, really reliable. But it often isn't. So that is the process that needs to be improved, because the Federal Circuit can't realistically fix it. Too late.

Mr. NADLER. So when we say that there are two standards of review, what we really mean is that the standards of fact determination in the Federal court ab initio as opposed in the IPR is different?

Judge MICHEL. Well, yes. The procedures are different. The standards are different. And they shouldn't be, because the Federal court standards are the ones that the country is—

Mr. NADLER. Right. The standards on fact determination?

Judge MICHEL. Pardon?

Mr. NADLER. The standards on fact determination, because you are saying the legal question—the legal standards are obviously what the court says.

Judge MICHEL. Correct.

Mr. NADLER. So you are talking about, to coin a verb, uniformalizing the fact determinations?

Judge MICHEL. No. What I am trying to suggest is that the tests used in court and the standards for using those tests apply equally in IPRs as they would in a district court proceeding. So, for example—

Mr. NADLER. And that is what I just said. That is what I meant by uniformalizing it.

Judge MICHEL. Yes. Correct claim construction, not BRI, for example. But now they use BRI, and it is not fair, it is not appropriate, and it is not just, because we have defined “just” as being what the courts do. That is—

Mr. NADLER. And we have to define it that way.

Judge MICHEL. Yes.

Mr. NADLER. Thank you very much. I yield back.

Mr. ISSA. Thank you.

Mr. Johnson, did you have a further question?

Let me try to ask a few—if you don't. Okay.

Thank you. I appreciate that.

Let me go through a couple of more things.

Mr. Lee discussed earlier that he had a task. He didn't look at patents, but it took him a few hours using available coding software to accomplish a task. Isn't he dividing—and I will go to each of you, but, Mr. Reilly, I am going to start with you, as a former examiner.

Wasn't Mr. Lee giving us something that, notwithstanding a passage of time, potentially, is exactly what we did not intend to make patentable?

In other words, someone of ordinary skill in the art needs to be able to be taught an invention that has been patented. But, in fact, if somebody of ordinary skill in the art given a common task would be able to accomplish it in a few hours, doesn't that inherently make it obvious?

Mr. REILLY. Mr. Chairman, I mean, I think you would always have to look at the specific facts, but I completely agree with that line of reasoning there. And the bigger challenge here is looking at the evidence and getting the prior art or the evidence of invalidity in front of the PTO, whether it is at the examining level; the district court, if you are trying to invalidate it there. That is the big challenge. Where is the stuff written down? Where can you get it to invalidate these assets, and that is quite complex.

Mr. ISSA. I understand. But as a former examiner, wasn't that one of your challenges, is that you only heard from one side, they certainly didn't tell you that what they were doing was anything other than pioneering, novel, a breakthrough—I can't remember all

the things I claimed, but I remember there was a court case afterwards that said be careful how you use those words, because that is another element for disagreement.

But habitually you saw that, including your years before the decision on means plus function. But in the old days, people would come up with a simple means plus function and then want the broadest interpretation, wouldn't they?

Mr. REILLY. Yes. I think we have to be cautious here, though, putting—you know, we really want to be respectful of patent owners' rights and establishing too much of a burden on the way in with applications.

Mr. ISSA. No, I don't want to establish a burden. I recognize that the patent owner will always come with a verbose statement of invention, argue for the broadest claims, as you try to narrow them.

I am really concerned about that next step. When Mr. Lee describes what he has done 100 times on request and says, but that is obvious, and then Judge Michel's former colleagues have a case coming up to them where the court says, well, I don't have the ability to really consider the obviousness on the same standard that you would have been able to consider it as a patent examiner. And that is a lot of what I hope to learn here today, because Mr. Nadler and I, I think, want to further fix venue, and we want to make IPR more just, and we want to deal with covered business methods expiration in a way that is fair, because it was a temporary program.

So, again, particularly between the two of you, Judge Michel cannot, or his colleagues in the district court cannot consider what you could consider as an examiner. Isn't that true?

Mr. REILLY. That's correct.

Mr. ISSA. And we—is it fair to say we need to have a process that brings back to the examiner or equivalent level new information that can be considered as though it was known so that we can get a just result while, in fact, the court has to defer to the examiner ultimately? Isn't that correct?

Mr. REILLY. Mr. Chairman, on this, I think as a general matter here, we already have that in the post-grant review proceedings. I think you have a BRI standard that is applied, and you have, most importantly, the ability to bring the best prior art forward, if you are in the IPR, and the best invalidity grant if you are—

Mr. ISSA. I couldn't agree with you more. But Judge Michel has brought up a valid point, and we have known each other for a long time. He brings up a lot of valid points. He did when we were considering the legislation before it was passed. And that is if the IPR process is not doing what you would have done as an examiner, if a patent holder in the final stages brought you new information he became aware of and wanted to amend his claims, not based on his original disclosure, but based on the claims with this new knowledge, you did that regularly, didn't you? You considered those things in the continuation in part and so on. That is something that Judge Michel says doesn't happen in the IPR process.

Mr. REILLY. I think, Mr. Chairman, that the chief judge and—the chief judge and I have spoken on occasion. I think what he is focused on, correct me if I am wrong, is the burden that is placed on the amendment process. And I am not sure that off-loading that to a whole separate regime within the PTO is the best way to solve

it but interested in discussing the proposed solutions there and weighing in from the financial services perspective.

Mr. ISSA. Yeah. And I am not prepared to talk about solutions today as much as I want to vet the problems, the differences between ex parte, where it does effectively go back to an examiner or equivalent, and the inter parte.

But, Judge Michel, again, I have been quoting you without properly giving you an opportunity to interpret yourself.

Judge MICHEL. Well, I think the offering is critical, because, as you say, if there is new information and the patent owner is willing to give up some broader claims in order to sustain the narrower claims, then everybody benefits. People can't be threatened with invalid, overbroad claims, because they go away. The inventor gets the narrow claim he is entitled to by having a reexamination by an examiner.

The problem is the Board judges are not examiners. They can't do examination. They don't have the skill and they don't have the time. So where the situation arises where there is new prior art and the patent owner wants to narrow his protection, let him go back to examination. Give him an off-ramp. It is not mandatory, but it is his choice. And meanwhile, he has to surrender the patent, so it can't hurt anybody. Nobody can be sued on that patent until the reexamination and reissue is concluded. And then you come out with the narrower patent. Everybody is better off.

Mr. ISSA. Food for thought.

The gentleman from New York has joined—another gentleman from New York, from Brooklyn.

Mr. Jeffries, do you have questions?

Mr. JEFFRIES. Yes. Thank you.

I thank the distinguished chairman as well as the ranking members for convening this very important hearing. I thank the witnesses for your presence here today.

I just wanted to explore some territory. I apologize in advance if it may have already been covered. But I believe, Judge Michel, you mentioned during your testimony that you believe the U.S. patent system was in crisis mode. Is that correct?

Judge MICHEL. Yes.

Mr. JEFFRIES. And I think you testified that it no longer incentivizes investment and innovation. Is that right?

Judge MICHEL. Yes.

Mr. JEFFRIES. Now, I believe there was a chamber of commerce study that was done, which concluded that the U.S. patent system, which had long been number one in the world, had declined to number 10 in the world. Is that right?

Judge MICHEL. Correct.

Mr. JEFFRIES. And I believe they concluded that that decline took place over a 1-year period. Is that right?

Judge MICHEL. Yes.

Mr. JEFFRIES. Would you agree with that conclusion or do you think that there are factors that have been at play for a longer period of time that have resulted in what you have concluded is a crisis and what many others have concluded has been a decline in the system?

Judge MICHEL. Well, the problem is that the level of uncertainty that drives away investment has been going up sharply in recent years. So it doesn't surprise me that a year or two ago, the rating was number one, but then, in the most current rating, we dropped to 10, because there has been an escalation of the uncertainty that drives away the investment.

And it is not my opinion, the National Venture Capital Association has massive evidence of what the investment trends are. And there is more venture investment now, as Ms. Samuels said, but it isn't going into R&D. It is going into things with lower risk and higher return on investment. So the R&D world is being starved for the necessary money because the venture money is going into non-R&D, nontechnology investments, like entertainment, that have a better return.

And it is often going abroad where patent systems are stronger, where injunctions are routine, where trials are very fast and very cheap, where eligibility has been made much broader in Europe and in Asia, even in China this past spring, compared to the United States where we have been shrinking eligibility hugely, denying injunctions except in rare cases, and making litigation so expensive that 90 percent of the owners of valid patents cannot afford to enforce their rights.

Mr. JEFFRIES. Thank you.

As it relates to how we deal with this crisis, as well as the uncertainty that exists, is there an administrative approach that can be taken through the Patent and Trademark Office, including presumably reducing the caseload of workers there so they can better evaluate the appropriateness of patents? It seems to me that there is obviously a legislative approach that can be taken.

And then there is also deference to the judiciary in light of the Supreme Court decisions that have been issued most recently in terms of venue and prior to that as it relates to strengthening the opportunity for fee shifting pursuant to section 285. Could you just comment on your view as to whether a balanced approach, you know, utilizing the tools that are available administratively, legislatively, judicial deference, what is most appropriate?

Judge MICHEL. Certainly, balance is a critical consideration. Balance between plaintiffs and accused infringers, between small companies and large companies, between drug technologies and software technologies, and on and on like that. So balance certainly is a key part of it.

In terms of balance among the different actors—the Congress, the courts, the patent office—there is a role for everybody. Obviously, I think big improvements can be made in examinations and in IPRs in the patent office, particularly under the leadership of this committee, if you monitor what they are doing and make them justify what they are doing.

But, you know, at the end of the day, our system is a statutory system. It is not a common-law system. So when the Supreme Court says, well, we think eligibility should be this, that, or the other, okay, they can think that. But you have the final say, because eligibility is defined by the Congress in section 101.

If you think the Supreme Court has restricted it too much, you can broaden it by changing the wording. If you think the Supreme

Court didn't restrict it enough, you can narrow it further by changing the wording. It is really, in the end, up to the Congress. You are the elected representatives of the people who should be making national innovation policy, not unelected judges on the Supreme Court. They don't have the information about investment that you can procure by having hearings like this and other hearings. You have the database to make sound decisions; the Supreme Court doesn't. They just have the briefs of the party and a few amici. And they don't really understand what is going on in the investment world. And that is where the action is. The shift of investment out of R&D and out of America, that is the problem.

Mr. JEFFRIES. Thank you for your testimony.

I yield back.

Mr. ISSA. Thank you.

I am going to try and bring this to a close. We did a great deal, and there is more to do.

First of all, sort of doing in reverse order, as Judge Michel said at the end, the obligation to promote and reward for these useful inventions and works is ours. And so a body made up of people who, for the most part, have not been technology promoters and creators does fall to us. And that is an area of great concern that we, in fact, do have an obligation to find ways to make, among other things, 101 as broad or narrow as is necessary to promote those useful—the investments that lead to useful discoveries.

Additionally, it is clear that we are going to have followup in a number of areas. And I am going to encourage each of you to supplement what you have said today in your written thoughts of any length. And they have to do not exclusive but including thoughts on how venue could be further legislated as a companion to the TC Heartland case and, in fairness, a response to the *Raytheon v. Cray* case that now has a four-part test, at least in one place in the United States.

Secondly, the comments and the discussion on the harmonization between the court and the PTAB for inter parte reexamination. It is a valid question. It is one that has been asked a great deal, and I would ask all of you to supplement your thoughts.

Harmonization, of course, does bring us to what Judge Michel talked about, and that is the lack of the ability for what would effectively be ex parte reexams or reexams in which claims could be appropriately narrowed and, as we discussed I think fairly well, when they would or wouldn't relinquish prior damages rights.

Lastly—and, again, there are other items, but I am just closing with this. The question of the expiration of CBM. And since it was intended to be a temporary program, whether or not some part of IPR should be modified to take on legacy activities that would otherwise not be covered, which, of course, brings us in a vast way back to the possibility of broad IPR reform, not to bring uncertainty, but to further empower a system which is considered by all of you to be good. But, quite frankly, I think I heard from all of you, not good enough.

So that is a lot of homework.

Judge Michel, I appreciate the fact that you have not retired, you have simply changed suits.

And with that, does the ranking member have any comments?

In that case, we stand adjourned.
[Whereupon, at 12:00 p.m., the subcommittee was adjourned.]

