



REINVENTING THE PATENT ACT

A COMPROMISE IS BREWING ON CAPITOL HILL THAT WOULD RECAST THE U.S. PATENT SYSTEM. WILL IT MAKE ANY DIFFERENCE—FOR BETTER OR WORSE?

Brandon Shalton is on a mission from God. Well, sort of.

Shalton created a company in 1999 that developed audio-to-web technology that could instantly digitize phone messages and post them on a Web site. Although the company foundered on the shoals of the dot-com disaster, it gained new life in 2003 in the form of SpokenMessages.com, a Web site serving the online-ministry needs of churches.

"The site would allow pastors to call and make messages available on the church Web site," Shalton says. "We were marketing the service with two nuns on the sales team. We were in beta testing with about 20 churches, and ready to go live, when I heard about Acacia."

Acacia Research Corp., based in Newport Beach, Calif., acquires and licenses technology patents in a variety of industries. Acacia is one of a group of companies that have earned the ignoble

moniker of "patent trolls," because they use broad interpretations of patent language and threats of lawsuits to convince alleged infringers to pay licensing fees.

Shalton learned that Acacia held a patent to the process of transferring audio or video content from a remote network server—effectively claiming exclusive rights to one of the most basic functions of the Internet. "I knew this was a bogus patent claim," Shalton says. But this fact wouldn't prevent Acacia from suing Shalton and his resource-starved clients.

"Defending against a patent-infringement claim is expensive," Shalton says. "Just an opinion paper runs around \$10,000."

So Shalton faced a choice: He could continue developing SpokenMessages.com and take it on faith that Acacia wouldn't have the temerity to

sue churches, or he could contact Acacia and arrange to pay licensing fees for a business method he knew pre-dated the company's patent.

The situation troubled Shalton so much that he decided to pursue a third choice: discontinue SpokenMessages.com and launch a one-man crusade against patent abuse. "I felt a calling to take a stand," he says.

Since then, Shalton has dedicated hundreds of hours of work to researching examples of prior art that would invalidate abusive patents. He has provided this information for free to companies facing infringement notices from patent trolls and launched the Web site fightthepatent.com. Thus far, however, only a few have had the resources to take the battle to court.

Frustrated by such dilemmas, Shalton and other technology-industry advocates have turned to the U.S. Congress for help—and legislators have heard their pleas.

In June 2005, Rep. Lamar Smith, R-

Texas, introduced a patent-reform bill (HR 2795) that included provisions aimed at curbing patent abuse.

If enacted, the bill will change the U.S. patent system in some fundamental ways—most notably implementing a first-to-file system of establishing rights to a patent, replacing the first-to-invent system that has been in place since Thomas Jefferson ran the PTO. Even so, the effort to find a viable consensus has driven lawmakers to pare down HR 2795 to those reforms that have achieved widespread approval among major constituent groups. Now it's unclear whether this slimmer version, if enacted, will deter patent abuses, encourage innovation or streamline the system.

"It won't stop patent trolls," Shalton says. "The patent office is an institution that some people believe exists to serve their purposes. A system that was intended to protect the 'little guy' from larger companies stealing their ideas is turning into a system that serves large companies who can just patent anything."

Two-Front Warfare

Several factors stand in the way of significant patent reform. In general, the stumbling block is the fact that any change to the patent system affects many inventor groups differently and will almost certainly have unintended consequences. As a result, various constituencies oppose major changes to the system. However, legislators respond to momentum, and patent reform has gained significant momentum in Congress.

"We have a flavor of what might be an achievable bill," says Mike Kirk, executive director of the American Intellectual Property Law Association. "That's what we're after. The perfect airplane never flies, and someone somewhere will want to tweak it. But I'm hopeful we'll see a bill attract a coalition that will allow it to move forward."

Most of the momentum on patent reform is occurring along two battlefronts. On one front, large entities, primarily corporate patent owners, face off against small ones: non-profits, small businesses and independent inventors. On the second, pharmaceutical and biotechnology companies face off against software and IT firms.

Of course in reality the battleground isn't divided so neatly; there are many

other constituencies and interests in play. In general, however, the competing interests on these fronts are shaping the legislation. The most heated battles seem to be occurring on the second front: pharmaceutical/biotech versus software/IT. In the world of patent regulation these industries' interests clash violently.

"When it comes to patents, the needs of the software and IT industries are very different from pharmaceuticals and biotech," says Jason Schultz, staff attorney with the Electronic Frontier Foundation, a non-profit group dedicated to protecting the free flow of information on the Web. "Software, e-commerce and IT companies evolve their business models every couple of years. You can't thrive in those markets without constantly reinventing yourself."

Because these fast-moving companies aren't wedded to a given business model, they aren't dependent on a certain regulatory model either. Indeed, they are lightly regulated in general, so government relations and compliance aren't their central competencies. Conversely, the regulatory issues they face represent barriers they would like to overcome, and as a result they tend to favor major policy changes that embrace "new-economy" business models.

Also, as a functional matter, software and IT companies sell products and services that incorporate hundreds of design components and business methods—none of which cost much to develop. This exposes software and IT companies to myriad patent-related risks, including patent trolls whose revenues depend on extorting settlements from alleged infringers.

"Our industry is vulnerable to these claims," says Bart Eppenauer, chief patent counsel and associate general counsel for Microsoft Corp. "Microsoft spends more than \$100 million annually defending patent-infringement lawsuits. Most of the cases are brought by patent speculators who don't have products or conduct their own R&D, but are there to win a lottery-ticket case."

However, on the other side of the debate, pharmaceutical companies (and businesses in many other traditional manufacturing industries) are not vulnerable to patent trolls. They sell products based on fewer inventions, and each one is more costly and time-consuming to develop than almost any software or IT compo-

nent. Pharma/biotech companies are accustomed to spending millions of dollars on R&D, and protecting their IP is a paramount consideration. Thus these companies invest heavily in patent protection and regulatory compliance, and a strong government-relations infrastructure is vital to their success.

One result is that pharma/biotech companies are naturally reluctant to make big changes to the regulatory structures around which their business models are built, and are well positioned to argue their case before legislators.

"Legislation moves forward when you get a broad consensus among affected people," says Robert Armitage, senior vice president and general counsel for Eli Lilly and Co. "Any issue that goes to a fundamental feature of the patent system will have difficulty garnering the diversity of support needed to enact it into law."

Concurrent with these conflicts, battles are taking place between large and small inventors. On this front, independent inventors, small businesses and non-profits, such as universities and research laboratories, are positioning themselves in opposition to large corporations. Small inventors face challenges quite different from those affecting large companies in either fast- or slow-moving industries.

For example, while most large companies develop inventions primarily for manufacturing and sales, many smaller entities don't. Instead their inventions are intended for further research or licensing. This affects how small entities view patent reforms—they are less concerned about automatic injunctions, for example, and more concerned about administrative issues and costs.

Given this complicated landscape of interests and sensitivities, common ground in patent reform can be difficult to find. As a result, the most dramatic changes proposed have been sidelined or watered down, which most analysts consider a good thing.

"It's known that technology advances in small increments," said Judge Pauline Newman of the U.S. Court of Appeals for the Federal Circuit, speaking at a symposium in early June. "If incremental advances won't be as readily protected, and will provide no competitive advantage, what will be the effect of this change to economic incentive? Will there be more or less incremental advances? We need to

be confident in our answers to these extremely difficult economic fundamentals before we make a major change.”

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Chief Patent Counsel
Microsoft Corp.

On the other hand, if the interests of large inventors or powerful political lobbies are allowed to stymie needed changes—or divert those changes in directions that hurt other constituencies—innovation could likewise suffer.

“In the big picture, what’s going on here is that the established, entrenched members of the patent community, including the lawyers, are accustomed to the system and don’t want it to change,” Schultz says. “The Patent Act of 2005 is a step in the right direction, and generally all the reforms are necessary. But there are serious management and structural issues at the PTO itself that the PTO doesn’t even acknowledge. I’d caution anyone against seeing this bill as a panacea.”

Unintended Consequences

HR 2795 is evolving toward a more conservative bill precisely because various constituencies want to avoid certain unintended consequences. At the same time, however, the way the legislation has evolved raises questions about how it will affect various interest groups. Perhaps the most vulnerable group is the one with the least amount of political clout on Capitol Hill—the little guys.

Although the individual inventor has a colorful and storied history in the U.S., the true importance of this group to the economy is not well understood. “It’s hard to say where true innovation comes from,” says Thomas Duston, a partner with Marshall, Gerstein & Borun in Chicago. “Venture capital firms point to a lot of small incubator-type companies that grew up outside the Fortune 500, but others dismiss these stories as apocryphal.”

Nevertheless, few would openly dispute the fact that small businesses and non-profits play an important role in advancing technology in many areas of the economy, and protecting their place in the patent system is an important goal.

Small entities welcome some of the reforms proposed in HR 2795 and fear others that could make it more difficult for them to compete in a world dominated by large corporate patent owners. For example, some small entities might find themselves playing catch-up under a first-to-file patent system, versus the current first-to-invent system (see “Pros and Cons Of First-to-Invent”).

“Big companies already treat everything on a first-to-file basis because they are operating in international markets where first-to-file is already the standard,” says Herb Hart, a board member with McAndrews Held & Malloy in Chicago. “Smaller companies and individuals would suffer under a first-to-file regime because they don’t have the resources of a multinational corporation to hire patent lawyers and drive lots of stakes into the ground.”

Whereas smaller entities might move almost as quickly to file a provisional patent on a new invention, for example, they might be less able to flesh out such filings and update them with enough detail to make them stick. “One thing a big corporation can do is to file a provisional application and then file another a day later, or a week later, over and over again, to preserve their right to the invention at each stage of its development,” says Jon Sick, board member with McAndrews Held & Malloy. “For a small inventor, that procedure would be burdensome and expensive.”

In the long run, the outcome could be to degrade the innovation prowess that has made the U.S. a technology leader on the world stage. “Opponents of first-to-file say our technology advantage is somewhat related to the fact that our system is different,” says Ken Godlewski, a partner with Kilpatrick Stockton in Washington, D.C. “We create incentives for people who aren’t necessarily the first in line at the PTO to establish they are entitled to a patent.”

Furthermore, some proposed changes designed to help small players might actually hurt them. Namely, the post-grant opposition procedure would provide a

lower-cost venue for challenging questionable patents, but smaller entities might find themselves at the mercy of large companies that can afford to make the most of the post-grant process.

“Some in-house law departments will create mini-departments for the sole purpose of watching patent applications and being prepared to challenge those that are issued,” says Brian Roche, a litigation partner with Sachnoff & Weaver in Chicago. “Big companies do this already, but smaller companies haven’t because they couldn’t afford to challenge patents anyway. Now, with a post-grant opposition procedure, it will be a lot cheaper and easier to challenge a patent at the PTO, so there’s an incentive to be vigilant.”

Incentive or not, small entities may be simply unable to muster the resources to use the system as effectively as larger players can.

“There is still debate regarding the post-grant opposition procedure,” says David D’Zurilla, a patent attorney with Schwegman Lundberg Woessner & Kluth in Minneapolis. “In our complex society and patent system, it will be difficult to predict how these changes will affect individual inventors.”

Unintended consequences might affect larger entities too. Some measures intended to streamline the system for disputing patents might only shift conflicts from one part of the system to other venues that might or might not be able to handle them more effectively.

One example is the proposal to implement a first-to-file system. This provision of HR 2795 has widespread support as a logical step to simplify the process of establishing claim ownership and harmonize the U.S. patent system with other systems around the world. But the first-to-file approach likely will lead to an increase in provisional patent filings, and this could yield its own problems.

“We could be moving into a situation where the focus shifts toward proof of disclosure priority,” Hart says. “The result could be serious disputes over what was disclosed at a particular time, and what gets priority under the written-description and enablement requirements of Section 112 of the Patent Act.”

As such, a change in law that is intended to simplify the process could create a different set of conflicts. Whether this will be more or less burdensome remains to be

seen. “In a qualitative sense, I don’t see the dispute over adequacy of disclosure being any less complicated than the issue of first inventorship,” Hart says.

Moreover, filers could create a logjam of ill-defined patents at the PTO as they rush to file before they are ready to fully specify their inventions. Few argue, however, that the first-to-file provision will flood the office with provisions, simply because multinational corporations—who represent a majority of the filers—already are operating under a first-to-file regime.

A flood of post-grant oppositions, however, is a real concern that might have dramatic effects on the PTO.

“The whole proceeding was designed to be quick and reasonably effective,” Kirk says. “We don’t know how many of these things will be filed. It’s frightening to look

at what goes on elsewhere. In Europe, about 5 percent of patents granted end up in opposition. If even one-fourth of that were to occur in the U.S., the numbers would be enormous.”

To be precise, the PTO would field about 10,000 post-grant opposition procedures each year. “Where do you get the trained administrative patent judges to handle these cases?” Kirk asks. “It means we need to attend to the funding issue sooner rather than later.”

Unfinished Business

As many questions as HR 2795 raises, the bill strikes a relatively moderate balance of reforms. It offers a measured response to complaints about litigation excesses. In addition the latest working drafts of the bill have included provisions that would

narrow the definition of “willful infringement” judges apply when setting damages awards, and would provide a clear defense for companies who obtained an attorney’s opinion in support of non-infringement or invalidity. This is expected to reduce plaintiffs’ leverage in patent cases, serving the goal of fighting patent trolls and other types of litigation abuse.

Additionally, at presstime policymakers were vetting various approaches to addressing perceived forum-shopping abuses. Chairman Smith floated a substitute bill just before the August recess that included a section on venue selection that hadn’t appeared in the original language.

“While the specific proposal opened a hornet’s nest of issues, it also opened dialogue on how to address some of the forum issues,” Armitage says. “It set the stage for

Securing PTO’s Lifeblood

While operating a small print shop in suburban Chicago, Daniel Russo had an idea for more durable and easy-to-use masking sheets, with registration marks printed on vinyl instead of paper. In 1995 he filed a patent application and contacted manufacturers to gauge their interest in marketing the product. Then he hit a snag at the PTO—namely, the agency denied the patent on the basis that the invention was obvious and therefore couldn’t be patented.

Russo filed an appeal, but the PTO was so backlogged with work in the booming Internet economy that the office took more than four years to hear the appeal. Finally, in 2001, the appeals board overturned the examiner’s decision and issued Patent No. 6,258,446.

By then, however, a company called Base-Line, Inc.—one of the companies Russo had contacted to market the product—had been manufacturing and selling pre-ruled vinyl masking sheets since 1998. “They were infringing on our patent,” Russo says. “We had gone out of business because the larger companies were just waiting to see if we got the patent. The delay at the patent office cost me the business and umpteen dollars.”

Russo’s story illustrates the real-world consequences of funding policies at the PTO. Congress provides the agency with a budget, and filing fees the PTO collects go to the general fund rather than back into the agency’s budget. Hence when filings and other activities increase rapidly, as they did in the late 1990s, the PTO quickly becomes swamped with work it can’t afford under its fixed budget.



The PTO's new office building.

The Patent Act of 2005 (HR 2795) would exacerbate this problem because it would add duties to the patent office, most notably a post-grant opposition procedure that didn’t exist before, and the responsibility for determining whether a filer has violated duty-of-candor requirements. However, the bill doesn’t provide any additional funding resources for the PTO to implement these requirements and does nothing to fix the basic problem of fee diversion.

Fortunately, anti-fee diversion legislation has gained momentum in Congress. What form it eventually might take is unclear, however. In the House, The Patent and Trademark Fee Modernization Act of 2005 (HR 2791) would end the diversion of PTO fees and also would extend a program to outsource patent searches. In the Senate, a similar bill, The COMPETE Act (S 1020), was introduced in May. The bill would avoid fee

diversion in a different way, using a fee-reduction system.

Either way, the reforms won’t help Daniel Russo, who ultimately prevailed in securing a licensing arrangement with Base-Line Inc., but whose invention is no longer as valuable as it once might have been. The printing business has evolved dramatically in the past 10 years, and the settlement with Base-Line only goes back to 2001, when the patent actually issued.

“I’m glad that we were able to settle on a licensing arrangement, but it probably wasn’t worth the wait,” Russo says. “It would have been much better for my business if we’d been able to get the patent when we expected it.”

—Michael T. Burr

the interested players to work together from the text to try to find common ground. There is some hard looking now about changes in the way venues are selected.”

While the specifics of the language are still up for debate, the discussions have raised the odds on venue-selection reforms being included in the final bill.

“There is a growing level of support for the proposal,” Kirk says. “The discussion has changed to focus on how you can achieve venue-selection reforms without engendering opposition from trial lawyers that we’d rather not see.”

At the same time, while Smith’s original bill included provisions that would limit plaintiffs’ ability to secure an automatic injunction against defendants found to be infringing, the substitute proposal omitted any language on injunctions.

“Chairman Smith was wise to take it off the table,” Armitage says. “Whether it was included in the bill likely would predict the outcome of the legislation.”

Opponents to the injunctions provision

saw it as an immoderate solution to the problem of abusive litigation, and in fact it might have encountered a constitutional challenge in the Supreme Court.

“The Constitution gives inventors the right to exclude others from manufacturing an invention,” Roche says. “The type of reforms proposed—replacing the right to an injunction with compulsory licensing—might be unconstitutional.”

That doesn’t mean, however, the issue might not be addressed in some other form, outside the vehicle of the Patent Act. Advocates seem likely to pursue the debate on a separate legislative track, and already the question is on its way to a hearing before the U.S. Supreme Court in *MercExchange v. eBay*).

With the injunction issue out of the way for the time being, and a compromise brewing on the venue-selection question, the most stubborn wrinkles of patent reform seem to have been ironed out. In fact the Patent Act of 2005 actually might see a House floor vote this year. But irrespective of unintended consequences that

might emerge, the key to making it work will be found in its implementation by the PTO—and therein lies a major problem (see “Securing PTO’s Lifeblood”).

“It isn’t going to work unless the PTO gets the funding,” says Don Martens, of counsel with Knobbe Martens Olson & Bear in Irvine, Calif. “I’m optimistic that it will get worked out, because everyone realizes the PTO needs financial resources.”

If the legislative momentum Congress gained with HR 2795 can carry through with the separate funding bill, the patent system might be on the verge of undergoing the most significant changes that it has seen since 1952. As these changes take effect, however, in-house practitioners and policymakers alike will be wise to study their consequences, to ensure in the long run they don’t cause more harm than good. ◀

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