

May 15, 2009

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Bureau of Competition
Federal Trade Commission
601 New Jersey Avenue, N.W.
Washington, D.C. 20580

Re: Evolving IP Marketplace — Comment, Project No. P093900
American Intellectual Property Law Association

Dear Ms. Michel,

The American Intellectual Property Law Association (“AIPLA”) submits these comments in response to the initial invitation of public views on the evolving intellectual property marketplace (73 Fed. Reg. 70645, Nov. 21, 2008), and as a follow-up to the FTC hearings on this subject since December of 2008.

AIPLA is a voluntary bar association of more than 16,000 members – including attorneys in private and corporate practice, in government service, and in the academic community – who work with patents, trademarks, copyrights, trade secrets and other legal issues affecting intellectual property. AIPLA represents a wide and diverse spectrum of individuals, companies, and institutions involved directly and indirectly in the practice of patent, trademark, copyright, and unfair competition law, as well as other fields of law affecting intellectual property. AIPLA members represent both owners and users of intellectual property. AIPLA seeks to improve the intellectual property laws of the United States and believes that a robust and balanced intellectual property regime promotes innovation, creates jobs, and spurs the economy.

AIPLA has taken part in the ongoing FTC hearings on this subject as represented by Executive Director Q. Todd Dickinson at the December 5, 2008 hearing and by AIPLA President Teresa Stanek Rea at the March 19, 2009 hearing. Without doubt, the legal landscape with respect to patents has changed since the FTC’s October 2003 report, *To Promote Innovation: The Proper Balance of Competition and Patent Law and Policy*. In addition to judicial interventions concerning validity, infringement and injunctions, the Congress is close to making the most dramatic and comprehensive reforms to the patent statute in over 50 years.

These developments warrant the type of review undertaken by the FTC. The comments that follow attempt to present AIPLA views on the specific questions posed, and are offered in furtherance of a balanced and effective patent system.

1. How has the IP marketplace changed in the past five to ten years? What changes are expected in the future? What aspects of the patent system drive those changes? What is the impact of those changes on innovation?

AIPLA members have seen a continuing trend of using or developing patents as the assets on which investors, such as venture capitalists, base their decisions to invest in university-developed

technology and early stage companies. These investments fund research and development as well as the commercialization that brings new products to market. “[T]he technological influence of small firms is increasing” as the number of small firms with 15 or more patents increased from 33% in 2000 to 40% in 2002.¹ Universities and non-profit research institutes (such as cancer research centers, among others) are important sources of innovation which often serve as incubators for start-up businesses. Cooperation between existing business and university research should be encouraged.

Based on anecdotal experiences, there is an increasing market for intellectual property as a stand-alone asset. This is consistent with the apparent continuing trend of transactions based on value and risk associated with patents and intellectual property, rather than labor/capital.

As the importance of the global marketplace increases, there is a growing need to obtain and enforce IP rights globally. However, the cost to obtain and enforce global IP rights is also increasing which has led to a strain on industries, which has been compounded by the global economic decline.

The current economic climate has decreased the amount of investment in research and development that would lead to innovation. Recent anecdotal evidence suggests that investment in long-term research and development is falling. One large pharmaceutical company recently announced that, over the past year, its in-house, early-stage drug development programs will decline by one-third. See Jeanne Whalen, “Glaxo Net Falls 7.1%; Job Cuts Planned,” *Wall Street Journal*, February 4, 2009.

Predictability and transparency in obtaining and enforcing patents decreases the risk associated with investments in research and development and therefore provides incentives for investment in innovation. Conversely, unpredictability, a lack of transparency, and policies that decrease the value of patents will also decrease the incentive to innovate. AIPLA is concerned that a decrease in the value of patents would, in combination with the current economic climate, have a very significant, negative long-term effect on innovation.

2. What are the new business models involving intellectual property? What has motivated the development of these business models? What is their impact on innovation?

AIPLA is aware of many different IP-based business models. Existing models include technology development companies, such as Qualcomm, Rambus, AmberWave, MOSAID, and Tessera, that engage in research and development, but do not directly manufacture products. Patent licensing and enforcement companies, such as Acacia Research and Lemelson Foundation, are examples of another IP-based model. These companies purchase patents and then license or enforce them. By contrast, there are companies that act through alliances to protect open source technology by purchasing patents and licensing them for free with respect to identified fields of use.

AIPLA is also aware of emerging business models. There are now patent aggregators, such as Intellectual Ventures, as well as IP auctions and exchanges, such as Ocean Tomo, IPAcutions.com, and Yet2.com. In addition, there has been the relatively recent development of the securitization of royalty streams, *i.e.*, securities backed by royalty streams, and financial derivatives, *e.g.*, standardized

¹ *Small Firms and Technology: Acquisitions, Inventor Movement, and Technology Transfer*, by CHI Research Inc. for SBA Office of Advocacy, January 2004, p. ii. See <http://www.sba.gov/advo/research/rs233tot.pdf>

license contracts such as IPXI Unit License Rights. Another model employed, for example, by Altitude Capital and Rembrandt IP Management, provides debt/equity financing of licensing and enforcement activities. In addition, IP financiers, including E.G. Paradox Capital and IPEG Consultancy, are making loans based primarily on the value of IP assets. There are also licensing agents and patent brokers who serve as intermediaries for bringing together licensors/licensees or buyers/sellers. Defensive patent aggregators/pools such as RPX and Allied Security Trust have developed to allow potential licensees to pool resources to purchase potentially blocking patents. Finally, there are Public Stock Indices, such as the Ocean Tomo indices and the Patent WSJ Scorecard.

AIPLA cannot speak to what motivates any particular business, but presumably, like all other business models, IP business models are intended to make profit, fund additional research and development, and/or to hedge risks associated with (1) the investment in innovation and new products and/or (2) the infringement of third party rights. For example, the stated motivation of defensive pools is to buy up threatening patents. Some of the new existing models appear to parallel those which have developed around other classes of assets.

Given the speed with which these business models have emerged, their impact on innovation is difficult to assess. However, the AIPLA believes that strong, valid IP rights encourage innovation. They encourage investment in activities that enable new innovations, and investment in commercializing new products based on those innovations, including formation of new businesses. They can often motivate transfers of technical information between existing business entities.

AIPLA also believes that liquid, transparent, and efficient markets for valid IP assets can have a number of beneficial effects. Liquidity and lower transaction costs for IP assets encourage greater investment in innovation. Efficient prices for IP assets established by markets, together with their transparency, could provide more meaningful evidence of damages caused by infringement.

While these and other types IP marketing dynamics could be explored, AIPLA does not recommend taking any action to curtail to new business models which comply with existing laws and regulations.

3. What economic evidence is relevant when analyzing whether to grant a permanent injunction following a finding of infringement? What proof have courts required? How should the analysis take into account the incentives to innovate provided by the patent system and the benefits of competition? What is the appropriate remedy when the court has denied a permanent injunction after a finding of infringement?

Section 283 authorizes district courts, upon a finding of infringement to, to impose a permanent injunction “in accordance with the principles of equity.” In *eBay Inc. v. MercExchange*, 547 U.S. 388 (2006), the Supreme Court held that long-standing equitable principles govern the grant of permanent injunctive relief in patent infringement cases:

A plaintiff must demonstrate: (1) that it has suffered irreparable injury; (2) that remedies available at law, such as monetary damages, are inadequate to compensate for that injury; (3) that, considering the balance of hardships

between the plaintiff and defendant, a remedy at equity is warranted; and (4) that the public interest would not be disserved by a permanent injunction.

eBay Inc., 547 U.S. at 391.

Under this test, the patent holder must demonstrate that an award of damages cannot adequately compensate the patent holder for the economic harm from continued infringement. Patent holders may show irreparable harm by proving, among other things, market share losses, price erosion, loss of customer relationships, etc. Likewise, the accused infringer may demonstrate the economic hardship that an injunction would impose.

AIPLA submits that the question of whether the public interest would be disserved by entry of a permanent injunction should not be answered by an economic inquiry into the effect of an injunction on pricing. The grant of exclusive patent rights, by definition, includes the right to foreclose competition for the patented invention for the life of the patent. Indeed, permitting competition in the market for the patented invention – *i.e.*, creating a “non-exclusive” market – is simply the converse of the grant of exclusive patent rights. Defining the public interest as little more than “price competition” would undermine the judgment of the Framers of the Constitution and Congress that the grant of exclusive patent rights itself serves the public interest. In considering the public interest prong of the four-part injunctive relief test, the courts have correctly deferred to Congress’s policy decision that the public interest in innovation is served by a limited monopoly with the patent. *See, e.g., Kewanee Oil Co. v. Bicron Corp.*, 416 U.S. 470, 480 (1974) (the grant of a patent circulates to the general public the information contained in it and stimulates the development of further advances in the art); *Bonito Boats Inc. v. Thunder Craft Boats Inc.*, 489 U.S. 141, 150-151 (1989) (the patent system embodies a carefully crafted bargain for encouraging new and nonobvious advances in technology in return for exclusive rights for a period of years); *Eli Lilly & Co. v. Premo Pharm. Labs., Inc.*, 630 F.2d 120, 138 (3d Cir. 1980) (“short-term competition does not, at least in the considered opinion of the Congress, serve the public interest”).

If the court has denied a permanent injunction, then under 35 U.S.C. §284, a patentee is entitled to damages adequate to compensate for the infringement. Since the decision of *eBay Inc.*, the courts have been developing appropriate methods of determining future damages. AIPLA submits that, given the fact-specific circumstances of each patent infringement case, further judicial expression is the best avenue for development of the law.

- 4. Do the legal rules governing patent damages result in awards that appropriately compensate patentees? Are there circumstances in which they result in overcompensation or undercompensation of patentees? What evidence is there of the extent of these problems? What information would be helpful to better assess whether damage awards appropriately compensate patentees? Are courts and juries able to make damages determinations with sufficient accuracy? To the extent that there are problems resulting from the determination of damages for patent infringement, how should they be addressed?**

The statute governing patent damages requires adequate compensation for use of the invention and sets a base or minimum compensation amount equal to a reasonable royalty:

Upon finding for the claimant the court shall award the claimant damages adequate to compensate for the infringement, but in no event less than a reasonable royalty for the use of made of the invention by the infringer, together with interest and costs as fixed by the court.

35 U.S.C. § 284.

The judicially developed doctrines of apportionment and the “entire market rule” address the determination of what the appropriate base of sales on which the royalty should be calculated.² The “entire market rule” recognizes that the economic value added to a product or process by a patented feature may be greater than the value of the feature alone. Placement of the burden of proof on the patentee to establish that the patented feature is the basis for the consumer demand for the entire product or process has led to relatively few instances in which the entire market rule has been used to expand the royalty base.³ The judicially developed multiple-factor *Georgia Pacific* test is intended to determine a market-based award consistent with what parties would have negotiated. Apportionment is one of the *Georgia Pacific* factors, cited for the proposition that portions of the value associated with the claimed product or process that are attributable to the infringer, rather than the patentee, can be subtracted from a damages award. In this instance, the burden is on the accused infringer to establish that damages should be apportioned.⁴

Damages apportionment and the entire market rule are the culmination of the courts’ long and careful efforts to adhere to the statutory requirement of “damages adequate to compensate” for infringement of a patent. Apportionment recognizes the reality that consumer demand for an infringing product or process may in part spring from contributions by the infringer, and that to reward the inventor for those contributions is inappropriate. The entire market value rule recognizes the reality that even complex assemblies may owe their marketability to a patented feature -- a feature that drives consumer demand for the overall assembly. In those cases, it is entirely appropriate to reward the inventor according to the actual impact of the invention. This delicate balance is intended to discourage infringement of others’ patent rights and encourage inventors to make their intellectual efforts available to the public.⁵

AIPLA submits that courts and juries are able to make rational damage determinations. In the past several years, there has been a movement toward better model jury instructions and better guidance from the Federal Circuit. AIPLA believes that further judicial development could solve any problems that truly exist in the patent damages area.⁶

Finally, AIPLA suggests that more information about licensing practices in various industries would be helpful to better assess damages awards on a case-by-case basis, by providing information on the valuation of comparable intellectual property in actual negotiations.

² See Rooklidge at 9.

³ *Id.*

⁴ *Id.*

⁵ *Id.* at 11.

⁶ See Q. Todd Dickinson, “Federal Trade Commission Workshop: Recent and Proposed Changes in Remedies Law,” presented December 5, 2008.

5. How have changes in the willfulness doctrine changed the behavior of patentees and potential infringers? Do recent changes in the law adequately address the concerns with willfulness doctrine identified in the October 2003 FTC IP Report?

In its en banc decision of *In re Seagate*, the Federal Circuit eliminated the “duty of care” that infringers had to exercise to avoid willful infringement, as recited in *Underwater Devices, Inc. v. Morrison-Knudson Co.*, 717 F.2d 1380 (Fed. Cir. 1983), holding that willful infringement requires “at least a showing of objective recklessness.” 497 F.3d 1360 (Fed. Cir. 2007).⁷

Under *Seagate*, willful infringement must be proved in two steps: (1) a patentee must show by clear and convincing evidence that the infringer acted despite an objectively high likelihood that its actions constituted infringement of a validity patent; and (2) it knew or should have known of the risk of infringement. The first step sets out an objective test to which the accused infringer’s state of mind is irrelevant; the second step, the patentee must also demonstrate that this objectively-defined risk (determined by the record developed in the infringement proceeding) was either known or so obvious that it should have been known to the accused infringer. The appellate court left it to future cases to develop the application of this standard.

AIPLA submits that the heightened willfulness standard has helped to address the concerns expressed by the FTC in its October 2003 report. The change in the willfulness standard has significantly diminished *in terrorem* effect of a willfulness claim. As a result, companies are now less deterred from reading their competitors’ patents, from building on the disclosures made therein, and from planning non-infringing business and research strategy.

6. How will changes in patent law rendered by Supreme Court and Federal Circuit decisions of the past five years affect the value of patents? How will these changes affect the operation of the IP marketplace? How will they affect innovation and competition?

Several changes in patent law over the past five years have threatened to degrade the value of patents. Since the Supreme Court’s *eBay Inc.* decision, it is more difficult to obtain permanent injunctions against infringers who are not direct competitors. In addition, to the extent that the threat of a permanent injunction has been diminished, accused infringers have less incentive to negotiate a settlement and may be more likely to litigate a case through trial. The *KSR v. Teleflex* decision, which clarified the section 103 obviousness standard, is making it harder to obtain and enforce patents in some instances. The Federal Circuit’s en banc decision of *In re Bilski*, which has altered the test for subject matter eligibility under section 101, has created a great deal of uncertainty for the software and biomedical diagnostics industries.⁸ Similarly, heightened standards in both section 112 written description and enablement can often be contradictory and result in uncertainty.

Several changes in the patent laws have encouraged innovation and competition. For example, the Supreme Court’s decision in *MedImmune v. Genentech*, 549 U.S. 118 (2007) may be decreasing business uncertainty by permitting more putative infringers to seek declaratory relief. The Federal Circuit’s en banc decision of *In re Seagate* increases the predictability of the courts’ application of the willfulness standard. By raising that standard, it also diminishes the incentive for companies to avoid review of their competitors’ patents, thereby encouraging innovation built upon prior patent disclosures.

⁷ *Id.*

⁸ Dickinson FTC presentation.

At the same time, the risk of harm from patentees that overreach was moderated by the Supreme Court's ruling in *Quanta Computer, Inc. v. LG Electronics, Inc.*, 128 S. Ct. 2109 (2008). The Court held that the authorized sale of an article that "substantially embodies" a system or method patent exhausts a patent owner's rights in those patents. It reversed the Federal Circuit's decision that the sale avoided the exhaustion of patent rights because it was conditional, and that the exhaustion doctrine does not apply to method patents. Under *United States v. Univis Lens Co.*, 316 U.S. 241 (1942), Justice Thomas wrote, the patentee's ability to apply restrictions after the sale of an item applies "when the item sufficiently embodies the patent—even if it does not completely practice the patent—such that its only and intended use is to be finished under the terms of the patent." This ruling represents another course correction by the judiciary that resets the limits on exclusive rights without the need for legislative or administrative intervention.

AIPLA is not aware of any studies that have been conducted to measure empirically the effect of these decisions on the amount of money invested in research and development or obtaining IP rights. However, given the often lengthy period of time from investment in early-stage discoveries to launching a product, particularly in the biomedical industries, the full effect of these changes will not be known for many years, if not decades. In the meantime, AIPLA suggests that interim indicators of "innovation" may include, among other things, (1) the amount of money invested in research and development, and (2) the number of new patent applications filed by U.S. entities (not including continuation or divisional applications). AIPLA suggests that the FTC is well-positioned to commission a study intended to measure the aggregate effects of these changes in the patent law on the amount of innovation in the United States.

7. How does uncertainty regarding the validity and scope of patents affect the operation of the IP marketplace? Does the current system adequately fulfill the notice function of patents? How does uncertainty influence the operation of the IP marketplace? What are the sources of uncertainty that affect the value of patents and the operation of the IP marketplace? What could be done to address them?

In the experience of AIPLA's members, uncertainty regarding the validity and scope of patents discourages investment in innovation, particularly in industries requiring long-term investment.

One of the most consistent sources of uncertainty remains the essential step of claim construction in patent litigation where the Federal Circuit persists in the *de novo* review under *Cybor Corp. v. FAS Technologies, Inc.*, 138 F.3d 1448 (Fed. Cir. 1998) (en banc). While a patent claim is a legal document, it is to be read through the eyes of a person of ordinary skill in the art, a perspective that is factually dictated. While some have discussed a legislative correction for this issue, it is clear that most of the judges on the Federal Circuit are looking for an opportunity to reconsider the *de novo* standard of review set out in the *Cybor* decision.⁹

⁹ The dissenting opinions to the denial of en banc review in *Amgen Inc. v. Hoechst Marion Rousse, Inc.*, 469 F.3d 1039 (Fed. Cir. 2006), revealed that eight judges are now willing to reconsider the no deference rule when the seven judges saying so in *Amgen* (Michel, Newman, Rader, Moore, Gajarsa, Linn, Dyk) are counted with Judge H. Robert Mayer, the most vocal critic of *Cybor*.

To improve the notice function of patents, AIPLA endorses efforts that would require the PTO to publish all pending patent applications at 18-months after initial filing. AIPLA also endorses a procedure by which third parties are able to submit prior art to the PTO during the course of a patent examination. Such a procedure should help increase both the quality of and certainty in the validity and scope of issued patents.

In addition, AIPLA believes that the adoption of a fair and balanced post-grant opposition system would eliminate some uncertainty. Such a system is not a complete alternative to litigation, but can provide the public with an effective mechanism to promptly correct mistakes made by the PTO in issuing patents. We believe that the opportunity to challenge patents should only be for a limited period of time after patent issuance. This will encourage the public to promptly challenge questionable patents and prevent harassment of the patentee.

Finally, AIPLA notes that the lack of consistency in obtaining and enforcing consistent IP rights adds to the uncertainty that industries face. The harmonization of IP laws and procedures would add confidence to the global IP marketplace.

8. How transparent is the current IP marketplace? Can it be made more transparent? Is that desirable?

As noted above, a requirement that the PTO publish all pending applications for a patent at 18-months after initial filing would increase transparency and improve the notice function of patents. AIPLA also supports efforts to allow third parties to participate in the examination process by submitting prior art. In addition, we support the adoption of a fair and balanced post-grant opposition system that can provide a prompt and effective mechanism to correct mistakes made by the PTO in issuing patents. Regardless of the exact procedural reforms, AIPLA firmly believes that there is a need for certainty in the resources available to the PTO and supports an end to PTO fee diversion.

9. During the past five years, what new learning has furthered the understanding of the patent system and the IP marketplace?

Recent decisions of the Supreme Court and Federal Circuit show that courts as agents of change can be effective. In addition, the experience of the past five years demonstrates that legislative reform has not been an effective vehicle to achieve consensus approach to change. For this reason, AIPLA submits that the need for comprehensive legislative reform has diminished.

However, legislative action should be taken in those areas where change is needed that cannot be accomplished through the courts. For example, only Congress can create a post-grant examination procedure, create a procedure by which third parties may make prior art submissions during the course of patent prosecution, end PTO fee diversion to ensure that the PTO has sufficient funds to enable high quality review of pending patent applications, and eliminate the statutory requirement that the best mode of practicing an invention be disclosed.

Finally, AIPLA is concerned about the unfortunate effect of certain media stories on the public's view of the patent system. On balance, the popular press has harmed the public's understanding of the patent system by dramatizing negative aspects of the patent system, *i.e.*, the perceived exploits by patent "trolls," the delay of generic drug entry, and high damages awards in

some patent infringement cases. In presenting these slanted views, the press has sadly missed an opportunity to educate by explaining the important benefits of the patent system, including the development of new diagnostic products and drugs to treat previously untreated conditions and/or improve the quality of life of patients, as well as technological advances in green energy, education and safety.

Sincerely,

Teresa Stanek Rea
AIPLA President