



Not Patently Obvious:

The Innovation Alliance's Position on Proposed Patent Reform Legislation
March 2007

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Everyone involved in patent reform acknowledges the strategic importance of the nation's innovation ecosystem and the vital role played by our constitutionally created and congressionally codified patent system. Everyone favors constructive reform, and no member of the patent community wants to harm U.S. innovation's critical dynamic. But differences abound among the various sectors in the U.S. patent community over the best way to ensure the system's continued contribution to U.S. economic leadership. Even within the IT sector, there are deep divisions concerning the right formula for successful reform. Vertically integrated manufacturers and distributors of IT products and services are pushing patent reforms designed to lessen the risk and impact of infringement litigation. In contrast, smaller firms and other IT specialists fear that measures of this type would diminish the enforceability and value of all patents and disproportionately disadvantage patent holders that license their innovations for subsequent downstream utilization.

The innovation ecosystem is inhabited by many different operating models, each of which is dened to maximize efficient economic performance and all of which are critical to the innovation value chain. As Congress considers major structural changes to our patent system, it is important to keep in mind that tomorrow's innovation is at stake. Our innovative ecosystem will continue to yield new and improved technologies only if its many and varied components are allowed to operate economically. Those who choose or are required to license their inventive efforts are no less important than those who manufacture and sell their products to the public. Collectively, they all play a collaborative part in our nation's innovation, and none of them should be sacrificed.

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Executive Summary

Certain Patent Reform Proposals Would Undermine American Innovation

The Innovation Alliance supports patent reforms that would improve patent quality without diminishing patent rights and the strength of the U.S. patent system. Our country's history is replete with examples of technological pioneers that cultivated and developed new ideas and worked hard to become global market leaders. The future growth of our economy will rely upon that same drive and inspiration in the many small businesses and independent inventors that comprise much of today's innovative economy. What unites us all is a passion for new ideas and confidence that we will ultimately reap the rewards of our investments in innovation.

Economic growth depends upon the continued strength and reliability of the U.S. patent system, which has recognized and protected the rights of inventors for more than two centuries. Our country's Founders understood that property rights are as essential to the fruits of the mind as they are to the fruits of the land. Just as a deed creates legal incentives to cultivate and improve a plot of land, patent rights create incentives to invest in the development and commercialization of an idea. Patent certainty and reliability enables the collaborative development and funding required to nurture basic research through its upstream refinement to its downstream commercialization for the public benefit. That same certainty enables others to confidently invent around, or incrementally improve, published, patented technology. Thriving innovation is the key to a sound economy. It benefits the public while enhancing our nation's security and economic leadership.

As patents become more significant to U.S. industry, congressional interest in the operation of our nation's patent system has increased. As the United States becomes a high-technology, knowledge-based economy,¹ the commercial and social significance of patents is at a premium. An increasing recognition of the value and importance of patents to our nation's economy has nevertheless been accompanied by calls for significant reforms to the current system, many of which are aimed at addressing perceived deficiencies in the operation of the patent regime. While experts differ on whether major alterations in existing law are in fact necessary, both houses of Congress are expected to consider legislation in 2007 that would overhaul the U.S. patent system and implement the most sweeping reforms since the nineteenth century.²

With so much at stake, The Innovation Alliance must call attention to, and express deep concerns with, certain proposed measures that would significantly weaken the foundation of our patent system, which is respected and emulated around the world. Legislation aimed at so-called trolls should not be allowed to inflict "collateral damage" on other legitimate patentees whose public purpose or private sector business models require patent reliability and enforceability.

¹ CRS, Report to Congress, *Patent Reform: Innovation Issues*, January 17, 2007.

² CRS, Report to Congress, *Patent Reform: Innovation Issues*, January 17, 2007

Since patent reform was first introduced in Congress, the U.S. Supreme Court has become deeply engaged in its own adjustments to the U.S. patent system. Decisions made recently, and oral arguments and bench responses in other pending cases, suggest that more significant adjustments may be coming shortly. Prudence in pursuit of fairness suggests that Congress examine the impact of these recent substantive changes before congressional rebalancing begins.

Of particular concern are (i) fundamental changes to the well-established principles used to calculate damage awards; (ii) the addition of a costly new post-grant opposition system that would undermine a patent's enforceability potentially throughout its life; and (iii) undue restrictions on continuation practice that would prematurely truncate the patent prosecution process. As explained more fully below, these drastic structural reforms would combine to destabilize America's incentive-based system of innovation and encourage a weakening of patent rights worldwide.

The proposed mandatory "*apportionment*" test would eliminate the deference given market-based royalties and other relevant factors when calculating damages and instead encourage juries to value patents based on an artificial and arbitrary parsing among patented and non-patented product components. In addition, previous House and Senate versions of apportionment would require a jury to substitute its judgment for that of the USPTO in determining which parts of the patented invention are "inventive" and thus relevant to the damages award. In effect, this would result in a legal and logical conundrum where features of a valid and thus inventive patent claim could be deemed non-inventive and de facto invalid for purposes of a damages calculation. There is simply no justification for such a radical departure from existing principles of patent law and market economics. Under existing case law, courts already have discretion to "apportion" damages where appropriate, but rightly calculate a reasonable royalty according to a broad range of factors that may impact the patent's market value, including existence of a licensing history. Any other standard would potentially undervalue patents and encourage and reward infringers. Moreover, to the extent that apportionment is deemed appropriate, a jury rightly looks to the value of the entire invention since all claims at issue have been found valid and thus inventive. When coupled with the Supreme Court's recent *eBay* decision,³ which significantly limits a patentee's right to enjoin ongoing infringement, the proposed mandatory apportionment rule would eviscerate the remedies that have driven patent-based innovation for more than two centuries. In doing so, this measure would encourage infringers and even existing licensees to reject negotiated, market-based royalties in pursuit of a more favorable jury award, thus increasing the prevalence, cost and uncertainty of litigation.

A second area of concern that threatens the strength and stability of our patent regime is the proposed "post-grant opposition" system, which would subject patent owners to an additional layer of administrative litigation on top of existing administrative and judicial processes for challenging a patent's validity. Although characterized as a check on patent quality and a means of reducing patent litigation, a post-grant opposition system is unlikely to accomplish either goal.

³ *eBay Inc. v. MercExchange*, 547 U.S. ____ (2006).

Post-grant review would encompass a quasi-judicial proceeding with judges, experts, discovery, cross-examination and other costly aspects of litigation. However, it would lack the many safeguards of existing judicial and administrative reexamination procedures that protect patent owners against unwarranted, duplicative and abusive post-grant challenges. As a result, the proposed post-grant opposition system would encourage patent litigation and significantly increase the costs, delays and uncertainty of patent ownership. Moreover, the threat of expansive opposition litigation would significantly undermine a patent's value and enforceability if such procedures were available throughout a patent's life, as contemplated by the so-called "second window."

Additionally, this surge in complex post-grant proceedings will further strain an already over-burdened and under-funded USPTO staff. With a portfolio of some 400,000 patent applications per year, the USPTO is struggling to perform its core examination functions, as evidenced by application pendency periods of 30-40 months. Unless coupled with significant additional resources, a post-grant system will inevitably divert funding from the examination corps, potentially resulting in even greater delays and, most importantly, diminished patent quality. To guard against these negative effects, we urge Congress to consider improvements to the existing post-grant system of *inter partes* reexamination in lieu of a new, duplicative and potentially burdensome administrative review process. Should Congress ultimately decide to supplement or replace *inter partes* reexamination with an opposition process, we ask that it do so only after the USPTO has demonstrated that it can effectively perform its core examination responsibilities. Even at that point, it is imperative that Congress provide USPTO with the additional resources necessary to manage the significant demands of a new quasi-judicial opposition process.

We also ask that Congress and the USPTO refrain from legislative and/or regulatory measures that would drastically alter continued examination practice to the detriment of both patent applicants and users. Of particular concern is any measure, whether regulatory or legislative, that would impose severe and unprecedented limitations on continuation practice, a critical and necessary part of the patent examination process. Continuing applications help to define and clarify the proper scope of a patent and its claims, thus ensuring that a patent confers adequate protection, certainty and notice to the public. With increasingly complex technologies, a patent application may require several written communications between the examiner and the applicant before the invention and its relationship to the prior art are clearly understood. This iterative process necessarily results in the filing of one or more continuation applications. Arbitrary quantitative restrictions on continued examination filings, such as those recently proposed by the USPTO, would diminish the clarity of patent claims and prematurely truncate the prosecution process. As a result, the proposal would, contrary to the objectives of patent reform, reduce patent quality, increase administrative appeals and escalate the costs and delays of patent examination. Although some small percentage of applicants may abuse the existing continuation practice, the USPTO's proposed changes would wield a sledgehammer to target a few bad actors and, in the process, harm all inventors. These concerns and others are set forth in comments filed by numerous patentees, both large and small, in opposition to the USPTO's continuation proposal.

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**The Innovation Alliance Supports Reforms that
Would Improve Patent Quality without Diminishing Patent Rights**

The Innovation Alliance does not oppose patent reform; however, the necessity and efficacy of each proposed reform must be measured against the overarching goals of motivating and rewarding innovation, increasing patent quality and fairness, and reducing litigation uncertainty and costs. The solution is not to gut the patent rights critical to these and other innovations, but instead to bolster the system with measures that will improve *pre-grant* patent quality.

Patent quality is best achieved by pre-grant measures that provide examiners with the resources, training and information needed to properly assess whether an invention is, in fact, novel, non-obvious and useful. A recent study by the National Research Council also demonstrates that increases in patent examination resources yield important reductions in post-grant litigation, further underscoring the critical importance of such measures.⁴ To its credit, the USPTO has taken several steps in recent years to improve pre-grant quality, including by the hiring of thousands of new examiners and strengthening of its training programs.⁵ The results are promising. In December 2006, the USPTO reported a significant decrease in the patent allowance rate to a record low of 54 percent -- a dramatic drop from the 2000 rate of 70 percent. In addition, the USPTO in 2006 achieved its lowest error rate in 20 years -- 3.5 percent. Of course, to maintain this trend, it is imperative that the USPTO continue to receive the resources necessary to evaluate an escalating number of patent applications. And to that end, what is most needed is legislation to permanently end patent fee diversion. Although we recognize the political considerations that have thwarted past efforts to end this ill-advised practice, patent reform legislation stands little chance of achieving positive and concrete improvements without addressing vital resource issues.

In that same vein, increased USPTO resources will yield quality gains only if examiners have the information and incentives to recognize and reject claims for obvious or non-novel inventions. The Innovation Alliance thus supports measures that would foster an environment of cooperation between patent examiners and applicants and increase the prior art available to examiners. These include, for example, proposals to increase third-party submissions and mandate universal publication of all patent applications. Similarly, clarification of the willfulness standard and inequitable conduct defense would benefit all participants in the patent system, provided that they appropriately balance the interests of patent owners and users and preserve disincentives against infringement. At the same time, the USPTO should reconsider policies that potentially encourage patent examiners to issue questionable patents, including quotas or other benchmarks that tie compensation to the number of applications processed.

⁴ *Patents in the Knowledge-Based Economy*, Wesley M. Cohen and Stephen A. Merrill, Editors, Committee on Intellectual Property Rights in the Knowledge-Based Economy, National Research Council (2003).

⁵ In addition, the USPTO just announced a revolutionary beta program to identify the most relevant prior art through the use of peer review system. Innovative approaches of this type should be encouraged.

Of course, even if we improve the quality of issued patents, disputes will inevitably arise, as in any system of property rights. However, The Innovation Alliance takes issue with exaggerated claims that patent litigation is out of control or inherently unfair to patent users. Having experienced patent litigation as both defendants and plaintiffs, our members share the frustrations of all Americans that litigation is expensive, distracting and time-consuming. At the same time, we are grateful for a strong statutory framework and stable judicial system that protect and enforce the rights of patent holders. Indeed, the strength and stability of America's patent regime have created powerful incentives for entities of all size, structure and focus to collaborate through market-based agreements, helping to fuel a dynamic and prolific innovation ecosystem and decreasing the likelihood and cost of litigation.

The Innovation Alliance has yet to see any credible evidence that patent litigation is any more prevalent or prone to abuse than other high-stakes commercial litigation. Indeed, the Administrative Office of the Courts, the administrative arm of the Federal Judiciary Branch, reported modest increases in patent litigation over the past five years -- i.e., a 12 percent increase in cases filed between 2001 and 2006 -- and an actual decrease in patent cases since the peak year of 2004. This increase is attributable to a range of factors, most notably the growing number of patents issued in recent years and their relative commercial significance to our knowledge-based economy. Significantly, the number of trademark and copyright cases filed throughout this period has consistently exceeded the number of patent cases. A recent study affirms the findings of the Judicial Branch that patent owners have become more judicious in using patents to enforce their IP rights and thus are bringing cases less often.⁶

The Innovation Alliance supports reforms designed to reduce litigation costs and uncertainty. It is, however, a mistake to characterize efforts to weaken the enforceability of legitimate patents as litigation reforms. Not only would such measures undercut the rights of all patent owners to protect a few corporate giants from potential infringement litigation, they would ultimately increase the number of lawsuits by encouraging infringers to seek court-ordered rather than market-based solutions. In contrast, several of the other proposed reforms -- for example, elimination of the best mode requirement -- correctly target subjective aspects of the patent system that increase litigation costs, while leaving intact the rights and remedies of legitimate patent owners. Measures of this type would heighten the fairness, predictability and efficiency of patent litigation for all stakeholders.

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⁶ PricewaterhouseCoopers, *2007 Patent and Trademark Damages Study* found that intellectual property rights remain important but enforcement actions are declining (p.7). The continuation of this trend is subject to change as the Supreme Court's *MedImmune* decision (*MedImmune, Inc. v. Genentech, Inc.*, 549 U.S. ___ (2007)), may encourage more patent actions and a declining dollar may result in foreign entities attempting to introduce infringing products into the US market (p.11).

**Mandatory Apportionment: Diminishing the Value of
Patent Rights and Discouraging Investments in Innovation**

A hallmark of America's patent system is the recognition that issued patents are property rights whose infringement merits strong remedies, including the right to prevent future violations and obtain adequate damages for past infringements. These remedies form the foundation of any system of property rights, but are particularly critical to patent owners - especially small and medium-sized innovators - that typically have no other means to protect their inventions. Patents owned by members of The Innovation Alliance represent years of research and billions of dollars in investments. However, once disclosed to the world, as the patent system requires, our innovations can be copied by any competitor. For this bargain to work properly, a patent right must be enforceable and have meaningful remedies associated with that enforcement.

Since the codification of the U.S. patent system, the guarantee of strong remedies has given patent owners the leverage necessary to secure fair royalties from free-riders, including larger, better-financed competitors, and the confidence to share their inventions with the rest of the world. Consider, in contrast, an America without a strong patent system. Most small inventors, which comprise an estimated 40 percent of patent owners, would lack the financial wherewithal to make their vision a reality, and many established companies would reduce investments in research and carefully guard the secrecy of their inventions. Our system of innovation would, in turn, take a giant step backwards, and the American economy would suffer.

Under Section 284 of the Patent Act, the minimum permissible measure of compensatory damages is the "reasonable royalty for the use made of the invention by the infringer, together with interest and costs." In cases where the patent owner can demonstrate a pattern of negotiated licenses, this market-based "established royalty" rate serves as the *minimum* baseline for damages awarded to the patentee. Any lesser damage award would fail to make the patentee whole and encourage infringement.

In cases lacking an established royalty, courts have long considered a variety of factors to determine the royalty the parties would have agreed to in a hypothetical negotiation. Indeed, in the seminal case *Georgia-Pacific Corp. v. U.S. Plywood Corp.*,⁷ the district court identified 15 factors as potentially relevant to a determination of reasonable royalties. Among these 15 factors is the "portion of the realizable profit that should be credited to the invention as distinguished from non-patented elements" -- the so-called "apportionment" test -- which forms the basis of the previous House and Senate proposal on damages. Other factors include, for example, royalty rates paid by the infringer for licenses to similar patents; the commercial relationship between the licensor and licensee, such as, whether they are competitors in the same territory in the same line of business; the duration of the patent and term of the license; the established profitability of the patented product; and the testimony of qualified experts.

⁷ 318 F. Supp. 1116, 1120 (S.D.N.Y. 1970).

Once the patent is deemed valid and infringed, the court's objective is to give due consideration to all relevant market factors and predict with as much accuracy as possible the royalty the parties would have decided at the negotiating table. However, for this hypothetical negotiation to achieve an equitable outcome, it is imperative that courts retain the discretion and flexibility to determine which subset of the 15 *Georgia-Pacific* factors is relevant to a particular patent, and the relative weight to be given each factor. Of course, this process of using hindsight to replicate a hypothetical negotiation is necessary and appropriate only in the absence of a market-tested royalty rate. Where a pattern of established royalties exist, the market has already spoken, and there is no need to "apportion" the infringed-upon patent or consider other factors. In fact, doing so would encourage juries to substitute their judgment for that of the market -- a result that would violate the spirit and letter of U.S. patent law and weaken the property rights inherent in patented inventions.

It is this aspect of the proposed mandatory apportionment test that is most troubling and most at odds with *Georgia-Pacific* and the thousands of cases that have applied its flexible, market-based approach to damages. Although they differ in their particulars, both the House and Senate bills from the 109th Congress would mandate apportionment of damages in all cases and elevate this one factor above all others, including evidence of a market-established royalty rate.⁸ Such a standard would be extremely harmful, jeopardizing the ability of innovators to sustain a licensing-based business model and cycle of innovation.

By encouraging juries to ignore the full range of relevant factors that impact a patent's market value, a mandatory apportionment test will increase the cost and uncertainty of enforcing patent rights and, in turn, diminish the value of all patents. Among other effects, a patentee will be forced to sue on each and every patent infringed by the product -- as opposed to the subset of patents most relevant to the product -- so that other features of the product will not be used against it in a damages determination. This is especially true for a patentee that owns a large number of patents that cover specific devices or standards. In addition, instead of using the industry standard royalty as the basis for a damages calculation, a jury will be instructed to parse the "realizable value" of the "inventive contribution" of the patents, as distinguished from other features of the device.

What this means in practice is anyone's guess, particularly since the terms "realizable value" and "inventive contribution" have no defined meaning under the Patent Act or case law. Assuming the undefined term "inventive contribution" is intended to mean something other than

⁸ Congressional sponsors of comprehensive patent legislation have yet to introduce their proposed bills for the 110th Congress but have indicated that the new bills will be very similar to proposals introduced and debated during the 109th Congress. Both houses of the 109th Congress considered patent reform bills. With respect to the House of Representatives, H.R. 2795 was originally introduced on April 4, 2005. Titled the "Patent Reform Act of 2005," H.R. 2795 was then subject to a Chairman's Substitute Amendment on July 26, 2005. Efforts in the House of Representatives were complemented by a distinct "Patent Reform Act of 2006," S. 3818, that was introduced in the Senate on August 3, 2006. Although neither of the bills resulted in enacted legislation, they may contribute to further discussion of patent reform in the 110th Congress.

the patented invention, the apportionment proposal would arguably require a jury to reevaluate a patent claim (after finding it to be valid and enforceable) to determine which portion is truly “inventive.” Once again, the jury’s judgment would reign supreme, displacing that of the patent examiner and necessitating a costly and time-consuming battle of the experts. Such a standard would lead to considerable confusion and complexity and jeopardize the established rights of all U.S. patent owners.

Given the likelihood that mandatory apportionment will produce an artificially low valuation of the patent, potential infringers and even existing licensees will have greater incentives to risk litigation rather pay, or continue paying, the standard licensing fee. No longer will the market be the arbiter of a technology’s value; instead, a paid expert and jury will be. Many small innovators will lack the resources to defend their patent rights against abusive tactics of this type. Larger, better-funded companies will have little incentive to pay a fair royalty to a smaller patentee, or even execute a license, knowing that a jury will be forced to parse the value of a little-known or understood patented technologies among “inventive” and non-inventive components. This is precisely the predicament that faces Innovation Alliance members AMBERWAVE and IMMERSION -- two small U.S. companies that recently licensed their technologies to larger, better-funded companies that had, at first, been unwilling to pay a licensing fee.

When coupled with the heightened *eBay* standard for injunctive relief, a mandatory apportionment test would further weaken and destabilize our system of patent rights and jeopardize the very existence of smaller firms with an innovation and licensing based business model. Since *eBay*, courts are increasingly reluctant to award permanent injunctions to patent holders (historically, the first line of defense against infringement), unless the infringement undermines competition for the patentee’s product. In cases where a patent holder licenses the right to practice its patented technology to others, but does not practice the technology itself (as is often the case with small inventors that lack the resources and infrastructure to manufacture their innovations), courts have, since *eBay*, shown a greater reluctance to award permanent injunctive relief. As a result, a small inventor will in many cases be forced to permit ongoing use of its patented technology pursuant to a court-imposed compulsory license (without the benefit of important standard non-royalty license terms such as confidentiality) and a jury-dictated royalty. In the post-*eBay* world, it is thus all the more important that Congress preserve the ability of patent holders to obtain adequate damages for patent infringement, as this will be the only viable remedy in many cases. Indeed, now that a post-*eBay* jury may be deciding the royalty rate both for past infringement and future compulsory licenses, it is essential that it retain the discretion to consider all relevant market factors.

To illustrate the point further, consider this real property analogy. Suppose a trespasser decides to take up residence in a property owner’s apartment building. Under the *eBay* decision, one’s ability to evict (or enjoin, in the case of patents) that convicted trespasser stands in doubt. Now the only question is how much the trespasser will pay in rent (damages). Under the *Georgia-Pacific* standard, a jury would, at a minimum, award the \$500 in monthly rent that the owner currently charges other tenants for comparable apartments. But under the mandatory apportionment test, a jury will be encouraged to ignore existing rents in favor of an artificial process of apportioning the value of one’s property. What if the jury decides that the

“apportioned” value of the trespasser’s apartment is only \$300 per month? Certainly, all other tenants would demand a similar reduction in rent, diminishing significantly the commercial value of the building and the property owner’s ability to maintain, improve and finance the property. Patents are no different -- unless supported by strong property rights and remedies, patented technologies will diminish in commercial value, and patent holders will lose access to financing and critical incentives to invest in ongoing innovation.

Of course, proponents argue that mandatory apportionment is necessary to protect against inflated damages in cases where a patent represents a trivial component of a complex system. What they neglect to mention, however, is that *Georgia-Pacific* already permits apportionment in such cases. Under *Georgia-Pacific* factor 13, a jury may take into consideration the “portion of the realizable profit that should be credited to the *invention* as distinguished from non-patented elements” when determining a reasonable royalty rate. Consistent with this decision, the Federal Circuit’s model jury instructions permit consideration of the “portion of the profit that is due to the patented invention, as compared to the portion of the profit due to other factors.” Apportionment, however, is not appropriate in all cases. In particular, courts have long held that the parsing of a patent’s value is sensible only if the patent represents a relatively insignificant and separable part of the overall product. In contrast, where a patent is responsible for all or substantially all of the product’s market value, apportionment is unnecessary and inappropriate.

None of these nuances and complexities are reflected in the proposed mandatory apportionment test, which would primarily protect the interests of large, established firms with a vertically integrated business model, to the detriment of smaller and arguably more innovative firms that rely upon their patents to generate licensing revenue and venture capital financing. The *Georgia-Pacific* factors, in contrast, are technologically neutral and thus accommodate all industries, business models and types of patented inventions, without favoring or disadvantaging the interests of any one sector. Unlike the proposed mandatory apportionment test, the full *Georgia-Pacific* analysis is sufficiently flexible to apply in all situations, resulting in appropriate damage awards for a wide variety of technologies and royalty arrangements.

Furthermore, the law already provides safeguards to prevent excessive damage awards. Patent owners, for example, bear the burden of proving the monetary amount necessary to compensate for acts of infringement and are not eligible to receive remote or speculative damages. There is simply no credible evidence that such safeguards are insufficient to prevent inflated damages, or that the current method of calculating damages is inherently unfair to patent users. Citing this lack of evidence, the ABA Intellectual Property Section has publicly opposed a mandatory apportionment amendment, noting that the proposed language “would have undesirable consequences.”

**Post-Grant Opposition: Jeopardizing Investments in
Pre-Grant Patent Quality, Increasing Litigation Costs and Destabilizing Patent Rights**

The proposed “post-grant” opposition system is, unfortunately, another example of a well-intentioned but ill-conceived measure that could significantly undermine patent rights without any countervailing benefit. The proposed system would create new quasi-judicial procedures within the USPTO for resolving post-issuance challenges to patent validity.

Although both the House and Senate versions of post-grant share the worthy goals of improving patent quality and decreasing litigation, each proposal, as drafted in prior bills, could have the opposite effect. Of particular concern is the fact that the USPTO lacks the resources to administer a European-style opposition system, which would require it to oversee the equivalent of a judicial trial to resolve questions of validity. The USPTO is already struggling to manage a growing workload of over 400,000 patent applications per year, resulting in significant backlogs and ever-increasing pendency periods. Without a significant increase in USPTO resources, the introduction of a post-grant system would strain an already over-burdened office, leading to even further examination delays and potentially diminished patent quality. In Europe, for example, opposition proceedings prolong already lengthy pendency periods by an average of three to five years, significantly curtailing the commercial life of the patent.

Although the previous House and Senate bills attempted to alleviate certain deficiencies of an opposition system -- for example, by requiring completion of the proceeding within 12 to 18 months of its commencement -- they altogether failed to address this fundamental issue of resources. Similarly, each failed to address adequately the inefficiencies, delays and potential abuses that would inevitably result from introducing a new administrative reexamination procedure on top of existing *ex parte* and *inter partes* post-grant processes. Although characterized as a means of reducing patent litigation costs, the proposed post-grant opposition system would merely shift litigation costs to the administrative arena. Moreover, because the opposition process would lack existing safeguards against frivolous or duplicative invalidity challenges, while also increasing the expense and difficulty of defending patent rights, it would significantly increase a patent owner's litigation risks and costs and undermine the enforceability of all patent rights.

Although improvements to existing judicial and administrative reexamination procedures may be warranted, proponents of an expansive post-grant opposition system have yet to explain why a wholly new and potentially duplicative layer of administrative litigation is necessary. Clearly, an opportunity to reexamine questionable patents is an important component of a properly functioning patent system, but such procedures must also strive to preserve the value and enforceability of the vast majority of meritorious patents. In federal court, for example, only accused infringers and licensees have the necessary standing to challenge a patent's validity; and a challenger must prove invalidity by clear and convincing evidence. At the same time, however, the challenger can seek to invalidate the patent on any substantive or procedural ground and invoke the full arsenal of evidentiary tools available at trial. In combination, these factors permit an exhaustive judicial review of questionable patents, but also discourage frivolous litigation.

The current administrative system of *inter partes* reexamination, introduced in 1999, is designed as a relatively quick and low-cost alternative to litigation in cases where invalidity can be established on the basis of published prior art. As its name suggests, reexamination requires the examiner to take a fresh look at a patent claim and, on the basis of prior patents and printed publications, determine whether the claim fails to satisfy the statutory conditions of patentability. A challenger may request reexamination throughout the life of the patent, provided that it demonstrates a substantial new question of patentability. However, because an unsuccessful challenger is generally estopped from asserting invalidity in a subsequent civil trial or *inter*

partes proceeding, patentees are effectively shielded from the risk of abusive or duplicative reexamination. As with existing judicial procedures, this system of *inter partes* reexamination attempts to create an effective check on patent quality without diminishing the value and stability of patent rights generally.

In contrast, the proposed post-grant opposition system would combine aspects of a judicial and administrative reexamination process, but eliminate or substantially dilute existing safeguards that have effectively discouraged misuse of the system. In the process, it would create a quasi-judicial system of administrative litigation that heavily tips the balance in favor of the challenger's interests; increases incentives to litigate; and disproportionately shifts litigation costs to the patent owner. Unlike a civil proceeding, a post-grant opposition system would invite challenges by any party adversely affected by a patent. And it would facilitate invalidation by eliminating the patent's presumption of validity and reducing significantly the challenger's evidentiary burden. In addition, the challenger would be free of constraints designed to reduce the cost, scope and potential abuses of administrative reexamination. For example, the proposed opposition process would, unlike existing administrative procedures, allow challengers to demand discovery, hearings, cross-examination and other aspects of litigation that quickly escalate the cost and complexity of defending a patent. At the same time, the proposed opposition system would significantly relax the estoppel effect of an unsuccessful challenge, thus permitting the challenger to "try again" in a subsequent litigation or administrative proceeding and negating an important deterrent against the harassment, waste and delays of redundant proceedings.

Patent owners would bear the brunt of these increased litigation costs, particularly if expansive opposition litigation is permitted for any issue of patentability throughout the life of the patent. In contrast, a competitor or free rider - relieved of robust evidentiary requirements and the risk of estoppel - would have every incentive to seek opposition, regardless of the patent's strength. Such a system would inevitably invite abuse, allowing corporate giants to misuse opposition litigation as a means of blocking patents that frustrate their business interests. Indeed, by stripping a patent holder of the protections that guard against baseless challenges, an open-ended opposition threat would effectively destroy a patent's statutory presumption of validity and cast a permanent cloud over its legitimacy and enforceability. This uncertainty will undoubtedly undermine a patent holder's ability to negotiate fair licensing terms and secure financing. Such a result would be particularly devastating for start-ups and other smaller firms whose very survival is often dependent on early stage venture capital and licensing revenue.

Indeed, if the experience of other countries is any guide, the United States should exercise great caution before introducing a post-grant opposition system. Less than 10 years after adopting such a system, Japan, Korea, Taiwan, and China have all recently abolished post-grant patent opposition procedures in favor of a streamlined invalidation proceeding that permits a centralized process for administrative reexamination. The Japanese Patent Office has publicly acknowledged that repeated attacks against a patent under duplicative administrative and judicial opposition systems have imposed undue burdens on patentees, resulting in increased costs and delays. Similarly, Taiwan concluded that its post-grant opposition system unfairly benefited infringers to the detriment of all patent owners.

Although proponents of an opposition system contend that existing *inter partes* reexamination procedures are overly restrictive in certain respects, and thus underutilized by challengers, such claims merely argue for improvements to the existing system, not the creation of a costly, duplicative and resource-intensive opposition process. For example, the USPTO has recommended amendments that would extend *inter partes* reexamination procedures to all enforceable patents (eliminating the existing bar on *inter partes* reexamination of patent applications filed before enactment of an *inter partes* process). Incremental and carefully-tailored amendments to the existing *inter partes* process merit serious consideration before wholesale adoption of an expansive new system of administrative litigation. As a result of improvements of this type, the USPTO has experienced a gradual but marked increase in *inter partes* reexamination proceedings since 2000 (i.e., 120% increase in *inter partes* requests from 2004 to 2005). Thus, there is every reason to believe that further incremental improvements to the *inter partes* system could address any remaining deficiencies and greatly expand usage of existing administrative procedures.

Even if post-grant opposition is ultimately deemed to be a necessary and preferable alternative to *inter partes* reexamination, implementation of a new opposition proceeding should not occur until USPTO has demonstrated its ability to perform core examination functions in a timely manner and is given the resources to manage the significant demands of a new system of administrative litigation. Even at that time, opposition proceedings should be limited to a single window of review (i.e., within 12 months of issuance) to ensure that patent owners enjoy clear title over their inventions throughout the lives of their patents.

Conclusion

Given the critical importance of our patent system to American innovation and economic leadership, it is imperative that patent reforms be carefully tailored to achieve necessary improvements and, in all cases, to promote and protect investments in innovation. The over-arching goal of patent quality is ill-served by measures that would destabilize our current system of patent rights and remedies and, in turn, jeopardize the global leadership of this country's most innovative industries. In this respect, The Innovation Alliance takes issue with certain corporate giants that would weaken patent rights to reduce their own litigation costs and promote their particular business models. No doubt their businesses can survive such a trade-off, but we are far less sanguine about the future prospects of the many thousands of innovative firms that live or die on the strength of their patent portfolios. Moreover, by creating uncertainty as to the validity and enforceability of patent rights, we stand to encourage, not discourage, costly litigation.

If our shared objective is to improve patent quality while preserving incentives to innovate, we should instead pursue reforms that enhance patent examination resources and capabilities within the USPTO and make it harder for questionable patents to survive scrutiny. The USPTO has already taken important steps to achieve these goals, hiring thousands of new examiners, instituting new training programs and committing annually to performance benchmarks. But it needs Congress's support in the form of a predictable flow of resources and hence a permanent end to fee diversion. In addition, Congress should continue to pursue constructive but narrowly tailored reforms that would increase access to prior art and lessen the

subjective aspects of litigation. Carefully structured measures of this type would ultimately fortify the health of our patent system without endangering the rights of American's most innovative firms.

In contrast, there is simply no justification for legislation that would artificially constrain damage awards through mandatory apportionment, particularly now that injunctive remedies are increasingly unavailable to patent owners. In the wake of *eBay*, Congress should take pause before adopting unprecedented reforms that would further weaken the entire patent system; favor the interests of large corporations to the detriment of smaller innovators and licensing-based business models; and ultimately jeopardize America's competitive advantage in today's knowledge-based economy. Such measures would serve no other purpose than to protect the interests of large corporations against infringement claims, no matter how meritorious. Similarly, a post-grant opposition system, unless accompanied by adequate resources and safeguards, will subject patent owners to unwarranted delays, costs, uncertainty and harassment, without offsetting benefits to patent quality. If the United States is to remain the world's leading innovation-based economy, we cannot destabilize and weaken patent rights with measures of this type.

The Innovation Alliance thus urges Congress to eliminate mandatory apportionment from any patent reform package or alternatively to codify all of the *Georgia-Pacific* factors, including the existence of an established royalty rate, as recently proposed by the Intellectual Property Owners Association. Moreover, we ask that Congress consider improvements to the existing *inter partes* reexamination process in lieu of a new post-grant opposition system, and ensure that any such opposition system is coupled with adequate resources and safeguards to prevent abuses and achieve the ultimate goal of improved patent quality.

In closing, we urge Congress to keep in mind the likely domino effect of proposed patent amendments on intellectual property rights worldwide. The U.S. economy has long benefited from the strongest intellectual property laws in the world. America's system of patent rights and remedies is universally recognized as the gold standard, and, as such, it has given us the moral authority and credibility to fight for stronger protection of U.S. innovations in other markets. Maintaining that authority is critical in today's increasingly competitive global economy. America's leadership in this knowledge-based economy is critically dependent upon the ideas and innovations that constitute our most valuable natural resources and our most desirable exports. If the United States weakens patent rights and remedies at home, our ability to press foreign countries to respect American intellectual property will be greatly diminished. Indeed, we will embolden other countries to adopt even more damaging policies that could jeopardize the continued preeminence of America's most productive industries. This is a slippery slope, and we must be careful.