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February 13, 2014

The Honorable Winslow Sargeant
Chief Counsel for Advocacy
US Small Business Administration

Subject: Patent Reform

Dear Dr. Sargeant,

The Small Business Technology Council (SBTC) believes that HR 3309 and other "patent reform" bills in the Senate will cloud patent titles, making them weaker. For small business, patents will become mostly unenforceable due to the proposed much higher upfront cost of litigation, thus making small business patents significantly less valuable. Loss of patent value constricts new company formation, chilling new investments, and choking job formation. Legislating disincentives for capital investments will result in the loss of many hundreds of billions of dollars of wealth in America and dry up the major source of new jobs, small inventing businesses. Purporting to attack predatory trolls, the bills instead attack all small companies with legitimate patent suits to protect the interests of large infringers at the expense of new business job creation. Furthermore, these bills do not specifically define or address "trolls" or "non-practicing entities," but instead lump all patent holders together. With the current patent legislation, we have a baby and bathwater problem, we are "throwing out" our small business inventors.

HR 3309 ("Innovation Act of 2013") is anti-innovation and anti-job, and will further raise the barriers against small business technology development by making it yet harder to win and defend a patent in the U.S. The House and Senate bills raise the costs of obtaining and defending new patents, which disproportionately empowers the largest firms while straining the capability of smaller firms. Intellectual property is a key component to make and keep good jobs in America. By raising the barriers to development and protection of intellectual property, the bills remove a key incentive to innovate, and provide large international manufacturers the ability to infringe with impunity. Patents protect U.S. jobs, and these bills are anti-patent and anti-job.

- By making it much easier for large integrated multi-national corporations to simply adopt new technology without consideration for patents, the resulting jobs will tend to flow overseas to the lowest-labor-cost location, rather than be held by U.S. workers defended by U.S. patents. U.S. patents are a primary defense keeping U.S. jobs in the U.S.

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- Over time, these changes also reduce the incentives for American small businesses to continue their valuable innovation if their products can no longer be defended against appropriation by the large manufacturers. Small businesses create and tend to keep their jobs in the U.S.

Furthermore, the bills do nothing to help reverse the most pressing need at the US Patent and Trademark Office (USPTO), Fee Diversion. Over $1.7 Billion of patent fees has been withheld by the Treasury.[1] As the patent office is self-funded using fees collected from inventors, withholding acts as a tax. Thus, this "Invention Tax" is a $1.7 Billion disincentive for invention in America. Even more importantly, since the withheld fees are not being used to modernize the USPTO technology or hire new examiners of the highest caliber to provide faster, better reviews, pendency remains near record highs,[2] which delays issuance of patents. This in turn retards corporate formation and funding, slowing the economy.

The U.S. innovation sector is responsible for 27.7 percent of U.S. jobs and 34.8 percent of U.S. GDP.[3] According to David Kappos, the former head of the United States Patent and Trademark office, when discussing the lack of focus on Trolls in the current bills, "untargeted legislation puts in jeopardy U.S. technology leadership."[4]

Patents are the number one indicator of regional wealth according to the Federal Reserve Bank.[5] Where do the best patents come from? "SBIR-nurtured firms consistently account for a quarter of all U.S. R&D 100 Award winners,"[6] on 2.5% of the Federal R&D budget. Regions that increase their number of patents gain $4,300 more per worker over a decade's time.[7] If these "Patent Reform" bills are signed into law, they will discourage small business patents, and the contrapositive indicates that we will be a poorer nation. Changes in the law will also adversely affect the over 21,300 SBIR award winners and their over 112,550 patents.[8] This will become even more critical over time as there has been a shifting in engineering talent from large businesses to small businesses. (The employment share of American small business engineers grew from 6% in 1978 to 38% in 2005.[9])

We would like to establish a time to discuss with you and other SBA officials what position the SBA has taken with the Administration on the latest patent reform bills going through the Senate, now that HR 3309 has overwhelmingly (325-91) passed the House. We are extremely concerned about the President's indication, including comments in the SOTU address,[10] that he will sign a patent reform bill (such as HR 3309).

Has the SBA discussed with the President the inconsistencies that this statement appears to be at odds with his prior goals and statements such as:

"President Obama has said, if we are to win the future and be successful in an increasingly competitive international market, the United States of America must innovate. … The Obama Administration's determination to promote innovation and protect intellectual property (IP) rights will harness the inherent drive and ingenuity of the American people in meeting that goal. … Innovation protected by IP rights is key to creating new jobs and growing exports. … Protecting our ideas and IP promotes innovative, open, and competitive markets, and helps ensure that the U.S. private sector remains America's innovation engine." [11]

The America Invents Act (AIA) was fully implemented about 1 ½ years ago, and its effect on our patent system has yet to be fully understood. One of the AIA's requirements was to have a study performed by the Chief Counsel for Advocacy of the SBA on the effects of the Act on small business.[12] This report was to have been completed by September 16, 2012. To our knowledge, almost 17 months later, we have not had any indication of the results of this report. We are very concerned that the Administration needs to be cautious before making additional changes to our patent laws, before the effects of the prior law have been evaluated.

We must be certain that changes that are made should not undermine incentives for developing new U.S. patents, their robust enforcement, or the existing economic incentives for companies of all sizes to invest in research, development, and new jobs. We encourage the Administration to request the Senate to hold additional hearings on the many different aspects of the legislation and its effects on small businesses.

The current Senate bills and HR 3309 have many items that we are concerned about. These include but are not limited to:

- **Loser Pays:** American laws do not apply "loser pays" provisions to consumers, corporations, protected groups, or any other class of private litigants. This would induce these groups to tend to decline to enforce their legal rights. Why should inventors be singled out as the only class so onerous that inventors alone should face this burden, when it applies to no one else? The result will be that small inventors will be deterred from exercising their rights and that invention and resulting jobs will dwindle. More perniciously, the smaller firms will be further deterred from investing to develop such rights, as they will need a $5-10 million legal war-chest before they try to exercise any patents. The large multi-national companies know that smaller companies cannot afford to pay the larger business's legal costs if they lose, and so small businesses will not take the chance. In contrast, the larger business can afford the risk. This is anti-small business, anti-technology development, and anti-US jobs.

* **Pay to Play** provisions require the inventor plaintiff to post a bond or certify that they can pay the alleged infringers legal fees should they not prevail. This puts enforcing a patent beyond the financial capability of all but the largest of small businesses. Patent litigation is already very expensive, highly risky and skewed unfairly in the favor of the infringer. Pay to Play will make almost all of the over 5,000 active SBIR companies lose most of their value, without any hope of being able to enforce their patents unless they give up the majority of their equity to a larger company (which would then put them out of the SBIR program).
* **Fee Shifting "Joinder"** makes investors and others personally liable for the legal fees of the alleged infringer if the plaintiff does not prevail (possibly on each and every claim). This provision eliminates a basic tenant of corporate law, protecting investors from personal liability, making patents a "toxic" asset. Why would investors risk personal assets beyond what is directly invested in a business? This provision is antagonistic to investment in new technologies. With no investment, this is fatal to most inventors. Why are inventing companies now so heinous that America would revise corporate law to eliminate personal liability protections only for patent holders? What have inventors done to be singled out as to not be deserving of the personal liability protections that all other Americans receive. Is it in America's interest to so persecute its inventors, investors, and entrepreneurs? (Please see **Appendix 1** for additional information on Loser Pays, Pay to Play, Fee Shifting, and Joinder.)
* **Covered Business Methods (CBM)** provisions were removed from HR3309, but are still in some Senate bills (S.866). These provisions will devalue many software patents, thus hurting the economy. With the pervasive use of the computer, software patents have continued to grow, and now make up more than half of all patents.[13] Thus, CBM provisions will adversely affect the fastest growing segment of our economy. (See **Appendix 2** for more information on CBM).
* **Elimination of Post Grant Review Estoppel** – Under the AIA, a Post Grant Review prohibits the petitioner from later arguing "*any ground that the petitioner raised or reasonably could have raised during that post-grant review*." The proposed legislation deletes "or reasonably could have raised." This will allow a defendant to bring multiple sequential Post Grant Reviews in an effort to defeat the patent holder by burning the inventor's financial resources and time with effectively perpetual litigation. It would also now allow the infringing petitioner to assert in a civil action or at the International Trade Commission (ITC) "that the claim is invalid on any ground" even though the petitioner could have *reasonably* raised *the issue* during that post-grant review. This provision could easily become fatal to most inventors. These multiple "bites at the apple" by infringers will continue to cloud patent title and frustrate legitimate inventors, denying them justice and making fundraising even more difficult. This provision is another example of how small business inventers can be driven to

extinction by exhausting their resources while trying to enforce, or even just keep, their patents.

- **Disclosure of All Plaintiff Interested Parties** requires both investors and licensors to be disclosed. This will discourage commerce in two ways. First, in the early stages of company formation, it will require Angel investors to break one of their major tenants, secrecy. Angel groups are formed to provide anonymity. This provision will discourage Angels from investing in the smallest companies, when outside funding is hardest to obtain. Secondly, it will dampen licensing activities. When a licensee needs time to incorporate the licensed invention into their product, they normally do not want to alert their competition as to where they are moving in the market. This will disclose the fact that the licensee is adding a new feature or an entirely new product line. (See **Appendix 3** for comments.)
- **Enhanced Pleadings and Limiting Discovery** – HR 3309 and other bills (S.1013) have a provision that dictates enhanced pleadings requiring that the plaintiff produce substantially more information, and a provision limiting discovery prior to claim construction. Patent suits are among the most complicated and detailed, with many variables. The trial judge is the closest to the case and legislating how that judge manages the case will damage the trial judge's ability to bring a fair solution to both parties. What's more, both of these changes affect the inventor negatively and the infringer positively, thus stacking the deck even further against the inventor. In an already expensive and complicated process, these two elements require the patent holder to spend more money up front and operate with less information than is needed. These are particularly onerous to small business inventors as they curtail the patent holder's ability to enforce a patent and reduce the ability of the judge to manage the case effectively.

  In addition to legislating court procedure, enhanced pleadings will cause delays in filing suit and add additional costs. It is anticipated that there will be more disputes about the adequacy of the complaints which will also increase the cost of litigation. And, limited discovery will "delay resolution" to the "disadvantage of patent owner" even with "meritorious claims" thus the "alleged infringer is incentivized to draw out" the claim construction ruling. (See **Appendices 4** and **5** for additional information.)
- **Customer Stays** present a problem for patents that focus on "use" rather than manufacture. The inventor is left with no way to enforce her patent when she can't sue a manufacturer as the manufacturer is not violating any claims of the patent, and they can't sue the end users ("Customers") until she prevails against the manufacturer. This may put the inventors in a Catch-22, where they will have no remedy. It also encourages foreign manufactures to collude to receive a "get out of jail card" and infringe with impunity. (**Appendix 6** provides additional information.)

- **Micro entity definition** includes universities and institutions of higher learning. If these substantially larger and better endowed institutions are given reduced fees as micro entities, SBIR firms should also be designated as micro entities and receive those same benefits.

The purpose of the U.S. patent system has been to promote innovation. The various “Patent Reform” bills will in fact retard innovation and cost America jobs. They are contrary to the Founding Fathers’ intent in Article 1, Section 8, Clause 8 of the Constitution, contrary to the policies of over 200 years of patent law, and contrary to prior statements of President Obama. We urge the SBA to discuss this with us and with the White House, and to encourage the Senate Judiciary Committee to hold additional hearings with small business inventors to be able to review the concerns expressed herein.

Robert N. Schmidt
National Co-Chair
SBTC

Heidi Jacobus
National Co-Chair
SBTC

Cc: Senators Landrieu, Cantwell, Risch

Appendix 1

Specific Small Business Issues with

Loser Pays, Pay to Play, Fee Shifting, Joinder

The US House passed the Innovation Act (HR3309) in December 2013. The Senate is now well on its way to incorporating this legislation which will make Americans poorer. The bills have many problems that will inhibit small inventors, but the most insidious are "Loser Pays" and "Pay to Play". It changes the law, singling out inventors as a class so onerous that only they must pay the other side's legal fees if they don't win every claim. Pay to Play makes inventors guarantee payment up-front. Some proposed Senate bills (e.g.: S.1013 & S.1612) make sure that almost all Americans and most small companies will never be able to afford to enforce their patents on their inventions.

The SBTC believes Loser Pays, Pay to Play, Fee Shifting, and Joinder are the death knell for small inventors. But it is not just the little inventors who will suffer. It will also adversely affect university invention and spin-offs, a primary source for America's innovation. One large company official commented to a university technology transfer group saying "what is the problem, you guys win most of your cases, so this should be an advantage", which misses the point on a number of issues.

1. This is a retrospective argument, "after you have won, you get your attorney's fees back." The problem is, the entrepreneur needs to address this before the case is started (prospectively). The entrepreneur needs to answer the following questions up front, before making the decision to start the case:
   a. Can I afford to pay out an additional $5-$10 million to pay for the alleged infringer's attorneys, on top of my own legal fees, if I don't win the case? Do I have that in cash? Can I liquidate my assets (which are mostly pledged to my business anyway) and raise that money? All are highly unlikely for small inventors.
   b. This field is far from level. The large firm will look at the cost and put it into its contingency reserve. The small firm will review the same cost and decide it cannot risk corporate death on a court case, even when it only has a slight chance of failing.
   c. Can I get a bond? (Virtually all of my worth is in the company and totally illiquid.) Who would provide a bond to an individual and their company who will both likely go bankrupt if they lose the case? And what assets can now be monetized to pay off the bond if the patent(s) (usually the biggest asset for a small inventing company) is deemed to be worthless? Thus, few bonds will be issued, so the bond route is highly unlikely.
   d. Can I win the case? I now need to plead with detailed specificity before I do due diligence. Can I be sure I win each and every claim? How much do I have to leave off the table to improve my chances for winning each claim? The language is ambiguous as to who may be a losing party when

there may be multiple claims and split decisions. Is it still worth enforcing my patent if I remove my higher risk claims, or do I just give up on enforcing the patent before I start?

e. What will this do to my investors? Under the one Senate bill, S 1013, investors with **any** amount of stock in a company at the company's "end-stage" (where the primary value is in the patent), would now be responsible for guaranteeing the legal fees of the other party if the inventor loses his suit. So, are universities willing to invest $5-10 million in each of the start-up companies in which they have stock; not for engineering, manufacturing and marketing, but solely for legal fees? And not the legal fees of the company they helped found, but the legal fees of the alleged infringer. If not, their companies become worthless, not being able to enforce their patents. Will other wealthy people invest in a university technology spin-off or a new Kickstarter company if they know that if they give a start-up a few dollars to try and help it out; all of a sudden, they might be on the hook for $5M of legal fees? This will kill the angel community, and severely damage VC investments. This "chilling effect," no, "*freezing effect*," on investments happens years before a suit. One will never get to the suit as the invention and patent won't have happened.

f. What will this do to the licensees? If the inventor is lucky enough to license the product, usually licenses include a confidentiality agreement, so that the licensee's business plans are not disclosed. Now, the entrepreneur will have to disclose to the world when the court orders the names of interested parties, or even earlier when a demand letter, which must include the licensee's name, is issued. If that isn't chilling enough on commercializing new inventions through licenses, the licensee will likely have to guarantee the $5M of legal fees in addition to the amount they paid up front in license payments (perhaps a few hundred thousand dollars). So why would any company want to license a product if the licensor must "publish" the licensees' business plans (showing that they intend to incorporate the licensed technology into their product) and the guarantee may increase the cost of the deal, perhaps by as much as 2-100 times.

2. Providing the guarantee for the Pay to Play provisions is a disaster for small businesses, but putting up the $5M up front to guarantee the other side's legal fees is **minor**, compared to the other issues and chilling effects they have on innovation and startups. This chilling (freezing) effect starts long before the law suit is ever envisioned.
   a. Why would any large business ever license a small business invention or buy a small company for their technology? They know the small company can never afford the $5M before the case goes to trial. So, why not just infringe (with impunity) as the inventor cannot afford to do anything to prevent it. These bills encourage infringement and punish invention.

b. Inventors/entrepreneurs will no longer start invention related businesses. (These invention companies are the highest growth, biggest job producing companies. They have the greatest impact on the American economy.) When the pot of gold (selling the company or invention) is removed because large companies need not fear legal action for infringement; who would take the risk to start a company and invent. Every inventor/entrepreneur I have ever met says it is much harder and more expensive than they could have ever imagined. Does Congress believe that it is nowhere near hard enough? Do we need to punish inventors by making a new class of plaintiffs, so vile that only inventors/entrepreneurs/ patent holders need to routinely pay the other side's legal fees if they lose a court case? And more importantly, they need to guarantee those fees up-front, even before the case is fully started.

c. Even if an inventor is so dedicated or foolish to go ahead and spend time and money inventing and starting a company to try and create jobs, who would ever finance it? Fee Shifting and Joinder reverses hundreds of years of corporate law by eliminating the corporate veil for even minor, non-decision making investors. Making friends, family, associates, Angels, and Venture Capitalists personally liable for the legal fees of the infringer, if the plaintiff does not prevail (possibly on each and every claim), **makes inventing companies toxic**. The cost of investing increases significantly because of the added liability in case they have the desire (audacity) to try and enforce their patent. So there is little upside win to invest in new companies.

d. The existing fallback position when an inventor does not have the capital to successfully commercialize is selling off the patents in the secondary market. Under the proposed legislation, this would be much less likely. This secondary market, considered "Trolls", is the primary target of the legislation. [It is like legislating away used car sales. Although few people like used car salesmen, they serve a valuable place in the market, and their equivalent in the patent field also serve a function by allowing some value to be derived from inventions that don't become blockbusters.]

3. Since Startups are to an economy, what births are to a population; and small businesses are to an economy what children are to a population; we are at risk of "killing our economic 'children'" by new artificial barriers to new invention and high-tech startups. Even if we get "births" (startups), we will stunt their growth by impediments to the capital supply for small high-tech businesses.
4. Since small businesses create 64% of private sector jobs and more than 25% of America's most valuable patents (R&D 100 awards), American small businesses will likely stop creating a large percentage of the world's most valuable patents and their corresponding jobs.

5. Since high patenting areas create $4,300 more per paycheck than low patenting areas, Americans will likely lose this income if this legislation becomes law.
6. Universities now collect $2.6 Billion annually with over 5,000 new licenses each year. Without a flow of new businesses attempting to commercialize university patents, this source of income will wither, drying up the foundation of America's Innovation Ecosystem.
7. Furthermore, since small high-tech businesses are frequently the feedstock of new products for large business, this action will affect America's large companies over the next decade; making the large businesses less competitive in world markets.

All of these impediments to business formation and job growth are the results of a proposed policy which **punishes invention** and entrepreneurship. We will curtail the line of 220 years of American inventors. As **intellectual property is worth well over $5 Trillion** in the US[14] (one-third of one year's GDP), a significant percentage of this will be the likely loss to the economy if the pending patent "reform" legislation is passed.

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Appendix 2

Specific Small Business Issues with

Covered Business Methods

The America Invents Act (AIA) limited Covered Business Methods (CBM) to a "financial product or service." It allowed post-grant review proceedings, to be made at any time until September 16, 2020, clouding their title for eight years. However, recently-introduced legislation proposes to make the transitional proceedings of Section 18 permanent and expand the definition of "covered business method patent" to include data processing patents used in any "enterprise, product, or service." This means that any party sued for or charged with infringement can *always* challenge an extremely broad range of patents at the USPTO. The request for a proceeding need not be related to financial products or services and can be submitted any time over the life of the patent. This would have far-reaching implications, because data processing is integral to everything from cutting-edge cancer therapies to safety systems that allow cars to respond to road conditions in real time to prevent crashes. Subjecting data processing patents to the CBM program would thus create uncertainty and risk that discourage investment in any number of fields where we should be trying to spur continued innovation.

The Patent Coalition recently wrote:

On behalf of industry groups, professional organizations, university associations, and leading companies in America's most innovative industries, including technology, communications, manufacturing, consumer products, energy, financial services, medical devices, software, pharmaceuticals, and biotechnology, we are writing to encourage you to not include measures to expand the "covered business method" (CBM) patent program as you move forward with patent reform legislation. Expanding the CBM program will hurt America's innovators – both small and large - and weaken America's competitive advantage around the world, at a time when we can least afford it.

Last month the House of Representatives passed The Innovation Act (HR 3309). When originally introduced, this legislation contained a provision expanding the CBM program. However, before markup in the Judiciary Committee, the provision was removed because it had become clear that maintaining the measure was creating a roadblock to passing any legislation. We believe the same is true in the Senate. Expanding the CBM program is not just ill-advised from a political standpoint, but from a policy perspective as well. It's worth recalling the auspices under which the CBM program was enacted.

Under Section 18 of the America Invents Act ("AIA"), transitional post-grant review proceedings for "covered business method patents" (CBM program) allow the USPTO to take a second look at a patent after that patent's grant or reissuance, in order to determine its validity. A "covered business method patent" is a business method patent that relates to a “financial product or service.” Unlike regular post-grant review proceedings, which require that a proceeding must be requested no later than nine months from a patent’s grant date or reissuance date, a request for a “covered business method patent” proceeding can be made at any time until September 16, 2020 – the date the transitional program is scheduled to sunset.

During Congressional consideration of the AIA, proponents of Section 18 argued that it was a necessary and temporary measure to review a very narrow class of financial-services-related patents. However, recently-introduced legislation proposes to make the transitional proceedings of Section 18 permanent and expand the definition of “covered business method patent” to include data processing patents used in any “enterprise, product, or service.” This means that any party sued for or charged with infringement can *always* challenge an extremely broad range of patents at the USPTO. The request for a proceeding need not be related to financial products or services and can be submitted any time over the life of the patent. This proposal would eviscerate the delicate balance that was struck with the other new post grant review programs in the AIA to ensure that patents would not be devalued by limiting serial challenges during the patent’s life.

This would have far-reaching implications, because data processing is integral to everything from cutting-edge cancer therapies to safety systems that allow cars to respond to road conditions in real time to prevent crashes. Subjecting data processing patents to the CBM program would thus create uncertainty and risk that discourage investment in any number of fields where we should be trying to spur continued innovation.

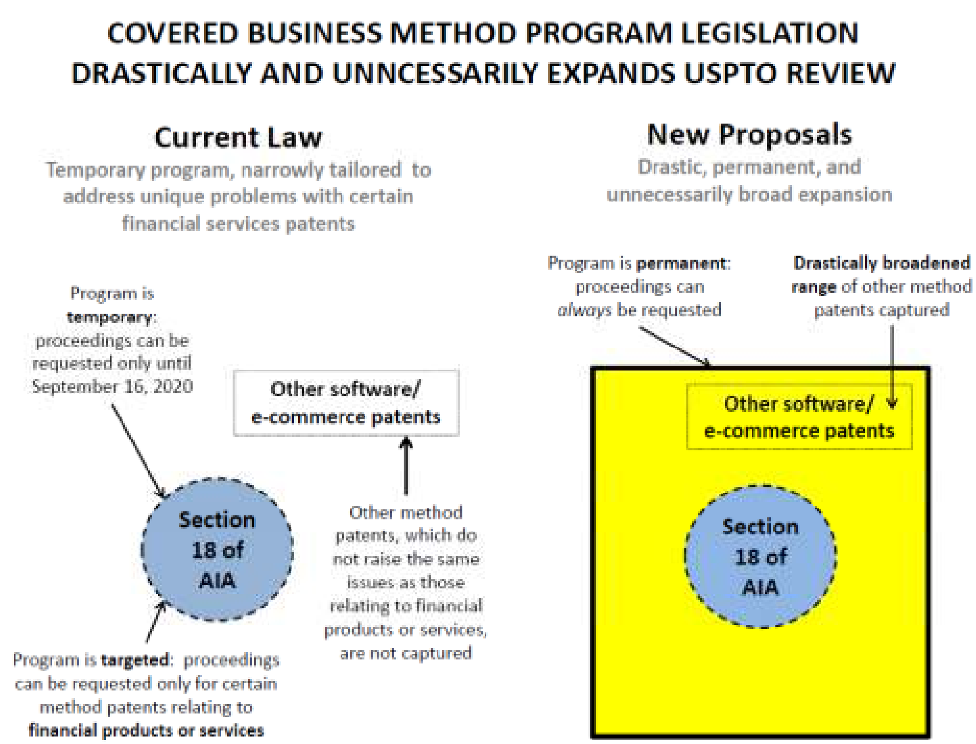
The US patent system for more than 200 years has succeeded spectacularly in promoting “the progress of science and useful arts,” as the Founders intended, in part because it has always provided the same incentives for all types of inventions. To expand and make permanent the CBM program would be to turn ill-advisedly and irrevocably in a new direction — discriminating against an entire class of technology innovation.

Supporters of expansion frequently argue that a less expensive alternative to litigation is needed to test the validity of patents covering areas other than financial services throughout their term. Unfortunately, this broad rhetoric ignores another key reform included in the AIA: the Inter Partes Review (IPR) process which is available to all patents, including the ones sought to be covered by expanded CBM, and which provides just such an alternative PTO review. While some have suggested that this IPR leaves out certain other grounds for review, these other grounds typically involve witness testimony about prior use or sale events rather than the traditional published prior art. For long-issued and presumptively valid patents, such fact-finding should in any event remain consigned to 12 jurors in a Federal district court rather than to three PTO administrative judges.

Moreover, expanding the CBM program could inadvertently undermine many valid patents by giving infringers a new procedural loophole to delay enforcement. Because of the way Section 18 works, infringers would be able to delay legitimate lawsuits they face in district court by initiating CBM proceedings at the PTO. This would buy time to gain market share on innovative, patent-holding competitors.

Expanding Section 18 will not only stymie innovation at home, but it could also impact the relationship of the United States with its trading partners. We have already received questions from our colleagues abroad regarding how this expansion could be justified as compatible with the obligation of the United States under the Agreement on Trade-Related Aspects of Intellectual Property Rights ("TRIPS") to make patents "available and patent rights enjoyable without discrimination as to . . . the field of technology." Apart from this question, however, it is clear that if this discriminatory treatment of a select category of patents opposed by special interests in the United States were to be made a permanent feature of U.S. law, it would create a harmful precedent for our trading partners to enact exceptions in their laws to protect special interests in their countries. It would also significantly undermine the longstanding efforts of numerous U.S. government agencies to persuade some of our major trading partners to modify their laws to provide patent protection for important computer-implemented inventions and become compliant with their own obligations under the TRIPS Agreement.

As innovators, educators, researchers, developers and US employers, we hope Congress will not include the proposals related to expanding the CBM program as it considers smart and targeted legislation to further improve our patent system.



Appendix 3

Specific Small Business Issues with

Disclosure of All Plaintiff Interested Parties

The following is based on an article written by Andrew Williams. [15]

As the title of the Patent Transparency and Improvements Act of 2013 (S.1720) would suggest, one of the provisions of the bill is aimed at making the ownership of patents transparent with two techniques. First, any patentee that files an action in Federal Court would be required to disclose any and all persons that have a financial interest in the controversy or a party to the proceedings, or that have an interest that could be affected by the outcome of the proceedings. The complication comes in the definition of "financial interest." The proposed legislation refers to 28 U.S.C § 455(d), which is the section of the U.S. Code that addresses the disqualification of federal judges.

"Financial interest" is defined as "ownership of a legal or equitable interest, however small, or a relationship as director, advisor, or other active participant in the affairs of a party," providing any of the enumerated exceptions do not apply, such as passive ownership through a mutual or common investment fund. As a result, a publically traded corporation bringing a patent infringement lawsuit would be required to provide a list of every stockholder, no matter how many (or few) shares are actually owned. Such a requirement would be incredibly onerous, and would serve as a significant barrier to patent litigation for such patent holders.

Another "solution" provided for in this bill is an assignment disclosure requirement at the U.S. Patent Office.

When "all substantial rights in an issued patent" have been assigned, the name of the assignee and the ultimate parent entity of the assignee would need to be recorded with the Office within three months. However, the only hint as to what "all" substantial rights means in this context is whether the assignment "results in a change to the ultimate parent entity." The penalty for not complying would be that a party asserting infringement "may not recover increased damages under section 284 or attorney fees under section 285 with respect to infringing activities taking place during any period of noncompliance," and the party may be responsible for the reasonable attorney fees incurred by an alleged infringer in discovering the "ultimate patent entities in the chain of title."

NOTE: this registration requirement will discourage commerce because a new law would require the forfeiture of fees from infringers for failure to register assignments during a period when it was not required. The ability to recover such fees for some period of time may already have been forfeited.

Appendix 4

Specific Small Business Issues with

Heightened Pleading Standards

The following is taken largely from a Baker Botts Blog written by Jeff Becker.[16]

The Innovation Act significantly increases the pleading requirements for patent infringement actions. This adds costs, further adding a burden to small business. Currently, the Federal rule governing pleadings "'generally requires only a plausible short plain statement of the plaintiff's claim,' showing that the plaintiff is entitled to relief."[17] In 2012, the Federal Circuit's *In re Bill of Lading* opinion held that for patent infringement, the complaint need *not* "plead facts establishing that each element of an asserted claim is met" nor "even identify which claims it asserts are being infringed."[18] To state a claim for patent infringement, a complaint must merely follow Form 18 as set forth by the Federal Rules of Civil Procedure and include "a statement that defendant has been infringing the patent 'by making, selling, and using [the device] embodying the patent.'"[19]

Under the Innovation Act (HR 3309), the Complaint Must Include A Detailed Description of Patent Infringement. The Innovation Act incorporates pleading requirements similar to rules for disclosing patent infringement contentions that are found in the Local Rules of many Federal District Courts.[20] While such local rules typically require disclosure of infringement contentions early in the case (e.g., prior to the initial case management conference), the Innovation Act would require detailed infringement allegations to be incorporated in the complaint. In doing so, the Innovation Act would abrogate *In re Bill of Lading* and specifically abolish Form 18.[21]

This is a significant new burden and trap for small businesses, as the pleadings must be detailed ***before*** discovery. At best, this will delay justice for the small business, and add to the cost. At worst, it will deny justice for the small business as they will not be able to properly ascertain all of the details of infringement prior to performing discovery, and after discovery it will be too late to amend the pleadings.

The Innovation Act would require the complaint to include, for each accused instrumentality, an "identification of *each claim* of each patent . . . that is allegedly infringed," the name or model number (if known), and a detailed explanation of where each element of the claim is found in the accused instrumentality.[22]

The complaint would also be required to explain, "with detailed specificity, ***how*** *each limitation of each claim . . . is met by the accused instrumentality*."[23] This requirement can be compared to requirements for initial infringement contentions in districts that enact local patent rules such as the Eastern District of

Texas. In the Eastern District of Texas, for example, infringement contentions must state "specifically *where* each element of each asserted claim is found within each Accused Instrumentality."[24] Eastern District of Texas courts have also held that plaintiffs must explain "*how* [the] accused infringing products meet the claim language."[25] (Again, however, these details are provided later in the process, after the pleadings.)

Under the Innovation Act, the Complaint Must Identify and Explain Any Missing or Inaccessible Information. The Innovation Act recognizes that in some cases, the information required to plead patent infringement with specificity may not be "reasonably accessible." Even in such cases, the plaintiff is nonetheless required to include in the complaint "*a description of any [such] information . . . , why such undisclosed information was not readily accessible, and the efforts made by such party to access such undisclosed information*."[26]

Under current local rules, defendants may move to strike deficient contentions or move for a more definite statement. The Innovation Act would give infringer Defendants an additional weapon to use against patent plaintiffs that provide deficient infringement contentions—moving to dismiss the complaint for failure to state a claim upon which relief may be granted. Although it is unclear how strictly judges would interpret these new pleading requirements, the Innovation Act would nevertheless provide a potentially powerful mechanism for dealing with infringement contention deficiencies while making pleading more difficult for patent plaintiffs. This will be particularly onerous for small business inventor plaintiffs with limited budgets.

Appendix 5

Specific Small Business Issues with

Limitations on Discovery

Again, the following is taken largely from a Baker Botts Blog written by Jeff Becker.[27]

The Innovation Act significantly restricts non-claim construction discovery prior to any *Markman* ruling. As a general rule, "discovery shall be limited, until such ruling is issued, to information necessary for the court to determine the meaning of the terms used in the patent claim, including any interpretation of those terms used to support the claim of infringement."[28] In addition to placing a de facto stay of non-claim construction discovery until after *Markman*, the bill encourages that the judiciary create additional rules to further limit discovery and provide cost-shifting mechanisms for discovery. This would further shift the law against inventors and help infringers by limiting the discovery that can be performed by the plaintiffs to obtain additional proof that the defendants are in fact infringing.

Rules regarding "Core Documentary Evidence." First, the Innovation Act introduces the concept of "core documentary evidence," which the bill defines to include documents related to conception and reduction to practice, documents that show the technical operation of the accused products, invalidating prior art, licensing, profit, pre-suit knowledge, standards-setting organization commitments, and marking.[29] S.1013 requires that any information beyond the core documentary evidence be paid by the requesting party.[30] Again, this penalizes inventor plaintiffs and helps infringer defendants by limiting the discovery. It also requires payment for the other side's discovery costs and legal fees in advance or posting of a bond. This is particularly difficult for small business inventors.

Rules regarding electronic communications and computer code. S.1013 limits electronic discovery. It prohibits discovery of "electronic communication, such as email, text messages, instant messaging, and other forms of electronic communication, unless the court finds good cause for including such computer code or electronic communication."[31] This language will shield infringer defendants.

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Appendix 6
Specific Small Business Issues with
Customer Stays

The following is extracted from an OP-ED written by Ben Pless and David J. Kappos.[32] Kappos is the former Director of the USPTO.

> *The problem [with customer stays] is that many modern products are built by assembling component parts from different sub-manufacturers — in some cases hundreds or thousands of parts like memory chips, connectors, processors, displays, cases, fasteners, etc. As drafted, the law is so broad that it would hand out "get out of jail free" cards within these networks of sub-manufacturers, including the infringing product's actual manufacturer, instead of just protecting consumers and retailers.*
>
> *This untargeted approach invites clever patent infringers — including foreign manufacturers, assemblers and parts suppliers — to conspire with one another, arranging for the lowest value, least accessible, least answerable party to handle suits for patent infringement instead of the product's actual manufacturer having the liability. That would make it considerably more difficult for innovators like ATI to stop patent infringers, who under the proposal would be able to hide behind complicated assembly and manufacturing chains.*
>
> *For products like the ATI neurostimulator, and thousands of other American innovations that integrate component parts from many suppliers, this would be devastating. It would mean mass devaluation of investments in interdisciplinary products integrating diverse components. That will cause investment to move away from the ATIs of the world, with the certain result of fewer bright new breakthroughs that integrate multiple scientific disciplines.*
>
> *Perhaps this gambit would be understandable if our laws contained no mechanism to correct situations where suits fail to focus on the most appropriate party. But that is not the case. In fact, every federal court already has the power to "stay" patent litigation against an inappropriate defendant in favor of a more appropriate one. And the data shows that, with few exceptions, courts have succeeded in granting stays in the customer/manufacturer cases cited as the rationale for this provision.*
>
> *There is a simple way to achieve the laudable objective of the stay provision at the center of the Senate's patent bill. Congress should limit the provision to small businesses and retailers who use and sell unaltered goods, period. That approach achieves the core purpose of moving infringement suits to where they belong, without opening a huge gap in our patent system. In an important sense it is a lot like a modern neurostimulator — targeted.*

A more detailed discussion of the problems with the Customer Stay provisions is shown in Appendix 6-1

Appendix 6-1
Specific Small Business Issues with
Details of Customer Stays

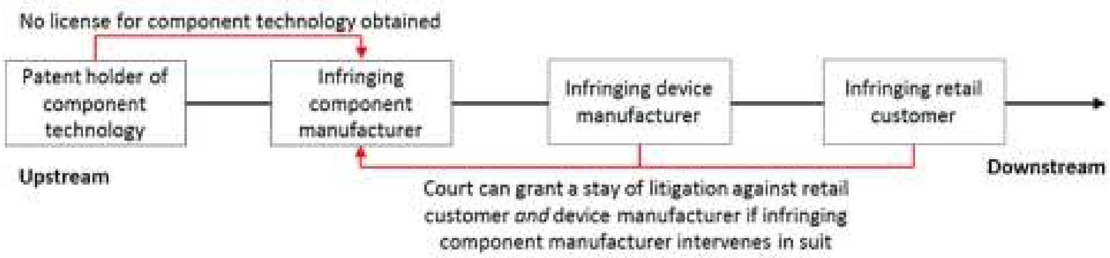
PROPOSED STAY PROVISIONS FAIL TO PROVIDE ACCESS TO JUSTICE IN A FAIR AND PROMPT WAY

Several Members of Congress propose stay provisions as part of patent litigation legislation. These stay proposals direct courts to stay judicial proceedings gainst vendors, manufacturers, and end-users of a product when a retailer or manufacturer farther "upstream" in the distribution chain of the product or component that is covered by the patent is a party in the infringement suit.
Stay proposals aim to spare "innocent" end-users from patent litigation suits and promote the efficient resolution of infringement cases by placing the burden of litigation on "manufacturers." However, current stay proposals raise numerous negative consequences, *without* promoting judicial fairness and efficiency. These proposals are drafted too broadly, invite abuse by infringers who want to limit their damages, prevent patent holders from obtaining relief in court, and actually *increase* patent litigation.
Instead of mandating a broad, one-size-fits-all approach, lawmakers should craft stay proposals to target true consumer end-users, rather than protecting vendors and other manufacturers "downstream" in a distribution chain.
In all other cases, lawmakers should encourage courts to use their existing discretion to manage their patent litigation cases. In complex patent suits, which involve many different kinds of implementations, conduct, and distribution chains, judges are typically best positioned to allow for intervention by upstream parties and grant stays.

Stay proposals are drafted too broadly, shielding many parties other than "innocent" end-users from litigation.
• Stay proposals aim to protect "innocent" end-users of allegedly infringing products from costly litigation, particularly small "mom-and-pop" businesses that may use retail products that incorporate patented technology. However, current stay proposals are drafted broadly to reach all parties downstream in the chain of commerce, not just small businesses. In some cases, these parties are large companies that incorporate infringing technologies in their own operations and truly devalue the patent holder's rights, thus making them an appropriate target for litigation. Under current stay proposals, these infringing companies would be unfairly protected from suits.
• For example, suppose a patent holder has a patent that covers a certain technology. This technology is incorporated into hardware components by a component manufacturer that is not a licensee of the patent holder. The

infringing components are then incorporated into consumer electronic devices by a manufacturer that sells devices to retail customers. As you can see from the example below, stay provisions protect the infringing retail customer *and* manufacturer from liability.

Consumer Device Stream of Commerce



Stay proposals are ripe for abuse by infringers who want to limit their damages.

• Under the current proposed stay provision, if either the end user or the device manufacturer is sued for patent infringement by the patent holder, that suit would be stayed by the court so long as the component manufacturer is also a defendant in the suit, and agrees to a stay.

• A stay against the device maker could effectively cap compensatory damages at the price of the infringing component even if the market value of the patented technology is far greater, for example, where the technology contributes significantly to the value of the consumer device.

• This attempt to cheapen the cost of infringement mirrors an "apportionment of damages" policy that Congress rejected when it passed the America Invents Act.

Stay proposals may leave patent holders whose claims rely on a showing of indirect infringement with no relief.

• Under patent law, there are two types of infringement: direct and indirect infringement. Direct infringement occurs when a single party manufactures, sells, or uses a patented invention without the permission of the patent holder.

• Indirect infringement, on the other hand, occurs through something less than the full act of sale, manufacture or use of a patented invention but nonetheless ultimately leads to direct infringement by another party. To prove indirect infringement, a patent holder must generally prove that another person directly infringed the patent and that the alleged indirect infringer knew about the patent and intended to encourage direct infringement.

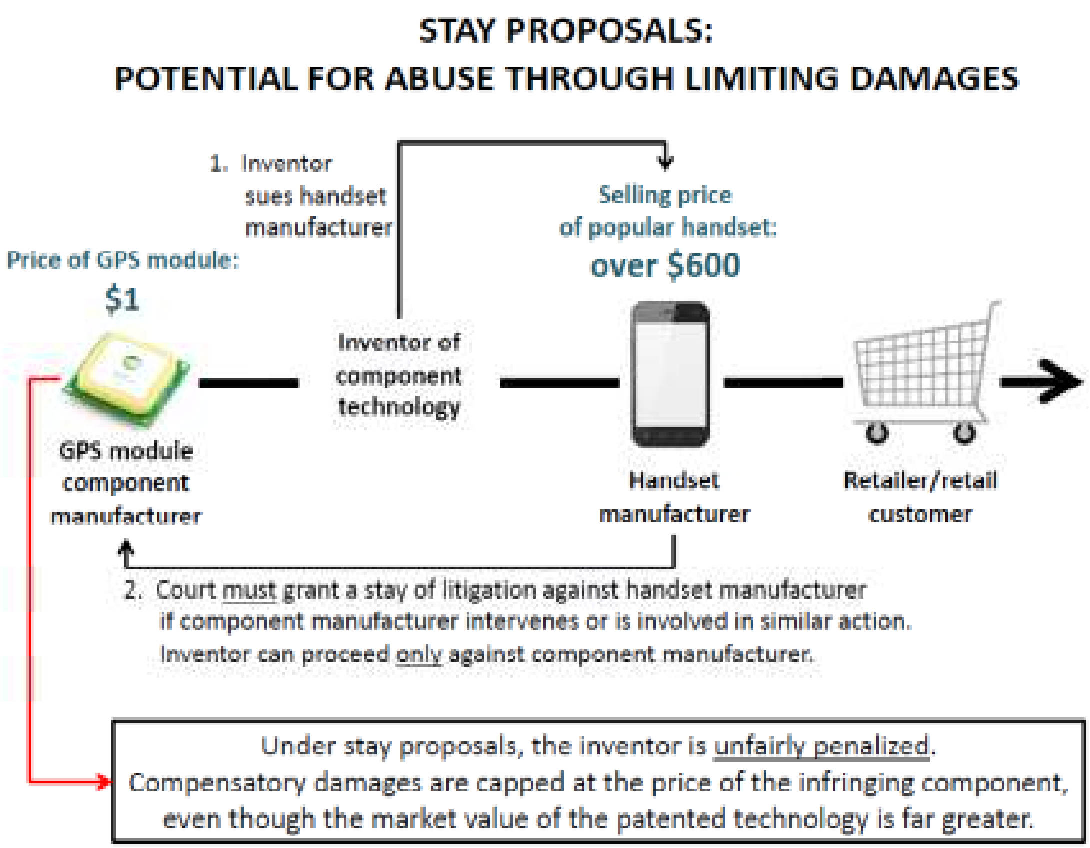
• Where the downstream party is an alleged direct infringer and the upstream manufacturer is liable only under indirect infringement theories, the proceeding against the upstream manufacturer can't advance without having first established direct infringement by the downstream party. If the litigation against the

downstream party is stayed under current stay proposals, the patent holder must rise to the very difficult task of proving direct infringement *without* the direct infringer.
• In addition, under recent Federal Circuit case law, certain indirect infringers need only plead that they had a good faith belief in patent invalidity to avoid all infringement liability under indirect infringement theories -- making it very easy for indirect infringers to avoid liability.
• Thus, stay proposals could inadvertently insert patent holders into a “Catch 22” scenario -- they are not able to proceed against the direct infringer *and* may not get relief against the indirect infringer, the only party they are permitted to sue.

Stay proposals *increase* patent litigation and *decrease* judicial efficiency.
• Current proposals state that a stay will be granted if the downstream party agrees to be “bound” by any judgment entered against the upstream party “with respect to issues that they have in common.” This ambiguous commitment is easily subject to gaming and will do little to prevent piecemeal litigation against different infringers in the stream of commerce. A downstream party for whom a stay is granted will invariably argue that different parts of the patent case – e.g., infringement, validity, and remedies – present unique issues that preclude enforcement of the upstream judgment and must be litigated *again* against the downstream party. Thus, even if the patent owner succeeds in proving its case against an upstream infringer, it will be forced to bring potentially multiple suits against downstream infringers to fully enforce its rights. The resulting piecemeal litigation, with the attendant costs and delays, is the antithesis of litigation reform and judicial fairness.
• For instance, a difference in when the upstream and downstream parties received notice of the patent will lead to a difference in damages, meaning that the parties will not have the damages issue in common. A downstream party may also have different licensing agreements than the upstream party, leading to different defenses that must be litigated separately. The downstream customer may also discover different prior art references that weren’t litigated during the upstream party’s case.
• In other words, as a result of the stay provision, to recover against the covered manufacturer and covered customer, the patent holder will need to litigate most of the issues twice. This added expense and time is unfair to the patent owner, and to the taxpayers who support the judicial system.

Congress Should Target True End-Users and Courts Should Retain Discretion
• Instead of a broad, one-size-fits all statutory approach, lawmakers should target end-users whose unwitting use of a patented technology has a *de minimis* impact on the patent owner’s rights relative to others in the stream of commerce: i.e., “innocent” consumers like mom-and-pop stores who purchase goods at retail.

• In the case of other alleged infringers, judges already have the discretion to decide motions for stay based on the myriad facts and circumstances of the particular case. Courts have decided whether to grant stays in different patent cases by weighing over a dozen relevant factors. In appropriate cases, they have allowed for intervention by upstream parties and granted stays with respect to certain classes of defendants.



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