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Patent Reform Threatens Small Business Innovation

Patents are an indispensable part of American innovation and commerce, so much so that the basic concept of patents and the right of inventors to defend them were included in the US Constitution as an essential power of government. Article I, Section 8, Clause 8 of the Constitution grants Congress the power to: "promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries;"

Patent protections are particularly important for innovative small businesses, which operate on much smaller margins, and often rely much more heavily on their intellectual property for revenue than large firms. According to the SBA: "Of high patenting firms (15 or more in a four-year period), small businesses produced 16 times more patents per employee than large patenting firms. Research also shows that increasing the number of employees correlates with increased innovation while increasing sales does not."[1]

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. 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. All these changes to the patent system have the collective effect of raising the cost of business for small firms, particularly those in innovative, high-tech areas. Furthermore, these bills do not specifically define or address "trolls" or "non-practicing entities," but instead lump all patent holders together.

The America Invents Act requires a study be conducted by the SBA on the impacts of the new law on small business. So far, a year and half after implementation of AIA, that study has not been produced. It is important that a new round of patent reform legislation is not rushed through before careful consideration of the effects the changes AIA has already made to the patent system. To do otherwise could compound any burden felt by small businesses due to the proposed changes.

There are many changes proposed by the new patent reform legislation that we believe will negatively affect small business. The following is a list of just some of these changes:

- **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 that should bear this burden? 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.
- **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 and wealthiest of small businesses. Pay to Play would result in most of the over 5,000 active SBIR being unable 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).

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[1] Source: Advocacy-funded research, An Analysis of Small Business Patents by Industry and Firm Size, http://archive.sba.gov/advo/research/rs335tot.pdf; Innovation in Small Businesses: Drivers of Change and Value Use, www.sba.gov/sites/default/files/rs342tot_0.pdf

- **<u>Fee Shifting "Joinder"</u>** 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, thereby making patents a "toxic" asset. This provision is antagonistic to investment in new technologies.
- **<u>Covered Business Methods (CBM)</u>** provisions were removed from HR3309, but are still in some Senate bills (S.866). The AIA limited CBMs 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 ca*n 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 innovatio**n**.
- **<u>Elimination of Post Grant Review Estoppel</u>** – 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 hav*e reasonably* raised *the issue* during that post-grant review.
- **<u>Disclosure of All Plaintiff Interested Parties</u>** 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 priorities: 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.
- **<u>Enhanced Pleadings and Limiting Discovery</u>** – HR3309 and other bills (S1013) 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.
- **<u>Customer Stays</u>** 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.

The purpose of the U.S. patent system has always been to encourage and promote innovation. The cumulative effect of the "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 stated intention of the President and Congress to stimulate innovation. We urge the SBA and the White House to oppose these potentially damaging changes, and to encourage the Senate Judiciary Committee to hold additional hearings with small business inventors to be able to review the concerns expressed in this paper.