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Lawmakers should be wary of SHIELD Act

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On Feb. 27, U.S. Rep. Peter DeFazio, D-Ore., introduced H.R. 845, the Saving High-Tech Innovators from Egregious Legal Disputes (SHIELD) Act of 2013.

The proposed bill attempts to limit patent infringement lawsuits brought by nonpracticing entities (NPEs), also referred to as patent assertion entities (PAEs) or patent trolls. The nonpracticing entity business model revolves around purchasing patents and receiving a return on the investment through enforcement of the patents — either through licensing or litigation.

Although the SHIELD Act addresses some key concerns of the current state of patent litigation (namely, curtailing frivolous lawsuits), if passed, the bill will likely not have as drastic of an impact on the NPE landscape as some might hope. Moreover, legislators should remain cautious when considering modifications to the current U.S. patent system, as NPEs play an important role.

The SHIELD Act would implement two changes that would impact NPEs. First, under the proposed Section 285A to Title 35 of the United States Code, NPEs face the risk that courts award the "recovery of full costs to any prevailing party asserting invalidity or noninfringement." Second, NPEs would be required to post a bond to "cover the recovery of full costs."

This loser-pays system and bond requirement would only apply to parties that allege infringement but are not the original inventor (or original assignee of the patent), a university or technology transfer organization (defined as an organization "whose primary purpose is to facilitate the commercialization of technology developed by one or more institutions of higher education") or have not made a "substantial investment" in the "exploitation of the patent through production or sale of an item covered by the patent." Consequently, NPEs are the main targets of the act.

Proponents of the SHIELD Act cite statistics regarding the growing number of patent litigation suits brought by NPEs, the shift in targets of NPE lawsuits and the costs of defending these suits for support. For example, according to RPX Corp., NPEs initiated 62 percent of all patent litigation in 2012 as compared to 45 percent in 2011.

Although this increase seems significant, some of the rise can be attributed to the America Invents Act misjoinder rules that ended the NPE litigation strategy of naming multiple, unrelated defendants in one action.

More importantly, however, there has been a shift in the companies that NPEs have targeted. Traditionally, tech companies were the major targets for NPE lawsuits. But, as more low-tech companies continue to adopt more technology for use in their business systems, they are increasingly becoming targets of NPE lawsuits.

Analysis conducted by Patent Freedom shows that in 2012, NPEs sued more nontech companies than tech companies. Because of this, more nontech companies are finding it necessary to invest in new infrastructures to handle and defend against NPE demands.

This change, coupled with the litigation costs of defending an NPE suit, has diverted valuable funding from companies' other departments, such as research and development, thereby hindering new innovation. This is particularly true where companies find themselves defending against frivolous lawsuits with questionable patents.

Cisco Systems Inc. general counsel Mark Chandler, who recently testified in front of the House Judiciary Committee on abusive patent litigation, stated that Cisco spends more than $50 million a year on legal fees for outside lawyers defending against NPE lawsuits. Furthermore, to meet the legal department budget requirements, Cisco had to reduce funding for new patent applications.

Still, it is important to note that often NPEs do not file lawsuits until licensing discussions break down. It is understandable that companies fight the demand from NPEs for questionable patent claims. But where the NPEs claims are strong, an improvement to licensing effectiveness will go a long way in lowering the additional costs that many companies face when litigation is involved. Patent litigation costs are not only driven by counsel legal fees, but also by the cost of discovery.

The SHIELD Act's proposed loser-pays system will certainly go a long way in restricting the frivolous lawsuits. NPEs will have to be more selective when deciding which patents to file litigation on, as the risks of losing at trial will be greater.

Perhaps this will also improve the effectiveness of licensing discussions overall if the questionable claims are no longer pursued due to the heightened risk associated with following through on a threat of litigation. Ultimately, this loser-pays system may decrease the number of NPE suits being filed, but it will not put an end to the NPE business model.

The other proposed SHIELD Act change — the bond requirement — however, may only have a minimal impact on NPE landscape as a whole. Many NPEs are well funded and would not have a problem posting the bond to cover the recovery of full litigation costs for the other party, if the NPE were to lose. Only the small NPEs would be affected by the bond requirement and, as a result, may need to seek additional funding if the SHIELD Act passes.

Although the SHIELD Act's goal is to limit NPE litigation, it should not seek to eliminate NPEs altogether, for NPEs play an important roll in the U.S. patent system. While defending against NPE claims may hurt innovation when companies' funds are allocated to NPE defense rather than research and development, NPEs do also foster and encourage innovation.

Some NPEs even have departments or networks devoted to helping inventors innovate. NPEs reward innovation by compensating inventors (whether an individual inventor or a large corporation) for their contribution and, in doing so, generate new revenue streams that can then be used to fund further research and development or patent application filings.

Lastly, NPEs expand the market for patents, thereby increasing their value. Without willing NPEs to purchase so many patent assets, inventors would have a more limited market to approach if they wanted to monetize their assets.

Legislators should, therefore, proceed with caution when contemplating restricting NPE activity, as restriction would negatively impact the current patent landscape.