

TESTIMONY OF C. GRAHAM GERST
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Good morning. My name is Graham Gerst, and I am a partner with the Global IP Law Group. My personal background is predominantly in the area of patent litigation, but our firm's activities also include some of the largest patent transactions of the last several years, including the sale of Nortel Networks patent portfolio in 2011 for \$4.5 billion and Alcatel Lucent's 2012 \$2.6 billion debt offering backed by the company's patent portfolio. Our clients range from Fortune 100 companies to individual inventors.

I am here today to urge caution before taking legislative steps that could have unintended consequences for a system that is critical to our economic growth and dynamism.

The first reason for caution is that we already have weakened patent enforcement rights to a great degree, and, as a result, we have hurt companies we intended to help.

I recently had lunch with the chief IP counsel of a sizeable U.S. company. We talked about the state of the patent-enforcement landscape, and his views may surprise you. On the one hand, he no longer worries about most patent-infringement lawsuits brought against his company. Enforcement is so difficult, and the likelihood of significant damages so low, that he generally plays those suits out for nominal settlements. On the other hand, he worries about his own company's ability to protect its inventions in the current environment for the same reason. His company relies on technological innovation to distinguish itself, but he now views its patent portfolio as ineffectual to protect their inventions.

Our Founding Fathers incorporated a patent system in the U.S. Constitution to encourage innovation,¹ and the United States historically has had the strongest patent rights in the world. At least partly as a result, we also have the most innovative economy in the world.

Today, we are weakening patent rights at precisely the time that our economic competitors are moving to strengthen theirs. With the creation of the unitary patent court and wider availability of injunctions, the E.U. is likely to become a more attractive venue for patent enforcement than the U.S. in the very near future. And China's efforts to strengthen its own patent system have resulted in an explosion of litigation making that country first in the world for patent cases filed.²

¹ U.S. Constitution, Art. I, § 8, cl. 8.

² In 2010, the last year of available data, China saw 7,819 patent lawsuits (<http://www.dlapiper.com/global/publications/Detail.aspx?pub=7373&RSS=true>), which is almost 2-1/2 times the 3,220 patent lawsuits in the U.S. that year (<http://www.uscourts.gov/uscourts/Statistics/JudicialFactsAndFigures/2010/Tab1>)

This momentum to weaken patent rights originated from a few infamous matters – particularly the Lemelson patent enforcement and the NTP v. RIM case that ended with a \$612 million settlement. People still raise these examples. But neither could occur today under U.S. patent law. Let me briefly run through some of the changes that have been made:

- In the late 1990s, the Federal Circuit restricted parties' ability to bring suit without strong pre-discovery proof of patent infringement. While there are good reasons for such a rule, it renders many patents unenforceable where infringement occurs behind closed doors.
- From 2000 through the present, most federal courts have become very amenable to staying patent lawsuits pending reexamination proceedings, delaying such actions approximately two years from filing. That stalling tactic is now a standard defense strategy.
- The Federal Circuit's 2002 *Symbol Technologies* decision revived the doctrine of prosecution laches, rendering patents unenforceable for excessive delays in prosecution.
- In 2006's *eBay v. MercExchange* decision, the Supreme Court effectively precluded non-practicing entities from obtaining injunctions.
- In 2007, the Federal Circuit's *Seagate* decision made it harder to obtain enhanced damages by establishing willful patent infringement.
- Also in 2007, in *MedImmune v. Genentec*, the Supreme Court lowered the bar for establishing declaratory judgment jurisdiction for even peaceful attempts to license patents. As a result, a patentee seeking to license its technology risks litigation in an unfavorable venue for almost any licensing effort.
- In a series of decisions starting in 2008, the Federal Circuit made it easier for accused infringers to transfer patent cases to their own preferred venue.
- In the 2008-2012 range, the federal courts changed the law with respect to method claims, making it harder to enforce those claims where multiple parties participate in the infringement.
- Since 2008, the federal courts have been aggressively limiting damages available to patentees under the entire market value rule. These decisions also have made proving damages much more complex and expensive for litigants on both sides.
- In 2011, the Federal Circuit and the Supreme Court rendered a wide array of issued patents of questionable validity with their decisions in *Bilski*.
- The 2012 America Invents Act eliminated a longstanding practice in the federal courts of allowing joinder of multiple defendants in cases involving the same group of patents. That legislation also increased the avenues available to challenge patent validity before the PTO, raising enforcement costs for patentees.

e407.pdf). This discrepancy occurred in a year when the Chinese economy was only about 40% of the size of the U.S. economy—about \$5.9 trillion to \$14.6 trillion.

- In 2013, a federal district court in the Northern District of California denied an injunction to Apple against directly competing products that had been proven to infringe multiple Apple patents.

I list those changes not to criticize them. Most of them are sensible. But their combined result is a system that no longer rewards innovation as it should for the majority of U.S. companies.

On one end of the spectrum is enforcement of exceedingly valuable patents reading on hugely profitable products, resulting in astronomical damages. These cases still make economic sense despite these legal changes.

On the other end are the suits of no or negligible merit brought to leverage the high cost of patent litigation for a nuisance-level settlement. These suits are a problem and are economically harmful. But this problem exists in all areas of our legal system. It is just worse in the patent area. Patent litigation costs are higher, giving plaintiffs more leverage. Things are being done to combat this strategy. The AIA took some effective steps, and the courts are doing their part with local patent rules, particularly with those limiting discovery.

The biggest problem, however, is in the middle of the spectrum – our small-to-mid-sized companies with valuable innovations of their own. An in-house counsel at one of those companies rarely can justify spending \$3-\$7 million in litigation costs when potential damages are unlikely to cover those costs, and the chances of enjoining a competitor from infringing with a directly competing product are uncertain or even unlikely. As a result, these companies no longer can protect their investment in new technologies. And historically, companies of this size are the most inventive and create the most jobs and economic growth. Legislation making it harder for these types of companies to protect their intellectual property through enforcement, such as instituting a “loser pays” system, would exacerbate this problem.

The second reason for caution is that our patent system is still digesting several significant changes made over the last couple of years. We should wait to understand the full effect those changes are having before any new significant legislation in this area. These include the AIA, some of which is still being implemented, experiments with local rules and discovery being undertaken by the district courts, and the changes to legal doctrine, particularly in the area of patent damages. There are even discussions of a small claims patent court, which could change the landscape. Legislation written now may not be optimal for the system as it will appear in the near future.

The third reason for caution concerns non-practicing entities. Although these entities are politically unpopular, they are not new. Thomas Edison was one of the original NPEs. And they serve an important role in the patent ecosystem, providing a mechanism to reward innovators, which is the goal of the patent system.

Numerous operating companies today depend on NPEs to generate revenues from the companies' patent portfolios, revenues that then can be fed back into R&D and further innovation. These companies do so by selling patents directly to an NPE, which often pays a sum up-front payment and sometimes includes a share of future licensing revenues.

NPEs also can help investors in startups recover their investments. When an NPE acquires patents from an unsuccessful startup, the investor can reinvest those proceeds in new ventures. Moreover, getting investment money back in this fashion incentivizes further new investments.

Finally, by creating more demand for patent assets, NPEs increase the monetary value of those assets and makes them a more liquid asset. These characteristics are important to lenders that take patents as collateral in financing deals, something we often see. Without NPEs, therefore, bank lending to startups would diminish at a time when our economic recovery is still weak.

Because NPEs do serve such a role, legislation targeting them based on their status, rather than on activities that are economically detrimental like the nuisance level suits, could have negative ramifications that we cannot fully anticipate.

Thank you very much for giving me this opportunity to speak to you today about some of the risks legislating in this area poses.