

Patent Reform 2.0

By Thomas M. Lenard

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The first major patent reform legislation in years is only two years old, yet the patent system remains plagued by wasteful litigation that is harmful to innovation. Fortunately, new patent reform legislation addressing these problems is gaining momentum on Capitol Hill.

The major concerns involve Patent Assertion Entities (PAEs), less charitably known as patent trolls. PAEs specialize in enforcing patent rights, by negotiating licenses or, if necessary, suing alleged infringers. They serve as intermediaries between the inventor and the manufacturer and, as such, can perform a valuable economic function. For example, PAEs allow inventors to focus on inventing rather than worrying about whether their patents are being infringed.

Mounting evidence suggests, however, that we have a litigation problem and that it applies to “practicing entities” as well as PAEs. This is because many patents, particularly software patents, which account for most of the increase in litigation, are overly broad or vague and therefore do not confer a well-defined property right. In addition, an asymmetry in litigation costs—which are borne disproportionately by defendants—makes it profitable for patent holders to sue and defendants to settle, even if the infringement claim has little or no merit.

Some of the reform proposals are no-brainers. For example, under the bill recently introduced by House Judiciary Chairman Goodlatte, patentees would be required to clearly state how the defendant’s product infringes the patent. They would also have to identify ownership of the patent and who has a financial interest.

There is also substantial support for fee-shifting—requiring the losing party to pay litigation costs—which is included in the Goodlatte bill as well as a bill introduced by Senator Hatch. “Loser pays” is in widespread use in other countries (not just in patent cases), but has been controversial in this country primarily due to opposition from trial lawyers. This would be a good place to introduce it.

Importantly, the current crop of bills targets behavior, not PAEs per se. This is the right approach and it minimizes the risk of unintended consequences. For one thing, it is difficult to come up with a definition of PAE that doesn’t require a lot of exceptions. Any PAE definition would invite gaming, perhaps in a way that is socially costly—for example, by inducing an entity to add a manufacturing division solely for the purpose of falling outside the PAE definition. In addition, as indicated above, PAEs can perform economically useful functions, and practicing entities are also responsible for frivolous litigation.

The most controversial proposals under consideration involve expanding the covered business method (CBM) review program established by the 2011 patent reform legislation. The CBM program provides a low-cost means for defendants to challenge at the Patent Office (rather than in court) the validity of a patent they are accused of infringing. The program is currently limited to “financial services” patents, but Reps. Issa and Chu and Senator Schumer have proposed expanding the program to a broader class of software and computer patents. The Goodlatte bill also broadens the interpretation of “financial services.”

Opponents of expanding the CBM program argue that the program is new and we should wait until we have more experience. In addition, they argue that covering more software patents will adversely affect a vibrant American industry.

The first-best solution would be to grant high-quality patents to begin with. However, the increase in litigation surrounding poorly defined software patents justifies providing a lower-cost alternative to the courts to determine whether these patents, when litigated, are in fact valid, notwithstanding our limited

experience with the CBM program. Hopefully, the success of the U.S. software industry doesn't depend on low-quality software patents.

The common theme of the proposals under consideration is to correct the asymmetry in the costs of patent litigation. Even though these measures don't directly address patent quality they do so indirectly. Increasing the costs of asserting (and decreasing costs of defending against) a patent claim means that marginal patents will become less valuable and there will be fewer lawsuits involving them. Infringement claims involving quality patents should not be deterred. Overall, the patent system would be strengthened.

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