PATENT FILE

Trouble in patent troll paradise?


Marc J Rachman


Devin A Kothari

Recent Supreme Court decisions will likely curb actions by non-practising entities, say **Marc J Rachman**, and **Devin A Kothari**

Patents are the strongest form of IP protection. Indeed, because patents provide strict exclusionary rights, typically for a period of 20 years, patent holders have long been given broad latitude by the courts to protect themselves against infringing competitors. The historically strong position of patentees was further bolstered when, in 1982, Congress established a specialised appeals court for patent matters, the US Court of Appeals for the Federal Circuit ("Federal Circuit"). Indeed, soon after its establishment, the Federal Circuit issued several pro-patentee decisions that expanded the range of patentable inventions and made it more difficult to invalidate issued patents.

Because of these decisions, the patent system quickly became subverted by bad actors. Rather than attracting innovation, these shifts in patent law emboldened what some have termed "patent trolls," who routinely seek patents on abstract ideas and have flooded the courts with litigation. In response to these abuses, the Supreme Court of the US has been forced to repeatedly reverse Federal Circuit precedent and neuter patent trolls. Below, we trace the origins and contours of these Supreme Court decisions, and their likely chilling impact on non-practising entities.

The Fed Circ's pro patent bent

On April 2, 1982, as President Reagan settled into the Rose Garden to sign the Federal Courts Improvement Act ("FCIA"), the patent world was abuzz. For many years, patent owners and the patent bar had complained of a lack of uniformity in patent law. These same groups had also complained of a lack of technical sophistication and patent law knowledge in the federal judiciary. The FCIA resolved both problems by creating the Federal Circuit.

The creation of the Federal Circuit immediately shifted the patent law landscape in favour of patent holders. For example, before the FCIA was passed, the Supreme Court issued several decisions that largely made mathematical algorithms, including those encapsulated in software, ineligible for patent protection. The Federal Circuit, however, reversed this trend. Indeed, in its 1998 decision, *State Street Bank and Trust v Signature Financial*, the Federal Circuit held that a strategy for managing a mutual fund via software was eligible for patent protection. Partly because of this change, the number of issued patents exploded, from nearly 58,000 patents in 1982 to approximately 300,000 patents in 2015. This boom was largely driven by software and computer technology companies. Microsoft, to take one example, had received just five patents in the 1980s. It received 1,116 patents in the 1990s and 12,330 patents in the 2000s.

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While it was clearing the path for more patent applications, the Federal Circuit also made it more difficult to invalidate patents that had already issued. Soon after its founding, the Federal Circuit strengthened the presumption of patent validity and required clear and convincing evidence to invalidate a patent. It also chipped away at long-established Supreme Court precedent that labelled the combination of previously known-technologies "obvious" and thus unpatentable. For example, in its 1984 decision *ACS Hospital v Montefiore Hospital,* the Federal Circuit held that obviousness not only required multiple inventions that could be combined, but also a "teaching, suggestion or motivation" to combine them. As a result of these changes and others, patents were being invalidated less frequently than ever. Indeed, after the Federal Circuit's founding, patents were sometimes found valid and infringed at a greater than 80% clip, after never reaching 50% in the 60 years prior.

With more patents being issued each year, and less risk that these patents would be found invalid, patent infringement lawsuits also skyrocketed. In the year the Federal Circuit was founded, there were approximately 1,000 patent infringement suits filed in the US. In 2012, that number rose to more than 5,000. Indeed, in response to the Federal Circuit's changes, a whole new business model arose. Whereas patent litigation was previously a defensive manoeuvre, meant to protect investments in technology from second movers and free riders, it now became a means to make money unto itself. Indeed, patent trolls often collected patents and sued solely to create settlement and licensing revenue. This onslaught of patent suits spawned patent litigation cottage industries in places like the United States District Court for the Eastern District of Texas ("Eastern District of Texas"), which lured patent holders with the promise of rocket dockets, plaintiff-friendly rules and high jury awards.

The Supreme Court gets involved

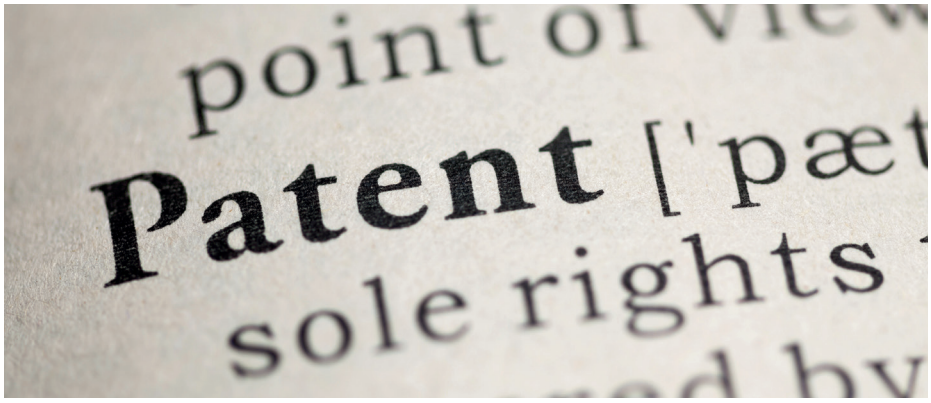
During the Federal Circuit's first two decades, the Supreme Court proved relatively non-interventionist. Eventually, however, the cacophony became too loud to ignore: several

commentators found that patent litigation had become so complex and expensive that it served as a disincentive to innovation. In addition, academics noted that frivolous patent troll litigation likely cost the economy $30-$80bn per year.

In 2006, under newly-appointed Chief Justice John Roberts, the Supreme Court therefore inserted itself into the fray. In the first two years of his tenure, the court heard four patent cases on substantive patent law issues. In *KSR v Teleflex*, the Supreme Court weakened the Federal Circuit's teaching, suggestion and motivation test, noting that a "common sense" test for obviousness should prevail. In *eBay v MercExchange*, the court made it more difficult to get an injunction for patent infringement. And in *Illinois Tool Works v Independent Ink* and *Microsoft v AT&T*, the court addressed patent licensing and restricted the extraterritorial application of patent law.

In this decade, the court's interventionist bent has continued unabated. Indeed, in four recent cases, the Supreme Court has continued to restrict the rights of patent holders as it attacks systemic issues in the patent system. For example, in 2014, the Supreme Court issued its decision in *Alice v CLS Bank*, which many commentators saw as aimed at the tide of bad patents that had entered the patent system. Specifically, *Alice* took issue with software and business method patents, noting that many such patents are simply "abstract ideas" such as algorithms or methods of computation. Merely performing those methods on a computer or reciting generic computer components, the Supreme Court held, could not render those ideas patentable. After *Alice*, the USPTO increased the number of rejections on non-patentable subject matter grounds, and issued fewer patents in these sectors. Similarly, in the first year after *Alice*, software and business method patents were invalidated approximately 70% of the time in district courts, 92% of the time at the Federal Circuit, and 100% of the time by the USPTO in covered business method proceedings.

Recent Supreme Court decisions also take aim at frivolous patent litigation. For example, in its 2014 decision *Octane Fitness v Icon Health & Fitness*, the Supreme Court relaxed the standard for recovering attorneys' fees in patent litigations, noting that a plaintiff could be forced to pay attorneys' fees either when it has brought a frivolous case or where it has litigated that case unreasonably. In its decision earlier this year in *Impression Products v Lexmark*, the Supreme Court noted that patent rights in a product extinguish once the item is sold, and that patentees cannot use the threat



"The Supreme Court noted that patent suits must be filed in the defendant's state of incorporation or where it has a regular place of business. This decision is likely to have an outsized impact on patent trolls."

of a patent suit to control a downstream consumer's use of a product. And, this year, in *TC Heartland v Kraft Foods*, the Supreme Court noted that patent suits must be filed in the defendant's state of incorporation or where it has a regular place of business. This decision is likely to have an outsized impact on patent trolls, which routinely used the specter of a suit in a foreign, patentee-friendly district to gain leverage in licensing negotiations. Perhaps as a result of these decisions, the number of patent filings have shown a marked decline in the last year.

Recent decisions give patentees hope

Taken together, the Supreme Court's recent decisions indicate that it believes the patent system is broken, and is taking active steps to fix it. For good faith litigants, however, the news is not all grim. For example, in 2016, in *Halo Electronics v Pulse Electronics*, the Supreme Court made it easier for patentees to recover for willful infringement. Similarly, in 2017, in *SCA Hygiene Products v First Quality Baby Products*, the Supreme Court noted that a long delay in filing a patent case was immaterial, so long as the case was filed within the statute of limitations. For legitimate cases brought by patentees, the court has therefore made it easier to recover damages.

In addition, a pair of recent Federal Circuit decisions give patentees hope that not all software and business method patents are ineligible for patent protection. For example, in *Enfish v Microsoft* and *McRo v Bandai Namco Games*, decided in 2016, the Federal Circuit held that not all computer-related inventions are per se abstract. Instead, the Federal Circuit held that where patent claims focus on a specific improvement in computer capabilities, rather than the use of computers as a tool for implementing an abstract idea, they are patentable. It is perhaps as a result of these decisions that grant rates for *Alice* challenges have recently leveled, giving hope to true innovators in the computer hardware and software space.

The bottom line

In its recent jurisprudence, the Supreme Court has attempted to reform the worst abuses of the patent system, while protecting the rights of practising entities in legitimate patents. Although this has proved to be a delicate balance, the Supreme Court's rulings appear to have made a positive impact. For example, the Supreme Court's *eBay* case removed the threat of injunctive relief in patent troll suits. *Alice* has led to the invalidation of many improperly issued patents and prevented the issuance of countless others. And *TC Heartland* is expected to have a similar chilling effect on the number and distribution of patent troll filings. In short, the Supreme Court's recent decisions have gone a long way towards reforming the patent system, and provided defendants with numerous tools to defeat invalid patents and frivolous litigations.

Whether or not this trend continues, one message has been made clear: the paradigm for patentees has changed. Patent trolls beware.

Marc J Rachman is a partner in the IP practice group of Davis & Gilbert. Devin A Kothari is an associate at the firm.