Patent Reform 2007 - A Needed Fix or a Threat to American Innovation?

Printed in the December 2007 edition of *Atlanta Business Magazine* and the *TELLUS International, Inc.* December 2007 Newsletter.

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Remarkable changes to the patent system in the United States seemed inevitable in mid-year 2007. Many people involved with patents agree that reforms to the system are needed, but the changes threaten to go too far.

The United States has the largest and most resilient economy of any country in the world. We are still the predominant source of major technological innovation in the world. Countries on all continents send their best and brightest to study at American universities. Many of those educated here, stay here, get infected with the American innovative spirit, and become entrepreneurs.

The patent system helps protect this innovation and keep the U.S.A. in the innovation lead. In order to legally protect an invention, an inventor has to claim it as his or her own – to patent it. Patents helped Alexander Graham Bell's company to become AT&T, and Thomas Edison's to become General Electric.

Patents promote innovation by providing incentives for inventors to disclose their inventions for the public good. In return for disclosure, patent owners receive exclusivity over their inventions for a limited time – so that investments can be recovered and profits made.

The U.S. patent system is the most highly developed and the best in the world. No other country has a system nearly as well-designed, sophisticated, and process-fair. The entrepreneurial spirit in the United States for technology inventions is fueled by the existence of good, solid patents. Investors draw comfort in seeing a portfolio of quality patents in their companies.

But in the past few years, a several highly publicized incidents have given patents and the patent system a bad name. Since about 1998, so-called "business method" patents and computer software patents have annoyed financial services and IT businesses. In 2000 the Amazon "One-Click" patent was viewed as incredible by many people involved in Internet commerce. Shortly after that controversy, there was amazement over a patent granted to J.M. Smucker Company for a "crustless" peanut butter and jelly sandwich—was every mom an infringer?. In 2006, Research in Motion (a/k/a "RIM", which makes the Blackberry wireless device) paid over $615 million to settle a patent infringement claim by a company that some called a patent troll. "Patent troll" is a perjorative term for a patent monetization company that generally has no business other than owning patents and attempting to enforce them. Some people believe that "trolls" are not legitimate businesses and attempt to extract exorbitant royalties and damages.

The result was a widespread belief that significant patent reform was needed. Many people felt that the U.S. Patent Office was issuing too many patents—especially too many "bad" patents—and that there were too many patent lawsuits. A 2004 book by two professors (Adam Jaffe and Josh Lerner, "Innovation and Its Discontents: How Our Broken Patent System is Endangering Innovation and Progress, and What to Do About It") got the attention of the Congress and the courts, and gave the patent reform movement further momentum.

Some reform indeed seemed a good idea. Now, the U.S. patent system is entering a new and dangerous era due to a number of ill-considered "reforms" that are probably a gross over-reaction. As a result, the vibrancy of the American entrepreneurial spirit in technology ventures is at risk.

In a three-pronged assault, the U.S. government is attempting to throttle back the patent system.

First, the Supreme Court this year handed down three major patent law decisions. One–KSR v. Teleflex –raised the bar for getting a patent. Now, in the words of the Supreme Court, "the results of ordinary innovation are not the subject of exclusive rights under the patent laws." Although the patent laws are designed to prevent patents on trivial (obvious) improvements to the prior art, a statement like this from the Supreme Court has the potential to be taken to an extreme. How does the Patent Office, or a Court, decide what is ordinary innovation and what is not? The Supreme Court did not provide any practical guidance. Lower courts and the Patent Office have struggled for years with this elusive concept of "obviousness," but the Supreme Court only muddled the issue.

Second, the U.S. Patent and Trademark Office (USPTO) recently developed new patent prosecution rules that were scheduled to become effective on November 1, 2007. Many of these new rules are just plain

arbitrary, capricious, unfair, and expensive. The new rules, among other things, would curtail "multiple continuation" applications, arbitrarily limit the number of claims, force admissions against interest in the official record, and create other expensive hurdles for inventors. The rules were designed to have an unfair retroactive impact on all pending patent applications not yet examined by the USPTO. The rules threatened to have a disproportionate impact on pharmaceutical companies, small businesses, and entrepreneurs. (Thanks to a lawsuit filed by the pharmaceutical company GlaxoSmithKline, a U.S. District Court in Virginia issued a preliminary injunction on October 31, 2007, barring the USPTO from implementing the new rules, at least temporarily.)

Third, the largest patent law reform in over 50 years is now before Congress, and was approved by the House of Representatives on September 7, 2007. The Bush Administration indicated it would sign a patent reform bill. If passed by the Senate, the reforms would become law. Many questionable provisions are contained in the bill under the guise of being an improvement and encouraging innovation. Among these changes are moving away from granting patents to the first inventor and instead to the "first inventor to file," and empowering the USPTO to implement the unfair and capricious new rules.

Of particular significance is the lack of studied attention to the real problem – getting valid, non-obvious patents through the Patent Office quickly. Many proposed reforms tend to focus on the downstream effects of patents – litigation in the courts and damages awards. The real problem is the inability of the Patent Office to provide an examination system that is speedy and thorough but fair, which results in part from its inability to hire, train, and retain enough qualified patent examiners. The proposed patent rules are supposed to improve the examination system, but the rule changes are excessively complex and seem to absolve the Patent Office of responsibility for examining patents adequately but fairly.

While legislative reform is clearly needed, the current bill before Congress is more of a downstream fix to an upstream problem, and does not thoughtfully address the real issues. The Supreme Court's KSR v. Teleflex decision did not provide any practical guidance on how to determine non-obviousness and left too many questions about patentability unanswered. Although attention to issues in the litigation stage is important, patent reform would be better directed initially at the examination stage where patents are filed and examined.

Instead of addressing the real issues, the prospective reforms have the potential for bad things in the U.S. economy:

- Innovation may be discouraged, certainly at the small company and VC-funded entrepreneurial level, as a result of unfair and expensive prosecution rules and uncertainty over what inventions are non-obvious and capable of patenting.
- Big business may get bigger and more monopolistic and aggressive towards small business (with reduced valuations for technology acquisition deals).
- Small businesses may have to resort to methods other than patents (such as expensive antitrust litigation) to protect themselves from predators—if they can protect themselves at all.
- Fewer patents may be issued, and fewer lawsuits may have favorable outcomes for patent holders. This by itself may not be bad, but fewer patents just for the sake of fewer patents is not a good result.
- Foreign manufacturers will be encouraged to flood in cheap, low quality products with less fear of patent barriers, causing domestic manufacturing to shrink even more.

If entrepreneurs cannot protect their inventions, venture capital may be harder to come by. If financial sources conclude that they cannot protect their investments, they may reduce investment in entrepreneurial start-ups whose innovations are susceptible to reverse engineering and copying – which basically is just about any computer software, electronic, telecommunications, mechanical, or other invention in the so-called "predictable" arts. The pharmaceutical companies, such as GlaxoSmithKline, already recognize the threat to their investments in new drug development.

Patent reform is certainly needed, and at least some of the reforms are good ideas. But the current set of reforms seems poised to create more problems and risks to U.S.-originated technology, especially entrepreneurial ventures. Good patent reform will require time, study, careful consideration, balancing of interests, and inevitable lobbying in Congress. It is not clear that this will happen as it should. But to keep this country competitive and prevent significant damage to the patent system and the innovation economy, a better effort at patent reform is needed. People involved in the patent system should pay close attention to developments in patent reform and be prepared to change business strategies quickly.

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