Prepared Statement of the Federal Trade Commission

Before the

Subcommittee on Courts, the Internet, and Intellectual Property
Committee on the Judiciary
United States House of Representatives

American Innovation at Risk: The Case for Patent Reform

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focusing on rapidly advancing industries such as pharmaceuticals, biotechnology and the computer industry.

A. Development of the Report

To examine the relationship of competition and patent policy, the FTC and the Department of Justice's Antitrust Division (DOJ) held hearings 8gsas 8gsas d7.s0 TdCpebrua4]>>BD5Im54erv Novembeebrua488 0 Td(r 2002.)Tj(Th)Tj4.44 0 Td(e heari)Tj2.68 0 Td(ngs tookebrua44]>>BD5Im place ovebrua46 0 Td(er tech in)Tj3.02 0 Td(dustries s)Tj3.75 0 Td(uch as ph)Tj3.7as d7.sarmace)Tj2.87 0 Td(uticals,)Tj0 Tc 0 Tw -304885 -2.36 Td

[4] Meeting participants debated recosmenda tions for patent reform made by the FTC, the NAS and AIPL

[4] A summary of the town meetings on patent reform co-sponsored by AIPLA, the NAS and the FTC can be found at http://www.ftc.gov/opp/intellect/050601summarytownmtg.pdf.

B. The Report's Findings

Patent policy stimulates innovation by providing an incentive to develop and commercialize inventions. Without patent protection, innovators that produce intellectual property may not be able to appropriate the full benefits of their innovation when competitors are able to "free ride" on the innovator's efforts. Patents may also encourage firms to compete in the race to invent new products and processes.[5] Following the initial innovation, patent rights may make it easier for inventors to attract funding and develop relationships needed to commercialize the invention. Moreover, the public disclosure of scientific and technical information made through a patent can stimulate further scientific progress.[6]

For example, at the hearings representatives from the pharmaceutical industry stated that patent protection is indispensable in promoting pharmaceutical innovation for new drug products. By preventing rival firms from free riding on the innovating firms' discoveries, patents can enable pharmaceutical companies to cover their fixed costs and regain the high levels of capital they invest in research and development.[7] At the same hearings, representatives from the biotechnology industry explained that many biotechnology companies conduct basic research to identify promising products and then partner with a pharmaceutical company to test and commercialize the product. Patent protection allows them to attract funding from capital markets, and to facilitate inter-firm relationships, such as licencing and joint ventures, necessary for commercial development of their inventions.[8]

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[5] See Thomas O. Barnett, Assistant Att'y Gen., U.S. Dep't of Justice, *Interoperatibility Between Antitrust and Intellectual Property*, address before the George Mason University Symposium on Managing Antitrust Issues in the Global Marketplace 3-4 (Washington, D.C., Sept. 13, 2006), http://www.usdoj.gov/atr/public/speeches/218316.pdf.

[6] Report, Ch. 2 at 3-7.

[7] Report, Ch. 3 at 11-12.

[8] Report, Ch. 3 at 15, 17-18.

Competition also plays a very important role in stimulating innovation and spurs invention of new products and more efficient processes. Competition drives firms to identify consumers' unmet needs and to develop new products or services to satisfy them. In some industries, firms race to innovate in hopes of exploiting first-mover advantages. Companies strive to invent lower-cost manufacturing processes, thereby increasing their profits and enhancing their ability to compete.[9]

At the hearings, many participants representing computer hardware companies observed that competition, more than patent protection, drives innovation in their industries.[10]

disrupts the other policy's effectiveness.[14] It is important to note that the Report and hearings confirmed that patents play an important role in promoting innovation. Nonetheless, many observers expressed significant concerns that, in some ways, the patent system has become misaligned with competition policy.

C. Concerns with Questionable Patents

One issue stood out at the hearings for the widespread agreement it generated among panelists: the importance of patent quality in maintaining the alignment between patent and competition policy. Panelists raised concerns about the issuance of patents of questionable quality–those of questionable validity or having overly broad claims. Patents of questionable quality can distort competition, innovation, and the marketplace in at least four ways.

First, they may slow follow-on innovation by discouraging firms from conducting research and development in areas that the patent improperly covers.[15] When firms fear that they will infringe a questionable patent, the substantial costs and risks of litigation may persuade them to direct their resources into other areas. For example, biotechnology firms reported that they avoid infringing questionable patents and therefore will refrain from entering or continuing with a particular field of research that such patents appear to cover.[16] A lawsuit may not be an

[14] The FTC's Report on the patent system is the first of two reports that the agency will issue regarding the relationshipmpltf9 >>BDC BTis

alternative because a competitor has no standing to challenge patent validity unless the patent holder has threatened litigation. In these circumstances, as one biotech representative complained, "there are these bad patents that sit out there and you can't touch them."[17] A competitor might attempt to invalidate the patent through a re-examination procedure in the PTO, but this allows only limited participation by third parties, and most hearing participants did not believe it proved effective.[18] Such conditions deter market entry and follow-on innovation by competitors and increase the potential for the holder of a questionable patent to suppress competition.

Second, patents that should not have been granted raise costs when they are challenged in litigation.[19] If a competitor chooses to pursue R&D in the area covered by the patent without a license, it risks expensive and time-consuming litigation with the patent holder that wastes resources.[20]

Third, questionable patents may

unjustified royalties and transaction costs.[21] Questionable patents particularly contribute to increased licensing costs in industries with "patent thickets."[22] In some industries, such as computer hardware and software, firms can require access to dozens, hundreds, or even thousands of patents to produce just one commercial product. Scholars refer to this phenomenon of overlapping patent rights as a "patent thicket." With so many patents at issue, panelists suggested, infringing another firm's patent can be inevitable, but there is often no economically feasible way, prior to making investments, to search all potentially relevant patents, review the claims, and evaluate the possibility of infringement or the need for a license. This is particularly true where the scope of patent coverage is ambiguous, so that questionable patents increase uncertainty about the patent landscape, and thereby complicate business planning.[23]

II. The FTC Report's Recommendations

The FTC Report makes ten recommendations for changes to the patent system to maintain its proper alignment with competition.[25] This testimony provides an overview of those recommendations, followed by a more detailed discussion of the three recommendations that correspond to provisions of previously proposed patent reform legislation: (1) establish a post-grant opposition procedure; (2) change the standards for willful infringement; and (3) require publication of all patent applications at 18 months.[26]

A. Overview

A first set of recommendations aims to increase a challenger's ability to eliminate questionable patents after issuance. Those recommendations are:

- enact legislation to create a new administrative procedure to allow post-grant review of and opposition to a patent after issuance by the PTO; and
- enact legislation to specify that challenges to the validity of a patent are to be determined based on a "preponderance of the evidence" rather than a "clear and convincing evidence" standard.

A second group of recommendations has the goal of minimizing the issuance of questionable patents. Those recommendations are:

- tighten certain legal standards used to evaluate whether a patent is "obvious;"
- provide adequate funding for the Patent and Trademark Office (PTO);

[25] Report, Executive Summary at 7-17.

[26] "The Patents Depend on Quality Act of 2006," H.R. 5096, introduced in the U.S. House of Representatives by Reps. Howard Berman (D-Cal.) and Rick Boucher (D-Va.), and the "Patent Act of 2005," H.R. 2795, introduced by Rep. Lamar Smith (R-Tex.), both contained provisions related to these three recommendations.

- modify certain PTO rules and encourage patent examiners to request additional information from patent applicants; and
- expand PTO's "second-pair-of-eyes" review.

A third group of recommendations seeks to promote the disclosure, teaching, and notice function of patents. Providing reliable and early notice of the subject matter a patent covers enhances business certainty for competitors who wish to avoid infringement. Those recommendations are:

- modify the doctrine of willful infringement by enacting legislation to require, as a predicate for liability for willful infringement, either actual, written notice of infringement from the patentee or deliberate copying of the patentee's invention, knowing it to be patented;
- enact legislation to require publication of all patent applications 18 months after filing; and
- enact legislation to create intervening or prior user rights to protect parties from infringement allegations that rely on certain patent claims first introduced in a continuing or other similar application.

The final set of recommendations encourages consideration of competition and economics in shaping patent policy:

- consider possible harm to competition and innovation, along with other possible benefits and costs, before extending the scope of patentable subject matter; and
- expand consideration of economic learning and competition policy concerns in patent law decision making.

B. Enact Legislation to Create a New Administrative Procedure to Allow Post-Grant Review of and Opposition to Patents

The Report recommended creation of a new administrative procedure for post-grant review and oand Oppositi

against undue delay in requesting post-grant review and against harassment through multiple petitions for review. The review petitioner should be required to make a suitable threshold showing. Finally, settlement agreements resolving post-grant proceedings should be filed with the PTO and, upon request, made available to other government agencies.[28]

C. Enact Legislation to Require, As a Predicate for Liability for Willful Infringement, Either Actual, Written Notice of Infringement from the Patentee, or Deliberate Copying of the Patentee's Invention, Knowing It to Be Patented

Courts have discretion to award treble damages after finding that patent infringement was undertaken willfully. Some hearings participants explained that they do not read their competitors' patents out of concern for such potential treble damage liability. Failure to read competitors' patents can harm innovation and competition in a number of ways. It undermines one of the primary benefits of the patent system–the public disclosure of new invention. This encourages wasteful duplication of effort, delays follow-on innovation that could derive from patent disclosures, and discourages the development of competition. Failure to read competitors' patents also thwarts rational and efficient business planning and can jeopardize plans for a noninfringing b W1.72 0 Toelt-o [illegible] f.72 0 Toel88 -1.18 a 0 ToelTj4.66 0c.0.61 3.9

questionable patent can raise costs and prevent competition and innovation that otherwise would benefit consumers. Implementing the recommendations in the FTC's Report will increase the likelihood that issued patents are valid and the efficiency of challenges to invalid patents. Thank you for this opportunity to share the Commission's views. We look forward to working with you on this important issue.