



3-1-2013

Does the US Patent System Need a Patent Small Claims Proceeding?

Colleen Chien

Santa Clara University School of Law, colleenchien@gmail.com

Michael J. Guo

Wilson Sonsini Goodrich & Rosati, michael.guo@gmail.com

Follow this and additional works at: <http://digitalcommons.law.scu.edu/facpubs>



Part of the [Intellectual Property Commons](#)

Automated Citation

Colleen Chien and Michael J. Guo, *Does the US Patent System Need a Patent Small Claims Proceeding?* (2013), Available at: <http://digitalcommons.law.scu.edu/facpubs/666>

This Article is brought to you for free and open access by the Faculty Scholarship at Santa Clara Law Digital Commons. It has been accepted for inclusion in Faculty Publications by an authorized administrator of Santa Clara Law Digital Commons. For more information, please contact sculawlibrarian@gmail.com.

Is a Patent Small Claims Proceeding a Good Idea?

RFC Docket No. PTO–P–2012–0050

Comments on a Patent Small Claims Proceeding in the United States

Colleen V. Chien¹ and Michael J. Guo²

Submission to: ip.policy@uspto.gov

1. Introduction

Patent litigation is expensive. The primary motivation for the creation of a patent small claims proceeding is to make enforcement more affordable. However, in the twenty or so years since the American Intellectual Property Law Association (AIPLA) first endorsed the idea of a small claims patent court through Resolution 401-4, the patent litigation landscape has drastically changed. Although patent litigation costs are still high, the equities have shifted. The marketplace for patents has developed, providing more options than previously existed to monetize and assert patents. However, the cost of patent defense has not gone down, and small companies cannot afford to bring meritorious defenses. As a result, it is the high costs of defense that now presents a pressing concern. We do not believe that a small claims patent court is the answer. Nonetheless, if a small claims patent court is to be adopted anyway, we include some principles below that should help inform such a court's creation.

2. Small Companies Suffer from Both the Underenforcement and Overenforcement of Patents

Though patent litigation is expensive across the board, it can be particularly unaffordable for resource-constrained litigants like startups and small innovators for whom the costs of litigation are insurmountable. As described by one medical device executive, his company decided not to sue a large corporation that was almost certainly willfully infringing his company's patents covering PET scanners because the cost and length of litigation would have been too great for the young startup.³ The costs of defense have also been recognized as a huge problem for small defendants. More and more of them seem to be finding themselves in the same position as college student Michael Karr who was sued by the patent assertion entity Lodsys, and settled, because he "simply didn't have the funds to continue on with the lawsuit."⁴ Even when cash is available, the costs can dwarf the benefits.

According to the 2011 AIPLA Annual Economic Survey, when less than \$1 million are at risk for a single-patent suit, the cost may approach or exceed the benefits, to the tune of \$490,000 through the end of discovery and \$916,000 inclusive of all costs.⁵ These are costs per party – litigation becomes even

¹ Colleen V. Chien, Assistant Professor, Santa Clara University Law School.

² Michael J. Guo, Associate, Wilson Sonsini Goodrich & Rosati. The views expressed in this comment are those of Prof. Chien and Mr. Guo and do not reflect those of Wilson Sonsini Goodrich & Rosati or of its clients.

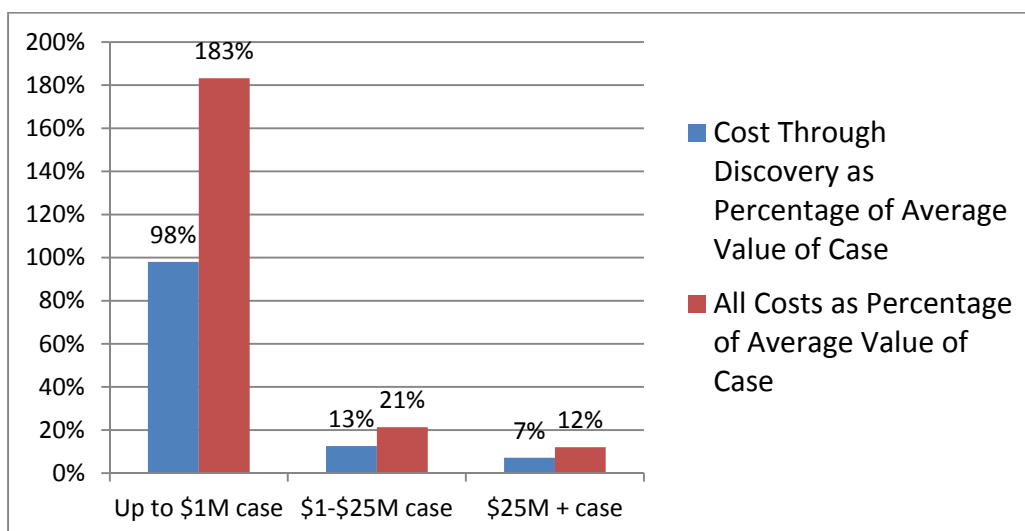
³ Michael Guo, Patent Small Claims Court: Strengthening Patent Rights, Boosting Small Businesses, and Slaying Trolls, *The Corporate IP Institute Program Materials* 411, 412 n.6, October 2012 (citing Michael Phelps, Director, Crump Inst. for Molecular Imaging, Remarks at the Ninth Session of Seminar on Technology and Science Commercialization and New Business Development (Nov. 23, 2011)).

⁴ Jeff Roberts, *App Developer Gives in to Lodsys in David-and-Goliath Patent Fight*, PAIDCONTENT.ORG (Oct. 12, 2011, 6:33 PM), <http://paidcontent.org/article/419-app-developergives-in-to-lodsys-in-david-and-goliath-patent-fight/>.

⁵ AM. INTELLECTUAL PROP. LAW ASS'N LAW PRACTICE MGMT. COMM., REPORT OF THE ECONOMIC SURVEY I-153-I-154 (2011) [hereinafter "AIPLA REPORT"]. The 2011 AIPLA Report of the Economic Survey shows that the average cost of a patent infringement suit where less than \$1 million are at risk is \$490,000 through the end of discovery and

more unaffordable when both sides' costs are factored in.⁶ This is less likely to be the case when more than \$25 million are at risk, where the average cost of \$6 million per party is a fraction of the reward.⁷

**Per Party Cost in Patent Litigation, as a Share of Value of Case
Based on AIPLA 2011 Annual Economic Survey Figures⁸**



The desire to fix this so-called “underenforcement problem” led the ABA Section of Patent, Trademark, and Copyright Law in 1990 to pass Resolution 401-4, favoring “in principle, legislation for the establishment of an expedited, low-cost small claims procedure within the federal judiciary.”⁹

However, while the high cost of patent litigation harms small patentholders, it also can shield small implementers of technology. From a consumer perspective, the underenforcement of patent monopolies is socially beneficial to a point, because it reduces the barriers to competition that patents pose. But high litigation costs have an endogenous benefit as well. They filter against the use of patents

\$916,000 inclusive of all costs. Where \$1-\$25 million are at risk, the average patent infringement suit costs \$1.633 million through the end of discovery and \$2.769 million inclusive of all costs. Where more than \$25 million are at risk, a patent infringement suit costs \$3.553 million through the end of discovery and \$6.018 million inclusive of all costs.

⁶ The survey instructions for “Litigation and Related Matters” are unclear as to whether costs are for each party or for both parties. *Id.* App. B at 7. However, interpreting the survey results as per party costs comports both with the authors’ personal knowledge of typical case budgets and with the instructions for “Prosecution and Client Counseling,” which is in the same section of the survey. *Id.* App. B at 5 (“Assuming a typical case with no unusual complications, what did you charge (or would have charged, e.g., based on a fixed fee rate schedule) or what were you charged (or what you would have expected to be charged, e.g., based on a fixed fee rate schedule), in 2010, for legal services only . . . in each of the following types of US matters?”).

⁷ *Id.* at I-154.

⁸ *Id.* Calculations are based on mean costs and average case values, e.g. \$500,000 for the up to \$1 million range, \$12.5 million for the \$1-\$25 million range, and \$50 million for the greater than \$25 million range. These cost estimates are for one party in a one-patent lawsuit assuming non-contingent representation.

⁹ ABA Resolution 401-4, 1990 ABA SEC. PAT. TRADEMARK & COPYRIGHT L. COMM. REP. 194.

to extract nuisance-driven rather than value-driven settlements, in particular from small defendants who themselves may not be able to afford to defend a case.

Just getting rid of a case is expensive.¹⁰ Although costs vary widely, each dispositive motion can easily reach into the six figures to brief and file. The AIPLA estimates for each sides' cost of litigation also apply to the cost of defense. Even when the stakes are small or the claim non-meritorious, the costs of disposing of a case is high. *Inter partes* reexaminations, which address only invalidity based on printed publications and are intended to be cost-effective alternatives to litigation, may cost each party involved \$278,000 per patent; their replacement proceeding, *inter partes* review, is even more expensive.¹¹ Such reviews are also no guarantee that case costs will be avoided since courts are under no obligation to stay cases pending *inter partes* review. Such exorbitant numbers prevent cases from being decided on the merits and drive nuisance-value settlements.

The potential for a small claims court to be used to harass defendants has long been recognized, as the 1992 Report of the ABA's Advisory Commission on Patent Law Reform, which endorsed the study and consideration of a small claims court, stated: "One such effect would be the capacity of such a system for creating a means for harassment and abuse. In this regard, if the proceeding imposes no cost on the party bringing the action, a significant potential for abusive practices would be created."¹² Simply put, a downside of creating a small claims patent court would be an "overenforcement problem," particularly against small entities.

3. Any Small Claims Patent Court Proposal Must Keep in Mind Small Defendants as well as Small Patentholders

While we decline to endorse the idea of a small claims court, we think that any serious consideration of this option must keep in mind both of these constituents: the small defendant as well as the small plaintiff. It must be designed not only to enable small companies to enforce their patents but also to enable small companies to operate free from patent harassment.

4. While Patent Enforcement Has Become More Affordable and Efficient, Patent Defense Still Remains Expensive

We believe that in the time that has elapsed between when the idea of a small claims patent court was initially introduced to the present, the equities have shifted, making patent overenforcement

¹⁰ The reported costs in this paragraph are based on an informal survey of legal practitioners at various firms with whom the authors are acquainted. Costs vary widely depending on case-specific factors such as the schedule, the size of the law firm retained, the geography of the law firm retained, the complexity of the asserted patents, etc., and are competitively sensitive business information that is difficult to survey and report, except in aggregate such as in the AIPLA Report.

¹¹ AIPLA REPORT, *supra* note 5, at I-176. Because *inter partes* review was only recently instituted, cost data is not yet available. Cost data for *inter partes* reexamination is the best available benchmark. However, it is likely that *inter partes* review will be more expensive than *inter partes* reexamination due to changes such as the speed of the proceeding and the allowance of discovery. We note that it is unclear as to whether survey results are per party. See *supra* note 6. However, interpreting the survey results as per party costs comports with the authors' personal knowledge of typical case budgets.

¹² THE ADVISORY COMM'N ON PATENT LAW REFORM, A REPORT TO THE SECRETARY OF COMMERCE 100 (1992).

against small companies a more urgent problem than patent underenforcement. The advent of patent assertion entities¹³ and rise of “patent litigation as an asset class”¹⁴ now means that plaintiffs have more options for monetizing and financing their patent litigation cases. Patent assertion entity Acacia’s website is filled with testimonials from small inventors like Paul Ware who report: “For 15 years I had tried, without any success, to license my technology to many companies which use it to protect their customers’ credit transactions. I had no credibility as an individual licensor and did not make any progress. In just about two years, [Acacia has] licensed over 100 companies, including some of the largest and best known retailers.”¹⁵ Patent assertion entities’ use of economies of scale by using the same patent to sue multiple parties multiple times¹⁶ and contingent fee lawyers¹⁷ has drastically reduced the costs and risks of enforcement for their patentee partners. Liquidity in the litigation finance market has also created opportunities for investors and patentholders alike, and has, for example “enabled the tiny single-patent business from Toronto [i4i] to survive a protracted four-year battle and win US\$300 million in damages.”¹⁸

On the defense side, however, no such market has developed, in part because the economics are far less compelling. No matter what, a company that successfully defends against a patent suit is left in a worse position than when it started. If it has not spent money on damages, then it has spent money on legal fees, making the objective to get out of the suit as cheaply as possible. When money is scarce, as it is for most startups, the toll goes beyond a financial impact. According to a survey of startups that one of us conducted, 40% of respondents experienced a significant operational impact as a result of a patent suit.¹⁹ This is why while we see contingent fee lawyers flocking to the plaintiff side,²⁰ we do not see it on the defense side. There is no comparable upside.

¹³ See generally Colleen V. Chien, From Arms Race to Marketplace: The Complex Patent Ecosystem and Its Implications for the Patent System, 62 HASTINGS L.J. 297 (2010) (describing patent assertion entities as “entities that use patents primarily to obtain license fees rather than to support the development or transfer of technology”).

¹⁴ Jack Ellis, Patent Litigation as an Asset Class, INTELL. ASSET MGMT., Nov./Dec. 2012, at 43.

¹⁵ Testimonials, ACACIA RESEARCH GROUP LLC, <http://acaciatechnologies.com/testimonials.htm> (last visited Mar. 18, 2013).

¹⁶ John R. Allison, Mark A. Lemley & Joshua Walker, Patent Quality and Settlement among Repeat Patent Litigants, STANFORD LAW & ECON. OLIN WORKING PAPER NO. 398 (Sept. 16, 2010), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1677785 (documenting that most litigated (eight times or more) non-practicing entity patents lose more than 90% of the time in court); Colleen V. Chien, Patent Assertion Entities, PRESENTATION TO THE DEC. 10, 2012 DOJ/FTC HEARING ON PAES (Dec. 10, 2012), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2187314 (stating that 61% of defendants named in 2011-2012 were sued by a PAE who had brought the case over eight times).

¹⁷ Colleen V. Chien, Turn the Table on Patent Trolls, Forbes, (Aug. 9, 2011, 11:37 PM), <http://www.forbes.com/sites/ciocentral/2011/08/09/turn-the-tables-on-patent-trolls/>.

¹⁸ Ellis, *supra* note 14, at 43.

¹⁹ Colleen Chien, *Startups and Patent Trolls*, SANTA CLARA UNIV. LEGAL STUDIES RESEARCH PAPER NO. 09-12 (Sept. 28, 2012), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2146251 [hereinafter “Chien Startups”], at Abstract.

²⁰ David L. Schwartz, The Rise of Contingent Fee Representation in Patent Litigation, ALA. L. REV. (forthcoming), available at <http://ssrn.com/abstract=1990651>; Roven Avraham & John M. Golden, From PI to PI: Yet Another Unexpected Effect of Tort Reform, U OF TEXAS LAW, LAW & ECON RESEARCH PAPER NO. 211 (July 12, 2012), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1878966.

Companies making \$10 million or less comprise 55% of the unique defendants named in patent assertion entity cases,²¹ which now comprise the majority of patent cases and for some time have named the majority of patent defendants to litigations.²² Litigation cost is still a problem, but it is the cost of defense that is the more pressing problem.

The result: For small entities, the overenforcement problem is as, if not more, pressing than the underenforcement problem.

5. Principles for Designing a Patent Litigation System to Help Small Companies across the Board

Although we decline to endorse outright the idea of a small claims patent court, we believe that a patent litigation system that works for small companies should have at least the following characteristics.

First, a patent small claims proceeding should allow the small entity to choose the lower-cost option when the stakes are below a certain threshold. During patent prosecution, the government recognizes the need for lower costs for small entities: The USPTO charges lower fees for small²³ and micro entities.²⁴ Yet, such lower-cost options do not exist for litigation. In fact, many litigation-type proceedings progress in parallel, multiplying costs, rather than as true alternatives to one another.²⁵ To balance the equities, the size of the entities involved and their resources should be taken into account during litigation as well. A small entity should not be burdened with a high-cost litigation when a lower-cost alternative exists. The small entity deserves to have their case resolved for a fraction of the value and not more than that, just as large entities do. In an ideal world, costs would be capped based on the estimated value of the case.

Second, a small claims patent court should award attorney's fees and costs to small company defendants if they prevail.²⁶ Although the current patent system has provisions for granting attorney's fees and costs, fee-shifting is the exception—not the rule.²⁷ Combine the low probability of a case being deemed “exceptional” with the cost of bringing a Section 285 motion, and most defendants would rather settle than fight even meritless claims. Awarding attorney's fees and costs would help prevent abuse of a patent small claims proceeding while enabling cases to be decided on the merits. Such a rule would incentivize both patent plaintiffs and defendants only to litigate when the case has merit and would encourage value-driven—rather than nuisance-driven—settlements.

²¹ Chien Startups, *supra* note 19, at Abstract.

²³ 35 U.S.C. § 41(h); <http://www.uspto.gov/web/offices/ac/qs/ope/fee100512.htm>.

²³ 35 U.S.C. § 41(h); <http://www.uspto.gov/web/offices/ac/qs/ope/fee100512.htm>.

²⁴ 35 U.S.C. § 123; http://www.uspto.gov/aia_implementation/fees.jsp#heading-2.

²⁵ For example, district courts are under no obligation to stay cases due to parallel ITC cases or pending *inter partes* reviews.

²⁶ See Guo, *supra* note 3, at 446.

²⁷ Under 35 U.S.C. § 285, a court may award reasonable attorney fees to the prevailing party if it finds the case “exceptional.” Colleen V. Chien, *Reforming Software Patents*, 50 Hous. L. Rev. 325, 377 (finding that fees are shifted in patent cases around sixty-six times per year).

Third, a patent small claims proceeding should place strict limits on discovery with generous clawback provisions and protective orders to keep costs low.²⁸ Discovery now comprises the vast majority of litigation costs and is an especially poignant problem for patent cases.²⁹ Yet, very little discovery actually yields truly relevant documents.³⁰ Furthermore, patent assertion entity cases typically have asymmetrical discovery costs. Patent assertion entities tend to have very few discoverable documents, whereas defendants tend to have many discoverable documents, resulting in high discovery costs for defendants while plaintiffs have low discovery costs.³¹ Strict limits on discovery combined with generous clawback provisions and overly inclusive protective orders would drastically cut down on the costs of document collection and review,³² which in turn would cut down on overall litigation cost.

²⁸ See Guo, *supra* note 3, at 444 (citing *A Conversation with Chief Judge Randall Rader*, INTELLECTUAL PROPERTY COLLOQUIUM (Oct. 2010), <http://www.ipcolloquium.com/Programs/15.html> (“We’ve got to attack the more attackable symptoms, which are things like discovery costs, and if we can reduce the administrative cost in the system, the system will be more efficient.”)); Chief Judge Randall R. Rader, *The State of Patent Litigation*, at 7, *available at* <https://www.docketnavigator.com/entry/img//The-State-of-Patent-Litigation-w-Ediscovery-Model-Order.pdf> (“[T]he greatest weakness of the US court system is its expense. And the driving factor for that expense is discovery excesses.”).

²⁹ See *An E-Discovery Model Order: Introduction*, at 1 [hereinafter “Model Order”]; Rader, *supra* note 28, at 7 (“Patent cases, in particular, produce disproportionately high discovery expenses.”).

³⁰ *Id.* at 8 (“.0074% of the documents produced actually made their way onto the trial exhibit list—less than one document in ten thousand.”).

³¹ See, e.g., Statement of John Boswell, Senior Vice President and General Counsel, SAS, Before the House Judiciary Subcommittee on Courts, Intellectual Property and the Internet, “Abusive Patent Litigation: The Impact on American Innovation & Jobs, and Potential Solutions,” Mar. 7, 2013, *available at* <http://docs.house.gov/meetings/JU/JU03/20130314/100399/HHRG-113-JU03-Wstate-BoswellJ-20130314.pdf> (“But, if you are a troll, and the biggest weapon you have to obtain financial remuneration is the asymmetrical discovery advantage, you obviously will never agree to a reasonable discovery process.”).

³² Model Order, *supra* note 29, at 4 (“A large source of e-discovery cost is the pre-production review of documents by attorneys or other human reviewers.”).