

Written by
David J Kappos



Getting the right balance: proposed US legislation aimed at abusive patent litigation

Legislation designed to reduce abusive patent suits that is currently before the US Senate could open up a major loophole for supply-chain manipulation – illustrating yet again that finding the right IP balance is far from straightforward

The US Congress is advancing legislation that aims to significantly change the US patent system again – this time with the goal of reducing abusive patent demands that, unfortunately, have become a part of the US technology scene. An important component of the proposed legislation – referred to as the ‘covered customer stay’ provision – would permit end users and retailers to opt out of patent lawsuits, leaving their high-tech product suppliers to defend against infringement claims implicating their products. While the goal of this legislation is laudable, any recalibration of the delicately balanced patent system demands careful scrutiny and an abundance of caution.

A recent op-ed published in the *San Jose Mercury News* – co-authored by the author of this article – critically analyses the pending legislation (Ben Pless and David J Kappos, “Patent Lawsuits: Senate Legislation would Seriously Damage Innovation Sector”, *San Jose Mercury News* (February 11 2014), www.mercurynews.com/opinion/ci_25113926/). This article reflects and expands on the views expressed in the op-ed, articulating the dangers posed by this legislation.

The legislation’s purpose is rooted in the real problem of abusive litigation practices. Few would argue that mom-and-pop shops selling unaltered goods or hoteliers offering free WiFi to their customers should be liable for infringement wholly attributable to an entity higher up in the supply chain. These innocent purveyors are often drawn into patent infringement suits merely as pawns to be used for leverage against product suppliers. However, the proposed legislation badly overcompensates by providing a safe haven not just to retailers that unknowingly acquire and offer infringing goods or services, but also to

any entity capable of positioning itself midstream in its supply chain.

The fundamental flaw in the proposed legislation is that it ignores the fact that supply-chain positioning is a commercial trait that can be manipulated with ease. The legislation would create a major loophole in a primary mechanism safeguarding the interests of good-faith patent rights holders – the ability to choose who to pursue for patent infringement – and provide an opportunity for strategic manipulation by bad actors.

Specifically, the entire channel approach adopted by the proposed legislation invites any or all channel companies (including foreign manufacturers, assemblers and parts suppliers) to conspire with one another in order to position the least answerable party in the product channel to answer a suit for patent infringement. Regardless of who actually manufactures the product, under the legislation as proposed, the relevant commercial actors can cherry-pick the party that will bear liability.

For patentees of all stripes, this makes it far more costly to seek justice from those who steal their innovations. Especially victimised would be holders of exclusive rights to innovations that integrate component parts from many suppliers. Many suppliers means many sources in many countries at many positions in the product-manufacturing value chain, which means many commercial actors with the opportunity to arrange collectively for the lowest value, least answerable participant to handle patent infringement claims. The more interdisciplinary the innovation (and the more diversely integrated its components), the more the proposed legislation would devalue it.

Such backdoor impunity for infringement would be destabilising to rights holders, which depend on exclusivity to recoup their investments in innovation and to fund future inventions. A foundational principle of the US patent system is that infringement is based on the unlicensed use of patented technology – not on the accused infringer’s supplier arrangements. Eviscerating this basic principle would upset the careful balance

between incentivising innovators and ensuring that innovations ultimately inure to the benefit of the public.

If US laws contained no mechanism to correct for suits that focus inappropriately on a downstream purveyor of infringing goods, then the collateral damage of the proposed legislation might be necessary. However, this is not the case. Every federal court in the United States already has the power to stay patent litigation against an inappropriate defendant in favour of a more appropriate one. And courts already routinely exercise this power. Guiding courts’ discretion to avoid occasional abuse is much better than providing a statutory free ride to all commercial actors that position themselves downstream of the first component part maker.

Pending patent legislation has already improved as it has progressed through the US House of Representatives (see “Newly proposed US patent litigation legislation: a note of caution” *IAM* 64). Now the US Senate is having its turn. It is vital that both houses of Congress keep sight of the critical IP balance.

There is a simple way to achieve the commendable objectives of the proposed legislation’s stay provision. Any bill that passes into law should direct the covered customer stay provision to small businesses and retailers that use and sell unaltered goods, period. This approach avoids opening the potentially devastating loophole of supply-chain manipulation, while achieving the core purpose of putting the most appropriate party front and centre in infringement suits.

The collateral damage to the US innovation ecosystem from the current covered customer stay proposal would be unfortunate and substantial. Precision is of the utmost importance. Any new rule providing for covered customer stays must be carefully circumscribed so as to affect only the legislation’s very specific purpose, and nothing more.

David Kappos is a partner at Cravath Swaine & Moore, New York, and the former director of the USPTO