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The EDTX and Local District Courts: Advancing or Stifling Innovation

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The EDTX and Local District Courts: Advancing or Stifling Innovation?

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Panelists:

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Mike Crowley, Research in Motion

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INTRODUCTION BY PROFESSOR XUAN-THAO NGUYEN, SMU DEDMAN SCHOOL OF LAW:

PROFESSOR NGUYEN: I want to introduce our last panel today. This particular panel has a topic of real importance and is looking at one of the controversial questions that many lawyers and companies have been asking: "Whether the Eastern District of Texas and other district courts are hurting or helping innovation?" And the moderator who will help us to navigate through this thorny issue is Phillip Philbin. I have had the pleasure of working with Phil for a number of years at the Center for American and International Law in Plano. Phil is a partner at Haynes and Boone in the IP practice. Many of you in this room probably have worked with Phil on numerous cases and committees. He is a litigator not only in patent cases, but in copyright, trade secret, and trademark cases, and has received impressive recognition from various journals and his peers. He graduated with a bachelor's degree from Trinity University and a J.D. from Baylor Law School, and so with that I turn it over to Phil to introduce the panelists.

MR. PHILBIN: Thank you, Professor. You know, it is not always the best position to go last on a Friday afternoon. Nonetheless, we have had some distinguished speakers today and controversial topics, and a few controversial comments. And if I could summarize kind of what we have learned today: some half-witted sixth graders can turn out to be very good trial lawyers, some guys in black dresses at the front of the room can be great trial judges, and "Kumbaya" is often the song sung by lawyers who do not want to try cases. But having paid attention to Sam Baxter this morning and talking about the number of females on juries and the need to have female speakers, I looked down at the panel and thought, "uh-oh, I have a problem." So at lunch I approached who I think might be the heartthrob of the patent docket in Dallas, Judge Lynn, to see if she would join us up here. She told me that asking her at lunch was certainly not enough notice. I thought it would be fun.

That said, we do have a very distinguished panel today and quite a controversial topic to discuss today of whether patent litigation in the Eastern District of Texas advances or stifles innovation. It may sound like an easy answer—particularly when a panel follows judges from the Eastern District of Texas—but our panel is going to tackle tough issues from whether the

current patent litigation system fairly and efficiently rewards inventors to how third party financing of lawsuits impacts litigation, and more.

We have a distinguished panel this afternoon. We have the chair of the Baker Botts IP Law Department and Adjunct Professor at SMU Dedman School of Law, Bart Showalter. In addition to being a well-known and well-recognized IP litigator, Bart has worked on artificial intelligence at MIT long before Watson prevailed on *Jeopardy*, and Bart truly was a rocket scientist at LTV Missiles and Electronics Group prior to going to law school.

To Bart's right is Michael Crowley, Senior Licensing Counsel at one of the leading—and I am proud to say local—technology companies, Research In Motion. Michael not only does licensing, but he has also prosecuted—and in fact designed and developed—data communications equipment, so he has some real-life technology experience to add to that.

To Michael's right is a well-known lawyer who assisted vendors and companies with commercializing their inventions through licensing and litigation, and the founding and named partner of Shore, Chan, Bragalone, DePumpo—Michael Shore. Michael is involved in patent litigation truly around the globe. Michael is not just an IP lawyer, he is also an inventor. If you have read your February *Texas Bar Journal*, Michael's picture is in the Bar Journal as an inventor.

To Michael's right is the head of the Intellectual Property Group at Kasowitz Benson Torres & Friedman, and a veteran trial lawyer of the Eastern District of Texas even though he chooses to office in San Francisco—Doug Lumish. Not only has Doug taught patent litigation at Stanford Law School, an arch-rival to SMU, but he also has some very prominent defense wins in the Eastern District of Texas. And I understand that he has a little bit bigger smile on his face this week because he had a big win in Delaware on summary judgment this week, as well.

With that said, let's get right to it. Let's start with the easy side—innovation. How does the patent litigation system in your opinion truly reward the inventor, anybody?

MR. SHOWALTER: You will probably hear a theme from me throughout the afternoon, and that is that we have the best patent system in the world. It is the gold standard. It is the crucible where all of the tough issues are tackled and it is truly the engine behind this innovative society in the United States. So it is clearly the greatest patent system in the world. It is the system that everybody wants in my line of work. It always needs adjustment. But I still think it is a tremendous catalyst for innovation, and I think if patent litigation—the assertion of patent rights—is done properly and is done reasonably and with valid, enforceable patents it is a tremendous engine for innovation for society, and I think it works. It needs to be adjusted from time to time, and we are going to talk about some of those adjustments. But generally I think it works.

MR. PHILBIN: All right, Mike, you want to add to that?

MR. CROWLEY: Sure, just to add to that a little bit. Bart mentioned valid patents, and you know, of course, the presumption of validity coming

out of the Patent Office. But the law—especially with regard to obviousness and combining references—has changed recently in the past couple of years. So for a lot of the patents that are being asserted either through licensing or litigation, there is a question of validity. And I think a court certainly needs to be taking a careful look at that early on in the case.

MR. SHORE: I guess if the question is: "What is going on?" in courts like the Eastern District of Texas, that district in Wisconsin, I forget which one that is, the Eastern District of . . .

MR. CROWLEY: Western.

MR. SHORE: The Western District of Wisconsin, the Eastern District of Virginia, and a few other courts around the country that are sort of getting into that side of innovation. I am a quantitative person. I like to actually look at facts, so I looked back. If you say the genesis of the Eastern District of Texas was the *Texas Instruments v. Samsung* case—which was the first really big patent case to come out of the Eastern District of Texas—that was just before 2000 or right around 2000. And you look at those districts, those kinds of rewards, and those patent systems that have accelerated since that time. How do you measure innovation and the effect on innovation?

Well, every year since 2000, the number of patent applications being filed has gone up, except for the massive depression we had between 2008 and 2009. Patent applications only went down 2.1%, so people are still filing patents. And if patent applications are a measure of innovation, then certainly patent litigation has not stifled innovation at all.

IBM put out an estimate that U.S. intellectual property was worth $5.5 trillion in 2007 and worth almost $7 trillion in 2010. So if innovation is measured by the value of what is being created, innovation has not been adversely affected. From the side of lawyers, if you take the average cost of the patent application, average a utility patent application at $10,000 per application, the 509,000 applications filed in 2010 would result in about $5 billion in attorneys' fees. I do not know if that is innovative, but it is certainly profitable for people like us.

I looked up on Google—I do not use Google as a source for briefs, but I will use it here—and I just entered "buying and selling patents." There are five pages of different exchanges now where you can buy and sell patents in patent auctions. So the idea that an inventor has to practice an invention in order to profit has now been sort of cast aside. Now, are you any less motivated to be innovative if you can invent something and sell it than you would be if you invent it and practice it? I do not think so. So when I look at objective evidence of the decrease in innovative activity, I cannot find it.

I know there have been books written—I have actually read one of them, and I had to go back and find it. It is a couple of years old, the Lerner and Jaffey book, *How Our Brilliant Patent System Is Endangering Innova-*

tion.[1] Their basic conclusion was that there are too many patents, the bad patents are getting out, and what we need to do is tighten up how patents are awarded and make the Patent Office a little better. I have no problem at all with that, conceptually. Let's make the Patent Office get better, so the courts do not have to re-examine every patent that comes out. I agree with that. That is painful for everybody, but I challenge anyone to come up with objective, measurable criteria that innovation is declining because of what Judge Ward, or Judge Folsom, or Judge Davis, or any other judge in the Eastern District of Texas is doing. I do not see it.

MR. LUMISH: Well, it is Friday, and I might as well shake it up a little bit. I have been accused of being contrary for contrary's sake, so why not keep up that label? I think there is an enormous difference between innovation and patents. I really do. You are not going to stop innovation. You are never going to stop American innovation, I do not care what you do. I do not care how many lawsuits you bring, and I do not care how you bring them, and I do not care in what state you bring them. Good patent decisions will reward the true inventors on the patent, and bad decisions will tax the true innovators on the defense side. Some decisions are good and some are bad. We are going to get a mix of those things. I think there is an enormous difference between patents and innovation.

Yes, the number of patents is going up—because the system is rewarding patents, for sure. That we can probably all agree on. But the way the system works at the Patent Office is that there are examiners who are spending about eight hours on a patent. That is according to statistics that may not be reliable because you cannot depose the examiners. If they are spending only eight hours, that means they are not even reading the prior law. Professor Lemley at Stanford has a student who is writing a thesis that says they do not even read the specification. The examiners read the claims. They read the abstract, and they read the summary sometimes. But they do not read the full specification, and they do not read the prior art. But then they issue the patent. Maybe that is fine. I think at some level the system is shifting the burden of good patents versus bad patents to us up here on the bar and to the judges who were here before. And that is okay, if that is the way it is going to work. But the notion of an enhanced burden of proof and the difficulties with the jury system—which I would like to talk about a little bit today—make that shift of hewing out the good from the bad and putting that on jurors very, very difficult. We heard before from the very first panel that the juries generally in every state in every district do not have a lot of college education. Some of them have graduated high school. And yet they may be great at picking out who they think is lying and who is not and the common-sense things, but I can tell you that is not exactly how somebody

1. ADAM B. JAFFE & JOSH LERNER, INNOVATION AND ITS DISCONTENTS: HOW OUR BROKEN PATENT SYSTEM IS ENDANGERING INNOVATION AND PROGRESS, AND WHAT TO DO ABOUT IT (2006).

who made a chip with eight billion transistors in it or wrote a piece of software with 50 million lines of code wants that case to be decided.

It is true that there is a narrative line that we as trial lawyers have to find, and I do not run away from that. I love that. I would rather go to trial than anything. But clients on the defense side want somebody to put the bytes up next to each other, and the bits up next to each other, and the transistors up next to each other, and to come home with a technical analysis that says that it is different or it is the same. And a jury just simply cannot do that.

So it is very rewarding to have patents. The system is absolutely geared toward that. The real inventors—the ones named on the patents—are rarely the ones getting the reward. In the inventor cases, the companies own the inventions. So in the competitor cases—where two companies that are in the same business going at it in a courtroom—sometimes the inventors do get the reward. In an NPE (Non-Practicing Entity) type of case, where the inventor is at most a consultant on a case—and generally they are not—the lawyers and the current principals of the holding company make more of the money. So if the reward is a financial reward, I think generally not. And when people are settling those big competitor cases—because they do not go to trial very frequently—what they are really doing is settling the lawsuit and reducing the risk of liability, not determining what the value is of the patent. So I see it a little different that way.

MR. PHILBIN: Doug, you have raised an interesting point that I am going to give other people a chance to comment on, and that is the money—the relationship between the reward and the inventor. If the inventor is the innovator and actually creating the invention, what relationship is there—or should there be—between the reward of patent litigation and that actual inventor?

MR. SHOWALTER: I was going to follow up on that as well. I am not sure that I associate the number of patent filings or the amount of attorneys' fees spent on patent applications as being a proper measure of innovation. I think it could be that folks see money being made in this business, and they want to get in on that action.

What I would want to look for is an innovation engine that encourages innovation and filing valid and enforceable patents. And I do think that Phil raises a good point and that Doug raises a good point, which has ultimately trickled down to the inventors. And that is what the patent system is trying to encourage: an incentive for the inventor for filing a patent application—for spending the money and the time to do that—and disclosing that to the public, and in exchange, he gets a monopoly—a limited monopoly—on the invention. I think we are getting a little more separated not only in quality of the patents, but also in ultimately the trickle-down effect of some reward in exchange for disclosing your innovation, and I think that is a problem. I agree with Mike and Doug that fundamentally there is an issue with the quality of the patents in our system. If we do not fix that, the patent system is going to lose credibility. And by losing credibility, it is going to start to be

reformed in a way that I think is bad for what we consider to be the best patent system in the world. So as long as we have credibility and we have valid and enforceable patents, as long we go to court and enforce those patents in a proper way and seek proper compensation—not damages that are outlandish or reasonable royalties that are crazy—I think that the patent system will survive. My biggest issue is trash patents that result in a loss in credibility in the system, which will then cause legislators to change it and screw it up.

MR. CROWLEY: I think that generally, many patent applications are filed for use in cross-licensing or to just protect the product that is out there. It is not necessarily a key that shows that we have innovated, and therefore, we patent. There are probably a lot of patents filed just so that there can be some protection of products.

As far as rewards go, some corporations provide bonuses to their employees who file patent applications. Some companies base promotions from junior to senior positions on the number of filings or granted patents. Some research universities, in their traditional paradigm of "publish or perish" in order to get tenured, have shifted to become a "patent or perish" paradigm. For some universities, this has been very profitable where licensing revenues are split equally between the university's inventors department and the inventor themselves. Japan has a little bit of a different twist on it. In Japan, they are required by law to provide reasonable remuneration to the inventors. This is a policy position on Japan's part to stem the flow of the brain-drain out of Japan into other countries.

MR. SHORE: I guess that is why I am up here, because I tend to represent universities, nonprofit research institutions, small companies, and individuals.

Regarding inventor compensation, it is not up to the patent system to decide whether the inventor should be compensated one way or the other. That is up to the inventor. That is the most socialistic, communistic, and ridiculous thing I have ever heard. If this guy wins and he is not the inventor, then he should not get as much money. The inventor decides what the inventor gets. If the inventor wants to sell his patent to somebody, and that patent ends up being worth $1 billion, but the inventor sold it for $50, then it is the inventor's right to sell it for $50. It is also the buyer's right to go out and make a billion dollars off of it. That is most illogical argument I have ever heard. That is the equivalent of saying: "If I sell you a piece of property in Denton county and five years later the Haynesville Shale comes, then they should not give you $25,000 per acre and a 25% royalty because you only paid $15 per acre for the property. You do not deserve it." A lot of times, patents are sold before technology moves toward that patent. Most patents that are enforced are seven to twelve years old. When a patent is first issued, it is a new idea and the industry has not yet gravitated toward it. The inventor might want to sell that patent for any number of reasons: he may need to pay his mortgage; he may need to send his kids to college; or he may be bankrupt. A lot of patents are bought out of bankruptcy. They are assets

created by the United States Constitution. They should be freely salable and transferable. Just because you bought it for $50 does not mean that you should only be able to enforce it for $55. To me that is a completely ridiculous argument. That is why we have these patent exchanges and patent auctions and other things like that.

Look at inventors who work for big companies. Some guy at IBM as a beginning engineer in 1997 makes $42,000 per year. That inventor comes up with an invention that IBM goes out and spends $10,000 to patent. IBM then decides to enforce that patent and make billions of dollars. IBM makes $1.84 billion per year on licensing. Should IBM be obligated to go back and give that $42,000-per-year engineer $50 million because they only spent $42,000 on that engineer and $10,000 at the USPTO? Should IBM only be able to get $60,000 for the invention? That is just as ridiculous. Inventor compensation is something that people like to try to get in front of the jury. It is as irrelevant as if you bought a house in Highland Park in 1962 for $50,000 and are now going to sell it now for $5 million. It makes no sense.

Regarding trash patents, I fully agree that we have underfunded the Patent Office. It is terrible. The problem is that some examiners are lazy. They are on this point system, and all they want to do is get their points. So they flush these patents through and they are not well examined. But you also have very conscientious examiners. Believe me, I am an inventor and I have had a couple of very conscientious examiners, and they have driven me nuts. You get them on both ends of the spectrum. The problem of fixing trash patents is not in the courthouse, and it is not in changing the damages model. The problem is fixed by hiring enough examiners, training them, and then requiring them to record exactly what they do in their searches and exactly how the searches were conducted. It is not that hard to do. The other thing that they are talking about is that there are only eight hours, or whatever the average is, to examine a patent. Think about if you were looking at a relatively small and discrete thing, and you had a supercomputer and a huge database that would allow you to search for eight hours straight. This is not 1972, where the effort was all by paper, this is 2011. We go out and do reverse contingencies. We represent companies that have people approaching them to take a license and we try to kill the patent. We can go to patent search firms in India, Denmark, Japan, and Korea, and for $3,500–$4,000 we can find some of the most obscure, weirdest art you have ever seen. If we can do that for $1,500–$3,500, then do not tell me that the U.S. Patent and Trademark Office cannot be efficient and find relevant art. Do we need better patents? Absolutely. Do we need tougher examination? Absolutely. Should we have experts assist the courts in mulling through some of the more technical issues that do not need to go to the juries? I totally agree with that, too. But it does not need to be changed to the point that patents become irrelevant and the only thing that is relevant is that you are a big enough company that you can squash the competition regardless of whether they have patents or not. That is where our system is headed and that would be a huge mistake.

MR. LUMISH: I tend to agree—believe it or not—that the compensation of the inventor should be left to the market system. I do not think we need rules and regulations to decide that. I think that there are smart people working at all of these different companies that can decide their own fates and their own employment contracts, and it is not something that we should be regulating on their behalf. Most people ordinarily would not have come up with the next big thing for their $42,000 job if they were not funded by the supercomputer, the infrastructure, and the support of the rest of their company. So I tend to think of the companies as the inventors—as a macro thing—as opposed to any one individual in those kinds of circumstances. Where I start to deviate pretty sharply is the case where you sold the patent for $50 because you felt like you needed the $50, and now seven years later—because that is how long I waited and the market has now moved toward it—you say it is now worth $1 billion. You say: "Do not look behind the curtains at the $50, because that does not matter." That is not the way that the damages laws are supposed to work. You are supposed to look at what would have happened at the time when the infringement began. That is normally those seven years ago by somebody, but it just was not done at a large volume. That $50 should tell you a lot. It tells you what the real engineer, the real owner of that patent, the real company or person who had it and thought it was worth running through the Patent Office, thought it was worth. They thought it was worth $50. Just because counsel comes in seven years later and says that because you have sold $15 billion of revenue, we should get $1 billion of that—that does not make the patent really worth that. Now the action might be worth $1 billion at that point because you are a large company and you are looking at a jury—who we talked about before—that is not going to understand, as Mr. Baxter put it, what is happening on the bus of the computer. You are putting your fate in that jury's hands. As a company, you are now assessing how much might you lose, not how much the patent is worth. That $50 ought to tell you a lot, and I understand it does not always do that.

The only other comment I would make is that it would be wonderful—it would be beautiful and utopian—if we would fund the Patent Office sufficiently to really handle the mass of patents it is facing every year, but I do not believe that is possible. I do not think the country has that kind of money, and I do not think we are going to invest in that way. I think what we need to do is stop pretending that has happened when these patents get to the courtroom. Stop pretending that somebody really read all of the prior art. What plaintiffs and patentees do—I am often a patentee—is submit hundreds of references to the Patent Office because nobody wants to be accused of being a fraud, and nobody wants to be accused of inequitable conduct. You know that he (Michael Shore) is going to hire somebody in India when he is on the defense side and pay them $10,000, and they are going to find very obscure art. If you did not turn it over and there is some link to you, then they are going to accuse you of having purposefully deceived the Patent Office. Lots and lots of prior art gets in front of the Patent Office for every patent, but they are not reading it. We could spend all the money we want to

dig it up, but if they do not read it—if the examiner does not do a claim chart and say, "I do not see a difference here between reference number 263 and claim 1"—then there is no point. I think that is what is really happening here.

MR. PHILBIN: All right, several of you all mentioned what I will call the "third-party market" for patents. We have exchanges that are ever and ever more efficient models for the buying and selling of patents. I have two questions: How does that affect your answer on promoting or stifling innovation? And is the valuation before the lawsuit is filed—whether it takes place seven years ago or yesterday—of what the entire patent sold for relevant in determining what the license or hypothetical negotiation will be worth in trial? I will start with Doug.

MR. LUMISH: I will try not to repeat myself. I think it is important that patents be fully market exchangeable. They ought to be exactly what Mr. Shore said—assets that at some level have constitutional protection. If somebody has a patent and they have gone through the system and obtained all of the rights that comes with it, they ought to be able to sell it. They ought to be able to make money on it. That does not bother me in the least. In the ideal, that transaction would reflect the value of the patent. It is not the value of the patent, but the value of the innovation, the value of the actual invention, the thing that was new over what had come before. More often than not, it does not reflect that to me. Sometimes it does, but more often than not, you have something that reflects the value of the potential lawsuit. For all of the reasons I have given without repeating myself, I do not think that those two things are the same.

MR. SHORE: The value of the lawsuit—the value of the claim—is the value of the patent. That is how we measure it in this country. If you want to enforce a patent, go to court. If you cannot negotiate with them, go to court. If the jury says the claim is worth $1 billion, then that is what the patent is worth. That is how we value patents. So if you do not like how we value patents, then I guess you can go and change how we value patents. But that is how it is done.

The other point is that over time, the value of patents will change. When a patent is first issued, generally, nobody is using it. Especially in the area that I specialize in: microelectronics. When microelectronics patents come out, for the most part, they are patents that are saying that it is not manufactureable right now, but as tools get better and processes get better, one day this thing might be able to make it. Maybe they are never able to make it, or maybe four or five years later, the tools get done and the speed gets to be where it needs to be and they are able to make it. It is no different than buying stock on the stock market. On one given day a year and a half ago Ford Motor Company stock was worth $1, now it is $16. What changed? Circumstances in the market change, and so the price of Ford's stock changes. Circumstances in the market change, and so the price of a patent or the value of a patent changes. A patent's value is never set in stone, never to change; that is not economic reality. A very interesting article was

in a science magazine on about the sixth of March 2009. It made the argument for a patent exchange, meaning that when a patent was issued the inventor ought to be able to put it on this exchange and sell 10% of it. Anybody could go on the exchange and buy shares of the patent, and the patent would then be valued the same way a stock is valued. Patent value at first may be $50, and as technology moves the market will decide whether or not that value goes up or down. The inventor can sell shares of his patent as time goes on. He can buy them back on the same open-market exchange. I think that is a good idea and that lets the market as a whole set the value of a patent.

MR. PHILBIN: If I could interrupt, do you think that the market pricing should be relevant and admissible in a patent case?

MR. SHORE: Absolutely. I think it should be, because as a trial is going on, people who participate in the market will monitor the trial and monitor the litigation. You will see that price go up and down just like you see the stock in companies go up and down when they are in litigation. Go ask some of these stent manufacturers whether or not litigation can affect their stock price. I think they would tell you that it surely can. I guess the closest approximation that we have to it is that we have a few of these patent holdings companies that are now publicly traded, and their stock fluctuates wildly. Look at Rambus. Rambus's stock has gone from a low of a couple of dollars up to $17, $18, $20. What is that based on? Litigation?

MR. PHILBIN: Let me ask you in a different way. If a particular patent sells on an exchange and it is purchased by a non-practicing entity for X number of dollars, is the purchase price of the entire patent something you would consider to be "cost?"

MR. SHORE: If the trial is that day, sure. Absolutely. If I am the owner of that patent, and bought it for $50 seven years ago, should that come into evidence? That will be something the judge should decide under Rule 403. If the judge says nothing has changed and you cannot make an argument that there is any factor that has changed, he will let it in.

MR. LUMISH: That is true, I just do not think that reflects the law. The law requires you to look at—among other things—the ultimate balance of factors under *Georgia-Pacific*.[2] At the time the infringement began, what would have the alleged infringer and the patent owner agreed to? They are both willing, and they are both there voluntarily. They are not in a lawsuit in this legal fiction. So what would they have agreed to in exchange? If you have a day a company defendant started selling this patent, you have a sale from the inventor to the holding company to a non-practicing entity for $50. Why they would not have sold it is at least relevant evidence that they might have sold it to the accused infringer on that same day for $50.

MR. SHORE: I would agree with that.

2. Georgia-Pacific Corp. v. U.S. Plywood Corp., 318 F. Supp. 1116 (S.D.N.Y. 1970).

MR. LUMISH: Then look at that five, seven, or eight years later, or whenever it turns out to be, and now it is really, really valuable. There is now a standard on it and you have $15 billion in revenue. The first day you started infringing it was not so valuable, but now it is super valuable. So we will look at that value as if the transaction were today.

MR. PHILBIN: We have been talking about promoting innovation. Let us talk for a minute about stifling innovation. Michael, you and I had an interesting conversation about standard-setting organizations potentially stifling innovation. Can you talk about that?

MR. CROWLEY: Sure. One of the issues in standard-setting organizations is that there is a technology being developed and there are competing solutions to the problem. Frequently there is intellectual property that is attached to different proposals. What happens is this: in exchange for getting your technical solution into the standard, you agree to license your patent on reasonable and nondiscriminatory terms. Simply put, anyone practicing the standard should get equal treatment. What will happen is that if you have a company that has not been participating in the standard development and they wait on the sidelines, they can potentially ambush the industry. They do not have that same FRAND requirement.

MR. PHILBIN: Is there any motivation for a non-practicing entity to participate in a standard-setting organization?

MR. CROWLEY: I think there is. There are companies that are not practicing entities and they focus on research, and they are involved in the standard-setting organizations. But they also may participate in an organization that includes practicing entities in regards to FRAND licensing. There are others, depending on the standard, whose patent may cover a particular implementation that is one way to do something that is defined in the standard. But there may be more than one way to do that. That is typically where an NPE can potentially ambush the industry—by not participating, and patenting something where there is only one way of doing it then claiming standard essentiality based on that patent implementation.

MR. SHOWALTER: A lot of outcomes depend on the rules in standard-setting organizations. The duty should be very clear and spelled out in that organization. I also think it is really tough, and there are some organizations that require disclosure of not only issued patents that may be essential to practice the standard, but also any pending applications that could be related to the standard. I agree generally with Mike's view of ambushing, although I frankly do not see non-practicing entities being problematic in the system and creating credibility issues. They are not the ones actually involved up front in trying to direct the standard and trying to participate in that activity. The issue is with the ones that—five years later and after the fact, when they had no participation in the standard—file a patent, and their patent flies through the Patent Office where the Patent Office examiner had eight hours to look at it. They do not look at the prior art, and they read it not in a $50 way but in $1 billion way—where they think the claims are incredibly broad. They ignore the fact that there are only two pieces of prior art cited on the

face of the patent, and they go in trying to assert against the standard. That is the issue.

MR. CROWLEY: To add on to that with an example, Bluetooth's special interest group (SIG) has a royalty-free licensing obligation for IPR that is part of that SIG. The question is: when we get to the damages, if you have an NPE who is not part of the SIG who is now asserting a patent against Bluetooth for some popular technology, does the second *Georgia-Pacific* factor kick in where the customer royalty for Bluetooth is royalty-free? Should the NPE be held to that same royalty-free obligation the members of the SIG are?

MR. LUMISH: I agree with what I heard. I will give a couple of examples where I have seen this. One is a case I had years ago for Cisco against a company called Datapoint. They decided that they invented the best Ethernet standard some number of years after the standard had gone obsolete and the company went bankrupt. After we won the case on summary judgment for non-infringement, they changed their name and decided they had invented the FireWire standard. So they sued on the FireWire standard. It is probably the smarter way to do it from an IP perspective, instead of jumping into the middle of the standard and potentially being subject to FRAND limitations on the licensing.

Although, I have seen something in my second example that scares me when I am on the defense side. It is a pretty easy place, a standard-setting organization, to set a willful infringement trap or to set a damages bell ringing by just sending a letter to the organization. Wait until the standard is pretty much done and the parties are pretty well committed to it and you send them a letter that says: "Just so you know, I think your standard might practice my patent or practice my published patent application." It is in the standards literature at that point, and you have several companies there. They could try to change the standard; they could try to get around it; they could look at it and make a decision. For example, maybe it is invalid, maybe it is non-infringement. Ultimately, however, that is going to end up as a court case where somebody has to decide whether you now have willful infringement, because the folks at the standard organization should have known that the person sending that letter was right.

MR. SHORE: I have been always amazed by standard-setting organizations that are made up of patent jurors in the industry. How is it possible to pass antitrust scrutiny when you have five or six of the biggest companies all deciding that these products are all going to meet this standard? We are going to pool our patents together and cross-license each other so we do not have to pay each other. But we are going to make this the standard.

MR. SHOWALTER: This is because patent is directed to one technology. That is what the Federal Circuit has said. You are not trying to lock every possible thread. That's the anticompetitive sense that the Federal Circuit came down on.

MR. SHORE: When you talk about standard-setting bodies, there should be three things. First, anybody ought to be able to participate. Big

companies participate and small companies participate. Anyone who wants to participate can participate. Second, if we are going to have a standardized royalty, you also need to be able to come up with something for the standard plus. What you end up seeing in a lot of these lawsuits is that you have the standard out there and someone will tweak or improve the standard slightly, and the tweak is a good improvement. But then the tweak is what forms the basis of the lawsuit. That needs to be addressed in some way. I am not smart enough to figure out how to do that. Third, on a royalty-free standard, if you are going to say that a non-participant in a standard-setting body has to be collared with the royalty-free standard if they have a patent that might cover it, how does that encourage innovation?

MR. SHOWALTER: Unless you participate and disclose your patent, and you have provided letters of assurance, I do not think you are bound by that.

MR. SHORE: Yes, but if they come in and sue on that standard, and the standard royalty between market participants is zero, should it be admissible in court that everybody in the standard-setting body agreed to zero? The idea of the patent system is to encourage innovation. Zero-royalty or royalty-free work—even if you make the standard slightly better, slightly more efficient—certainly does not encourage anybody to spend any time or money innovating.

MR. CROWLEY: But if you improved on the standard then is your patent really covering the standard or is it covering the next generation?

MR. SHORE: I guess it is true, that if the argument is that the standard part of your standard plus has a zero-royalty rate in the market place, then you should only get royalty on what the plus is. That is probably a legitimate argument. I can see that.

MR. PHILBIN: Is a possible solution to either require or encourage the non-practicing entity or others to participate in the standard-setting organization?

MR. LUMISH: One thought would be to apply laches to it in some sense if they were aware of the standard. For example, if you could establish on the defense side that they knew it was coming and they were aware of it, then it is not an obligation in the standards body's sense, but you can defend yourself by showing the way you relied upon it. Maybe it is estoppel; maybe it is a waiver; maybe it is laches. It is something that puts some meat on the bones for such defenses.

MR. SHOWALTER: There is one case that pulls from a lot of these concepts. A big technology company develops a technology that allows an Ethernet port to figure out whether it is ten or one hundred so that it is actually adjustable based on the bandwidth. It is an automatic detection concept. I think the company was National Semiconductor. They filed several patents and they actually participated in the standards body, since they are a big company. They wrote an assurance letter that essentially said: "We have all these patents that are essentially to standard, and we hereby, in the assurance letter, will grant to anybody a license to this technology for $1,000." That

was stated in the assurance letter, but then everybody forgot about that. Nobody ever said: "Give me a license for $1,000." Essentially, it was a dedication by National Semiconductor. Move forward about five years, and an NPE acquires these patents and writes my client a letter that says, "you need to take a license." We asked about all the information in the background to investigate this. I asked some of my associates to investigate this thing and they looked at the website, and said this thing is subject to this assurance letter that you get a license for $1,000. So I wrote them a check for $1,000 and said I would appreciate a license for my client. But the NPE said: "No, that was extinguished when I bought it." So it is that sort of issue—you have an assurance, and you received a certain price for the patent, held under the encumbrance that there is an assurance to the market for $1,000. The other side held his ground and argued: "I am not bound by some assurance even though I bought these patents." This had to be litigated in the Federal Circuit, causing millions of dollars to be spent. Ultimately, he lost and he got slammed by the Federal Trade Commission. The issue for me is later acquisition of patents and then trying to assert against the standard. Thankfully, in that case it was shut down.

By the way, the Federal Circuit case on anticompetitive rules was *Princo*.[3] As long as you have one technology which is the basis for the essentiality, there is no anticompetitive effect. You want it to be open, available for everybody, and also be directed towards essentiality. You want to have an independent way of determining if they are essential. If it is that technology, then that is not anticompetitive.

MR. SHORE: I had a client company that was sued on a single patent, in a single claim. They were claiming that this patent covered basically every memory chip made in the world. There were no claim charts, and no Rule 11 investigation. It was a total joke. But they sued thirty-seven people, and we looked at it and could not figure out what the patent meant. It was just a piece of junk. I called the client and said: "Well, I have seven lawyers calling me wanting to do a joint defense. If we have thirty joint defendants, by the time everybody circulates the simplest motion and gets comments from thirty lawyers, it would cost more than to litigate an entire case every time you wanted to file a motion. There is no efficient way to do this. The patent is garbage and does not cover the standard like it says it does. But there are thirty-seven people, so give this guy $200,000." I think it ended up selling for $215,000. So if you multiply $215,000 by thirty-seven, or however many it is, then you can see why somebody would do it. I think there ought to be a rule that if you sue more than a certain number of defendants on a single patent, or even on two patents, those patents should automatically go to the examiner before another penny is spent on anything, and the patent ought to be re-examined. And, now that we have interparty agreements, such an idea is more viable for newer patents. But that is the problem with these lawsuits that attack the standard. Generally, when you attack the standard

3. Princo Corp. v. Int'l Trade Comm'n, 616 F.3d 1318 (Fed. Cir. 2010).

you have thirty, forty, or fifty defendants, and it does not really matter if they cover the standard or not anymore at that point. It is just not economically feasible to deal with it.

MR. SHOWALTER: Let me make a comment about misjoinder, because I think it is a very good point. For Judge James Ware in the Northern District of California, as far as he is concerned, more than one defendant is too many and he considers it misjoinder. So he has actually pushed back in some of our cases where we have had twelve defendants. We have been on the defense side, so we love their working rule. So with twelve defendants he says: "That is too many. We have too many defendants here. I want you to whittle it down to just the laptop defendants." Well, that is four. You have four defendants and he says: "That is still too many, because these are all different products and this is misjoinder." And, of course, he likes to have case counts of how many cases he goes through. But as for the notion of more than one defendant in a piece of patent-infringement litigation, at least one district court judge says that constitutes misjoinder.

MR. PHILBIN: Let me bring this back to the Eastern District of Texas because there are a series of cases going on in Tyler where a single plaintiff has sued ten, fifteen, or twenty defendants in four or five consecutive lawsuits. Judge Davis has combined all of those. But then, in a series of scheduling conferences, he has become concerned that the plaintiff is using the Eastern District's patent rules against the defendants to exact the very kind of settlement you have talked about. And the plaintiff has asked for in camera submissions of settlement agreements. The plaintiff has gone so far, recently, to ask for damage models to fight the defense's requests. What are your thoughts on how the Eastern District is handling that?

MR. LUMISH: It is the oldest marketing trick in the world to make up for quality or price with quantity. If you settle out twenty people at $250,000 you still make $5 million. So if it is a rotten patent, sue more people. Do not focus on any one defendant. It also has great implications for the patentee and the plaintiff's lawyer because when you are trying to herd the cats of twenty-five defendants worth of lawyers—and then you magnify that times five or ten and put all the egos in—it can be incredibly hard to get a protective order agreed to, which is a routine action we do in every patent case. It can be very difficult to get a protective order out of the defense group and over to the plaintiff's side. Plaintiffs know this, I am not telling any secrets they do not understand already. I would like to see—and I think we are starting to see it in different courts and I think we are starting to see it in the Eastern District—but I would like to see more severances, and more stays under the customer-suit doctrine because it is just not reality. I have one of those cases in front of Judge Davis, and we will see how it plays out. He has certainly made comments off the record about it being very challenging to figure out how to manage a case of that size.

MR. SHORE: I have nothing against someone suing multiple defendants in a case, and I have done it myself. But if I put a judge's robes on, I think what definitely should happen is that Rule 11 definitely has to come

into play. A judge should be able to find out some information very early if you sue eleven defendants or fifteen defendants. As Judge Shore would say: "I want to see your claim charts and your Rule 11 investigation in chambers now. Not six weeks from now, not thirty days from now. I want to see them now. The day you file the lawsuit I want to see what you did with regard to presuit investigation on each and every single one of the products used and on each and every single one of the defendants." And if they bring it to me and I do not see it, that case is dismissed against everybody and they can go face declaratory judgment action in eleven, twelve, or fifteen different jurisdictions for their bad behavior. But it must stop—hopefully in the Eastern District. And there are districts that are doing this. Our district in California is doing this. Judges in Delaware are doing this as well. They are not allowing people to go in and conduct extensive discovery and basically find out if they have a case after they file the case. They are really starting to enforce Rule 11. If you want to sue lots of people, you need to do lots of work. Then I think there might be circumstances where it is okay. It is probably not fair to the plaintiff who does an adequate Rule 11 investigation on eleven defendants, to have to file eleven lawsuits and try them all in a serious fashion. Some of them may need to be tried together and some of them may need to be tried separately. The burden on a plaintiff in a legitimate case that is adequately and properly investigated should not be disregarded.

MR. CROWLEY: One of the problems that you see a lot of the time on multi-defendant cases is dealing with a component that is used in a device, and the device manufacturers are the ones who are being sued, not the component manufacturer. So if you are really looking at the claims against the alleged infringing device, that is the chip. And really, the only reason the device manufacturer is there is to go after the value of the product, not the value of the infringing device—which is the chip. So if you are really looking at it, properly applying the current valuables, you should really be just focusing in on the chip manufacturer and not on the company using the chip in the end product.

MR. SHOWALTER: I completely agree and wanted to talk about a case, I guess you probably know about, *Ethernet Innovations*—which is a chip-level invention.[4] It is a chip that is ultimately on the Ethernet port. They did not go after the chip-level folks that actually know how the product is made. Those are the people that would know what sort of product information there is. They did not go after the board manufacturers. They did not go after the device manufacturers. They went after every retailer in the United States because they had Ethernet-port-sales classes. So when you have something like that, when you have thirty or forty defendants that have nothing to do with the technology and have no idea what this technology is, then it is just like what Mike and Doug said—there are problems with the

4. U.S. Ethernet Innovations v. Acer, Inc., Civil No. 6:09-cv-448-JDL 2010 WL 2771842 (E.D. Tex. July 13, 2010).

economics of making up the volume. To me, that is a real problem with the system.

MR. LUMISH: Just to put my plaintiff's hat on though, it is not illegal, it is supported in the law, and it is an infringement if the practice agrees on the patent. There is nothing legally improper about that.

MR. SHOWALTER: And that is correct.

MR. SHORE: And it needs to be fixed legislatively. That is also something for the Patent Office. I love Caltech. Caltech is one of my favorite clients. They have a fifty-six-patent, multi-hundred claim portfolio on CMOS image-sensors. In a few of those patents some young, smart associate of one of the prosecution firms came up with the idea that instead of claiming a CMOS image-sensor chip, he would claim a camera comprising a CMOS image-sensor chip. So luckily for the defendants, it was Caltech, and Caltech was in a very pragmatic, reasonable place. I was telling them: "Oh man, on these we can go after the whole camera." They basically would not let me. I wanted to, but they would not let me. If I was a patent examiner I guess that is okay under the MPEP. But that just seems like something else that can be changed by the rules from the Patent Office, or something else that can be changed legislatively.

MR. SHOWALTER: Or changed by the judge, and that is what Judge Rader has been doing. Judge Rader has been sitting by designation and basically imposing a portion of damages.

MR. LUMISH: It is a damages question.

MR. SHOWALTER: Absolutely, it is a damages question.

MR. CROWLEY: In my early practice, with the partner I was working for, if you did not have a claim in place, then you would have to go back and work on your claims.

MR. SHORE: I think the worst example I've ever seen, when I think about it, is this: there is a company—and they are a real company that makes products—and they make centrifugal pumps for the oilfields. And they actually have a claim for oil produced by using their pumps. Unbelievable, you can patent oil. I did not know you could patent oil.

MR. LUMISH: You can patent anything. It does not make it an innovation.

MR. SHORE: I think one of the fixes to our system—and one I would love to see—is that patents are too cheap to obtain. One of the reasons why there are 500,000 patents filed every year is because they cost $10,000 or $12,000. At most maybe $15,000 or $20,000 if you have to go through a lobby firm or through an appeal. The cost is the same no matter what kind of patent you want to get. That is ridiculous, too. If you want a patent on a certain type of technology, it should have a different price than another kind of patent on a different technology, because a search costs more if you are going to do a thorough search. If you are going to do semiconductive circuitry, that search costs a lot more than if you are going to do a search for a patent mechanism for a water bottle. Those two patent fees at the Patent Office are exactly the same. It is crazy. I think one way you can solve a lot

of this—and get better patent examination—is to start having fees based on the work that should be done for an adequate search in that particular kind of technology.

MR. SHOWALTER: Give the examiners a billing rate.

MR. LUMISH: I was going to say: "Bill by the hour." Take away the credit system, and have no points. The examiners should start getting compensated by how hard they work and the quality of the patents they issue, and have them be paid by the hour. Now that can make for an expensive patent.

MR. PHILBIN: I do not think the government is going to turn down any new revenue ideas right now. Let's changes topics for just a minute. Let's talk about third-party funding in litigation. This is an era of banks basically promising to give your money back after keeping it for a year and then they give you a quarter percent interest. But I recently attended a seminar where venture capitalists in the patent field were asked: "What is your announced, expected rate of return on investing in the patent community?" The answer given was between forty-five and forty-seven percent return. Given the fact that the venture capitalists announced these return goals, what are your thoughts on how third-party financing of litigation—in particular patent litigation—is impacting the question: Are we truly encouraging this type of investment?

MR. SHOWALTER: I will go really fast. I am not sure it is about whether it is VC'ed. I think the money will be there, and I think that is a secondary effect. I think whether it is a VC or private equity fund or whatever, if the system still has these problems we have been talking about then money will find the system.

MR. CROWLEY: I think that some have expanded through greater efforts. Then I think the VC money will start drying up. The potential for windfall will not be there.

MR. SHORE: I have had those people come to me and ask me. I do not need it, so I do not know anything about it.

MR. LUMISH: It does not bother me too much, frankly. It goes back to the risk of it. To make sure I am not called a communist—I do not have a problem with the asset calculator; buy, sell, trade, barter, do whatever you want with it. If venture capitalists want to sink their money into it, that is fine. I find it somewhat unseemly though, as someone who is often on the defense side, that what we are really doing is encouraging lawsuits as opposed to trying to get to the root value of the patents. But again—it is not illegal; it is not against the rules; it is the way the system works. As many times as I try to find a way to make champerty work, it does not exist in Texas, in case you did not know that. There is no common law claim for champerty here in Texas, and there are very few states where there is. So, there is not much you can do about it.

MR. SHORE: I have seen it—on the other side of cases—where the law firms are actually charging by the hour and the VCs are paying the law firms on an hourly basis. I am not talking about small law firms. I am talking about big, hundreds-of-lawyer law firms who charge high fees and small

companies with non-VCs to fund their hourly lawyers. So it is not necessarily a deal that benefits members of traditional plaintiff's law. I will say one thing—I think contingent fees encourage good suits to be filed, if they are done right, because I am not putting my money into a poor patent. I think I have once, and it was a very horrible, painful experience. I think the people who probably do the best job of reviewing patents for validity and making sure the property is managed and making sure investigations are done correctly are lawyers like our firm and McKool Smith. And you know I can go down to Robins Kaplan and a bunch of those other guys, and I think what I have seen of their work is that they do a good job of making sure that they winnow out bad cases, and we probably accept five to ten percent of the cases that are presented to us. And then, of those we accept and go through the whole rigmarole on them, maybe only ten percent of those actually get filed. I think that is probably a good thing.

MR. SHOWALTER: I agree with that to an extent, that with better firms, that is going to help—to get through the most contentious cases, too. Yes, you are going to get good lawyers who are going to weed out the bad cases, but what happens now is that the market is really bifurcated. You have those cases, and then you have the $250,000 case that—the minute you see it cross your desk—you realize is not a serious case. This is not a case where this person really thinks they have an invention that my client is using. This is a case where they wanted to get a $100,000 settlement. I settled a case yesterday for $60,000. Not to be dismissive of $60,000, but this was not a serious case. This was not somebody who really thought they had caught my client with their hand in the cookie jar—they were just trying to make up for quality with quantity.

MR. CROWLEY: But what if you are in Europe, and they were to demand $60 million?

MR. LUMISH: That is obviously the latest point in this, right? I am much more afraid a case brought by a firm that I know is going to do its homework—that I know is going to weed out bad cases—and that I know is a contingency firm that is going to think hard before bringing on a contingency case. Those cases scare me much more than just a run of the mill, here-is-a-patent-pay-me-$200,000 case.

MR. PHILBIN: All right, I want to go to one last topic and then we are going to open it up to questions. This topic is near and dear to my heart, and that is admissibility and settlement agreements and trial. I can say I think I was in trial the first time this happened to me. I was dealing with evidence changes while trial was going on, and arguing about which ones were coming in and which ones were not. How do you think the change in the law with at least one trial court allowing admissibility of settlement agreements—and certainly we're seeing more discoverability of settlement agreements with the cases coming out—is impacting things?

MR. SHOWALTER: Are you talking about *ResQNet?*[5]

MR. PHILBIN: Yes, that is the one.

MR. SHOWALTER: In that case, they did not really have anything else. They just had some basic software licensing agreements that did not have anything to do with the patent. They were frankly just software agreements and some settlement agreements. My take is that it is something. How much sway that ultimately has on a suit for damages, I do not know, but it is certainly something. And if the business is not necessarily selling products or getting into a licensing program, but instead is just filing lawsuits and starting to get settlements, then I think that is pretty relevant information.

MR. CROWLEY: I think following *SanDisk*—which lowered the threshold for DJs—the first contact with an NPE was typically filing the lawsuit.[6] So the settlement that came out of that—certainly if it has comparable licenses or comparable technology—I think is certainly relevant to damage calculation and winning the case.

MR. SHOWALTER: Because that is the dance. Filing the lawsuit is the beginning of the licensing issue.

MR. CROWLEY: And it used to be that was the end of it. The initial dance was to sit down, talk about the essential things like your damages calculations, and we will take a look at those. And if we can't come to some agreement then eventually someday we'll go to court. But you know, that it is kind of a pain. So I think as long as all the facts around the lawsuit and in what phase of the lawsuit something occurred are clear, then as long as that all comes in with the license issue then it looks fine to me.

MR. SHORE: I agree with Michael in one very material way. I actually trust juries, for the most part. I have had pretty good experiences with them because I win, so I really trust them. If you are going to let a settlement agreement in, you have to let in with all of the context. If you do not, then what ends up happening is the guy who does not settle gets all the benefits of those who do. In other words, if somebody settles early—before the invalidity summary judgments, before the infringement, before the *Markman*, and all those kinds of things—then they should get a better deal because there is more uncertainty for the plaintiff. If later on, after the patent has been determined to be valid by the court, after the claims construction has given it broad terms with broad definitions to the terms that would cover a lot—these things come after that settlement. The patent is more valuable at that point. It is more litigation tested. The positions that were uncertain have now become certain. And then the defendant wants to come in and say: "Wait a minute, you signed a license with this guy for the same type of part with a one-percent royalty rate. Okay you beat me. I lose—I want the same one-percent royalty rate that the guy got two years ago, before you spent $3 million on the litigation, before the patent was determined to be valid, before

5. ResQNet.com, Inc. v. Lansa, Inc., 594 F.3d 860 (Fed. Cir. 2010).

6. SanDisk Corp. v. STMicroelectrics, Inc., 480 F.3d 1372 (Fed. Cir. 2007).

the claims construction." That is absolutely wrong. There should be some way to encourage people to settle—at the time when it is more uncertain—for a reasonable amount based upon the facts at the time. And as long as the judge allows the economic expert and the lawyers to argue that this guy should not be allowed to freeload on the deal made by the earlier settlers, and allows them to explain that and make those arguments, I trust juries will understand. They will understand that if a guy who waits—and basically accepts more risks—loses because the issues come out against him, then he ought to pay for it. And I think most juries will make him pay more if they are given a proper context.

MR. LUMISH: This is a subject that comes up in every case—and it is an incredibly difficult tactical decision in every case—on whether you want to let settlement agreements in or out. A lot of my work has been on defense, and I used to always want to get them in. I wanted those settlement agreements in. Because I am normally not going to be able to stop a patentee from telling the jury that they have licensees out there, which validates the patent. They are going to use it heavily in their opening statement, and say: "Look, it is not just me here telling you that it is a valuable patent. Look at all these companies that have signed up and paid for a license. But these guys will not take one over here. You need to now make them pay for one since they will not do it voluntarily." But on the other hand, those licensing agreements are so much lower than what the plaintiff thought they asked for at trial. Sometimes they are lower by a thousand dollars. I have seen license agreements that were granted for $100,000, or $200,000, or $1 million, and then they are at trial asking for $1 billion. And so you want them in as the defendant. You want to show what the value was when they actually had willing licensees and licensors who got together across the table and came up with a number. It was $1,000, it was not $1billion, and you want to be able to show that.

Mike McKool left, but he and I just had this surreal experience. We had a case getting ready for trial, and his team moved for a motion in limine to keep their own licensing agreements out because he did not want the numbers in. But at the same time I did not want the jury to know that he had all those licensees. So what did I do? It was a tough call. I spent a lot of time thinking about it. What we did is we took the position of bifurcating the trial. This was in Delaware, not in the Eastern District of Texas. As you heard before, you are not going to get that here. But in Delaware, that is normal practice. And I had a judge sitting by designation from Philly, so he had not done it off the first case-management conference. And we said: "All right, let us bifurcate the evidence. Let the settlement agreements come in only in the damages phase." That way I get the advantages of both. We do not hear about the licensees unless and until I have already lost on liability. Then I can use the numbers to my benefit. The case resolved before we were able to get a ruling on that. It is a really hard question. It is not one that I think can be answered in the abstract for every case. I think you need to look at it on a case-by-case basis.

On Michael Shore's point that you should get more because you are sort of the last person standing, I do not necessarily agree. Because again, that

goes back to my point earlier. That is just not the way damages analysis is supposed to be done. You are supposed to imagine that you are both willing. You are supposed to imagine you are doing this: you are negotiating the price of the license seven years earlier, five years earlier, or whenever the infringement began, which is often when the patent first issued. I might actually agree in the abstract that is not a very smart model. It does not really reflect necessarily the value the day the jury verdict comes out, but that is the law. That is what it says. And so if my client wants to be the last man standing, and stood up and decided he was not going to pay no matter what anybody else paid, should they be punished for that by having to pay by more than what the hypothetical negotiation would have been had they been willing to pay seven years earlier? Well, I can make an argument on both sides, but I am pretty sure the law says you do not do this. And to say that you needed to settle that, I do not think is right either. Because 95% of these cases are settling anyway. The mere risk of liability—regardless of how self-righteous people feel about their positions—is enough to get you to settle almost every time.

MR. PHILBIN: Are there any questions from the audience?

AUDIENCE QUESTION: One thing I would like you to address is that there are 10,000 patent agents active in the U.S., and 30,000 patent attorneys. I know I am number 65,000 in the history of the United States. But I think that is a core problem. What do you think about those numbers? Because you talk about patent examiners and—

MR. SHOWALTER: Do you think the problem is that there are too many?

AUDIENCE QUESTION: I think the problem is that there are not nearly enough patent attorneys, and patent attorneys go off and do other things and need help with litigation. We criticize the patent examiners, but there are not many. There are very few, and the Patent Office takes what it can get and inventors take what they can get. We are not producing patent attorneys.

MR. SHORE: You cannot blame an inventor who files a patent application for accepting a poorly examined patent as granted. He paid his fee and put his application in. Basically, a lot of the remedies we are hearing about punish the inventor because the government will not fund the Patent Office so that it will actually examine patents. Supposedly the inventor should self-examine his patent, and this is just not realistic. I think the answer to your question is that you need to change the way patents are acquired. If you want better examination, then it costs more. But if you look at the statistics where we had a 2.2% drop during the great recession of our economy, that is because people did not think they could afford as many filings. And so the filings went down. That is the proof right there that, if you raise the fees, the number of new patents filed for will go down. That will lessen the burden on the examiners. The examiners can then do a better job in using the particular point system. If you ever wanted objective proof that when money is scarce—and when something is made or considered expensive in that envi-

ronment—the number of filings will go down, there it is. I do not know of any other way to solve that problem.

MR. LUMISH: Well, the alternative way is not to try to solve that problem with the Patent Office. Just recognize that it is insoluble, and that you are not going to have enough money to really, truly examine every application that comes into the system. Either register them or come up with some other way of doing it. Then when you are in court, everybody knows—it is open and honest—that this patent has not really been examined.

MR. SHORE: But that is not true of every patent.

MR. LUMISH: Then maybe you make it true of every patent. You stop pretending you are examining any of them, and you do not even examine the ones you might have examined before. Or maybe implement a hybrid system—you bill by the hour for the ones you really want examined, and the rest go into more of a registration system. I do not think any of these systems are perfect, I do not think any one of them has been vetted enough; I think you are going to keep going the way we have been going now. And when you are on the defense side, you are going to deal with that fact that the patent being asserted against you was not really examined. And when you are on the patentee side you are going to take advantage of that.

AUDIENCE QUESTION: I want to talk admissibility of settlement agreements and the post-hypothetical negotiation when that happens. The book of wisdom seems to run counter to some of your arguments. And what I mean by that is, honestly, if there is a true licensing agreement—and not a settlement agreement—that comes after the patent agreement starts, that is sometimes admitted. It is not always admitted, but usually it is. So isn't your argument that "none of this should come in because you always have to look at the point of infringement" diluted a bit by the book of wisdom?

MR. LUMISH: Absolutely. First of all, I think that the book of wisdom is almost as silly as anything I have ever heard of. If you are going to pretend that the damages analysis occurs on the day of the first infringement, how could you have a book of wisdom? You are also supposed to have in the book of wisdom all of the prior art in front of you. You are supposed to be able to believe that both sides know every single reference that exists about that patent. That is not happening either, right? So if you are going to use the book of wisdom—and we are, courts are making us do it—then let's make sure we look at it for everyone. Let's make sure that what is being evaluated is not: "How much do I have you over a barrel because you sold $15 billion last year?" Instead, it is: "What is the incremental difference between your PNP transistor over here, and this PNP transistor over there. Okay, there are three gates that got moved? What is the value of those three gates?" You have got to get the book of wisdom, in my mind, to that level of granularity. And the sale of the patent should come in; the valuation of the company should come in; the settlement agreement should come in. If you are going to look at something through the prism of the book of wisdom, you should look at everything. But yes, you are right.

AUDIENCE QUESTION: You talk a lot about trash patents. If you could point the inventor community somewhere and say: "Go here and learn how not to write trash patents," where would you guide them to go? How would you tell them: "Here's the prescription on how to write a really good patent?"

MR. SHOWALTER: I do not think the trash patents come from the inventors. I think trash patents are a function of a breakdown of our Patent Office and an inability to actually examine these patents. I also think, regarding trash patents, that there are several filters in our system, but I think some of them have broken down. In many respects the Patent Office may be broken down. But there are also later filters about decisions to file a lawsuit when you have a trash patent in your hand that have broken down. So we need some incentives to prevent that. I do not think it is an inventor issue.

MR. PHILBIN: I would like to thank our entire panel. We have had a healthy, robust, and professional discussion.