CHIEF JUDGE MICHEL SPEECH

DECEMBER 5, 2008

FTC HEARING ON "THE EVOLVING IP MARKETPLACE"

Thank you, and good afternoon, everyone. I should probably start by explaining two things. One is why I was not here this morning. We had a full array of oral arguments in front of three panels this morning, so I was busy hearing a different form of argument than perhaps occurred here. Unfortunately, the same fate awaits this afternoon. We have a special session involving a portrait presentation for Judge Gajarsa of our court, so once again I am going to have to study the record after the proceedings close rather than sitting in the back of the room as I would have preferred.

The second explanation is that to my chagrin, Suzanne Michel and I are not related. At least we're not related by blood, but we worked together very closely and very happily in that wonderful relationship of judge and clerk, and I'm very pleased to see several of my other devoted law clerks and former law clerks here, so hello to Joe Miller and Michelle Lee and Matt Dowd and everyone else I might have missed.

I would like to admit up front two things: Number one is that, contrary to popular belief, I do not believe that all patent wisdom, patent law wisdom, patent policy wisdom or any other kind of patent wisdom resides exclusively in the brains of federal judges. In fact, I think federal judges should more be thought of as students of all of you and you as the teachers than the other way around. It's a great disappointment in reading petitions for en banc re hearings in patent cases to be struck again and again and again in nearly every case with just having your own words, maybe not my words, but some other Judge's words in some opinion thrown back as if they are perfect, immutable, logical, sensible, efficient and all kind of other good things, which of course isn't always the case. It isn't necessarily the case.

The other thing by way of preliminaries is that I'm going to use a lot of numbers, which I hesitate to do, but it's a little bit required. The numbers are very, very rough. You'll able to quarrel with some of them in terms of precision. It's a matter of trying to set the perspective, which I think is so important to the ongoing effort of the entire patent community to work toward a feasible, realistic, balanced improvements. So with that as a warm up, here we go.

As we all know, the PTO issues tens of thousands of patents each year. There are well over a million in force today. Many surely contain claims that might be thought to be invalid. The vast majority have no commercial value and therefore never enforced, so they're really no threat to anybody. On the other hand, several thousand patents each year will be enforced, and by enforced, I mean both in what shall I call, threatening letters or, no, we don't threaten any more. In any event, informing letters. But most particularly, of course, I'm talking about the filing of lawsuits, so what are those numbers?

Well, for most of the last decade, a little under 3,000 patent infringement lawsuits have been filed each year. That's been quite a steady number for the better part of a decade so that's kind of our baseline. Now, of course in all of those 3,000 cases, the validity of the patent is immediately challenged right in the answer and on through the litigation. Quite often validity doesn't get adjudicated because so many cases fall out on summary judgments of non-infringement based on claim construction, but there still is a fairly substantial number where validity is determined.

It's not at all infrequent to have at least some of the claims, and they may be the critical ones or maybe not, declared invalid on any number of grounds, but most commonly perhaps on the ground of obviousness. Now, it may be true that as the Federal Trade Commission observed in its report now five years in the past that we have a big issue or problem in this country that you could put under the label of 'patent quality.'

But I suggest that as we move forward into the seventh inning or round six or the third period or wherever we are in this patent reform, patent policy debate, that it's worth pausing to consider for just a minute what do we really mean when we're talking about more patent quality. Certainly lay people and maybe some lawyers could be forgiven if they take that as a suggestion that a very large number of patents are just flat-out invalid. That is, the entire patent is a piece of junk, worth nothing, illicitly granted.

I've been on the court for twenty years and eight months, and I cannot ever remember seeing a single patent, I'm sure they're out there, but I can't remember seeing one where every single claim was invalid. I've seen innumerable patents where some of the broader claims either were indefinitely broader or were damn close, but in all of those cases, the narrower claims seemed to me equally clearly to be plainly valid. So what we really have is a problem of some over-broad claims getting through the system, slipping through the sieve that in the ideal world would catch them.

Now, the other sort of buzz words associated with the debate in its earlier stages also strike me as not as helpful as they might be, so when we talk about patents like 'lacking quality' or patent applications lacking quality, I'm not sure how helpful that is. If we want to consider the patent system, the overall thing, everything, the PTO and the courts and all the other pieces of it, including the roles that all of you men and women here in this room and your counterparts elsewhere play, if we look at that system and we ask: Is that system sick, is that system very sick, what is the illness of that system, what is the right medicine?

Of course it's a question of diagnosis, so it seems to me very important to get the vocabulary straight and to sort of get our logic aligned with reality. So when we say there are many patents out there that are 'questionable,' well, sure, if somebody sues on them, the validity will be questioned, probably in 100 percent of the cases. Does that make them really 'questionable' or just subject to defenses of he who gets sued? Of course you fight back if you get sued, and you say the patent is invalid. Maybe it is. Maybe it isn't, 'Questionable' isn't the best kind of test.

Now, as I said, I think that certainly in the ideal world, and maybe in the world we actually live in, we might be able to expect or assist the Patent Office in doing a somewhat better screening job with respect to these broader claims that probably shouldn't be allowed. Of course, a downstream benefit of that would be there might be fewer suits filed. There might be even more suits that would fall out under summary judgment with greatly reduced costs compared to full trials, but it's not sure. It's not certain. Like almost everything else in life, you have to look at the cost versus the benefit. You have to look at trade-offs that inevitably flow from any decision you make, in any direction. At least that's the way it looks to me.

So the question then becomes: Can the PTO be strengthened enough to provide what I'm going to say are the needed rejections of all these over-broad claims and the large number of cases? The shallow answer is, well, yes, of course. If you spend enough money and hire enough examiners and train them well enough and retain them with bonuses and supervise them well enough and have everything else that you need going, including large enough net examiner numbers, you would hope that you would be able to do this function of screening out these over-broad claims.

But again there's something of a question in my own mind: Would it really work, and would it be worth it? And, in any event, is it even feasible? No less a leader than Reed Hundt who is associated with the president elect's transition team, two years ago, so he might not say the same thing today, but two years ago wrote publicly that he proposed that the Patent Office's budget be tripled. Tripled. Now, I don't object to the idea, but if we step back and consider where are we on December of 2008, it ain't going to happen. We'll be lucky if the budget goes up at all at the Patent Office. It certainly isn't going to triple. Obviously the financial crisis, the fiscal crisis is going to block that. Beyond that, it's not entirely clear, at least it's not clear to me that it really would reduce the number of lawsuits filed or the number that get past summary judgment or the cost of the lawsuits. It might, but it's far from clear to me.

Then I get to broader questions, like I keep hearing that we have a ‘litigation explosion’ in patent infringement cases. I keep hearing that we have lots of ‘wasteful litigation.’ I keep hearing we have excesses and abuses of certain types of defendants or maybe plaintiffs in some of these cases. I also read that for quite a number of decades now, the percentage of extant patents sued on has remained almost exactly the same, at about percent, so if you have a lot more patents out there, you would expect more lawsuits, and that's exactly what you get.

Now, of course you can say, yeah, but they're all bad patents. Well, maybe or maybe they're partly bad and partly good, so a little hard to be sure. I'm a skeptic about whether we have an excess amount of wasteful litigation or a crisis or a patent litigation explosion.

Now, as you may have heard me already throw out the number, about 3,000 patent suits filed a year, but the more interesting numbers that start to reduce that is that about 90 percent settle voluntarily. Now, of course now you may say, but yeah, only under coercion and under threats, under a gun at your head. All those kind of arguments.

Well, maybe. Maybe. But 90 percent never go to trial, so when we're talking about trial expense, trial delay, not minor matters, we're not talking about 90 percent of the lawsuits. We're talking about 10 percent of the lawsuits. What happens to the 300 that don't fall out on voluntary settlements between the parties?

Well, over two-thirds of them get resolved on summary judgment. Now, summary judgment isn't cheap. I'm not trying to make that argument, but it's a lot less expensive than a full trial, lots less, and much faster almost always, not in every case, but normally.

So now we're down to about a hundred trials per year, ball park figure. (All these figures are just ball park figures). If we step back and we say, all right, we're a nation, highly developed, high technological, fully industrialized advanced nation of 300 million people. We have something like a million and a half patents in force, and we have what, 30,000 companies in the marketplace? I don't even know the exact number, but accept the notion that it may be somewhere like 30,000 players. Are a hundred trials excessive in a country of that size and that vitality with that many patents extant? And what happens when there are trials? Most of them get affirmed on appeal. Of course, that also means some get reversed, but the numbers again are kind of instructive.

About a third of the hundred tried cases, fully tried cases, will get reversed on some basis or other. So we got about 30 going back to the trial court, so out of that 30, how many actually get retried as opposed to settled at that remand stage? I don't have precise statistics, but it's very few. Let's say it's five or maybe ten, so five or ten times we have the ugly circumstance of having to retry a case, expensive the first time, going to be expensive the second time too, but it happens very rarely, so is it really legitimate to say the big problem in the system is appellate reversals that require us to go through the horror of a slow, expensive trial twice? Rarely, rarely.

So it's out there. It's not negligible, but it's a pretty small piece of the problem, it looks like to me. Now, when we try to focus on ‘wasteful,’ if the courts are able to do screening out and avoiding trials in over two-thirds of the cases, that saves a lot of money. Now, depending on the complexity of the case, even the summary judgment related costs, lawyer fees and all the rest, can certainly be considerable.

Well, I'm not trying to suggest that summary judgment is always super fast or always very inexpensive. It is, on the other hand, as I've already observed, far better than the full trial alternative. So then the question for me as a Judge is: In the hundred or so cases we're trying a year, are we wasting the public resource? The taxpayers' money? Are we wasting the money of the combatants, the litigants?

When I look at the cases as they flow through the court year after year, my strong impression, and that's all it is, it's not scientific, is these tend to be the closest, most difficult cases, so if we're trying a hundred of the closest cases a year out of 3,000 that are filed, that doesn't sound very wasteful or horribly inefficient to me. It's not perfect, but it's not terrible either. We need to have some kind of sense of proportion, I think, if

we're going to diagnose the illness in the system in a way that will provide treatment that will really be meaningful.

So, of course, the magic bullet is a new kind of reexamination in the Patent Office. That's what everybody says will solve the problem. Why? It will be faster and cheaper than court trials. Well, maybe. In the real world, we've got a Patent Office that struggles to keep up with its current work. What basis would we have for confidence, particularly if it doesn't have a tripled budget, that it can run in-house what amounts to a court system with cross examination and discovery rules and a Judge presiding and making fact findings or Administrative Patent Judges even trained for this? How hard would it be to get them up to speed to function just the way District Court Judges do or ITC administrative judges in patent cases? I think these are hard questions, and I don't think the answers are too obvious, but they certainly give me a lot of pause.

So then when we look at, well, where does the litigation process in America start to impose costs that are worth really, really worrying about? Probably we could all agree, well, at least at the discovery stage. There's no other country in the world that forces litigants to spend one fiftieth of the money that we force litigants to pay routinely with American discovery rules. Of course, the discovery rules are uniform in patent cases and every other type of civil case. They're in the civil rules procedure as we all learned in law school, so if the discovery costs are viewed as unacceptably high, given where our society is, what we want, what we value, then it would seem to me the most logical, direct solution is to reform the Federal Rules of Civil Procedure to change the discovery regime as opposed to changing substantive patent law through legislative means.

I'm not against legislation. I think there's a place for it. Some things can only be done by legislation. I used to work on legislation, so I'm hardly an opponent of legislation, but it isn't a magic solution. It's not a magic wand.

Now, certainly the existing reexamination process has been less than a stellar success, and it certainly doesn't look faster than the courts, as slow as the courts are, compared to how they should be. I can't testify about how much cheaper it is, but the stories I've heard don't sound too encouraging, and then there's a big question of: Is it adequately accurate? Is it more accurate than what would happen in a well-run district courtroom? I'm not sure.

Now, of course the suggestion is, well, we're going to beef it up, we're going to make it work, we're going to have a restructured, refinanced PTO that's going to be able to do it better, faster, cheaper than the courts could. Well, we already talked about the budget problem. We talked a little bit about the training problem, but consider some of the other basic facts of life at the PTO. Recent reports suggest that in the effort to hire each year a thousand new examiners, they're losing 600 for every thousand they hire, so the gain is 400, not a thousand per year. The salaries are such that in private industry, these same young men and women, often engineers, but not always, can double or triple their salary the minute they walk out of the PTO. That's awfully tempting, pretty hard to stem that.

So what do we have? We have a horrendous revolving door. I'm told that the average examiner has been in the corps less than three years. Less than three years! That's a horrible fact in this country, even for our ongoing system of ex parte examination. If you try to lay on top of that a new beefed up litigation-like re-exam process, are there people there who can do it? Can the examiners do it? Can the supervisors do it? Even the board is also drowning in cases. They've greatly expanded in recent years. I think it's somewhere up to in the neighborhood now of 80 Administrative Patent Judges. What do they need, 160, 390? No one even knows what they would need to run these trials.

Of course, there are many other suggestions, diagnoses by various pretend doctors. One of my good friends suggested inequitable conduct, traditionally called fraud on the Patent Office, should be legislatively removed from the courts altogether and put under the PTO, again with a second sort of litigation-like system, mini-trials within the PTO. I'm not sure they can do it. That is the same desperately under-resourced PTO that can't do its current job right. Pendencies average three and a half years or something like that. In many art groups, the average pendency is even longer than that. That's the status quo. If you're going to give a whole lot more work to those people, I don't know if that makes sense.

Now, of course when you talk about the courts, their awards, people talk about excess damages. Everyone can cite some example of what they consider a horrendously excess damage award. A fair number of what I've read in print turn out to be nonexistent cases. I kept reading about the windshield wiper case where the cost of the car was used as the metric of damages, but I haven't been able to find such a case.

And Professors Jaffee and Lerner, who are very highly qualified economists, wrote in their book, which many of you read, that the courts often give double damages and actually cited a case that I was involved in as an example of double damages, and they said that I gave both lost profit damage and reasonable royalty damages to the winning patentee. Well, yeah, the Court did. Of course it did, because it was for different products and different time ranges, two different forms of damages, but they weren't -- but that's not double payment. That's paying once, so there's a lot of misunderstanding out there.

There are a lot of apocryphal cases that turn out to not really exist, and there are certainly some very large damage numbers; no question about that. On the other hand, most of those large damage amounts involve very large markets, very large profits, so we shouldn't be surprised, I wouldn't think. In any event, a few examples, if they're not very representative, hardly prove that excesses are common, but that's the charge, that half the time the damages are wildly out of proportion to anything that would be sustainable in common sense. It's easy to use words like ‘appropriate.’ The FTC talks about whether damages are ‘appropriate.’ Well, it's a little bit in the eye of the beholder. What you might think was appropriate I might think was way too little or way too much, but it's a pretty inexact yardstick.

Then of course you should look at proportions. How many really large awards are there? Well, by my recollection about five to ten times a year there's an award above

let's say 50 million dollars, and the rest are below that, and the median is something like $3-5 million. Does that make out the case that the courts are just kind of nuts and excess damages are kind of doled out right and left?

In some of the cases that have been cited as having excess damages, it turned out the damages were later -- were in the jury verdict and later were sharply reduced on post-trial motions by the District Judge as the District Judge is required to do, and in some cases modified on appeal, so some of the damage amounts that are cited as a problem didn't stand.

So does that prove that the system is sick, or that it's actually fairly healthy, and it made the correction in the way it's designed to do, post-trial motions if a jury makes a terrible mistake? Of course one of the most cited examples is the RIM settlement. People say, well, RIM was forced to pay 600 and some million dollars, 621 maybe, if I remember the number right, and obviously that's outrageous. That's exorbitant. That's just not reasonable.

Well, I'm not sure by what measure I could opine on whether it's reasonable or not. I assume given the skill of the actors in that case, meaning the businessmen even more than the lawyers, that RIM thought it was worth it to pay what, of course, on its face is a huge amount of money to get a license to continue to operate their system that we all use, and probably everybody here has Blackberry in their pocket or their pocketbook or somewhere, and they earn billions anyhow, so maybe it's excessive, but it's not clear to me it's excessive. I'm a bit skeptic about that example.

Then the argument keeps shifting. Well, it's not so much the number of infringement suits filed every year, it's who's filing. Well, why should we assume that a non-manufacturing patent owner shouldn't be allowed to enforce its patent? What is wrong with a university owning patents based on research of its faculty scientists or research institutes or small inventors or small innovative companies that either can or don't want to try to manufacture products themselves but license their inventions so others can make them?

Well, are these patentees really illegitimate somehow? I mean, after all, at least up until now a patent has given its owner the right to exclude, not the obligation to make. Then some say, well, it's not so much the non-practicing entities, it's certain companies that don't invent at all, but merely acquire and enforce patents, and of course calling them ‘trolls’ just confuses the analysis because obviously a troll is a bad thing.

It's a pejorative label. (Some people who used to complain about trolls allegedly have become trolls). But I don't think that it's helpful -- it's a slogan. It's a label. It's an excuse to not think carefully about the problem, as far as I'm concerned. It's like talking about ‘questionable patents.’ It's an excuse to not think carefully about the problem as far as I'm concerned. It's like talking about questionable patents. It's not helpful if we're going to try to diagnose the real illness and prescribe a useful medicine.

Besides, patents, like any other form of property, the essential element of property is it is alienable. You can sell it. You can sell it to anybody you want to for whatever price you want to sell it. Why should that be prohibited? Why should I be prohibited from buying patents if that's what I want to do, whether I invented them or not, whether I am going to practice them or not, whether I'm a research institution or a university or not? There might be some reasons. Maybe some of them are good, but it's not self-evident, at least not to me.

Then there's certainly the debate about motives. Well, they just want to acquire patents so they can squeeze royalties out of infringers. Well, yeah. Hey, this is commerce. This is about money. This is not an altruistic system. The whole constitutional idea was that the incentive of monetary gains would motivate innovation at a greater rate and to better ends than if the lure of money wasn't there, so I'm a little dismayed when I see it even creep into footnotes of Supreme Court opinions, that certain patentees were just trying to squeeze money out of the accused infringer. Well, all kinds of patentees are trying to squeeze money out of the accused infringer. That's what the lawsuit is all about, so come on. Let's be a little more adult about it than to worry about the greedy motive of the patentee. Of course the patentee is greedy.

That's the way the system is supposed to work I think. I think it's worth noting too that in the five full years and the month I guess since the pioneering work of the Federal Trade Commission in that first report, a great many changes have taken place, mostly through case law development. A lot of it at the Supreme Court, some of it at our Court and some elsewhere. But mostly in the courts. I would suggest to you that for the most part, not 100 percent, but 70, 80, 90, we pretty well solved the problem of strengthening the obviousness standard, making injunctions less routine, less automatic, whatever you want to call it, raising the bar on willfulness, restricting patent eligibility under Section 101.

Beyond those changes, of course, now any and every licensee, even in full compliance paying every month, can challenge the validity of the patents that are the subject of the license, so a whole lot has changed, so even if the diagnosis was perfect, maybe it doesn't apply anymore or for the most part doesn't apply anymore.

So again, I applaud the FTC for picking up the analytical trail and looking for new empirical data and bringing in people like all of you here and the stellar panelists, and I'm very sorry to have missed these panels, but I will read about it later.

Well, if I think a lot of the challenges that were the biggest have been solved and a lot of the problems have changed in their complexion, that we have a new disease -- the old one has kind of gone away. Maybe the immune system took care of it well enough. What remains the biggest challenges in terms of improving the patent system?

Well, I would suggest that it's actually a very broad, almost philosophical, perhaps metaphysical approach, and I would describe it this way. Our goal, all of our goals, should be to try to assure that any changes in the patent system are defined so that

they serve all types of inventors, all kinds of companies and entities, all technologies and all stages in the life cycle of each technology.

The system, particularly the litigation part of it and the Patent Office part of it, certainly should be as efficient as is practicable, but it also has to be fair, and it has to be fair to everyone, and it's never going to be super efficient. It's just not in the nature of patent applications or patent infringement lawsuits to be super efficient. So if we're going to strive for that, we're just going to die trying because it's never going to happen, and of course, no system is ever going to be perfect.

Every system is going to have certain huge costs. Life isn't fair. Some litigants are going to have a harder time than others, and that will be true if we leave the system absolutely unchanged, and it will be equally true if we change it a lot. All that will change is who will be a little bit disadvantaged, or more than a little bit perhaps, and who will be advantaged.

Of course we talk a lot about predictability, and particularly yours truly, but predictability has to be counter-weighed against other values: Fairness, enough flexibility. I certainly agree with the spirit of the KSR ruling that over-simplistic or overly rigid rules are to be avoided. So I would say we need to try to make sure that our reforms avoid categorical rules, rigid rules, overly simplistic rules and the like. In other words, they need to be thoughtful, modest, calibrated and balanced.

All right. Well, if those are the goals, do I have any kind of approach, a sort of overall strategy? I started by saying I'm quite sure that judges don't have all the wisdom on this or even most of it, maybe not any of it, but I do think looking ahead to the reform efforts and the Congress and the work of the Federal Trade Commission, maybe The National Academies will get back in the act again as they did the year after the 2003 report.

I don't know, but whoever gets in this game and the various coalitions up on the Hill, I would suggest to all of us, would-be reformers (and I count myself among them), that we ought to carefully consider, based on the nature of the precise problem we're looking at the moment, which kind of doctor do we need? Do we need an orthopedist? Do we need a brain surgeon? Do we need an infectious disease doctor?

Because if we don't match up the right approach for what the problem is, we're probably not going to get a great outcome, and I would go beyond that to say that I think that in the main, except for those things that can only be done by legislation, we probably will continue to make better progress in the courts, particularly those courts that have the most experience with patent infringement cases, and through case law development, careful, gradual case law development, even more than legislation, even more than overburdening the PTO or giving it greater powers or requiring that it be deferred to, to some extreme degree. The courts are probably the best equipped to work on most of theseproblems.

Now, I entirely agree with the perspective of the FTC that competitive interests and consumer wallets need protection and deserve protection, and the patent system has to

coexist with the antitrust law and competition law and lots of other laws. On the other hand, does it need to be said at this season -- and I'm not talking about the holidays, I'm talking about what's happening in our economy and with the layoffs and with stock prices collapsing – is it too much to ask that our reforms not only net promote innovation, but also promote job creation and avoid job loss and promote stock values going up instead of precipitously down?

Of course, wealth creation is the ultimate goal of the whole thing, and all of these mediations among these competing interests require very adroit balancing. Now, everybody should make their own choice about who they think the best actor is to make rather fine balancing decisions among many competing goals, but for my own money, putting it in betting terms, I would bet on the courts. This is what courts do all time. This is what courts usually, I think, do pretty well, probably way better than Congress, probably way better than an administrative agency like the PTO, although they of course also have a very big role.

Now I want to end with sort of a caution, a suggestion that all of us, as we pursue what would be good recommendations, exercise a lot of discipline on ourselves. Shouldn't we have to ensure that remedies that we recommend don't just state objectives, but define exactly how you're going to get there, with what resources and what mechanisms, and at what costs to somebody else, to other players, to other industries, other technologies, whatever the consideration is?

Second, if the mechanisms aren't spelled out, is the reform real? To say the Patent Office is going to invent a great discovery system I think is to talk nonsense. The courts have worked on this for over a half century with great input of the Congress and the Supreme Court, and despite all those decades of efforts, we have the discovery system we have now. Do we really think the Patent Office, in a short space of time, can crack this nut and deliver a great discovery system that's really fast, really cheap, really fair, really accurate? I don't see how, butmaybe.

Okay. What other cautions? Look for the trade-offs. Look down the road, to the downstream effects. Are you sure it's going to really net increase innovation if you make this adjustment or that adjustment? Is it going to increase jobs or are we going to offshore more jobs? What about wealth as measured on the stock market or as measured in a patent portfolio? Do we really want to make changes in the patent system that might cut in half the value of every companies' patent portfolio or most companies' patent portfolio? Do we really want to see stock prices drop in half? Do we really want to see more unemployment?

1Those are possible downstream effects of certain kinds of changes we could make in the patent system, and maybe we should. Maybe there are even higher values than those, but those are considerable values. They need to be weighed. It's all part of the trade-off analysis. Then of course the most obvious of all: Is it affordable? If the Patent Office would need a 10 billion dollar budget, it just isn't going to happen. We're just wasting our time talking about it if the reform would require that kind of resource.

So I end with once again applauding the bravery I will say and the rigor of the Federal Trade Commission to approach these exceedingly difficult problems in such an open, transparent way by bringing in all the players, putting people who fight with each other in court and elsewhere and sometimes on panels in this room. This is exactly the right way to do this. If this is all done on an ex parte basis in Congress or wherever, we're not going to get an optimal answer because optimal by definition means pretty well, almost all the time, for everybody. That's what we need, and we'll never get there unless we include all the players in a very open process.

So congratulations to the Federal Trade Commission. Thank you very much.

(Applause.)