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Hearing: Patent Reform

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Chairman Conyers, Ranking Member Smith and Members of the Committee, my name is Jack Lasersohn and I am a partner at The Vertical Group, a venture capital firm based in Summit, New Jersey and Palo Alto, California that focuses investment in the life sciences sector. I was originally trained as a physicist and have been an active venture capital investor since 1981. My investments have included, software, telecommunications , semiconductors and clean-tech , with a focus on life sciences for the past 20 years. I am also a Board Member of the National Venture Capital Association (NVCA), which represents over 460 venture firms across the country. It is my privilege to be here today and to have the opportunity to share the view of the venture capital community on reforming and strengthening the patent system which is the backbone of our innovation ecosystem.

Venture Capital Investing is Critical to Innovation

For the last four decades, the venture capital community has served as a founder and builder of companies, a creator of jobs, and a catalyst for innovation in the United States. This contribution has been achieved through high-risk, long-term investment of considerable time and dollars into small, emerging growth companies across the country and across industry sectors.

According to the econometrics firm Global Insight, venture-backed companies currently account for more than 10.4 million jobs and $2.3 trillion in US revenues, representing 9 percent of US private sector employment and 18 percent of US GDP. Venture capital investment has driven the growth of the information technology, communications, and life sciences industries, and more recently, the clean tech industry in the United States. Companies that received their start with venture capital dollars include: Genentech, Amgen, Intel, Cisco, Google, Medtronic, Microsoft, and eBay.

In addition to providing early stage funding to young businesses, venture capitalists also take an active role in guiding these companies through their start-up and expansion phases. Accordingly, we have a valuable perspective on the hurdles that emerging businesses confront and the environments that promote or stifle growth and innovation. Given this role that we play across a diverse set of industries and at various points in a company's life cycle, venture capitalists have the unique opportunity to observe the impact of patent system changes across a broad range of companies.

Our experience over the past 50 years, a period of extraordinary innovation and progress in technology and medicine, teaches us that a strong patent system has been absolutely critical to that progress. This is true across all of our industries, software, semiconductors, cleantech and life sciences. The explosion of inventions during the past 50 years, is itself compelling evidence that our patent system works well, and strongly belies the argument that somehow it is 'impeding' innovation. Indeed, the relatively weaker patent systems in other countries is an important reason why they lag so far behind us in innovation.
Inventors simply will not invent, and investors will not finance them, if they believe that the patent system will not protect them from unfair expropriation of the value of their inventions.

We agree that there are abuses of the patent system and improvements could and should be made. However, it is absolutely critical that any reform proposal is thoroughly vetted by legislators who are fully apprised of the consequences associated with each change to the system. In making any effort towards meaningful reform, we should avoid exchanging one set of problems for another, and avoid unintentionally harming early stage companies at a critical time in their existence.

My testimony today focuses on two critical elements of patent reform proposals: the calculation of damages in patent infringement cases and the structure of post-grant review procedures.

Damages Should be Based on Market Value

In general, the venture capital community believes that the current methodology for calculating damages is appropriate and working, and that patentees are not systematically overcompensated. Much of the patent reform debate has centered on the concept that the damages calculation should reflect the incremental value that is attributable to the infringer's

use of the invention, and not on the full market value of the invention. The language in H.R. 1260 requires that the reasonable royalty damages calculation should be applied only to the portion of the economic value of the infringing product or process properly attributable to the "claimed invention's specific contribution over the prior art. "

NVCA believes that the value of the patented features is often difficult to separate from the value of the whole product. Most innovation takes place in small incremental steps. While the incremental step can appear modest, especially compared to the complexity of the product that it is being added to, the change can result in dramatic shifts in market shares. A new coating on a solar cell , that increases it's conversion efficiency just a little bit, can dramatically shift the market for entire multi-billion dollar solar energy plants. A better drug on a drug eluting stent can shift the entire stent market. In either case, the question is 'who is entitled to the profits arising from the use of the invention, the inventor or the infringer'?
The venture capital community thus opposes a shift to solely awarding damages based on a "patent's specific contribution over the prior art." This language, which is unknown in the case law, appears to suggest that damages should be limited to the 'value' of some feature of the invention standing alone (the coating or the drug), without regard to it's impact on the functionality or value of the entire system taken as a whole, including it's potential impact on such things as market share. It is hard to imagine what this means, but it must be intended at least to change the current law, which under Georgia –Pacific, is a much broader and comprehensive attempt to ascertain the market value of an entire 'invention'. Apportioning damages in this way appears to be designed to deprive patent owners of the true economic value of their patents and will lead to tremendous uncertainty about the value of a patent. Such apportionment of damages also introduces added legal expenses to every patent case, discouraging investors from funding innovative technologies and therapies.

We believe apportionment of damages based on a "patent's specific contribution over the prior art" would encourage infringement rather than licensing arrangements for the product. If damages awards are based upon the value of a component part rather than the entire economic value created by the entire invention as a whole, the economic cost of infringement (value of the component part) becomes significantly less than the cost of licensing rights to the product (value of the entire product), incentivizing infringement rather than licensing. Again, this is a significant deterrent to venture capital investment in emerging companies.

It is also worth noting that the question of how to calculate a reasonable royalty has taken on even greater import since the recent Supreme Court decision in Ebay. In that case, the Court substantially weakened the presumption favoring injunctive relief against a proven infringer, thus expanding the number of circumstances in which courts will impose a mandatory royalty in lieu of an injunction.

We support an approach to calculating damages which would maintain the current *Georgia Pacific* multi-factored analysis for the majority of cases. Under this approach, the presiding judge would act as a "gatekeeper" in patent damage awards. The NVCA supports the "gatekeeper" language in S. 515, which was added during Senate Judiciary Committee consideration of the bill. The court is required to identify, on record, the methodologies and factors for calculating damages which have a "legally sufficient evidentiary basis" and the court or jury may only consider those factors when determining damages. This will ensure the law is properly applied by a jury, create a detailed record on which to appeal, and provide specific authority for judges to overturn jury verdicts not supported by the record. We encourage the House to include gatekeeper provisions is H.R. 1260 and to modify the damages section to limit the application of apportionment of damages.

Post-Grant Review and *Inter Partes* Re-examination:

Small and emerging companies need certainty and predictability with regard to the validity and the scope of their patents. For many emerging companies, intellectual property is the only asset of value. These emerging companies rely on patents to protect their intellectual property and deter competitors, large and small, from free-riding on their innovative work. Moreover, emerging companies rely heavily on venture capital investment, which in turn, is based on assurance that the asset of value—intellectual property—is well protected and not subject to infinite and unpredictable challenges to scope and validity.

Specifically, the venture capital community is concerned about legislative proposals which would provide those opposed to a patent several years ongoing opportunities in which to bring post-grant challenges to a patent. This would create harmful, extensive delays and uncertainty which could be highly detrimental to small venture-backed companies that rely on patent certainty to secure needed venture capital seed money. Our experience is that it is virtually

impossible for small start up companies to raise venture capital while their core patents are subject to challenges in the patent office. Larger competitors know this and can use these proceedings to delay final issuance of patents, thus blocking the small company's access to capital, which in many cases is a life and death issue for the start up. For the larger company , these proceeding are merely a cost of doing business. Thus, there is an enormous disparity in the balance of hardship in this situation.

Despite this, the NVCA has supported the creation of a well defined, limited post grant review process with strong estoppel, because we believe it will improve the quality of future patents, which is in the interest of all. However, we must recognize the imbalance of power intrinsic in this situation and take care that the system limits the potential for abuse by larger firms seeking to harass smaller competitors.

The venture capital community supports a limited, 12 month window after a patent is granted to allow time for challengers to file opposition. This single, finite post-grant window will serve to quickly weed out bad patents, but will not foster repeated challenges to patent validity nor introduce uncertainty into the patent system.

During the post-grant review proceedings, we also believe that petitioners for cancellation should be required to identify themselves and should be required to file all issues regarding patentability known to the petitioner and all material information known that supports its argument of unpatentability. The request by the petitioner should be required to provide specific reasons as to why they are seeking the cancellation and provide the evidence that supports the request. If a party elects to challenge a patent issuance through this process, they should not be permitted to again raise these or other issues that they had knowledge of at that time in any subsequent proceeding before the PTO or a court.

NVCA is concerned that H.R. 1260 expands the grounds upon which an inter partes reexamination may be instituted to include evidence that the claimed invention was in public use or on sale in the United States more than one year prior to the application for patent. NVCA opposes adding "prior public use or sale" to inter partes reexaminations because in this procedural setting patentees will be disadvantaged if such issues may be raised many years after a patent has granted.

Conclusion

Improving the quality of the patent system is critical to our nation's leadership in innovation. The venture capital community supports comprehensive patent reform that is balanced, rewards inventors for their innovation and is mindful that defending against infringement is disproportionately burdensome for small, emerging growth companies, while the benefit of infringing relative to the cost is disproportionately attractive to large companies. Any patent reform proposal needs to ensure a vibrant investment climate that spurs on the next generation of pioneering research and continues to support small and emerging businesses.