

The Florida Senate
BILL ANALYSIS AND FISCAL IMPACT STATEMENT

(This document is based on the provisions contained in the legislation as of the latest date listed below.)

Prepared By: The Professional Staff of the Appropriations Subcommittee on Criminal and Civil Justice

BILL: CS/SB 1298

INTRODUCER: Judiciary Committee and Senator Brandes

SUBJECT: Bad Faith Assertions of Patent Infringement

DATE: February 23, 2016

REVISED: _____

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	<u>Maida</u>	<u>Cibula</u>	<u>JU</u>	<u>Fav/CS</u>
2.	<u>Clodfelter</u>	<u>Sadberry</u>	<u>ACJ</u>	<u>Pre-meeting</u>
3.	_____	_____	<u>RC</u>	_____

Please see Section IX. for Additional Information:

COMMITTEE SUBSTITUTE - Substantial Changes

I. Summary:

CS/SB 1298 amends the Patent Troll Prevention Act in following three main ways:

- Requires that a demand letter to be objectively baseless before it may be deemed a bad faith assertion of patent infringement.
- Removes the act’s bond-posting requirement for a plaintiff who may have made a bad-faith assertion of patent infringement.
- Limits the entitlement to and amount of punitive damages awards against a person who makes a bad-faith assertion of patent infringement.

The bill imposes no direct costs to the private sector, but eases restrictions on filing patent infringement lawsuits. There is no fiscal impact to the government sector.

The bill is effective upon becoming law.

II. Present Situation:

Patent Law and Federal Preemption

The U.S. Constitution authorizes Congress “[t]o promote the Progress of Science and useful Arts, by securing for limited Times to ... Inventors the exclusive Right to their ... Discoveries.”¹

¹ U.S. Const. art. I, s. 8, cl. 8.

Federal patent laws grant patentees a limited monopoly in the form of a property right,² providing inventors with a “legal right, for a limited time, to exclude others from using, selling, offering to sell, or manufacturing the invention.”³ In order to promote progress as set forth by the U.S. Constitution, patent laws require inventors to describe their work in “full, clear, concise, and exact terms.”⁴ This strikes a “delicate balance” whereby inventors may rely on the aegis of the law while the public is “encouraged to pursue innovations, creations, and new ideas beyond the inventor’s exclusive rights.”⁵

As patents are creatures of the U.S. Constitution and acts of Congress, most issues related to patents reside exclusively within the province of the federal government. For example, federal district courts have original jurisdiction over any civil actions “arising under any Act of Congress relating to patents,” and “[n]o State court shall have jurisdiction over any claim for relief arising under any Act of Congress”⁶ Interpreting 28 U.S.C. section 1338(a), the Supreme Court held that cases “arising under” federal patent law require a plaintiff to “set up some right, title or interest under the patent laws, or at least make it appear that some right or privilege will be defeated by one construction, or sustained by the opposite construction of these laws.”⁷ As such, if a party brings a lawsuit alleging patent infringement, a federal court—and only a federal court—would possess subject matter jurisdiction. Even cases technically arising under state law may still be under the exclusive ambit of federal courts.⁸ As articulated by the U.S. Supreme Court, federal jurisdiction over a state law claim will lie if a federal issue is: 1) necessarily raised, 2) actually disputed, 3) substantial, and 4) capable of resolution in federal court without disrupting the federal-state balance approved by Congress.⁹ Nevertheless, some patent-related actions may properly remain in state court.¹⁰

Whether SB 1298 is preempted is an open question. Although a patent grant is within the exclusive purview of federal law,¹¹ federal patent law does not “occupy the field.”¹² Rather,

² See *Nautilus, Inc. v. Biosig Instruments, Inc.*, 134 S. Ct. 2120, 2124 (2014); see also 35 U.S.C. s. 261 (2012).

³ *Litton Systems, Inc. v. Honeywell, Inc.*, 145 F.3d 1472, 1474 (Fed. Cir. 1998).

⁴ 35 U.S.C. s. 112 (2012).

⁵ See *Festo Corp. v. Shoketsu Kinzoku Kogyo Kabushiki Co., Ltd.*, 535 U.S. 722, 731-2 (2002) (citing *Bonito Boats, Inc. v. Thunder Craft Boats, Inc.*, 489 U.S. 141, 150 (1989)); see also *Sears, Roebuck & Co. v. Stiffel Co.*, 376 U.S. 225, 230-1 (1964) (“Thus the patent system is one in which uniform federal standards are carefully used to promote invention while at the same time preserving free competition.”).

⁶ 28 U.S.C. s. 1338(a) (2012); see also *Biotechnology Industry Organization v. District of Columbia*, 496 F.3d 1362, 1367 (Fed. Cir. 2007) (“This court has exclusive jurisdiction to review cases which arise under the patent laws.”) (citing *Christianson v. Colt Indus. Operating Corp.*, 486 U.S. 800, 807 (1988)).

⁷ *Christianson v. Colt Industries Operating Corp.*, 486 U.S. at 807-8.

⁸ See *Gunn v. Minton*, 133 S. Ct. 1059, 1064-5 (2013).

⁹ *Id.* at 1065.

¹⁰ See *Milprint, Inc. v. Curwood, Inc.*, 422 F. Supp. 579 (E.D. Wis. 1976) *aff’d*, 562 F. 2d 418 (7th Cir. 1977) (holding that a contract action based upon patent license agreements and involving defense of patent noninfringement or invalidity may be brought and maintained in state court).

¹¹ *Sukumar v. Nautilus, Inc.*, 829 F. Supp. 2d 386, 394 (W.D. Va. 2011) (citing *Abbott Labs v. Brennan*, 952 F.2d 1346, 1355 (Fed. Cir. 1991)).

¹² See *Aronson v. Quick Point Pencil Co.*, 440 U.S. 257, 262 (1979) (“State law is not displaced merely because the contract relates to intellectual property which may or may not be patentable; the states are free to regulate the use of such intellectual property in any manner not inconsistent with federal law.”) (citing *Kewanee Oil Co. v. Bicron Corp.*, 416 U.S. 470, 479 (1974)). Note that federal law “occupies the field” if one can reasonably infer that Congress left no room to supplement it. See *Cipollone v. Liggett Group, Inc.*, 505 U.S. 504, 516 (1992).

patent law is subject to conflict preemption.¹³ As such, there may be room for states to regulate the improper or unfair use of patents. This includes state laws creating tort liability pursuant to “objectively baseless” patent infringement claims.¹⁴

Patent Trolls

“Patent assertion entities,” often referred to more pejoratively as “patent trolls,” make no products themselves but instead file dubious patent infringement lawsuits purely to extract money from commercially-productive companies.¹⁵ Having purchased a patent—rather than developing a patentable product—these “patent trolls” assert their newly-acquired patents against companies that use the patented technology in their business operations.¹⁶ Patent trolls typically function by sending notices of alleged patent infringement to large numbers of businesses threatening litigation if those businesses refuse to pay a licensing fee.¹⁷ Even if a targeted business believes the patent infringement claim lacks merit, it often chooses not to litigate.¹⁸ Justifying unpredictable litigation costs can be difficult, so targets often eliminate the threat by paying the patent troll a sum far less than the cost of successfully defending the lawsuit.¹⁹ In 2011, patent troll suits cost American technology companies over \$29 billion.²⁰ Much of this burden falls on small and medium-sized companies.²¹

Patent Troll Prevention Act

Recognizing that the “frivolous filing of bad faith patent claims ... have led to technical, complex, and especially expensive litigation,”²² the Florida Legislature passed the Patent Troll Prevention Act (“Act”), Part VII of ch. 501, F.S.²³ Under this law, a person is prohibited from making a bad faith assertion of patent infringement.²⁴ In determining whether an assertion of patent infringement violates the act, the court may consider the following factors, among others, as evidence that the assertion was made in bad faith:

- The demand letter does not include specified identification and contact information or factual allegations concerning the specific products, services, and technology that are covered by the patent infringement claim;
- The demand letter requests payment of a license fee or response within an unreasonable period;

¹³ *Sukumar v. Nautilus*, 829 F. Supp. 2d at 396-7 (“Where it is physically impossible to comply with both federal and state law, it is evident that federal law must prevail.”).

¹⁴ *Globetrotter Software, Inc. v. Elan Computer Group, Inc.*, 362 F.3d 1367, 1377 (Fed. Cir. 2004).

¹⁵ Eric Rogers, Young Jeon, *Inhibiting Patent Trolling: A New Approach for Applying Rule 11*, 12 NW. J. TECH. & INTELL. PROP. 291, 294 (2014).

¹⁶ Thomas A. Hemphill, *There Paradox of Patent Assertion Entities*, American Enterprise Institute (August 12, 2013), available online at <http://www.aei.org/publication/the-paradox-of-patent-assertion-entities/> (last accessed February 5, 2016).

¹⁷ See Paul R. Gugliuzza, *Patent Trolls and Preemption*, Boston University School of Law Public Law & Legal Theory Paper No. 15-03, 1-4 (Jan. 20, 2015), available online at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2539280 (last accessed February 5, 2016).

¹⁸ Eric Rogers, Young Jeon, *supra*, at 299.

¹⁹ *Id.*

²⁰ James E. Bessen & Michael J. Meurer, *The Direct Costs from NPE Disputes*, 99 CORNELL L. REV. 387, 412-13 (2014).

²¹ James E. Bessen & Michael J. Meurer, *supra*, at 388, 398.

²² Section 501.991(2), F.S.

²³ Sections 7-13, Ch. 2015-92, Laws of Fla, codified as sections 501.991-997, F.S.

²⁴ Section 501.993, F.S.

- The demand offers to license the patent for an amount that is not based on a reasonable estimate of the value of the license;
- The claim or assertion of patent infringement is unenforceable, and the claimant knew, or should have known, that the claim was unenforceable;
- The claim of patent infringement is deceptive;
- The claimant has previously filed, or threatened to file, one or more lawsuits based upon the same or a similar claim of patent infringement which either did not include required information or was found to be meritless; and
- Any other factor the court considers relevant.²⁵

Alternatively, the Act provides statutorily-defined factors evincing the absence of bad faith, including whether:

- The demand letter contains required identifying and contact information and factual allegations concerning the specific products, services, and technology that are covered by the patent infringement claim;
- The claimant provided omitted information within a reasonable period of time after request;
- The claimant made a good faith effort to establish that the target of the lawsuit has actually infringed the patent and negotiated an appropriate remedy;
- The claimant made a substantial investment in the use of the patented invention or discovery in a product or sale of a product or item covered by the patent;
- The claimant is the inventor or joint inventor of the patented invention or discovery, or alternatively the original assignee; or
- Any other factor the court finds relevant.²⁶

The target of a bad faith patent infringement action may request a protective order requiring the initial claimant to post a bond in an amount equal to the lesser of \$250,000 or a good faith estimate of the target's expenses of litigation, including attorney fees.²⁷

The Act creates a private right of action which may be brought in a court of competent jurisdiction. A court may award equitable relief, damages, costs and fees, and punitive damages of either 1) \$50,000, or 2) three times the total damages, costs, and fees.²⁸

Lastly, institutions of higher education, technology transfer organizations owned by institutions of higher education, and other patent infringement assertions arising under 35 U.S.C. s. 271(e)(2)²⁹ or 42 U.S.C. s. 262³⁰ are exempt from liability under the Act.

²⁵ Section 501.993(1), F.S.

²⁶ *Id.* at subsection (2).

²⁷ Section 501.994, F.S.

²⁸ Section 501.995, F.S.

²⁹ 35 U.S.C. s. 271(e) relates to the use, offering for sale, or sale of veterinary biological products.

³⁰ 42 U.S.C. s. 262 regulates biological products regarding the prevention, treatment, or cure of a disease or condition of human beings.

Other State Laws

As of February 1, 2016, 27 states—including Florida—have passed statutes regulating bad faith patent infringement assertions.³¹ Many of these new laws are modeled after a statute first adopted in Vermont,³² which itself prohibits bad faith assertions of patent infringement.³³ Other states have outlawed assertions that “confirm false, misleading, or deceptive information,”³⁴ or have defined specific acts as illegal, such as making infringement assertions that “lack a reasonable basis in fact or law” or failing to provide, in a letter alleging patent infringement, “factual allegations” about how, exactly, the recipient infringes the patent.³⁵ The Vermont statute is currently facing a legal challenge based, in part, on federal preemption. A pending petition seeks a writ of certiorari with the United States Supreme Court.³⁶

III. Effect of Proposed Changes:

CS/SB 1298 amends the Patent Troll Prevention Act in several ways. Most significantly, it removes the current criteria necessary to show a bad faith assertion of a patent infringement and replaces it with an “objectively baseless” standard, among other considerations. More specifically, the bill prohibits patent infringement demand letters that:

- Falsely assert that the sender has filed a lawsuit in connection with the claim;
- Assert a claim that is objectively baseless due to any of the following:
 - The sender, or a person whom the sender represents, lacks a current right to license the patent to the target or to enforce the patent against the target;
 - The patent is invalid or unenforceable; or
 - The infringing activity occurred after the expiration of the patent.
- Are likely to materially mislead a reasonable person because the letter does not include sufficient information to inform the target of: (1) the identity of the person asserting the claim, including the name and address of such person; (2) the patent alleged to have been infringed, including the patent number of the patent, and 3) at least one of the target’s products, services, or technologies alleged to infringe the patent, or at least one activity of the target which is alleged to infringe the patent.

The bill repeals s. 501.994, F.S. As such, plaintiffs in a proceeding against a target are no longer required to post a bond if the court finds that there is a reasonable likelihood that the assertion of patent infringement was made in bad faith.

The bill amends s. 501.995, F.S., to allow recovery of punitive damages in a private cause of action under the Act for bad faith assertion of a patent infringement claim only if the court determines that the entity asserting the patent infringement claim has repeatedly violated the Act. In addition, the bill limits punitive damages to a maximum of \$75,000. This removes a deterrent

³¹ Patent Progress’ Guide to State Patent Legislation (Feb. 1, 2016), available online at <http://www.patentprogress.org/patent-progress-legislation-guides/patent-progresss-guide-state-patent-legislation/> (last accessed February 5, 2016); See also Utah Code s. 78B-6-1901; Wash. Rev. Code. s. 19.350.900; and Va. Code. s. 59.1-215.2.

³² Gugliuzza, *supra* note 17, at 1582 n. 18.

³³ Vt. Stat. tit. 9, s. 4197(a) (2014).

³⁴ See, e.g., Wis. Stat. s. 100.197(2)(b) (2014).

³⁵ See, e.g., Tenn. Code. s. 29-10-102(a)(3) (2014); Gugliuzza, *supra* note 17, at 1582-83.

³⁶ *Vermont v. MPHJ Technology Investments, LLC*, 803 F.3d 635 (Fed. Cir. 2015) (affirming a lower court decision, holding, in part, that the company’s counterclaim that federal law preempts the Vermont statute arose under federal patent law).

that may have prevented companies with good faith patent infringement claims from initiating lawsuits based upon patent infringement because of a lack of sufficient capital to post a bond,.

The bill takes effect upon becoming a law.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

This bill does not require counties or municipalities to spend funds or limit their authority to raise revenue or receive state-shared revenues as specified in Article VII, s. 18 of the Florida Constitution.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

D. Other Constitutional Issues:

As stated earlier, federal patent law does not occupy the field. Rather, patent law is subject to conflict preemption. As such, there may be room for states to regulate the improper or unfair use of patents. This includes state laws creating tort liability pursuant to “objectively baseless” patent infringement claims. Because SB 1298 includes “objectively baseless” language in Section 3, it may well survive a preemption challenge.

V. Fiscal Impact Statement:

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

CS/SB 1298 imposes no direct costs to the private sector, but eases restrictions on filing patent infringement lawsuits.

C. Government Sector Impact:

None.

VI. Technical Deficiencies:

None.

VII. Related Issues:

None.

VIII. Statutes Affected:

This bill substantially amends sections 501.991, 501.992, 501.993, and 501.995 of the Florida Statutes.

This bill repeals section 501.994 of the Florida Statutes.

IX. Additional Information:**A. Committee Substitute – Statement of Changes:**

(Summarizing differences between the Committee Substitute and the prior version of the bill.)

CS by Judiciary on February 16, 2016:

The committee substitute omits portions of the underlying bill which would have eliminated the private cause of action in existing law in favor of the enforcement of the Patent Troll Prevention Act by the Attorney General. Instead, the committee substitute authorizes a revised form of the existing private cause of action.

B. Amendments:

None.