

**Richard A. Epstein**  
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**Chicago, Illinois**

March 30, 2011

Dear X:

My name is Richard A. Epstein and I have been asked on short notice by Mr. Rod Cooper, who represents DataTreasury Corporation on important legislative matters to offer an analysis of some key provisions of the America Invents Act dealing with the use of the Patent Office to reexamine patents that have survive multiple judicial challenges. I am presently the Laurence A. Tisch Professor of Law at New York University School of Law, the Peter and Kirsten Bedford Senior Fellow at Stanford University's Hoover Institution, and a senior lecturer at the University of Chicago Law School, where I am also the James Parker Hall Distinguished Service Professor of Law emeritus. A copy of my most recent resume is attached. In writing this letter, I have worked closely with F. Scott Kieff, Professor of Law at George Washington University School of Law and Ray and Louise Knowles Senior Fellow at Stanford University's Hoover Institution, who has long experience in dealing with all phases of intellectual property law. I have also attached a copy of his resume to this letter, which he has also signed as a coauthor. A copy of his resume is also attached. We both endorse all the arguments advanced in this letter.

In addressing the multiple defects contained in S. 23, we shall focus for purposes of exposition on the impact that this bill, if enacted, would have on DataTreasury Corporation. But the harmful effects of S. 23 are not confined to a single client, or even a large group of clients. The legislation is the most important piece of legislation to come before Congress since the passage of the Patent Act of 1952.<sup>1</sup> But while that statute represented a serious advance and clarification over previous law, this proposed legislative contains many unsound provisions that should never be enacted. The account that we shall give of the DataTreasury experience confirms what should be understood to be a widespread and dangerous change in the intellectual temper of our times. The America Invents Act is a piece of propaganda that conceals the dangerous anti-patent sentiment that has gained far too much unjustified support in recent years. Far from helping inventions, the Byzantine provisions of this act will frustrate innovation and development at every turn.

With that introduction let us turn to the particulars of our work with DataTreasury. In both April and October of 2008, I wrote letters to Senators Patrick

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<sup>1</sup> 66 Stat. 792 (1952). For access to the relevant documents, see IPMall, [http://ipmall.info/hosted\\_resources/lipa/patents/patentact.asp](http://ipmall.info/hosted_resources/lipa/patents/patentact.asp).

Leahy and Arlen Specter attacking the “Check 21” legislation, which was intended to strip DataTreasury of its valid patents by a set of maneuvers that did not deny the validity of the patents in so many words, but instead withdrew all the remedial protection for damages, injunctions or attorney’s fees when their covered technology was infringed by the select banks who were the sole beneficiaries under the proposed statutory changes. Both those measures were at the time naked efforts to convert the judicial defeats of some banks into legislative victories. Fortunately cooler heads prevailed, and both bills died in the United States Senate, once their unwise and unconstitutional nature was exposed. I attach the two letters that I wrote critiquing those statutes for the many constitutional infirmities.

Now over two years have passed. During that time DataTreasury has continued its unbroken string of litigation successes both in the courts and before the Patent and Trademark Office.<sup>2</sup> Yet the same forces that were active in 2008 to nullify its patents have devised another, more oblique strategy to achieve that same dubious end, by inserting Section 18 of S. 23, the sadly misnamed “America Invents Act,” many of whose provisions will in fact block innovation. In this round, a new strategy has been adopted. Instead of neutralizing the patents by stripping them of their remedial components, Data Treasury’s opponents are determined to oust the Federal Courts of most of their jurisdiction by setting up a set of new procedures that give virtually all judicial power to ad hoc tribunals set up within the Patent and Trademark Office. These tribunals are then allowed, in the final and unfettered discretion of the Director of the PTO to reopen decided cases for a broad class of business method patents, whose novel definition could easily be turned against DataTreasury’s patents, and target as well valuable business method patents of other innovators that have gained market traction. The patents for inventions that have failed to gain market acceptance will, of course be ignored. Owing to this enormous selection, it should be apparent that Section 18 of S. 23 has a momentous scope, which has never been acknowledged in the Senate. If enacted into law that section will transform the operation of the patent system for the worse by introducing additional expense and uncertainty into the patent system, which in the long run will further compromise America’s fast fading technological advantages. The purpose of this letter is to expose the social folly of some of its key provisions, which should be promptly removed from the bill no matter what treatment is given to other key provisions.

The focus of our concern in this letter is Section 18, which is captioned with the near incomprehensible and misleading title --“Transition Program For Covered Business-Method Patents.” In order to understand the mischief wrought by this Section, it is necessary to read it in connection with Section 5 that is directed toward Post-Grant Review. Together these two threaten to largely undermine the current system of patent law adjudication in federal district courts in ways that are both

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<sup>2</sup> A brief summary of those results can be found in the short memo that Data Treasury has prepared under the title **Section 18 of S. 23 is so Broad it Punishes Valid Patent Holders**, which chronicles a 13 year period of nonstop litigation.

economically unwise and constitutionally deficient. In this letter, we shall address some of the evident difficulties of these two interlocking provisions. In Part I, we outline the key provisions of Section 18. In Part II, we show why Section 18 should not be regarded as a transitional provision. In Part III, we examine the various arguments put forward to justify this provision in order to explain these three points. First, the broad statutory definition of a business method patent sweeps many cases into that section that do not fall within business methods patents as defined Class 705 of the PTO's classification system. Second, any poor quality of some business method patents does not justify the invalidation of those patents that have prevailed in litigation as well as in post-grant review procedures before the Patent and Trademark Office. Third, that the decision in *Bilski v. Kappos* affirmed the earlier broad scope of business method patents. In Part IV, we explain how the proposed statute is a systematic violation of the principles of res judicata. Part V explains why the novel procedures contained in both Section 18 and in Section 5 (dealing with the controversial topic of Post Grant Review) are inconsistent with the principles of separation of power insofar as they blend the functions of the executive and judiciary in judges who, unlike Article III or Article I judges, are not subject to Senate Confirmation and are not required to serve either for life or a term of office. Finally, in Part VI, we explain how the proposed statute dangerously undermines key positions that the United States has taken in international trade negotiations over intellectual property under the TRIPS Agreement, thereby the critical entertainment and information sectors of our national economy to intellectual privacy from abroad.

**PART I. SECTION 18 INTRODUCES AN UNPRECEDENTED SYSTEM OF AGENCY REVIEW FOR PATENTS WHOSE VALIDITY HAS ALREADY BEEN SUSTAINED IN COURT.** The major purpose of Section 18 is to create a four-year window, which allows for a reexamination of existing patents starting one year after the passage of the statute and lasting for a period of four years after the Director establishes the regulations at the PTO implementing the reexam.<sup>3</sup> During that four year window that runs between the enactment of the statute and the end of the sunset period, the right for a new hearing on the patent's validity shall be conducted in accordance with the procedures set out with respect to Post Grant Review, in Section 5 of the Act. These actions may be brought *only* by a person or his real party in interest who "has been sued for infringement of the patent or has been charged with the infringement of the patent."<sup>4</sup>

That privilege therefore extends to all persons who have had litigation commenced against them in federal court. It also covers parties who have *lost* these infringement cases, have paid damages, and have exhausted all their rights on appeal. Both portions are inadvisable. On the former, there is no reason to allow litigants who did not like their prospects in federal court to shift to what they hope will be a friendlier forum. In this regard potential infringers have a real advantage

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<sup>3</sup> Section 18(b)(1)(c) & (b)(3)(A).

<sup>4</sup> S. 23 at §18(b)(1)(B).

because the patentee, even if successful, must return to court to get either damages or an injunction. On the other hand, if the potential infringer is successful in his preferred forum, the case is at an end. The multiplication of these strategic possibilities thus introduces a tilt in the system with respect to patents that are subject to litigation.

Similarly, there is no justification, as we shall demonstrate later, for the second prong of Section 18, which allows losing parties to get a second bite at the apple so long as the challenged patent has yet to expire. That conclusion follows necessarily because Section 18 contains no statute of limitation. Hence so long as the patent is still in effect, it is fair game for a challenge under this Section. But regardless of the trouble Section 18 causes generally, it causes particular mischief for patentees like DataTreasury, who have already had their patents subjected to the most thorough challenges that could be thrown at a patent – full Federal Court adjudication financed by entities with so much money that they are actually banks.

As drafted, Section 18 thus causes a massive destabilization of vested rights, which in our view constitutes a clear taking of the patent that has already been successfully defended. Any provision that imposes fresh costs on a patentee to relitigate its patent after it has been successful causes a loss to that extent, which is compounded by the risk that it will lose in this Section 18 proceeding, at which point the status of its patent will become insecure not only against the victorious litigant, but against the world as others may seek to rely on that victory to disclaim their own licenses or to refuse to enter into licenses with the existing party.

The grounds on which the suit is brought is stated to be limited to those grounds under section 102 (dealing with novelty) and section 103 (dealing with conditions for patentability and nonobviousness), which cover the grounds on which most challenges to patents take place. (The Section concedes that these patents are valid under Section 101 of the Patent Act. See Section 18(e)). In effect, just about anything that could have been raised the first time through could be raised in this reexamination format. As such this provision is subject to massive objections that are covered in the remainder of this letter.

**PART II. SECTION 18 IS NOT A TRANSITIONAL PROVISION.** The initial difficulties with Section 18 start with its inaccurate first word, “transitional.” The provisions of section 18 have nothing to do with finding ways to move from the older regime to a new legal regime. Rather, their sole purpose is to remove all the defenses based on *res judicata* and statute of limitations that exist with respect to those patents that have been tested in the courts, by exposing them to collateral attack inside the PTO before administrative judges appointed by the director of the office without the need for any Senate confirmation now required of Article I judges.<sup>5</sup> Essentially S. 23 provides a four year window, starting one year after the enactment of the statute.<sup>6</sup>

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<sup>5</sup> Id. at § 6.

<sup>6</sup> Id at § 18(b)(2) &(3)(A).

During this period *all* the covered existing patents can be reexamined in the procedures set out in Section 18, which incorporate most but not all of the Post Grant Review procedures in Section 5 (eliminating, for example, those which deal with time triggers that are tied to post grant review of newly issued patents.) In proposing this grand revision of the patent law, the text of this Section makes no explicit reference to DataTreasury's patents, but it may well apply to them with full force in light of the definition of covered business method patents contained in section 18 (d). The broader verbal scope of this Section may insulate this provision from a charge that it counts as a bill of attainder directed at only one patent holder, but as a practical matter that expansion of coverage only compounds the uncertainty for a larger class of patents that already have been repeatedly validated.

In one sense, the provisions are like the short-term removal of the statute of limitations that have been adopted, for example, in connection with clergy abuse cases. The usual pattern here is that the statute of limitation defense is lifted for a one or two-year window, which then allows all time-barred cases to be brought until the window is closed. A short period of time is sufficient to allow *every* time-barred case to be brought, because there is quite literally no astute lawyer that cannot bring his client's case within that designated window. Yet the two statutory interventions are wholly different. The standard suspension of the statute of limitations applies only to those cases where the aggrieved party did not have the opportunity to bring his suit within the usual limitation period because of the unavailability of evidence, often deliberately concealed, with which to pursue claims that came to light only years later. Whether those waivers should be allowed is a close and difficult question, given the added risks it imposes on defendants who may not be able at that late date to marshal the evidence needed to resist inflammatory charges that might well be based on dubious or fabricated evidence. It is for that reason they have received a rocky judicial reception.<sup>7</sup>

Whatever the right result in those settings, however, these patent cases present a wholly different situation because all the evidence was fully available at all times, and served as the basis of unsuccessful litigation by the very party who is

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<sup>7</sup> See, e.g., *Stogner v. California*, 539 U.S. 607 (2003), where the Supreme Court used the ex post facto clause to strike down by a five-to-four vote a statute that removed the protection of the statute of limitations for criminal prosecutions of child abuse. In reaching this conclusion, Justice Breyer wrote that: "the new statute threatens the kinds of harm that, in this Court's view, the Ex Post Facto Clause seeks to avoid. Long ago the Court pointed out that the Clause protects liberty by preventing governments from enacting statutes with "manifestly unjust and oppressive" retroactive effects. Judge Learned Hand later wrote that extending a limitations period after the State has assured "a man that he has become safe from its pursuit . . . seems to most of us unfair and dishonest." *Falter v. United States*, 23 F.2d 420, 426 (2d Cir. 1928), cert denied, 277 U.S. 590, (1928). In such a case, the government has refused "to play by its own rules." *Carmell v. Texas*, 529 U.S. 513, 533 (2000).

now attempting this new reexamination. It is one thing to allow an aggrieved party a remedy against a defendant that had never been forced to explain its conduct and it is quite another to insist that those people who have prevailed have to go through the same process a second time against their former adversary. The finality of litigation between the parties surely is a high value in these cases, and there is nothing in this traditional statute which explains why this protection should be lifted only in some patent cases, i.e. those “covered business patents,” about which more later.

**PART III. ALL OF THE PURPORTED POLICY JUSTIFICATIONS FOR SECTION 18 ARE INCORRECT.** One striking feature of Section 18 is that it does not apply to all patents equally. Rather it singles out a class of statutorily defined “covered business-method patents” for special treatment. This maneuver is subject to three decisive objections. The first is that by design or oversight the definition used for a “covered business method patent” differs in several important ways from the standard definition of business method patents that are found in the Class 705 definition now in standard use today. The second is that Senators Charles Schumer and John Kyl are wrong to assert that the special treatment specifically called for in Section 18 is justified by the generally low quality of business method patents. The third is that the special provisions of Section 18 are not justified on the ground that the Supreme Court’s recent decision in *Bilski v. Kappas* has undercut the legal grounds for affording favorable treatment for business method patents. All of these points are critical to understanding why DataTreasury’s patents should not be subject to reexamination under the Section 18 procedures.

*A. The Statutory Definition of Business Method Patents is Both Flawed and Misleading.* The application of section is tied to the distinctive statutory definition that is contained in section 18(d), which includes:

a patent that claims a method or corresponding apparatus for performing data processing operations utilized in the practice, administration, or management of financial product or service, except that it shall not include patents for technological inventions.

As is explained by Senators Schumer and Kyl this definition is patterned on the definition of Class 705 patents, which provides:

This is the generic class for apparatus and corresponding methods for performing data processing operations, in which there is a significant change in the data or for performing calculation operations wherein the apparatus or method is uniquely designed for or utilized in the practice, administration, or management of an enterprise, or in the processing of financial data.<sup>8</sup>

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<sup>8</sup> U.S. Patent Classification System - Classification Definitions as of June 30, 2000 <http://www.uspto.gov/web/offices/ac/ido/oeip/taf/def/705.htm>

Yet nowhere do the two Senators identify or justify the key differences between the two definitions. Three deserve special note.

First, Class 705 definition does not contain any exception for patents for “technological inventions” because these are not within the scope of Class 705 patents to begin with.

Second, Class 705 eliminates the need of a huge explicit grant of administrative discretion to the Director. Just that discretion is conferred without limitation on the Director under Section 18 (d), which provides:

Solely for the purpose of implementing the transitional proceeding authorized by this subsection, the Director shall prescribe regulations for determining whether a patent is for a technological invention.<sup>9</sup>

The effort to isolate the distinctive definition of business method patents under this section is strengthened by Section 18 (e) which provides that

Nothing in this section shall be construed as amending or interpreting categories of patent-eligible subject matter set forth under section 101.

The question thus arises why either of these two fixes are needed when the need for special interpretation could be removed simply by substituting in a new section (d) which could read:

(d) For the purposes of this section, the term “covered business method patent” shall be those patents included in Class 705 patents.

Third, these differences matter. In a number of critical areas, the statutory definition in Section 18(d) is broader in scope than the definition of Class 705 patents. The Class 705 definition is limited to business methods patents that are “uniquely designed or utilized” in the practice, administration or management of an enterprise, or in the processing of financial data. These qualifications are all removed from the Section 18(d), which sweeps far broader. The word “uniquely” is no where to be found in Section 18. The words “financial product or service” found in Section 18 are far broader than the analogous phrase “an enterprise, or . . . the processing of financial data” found in the Class 705 definition. Senators Schumer and Kyl might protest that they intend the scope of the two sections is the same. If so, then they should just refer to Class 705 patents by name to remove the ambiguity that their own carefully honed definition has created.

Fourth, neither the statutory definition under section 18 or the supporting arguments advanced by Senators Schumer and Kyl draw any distinction between those patents that deal with an apparatus and those that only deal with a method for

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<sup>9</sup> I assume that the reference to “patent” is meant to cover those patents that are otherwise within the scope of the definition offered in Section 18(d).

processing and interpreting financial information. That difference is of critical importance to a company like DataTreasury whose check imaging devices could easily be caught by the statutory definition, even though they were originally designated as Class 380 and not Class 705. Yet in this case, it is an open question whether a Director's determination to include DataTreasury's patent under Section 18(d) could be defended under the judicial deference accorded administrative agencies under the *Chevron* doctrine.<sup>10</sup> Again, the entire confusion could be eliminated if, at the very least, the proposed Section 18(d) was removed, by inserting in its place an explicit reference to Class 705, which would eliminate at least one source of statutory uncertainty.

Nonetheless, even if the reexamination provisions were tied to the PTO internal classification system, the new provision would introduce new opportunities for strategic initiatives. Under current practice, the PTO's internal classification system primarily works for the managerial convenience of the office. By lumping the right patents together, PTO examiners who are likely to experience similar technological issues are now more easily able to consult with each other. But once the law explicitly attaches powerful legal consequences to this classification scheme the classification rules will drive parties to recast their patents, or their objections to patents, in ways that influence not only the final determination of validity, but the heading under which that determination is made. That change in focus gives applicants a strong motivation to appeal determinations within the agency, and perhaps outside of it. A new cottage industry will evolve in litigation, in which the tactical advantages to individual litigants will in the long run impose systematic burdens on the operation of the PTO, which is already short-staffed and underfunded. The anticipated deference that the agency PTO will receive under the Administrative Procedure Act will spur all sides to invest substantial resources in what is today a modest ministerial act. Powerful applicants will lobby to get their business method patents *out* of Class 705. Equally powerful opponents will work hard to get them *into* Class 705. The problem here cannot be cured by better drafting. It is a direct consequence of the decision to use this classification scheme to trigger different pathways for statutory review. No matter where the line is drawn, some important cases are likely to straddle it.

*B. The Broad Statutory Definition in Section 18 undermines the claims that the covered business method patents are all of inferior quality.* In defending Section 18, Senators Schumer and Kyl report a number of prominent economic studies that attack the poor quality of examination of Class 705 patents, which have been subject to a far higher rate of judicial challenge.<sup>11</sup> But those findings are quite worthless for

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<sup>10</sup> See *Chevron U.S.A., Inc. v. National Resources Defense Council, Inc.*, 467 U.S. 837 (1984).

<sup>11</sup> Charles Schumer & John Kyl, Nature and Scale of Business Method Patent Issue: "A particular aggravation in the case of business method patents is the existence of a high number of poor quality patents."

patents like DataTreasury's, which were not designated by the PTO as Class 705 patents in the first place. The proper evaluation of the overall situation depends on looking at the performance of the PTO with respect to that class of patents, which cannot be done given the dissonance introduced in the ever-changing definitions used in the case law and in the internal PTO management structures over the many years, since at least the Supreme Court's decision in *Gottschalk v. Benson*, 409 U.S. 63 (1972) relating to business method patents.

In addition, the Schumer/Kyl analysis of patent quality is both selective and incomplete. While the two Senators report high rates of litigation, they do not report the success rates of these challenges, which would give a better sense of the claimed quality differentials. In addition, they make a serious mistake because they do not break down their data between the two subclasses of business method patents found in Class 705: those that depend on a specific apparatus and those that only involve a set of data manipulations. It is quite likely that the quality failure rate with the process only patents are far higher than those which involve some type of apparatus or device, as the former are only process patents, while the latter are also machine-like patents. Ironically moreover, part of the spike in litigation stems from the multi-year attack that critics of business method patents have mounted since *State Street Bank* was handed down in 1998. Wholly apart from the substantive merits of any legal rule, the greater the uncertainty the higher the rates of litigation. Many business method patents that were litigated *before State Street* settled more quickly because there was less inherent doubt about the applicable legal rules.<sup>12</sup>

The Schumer-Kyl argument is also marred by yet another serious, if elementary, statistical error. Even if the average quality of a business method patent were low, it hardly follows that the quality of those patents that have been upheld against a variety of challenges is low as well. As the references of Senators Schumer and Kyl make it clear, the doubts about PTO quality control over business method patents is hardly a state secret. That information has been routinely available in all of the litigated cases about these patents. The patent that is upheld therefore cannot be thought to be a patent only of average quality. The added information from the litigation is well-nigh conclusive evidence that those patents are of high quality, whatever the average quality of the broader class of business method patents, both litigated and unlitigated.

In light of these conceptual mistakes, the remedy chosen in section 18 does not fit the perceived problem. In deciding to allow challenges by parties who have lost in court, section 18 picks out for special adverse treatment the *strongest* patents that have already been tested inside the system. A far better approach encompasses

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<sup>12</sup> See, e.g., *Paine, Webber, Jackson & Curtis v. Merrill Lynch*, 564 F. Supp. 1358 (D. Del. 1983). There the parties settled soon after the district court upheld Merrill Lynch's patent on its cash management account against the charge that it did not cover proper patentable subject matter. Surely, no one would want to throw that patent into uncertainty today.

two key elements. The first is to tighten either the definitions or requirements for business method patents covered in Class 705. The second is to allow new judicial challenges to business method patents to go forward under today's standard rules. If Schumer and Kyl are right, these challenges will succeed at a high rate, at which point the shift in judicial sentiments will reduce the bargaining position of the holders of business method patents in future settlement negotiations. If Schumer and Kyl are wrong about the selection of disputes for litigation, the settlements will continue as before. There is no reason to reopen patents that have already been successfully defended in courts to achieve the desired results.

C. *The Recent Supreme Court Decision in Bilski v. Kappos does nothing to undermine the validity of business method patents.* The second line of defense of Section (d) takes a different tack. It claims, falsely, that the recent Supreme Court's 2010 decision in *Bilski v. Kappas*, 561 U.S.—, 130 S. Ct. 3218 (2010) has wrought a major change in the law governing business patents to require this reexamination.

In its 1998 *State Street* decision, the Federal Circuit greatly broadened the patenting of business methods. Recent court decisions, culminating in last year's Supreme Court decision in *Bilski v. Kappos*, have sharply pulled back on the patenting of business methods, emphasizing that these "inventions" are too abstract to be patentable. In the intervening years, however, PTO was forced to issue a large number of business-method patents, many or possibly all of which are no longer valid.<sup>13</sup>

This passage is wrong in all its particulars. One issue that was live when *Bilski* came to the Supreme Court was whether the Court would decide that various "business methods" were not capable of being patented under Section 101(a). But *Bilski* emphatically rejected that position, when it explicitly reaffirmed a broad reading of that provision insofar as it covers any process, machine, manufacture or composition of matter, citing for that proposition *Diamond v. Chakrabarty*, 447 U.S. 303, 308-09 "laws of nature, physical phenomena, and abstract ideas." *Id.* at 209. The specific patent that was invalidated in *Bilski* fell into the class of "abstract ideas" insofar as it "explains how commodities buyers and sellers in the energy market can protect, or hedge, against the risk of price changes." *Bilski* does not contain any lengthy discussion of *State Street Bank & Trust Co. v. Signature Financial Group, Inc.*, 149 F.3d 1368 (1998), much less a repudiation of that decision. The only decision that was repudiated was that of the Federal Circuit below<sup>14</sup>, which Supreme Court explicitly rejected insofar as it recognizes only two patent types. (1) it [the patent] is tied to a particular machine or apparatus, or (2) it transforms a particular article into a different state or thing."

Indeed, this purported justification for section 18 gets things exactly backwards. If anything, the Supreme Court reaffirmed the general validity of

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<sup>13</sup> Summary of the Managers' Amendment No. 121, at

<sup>14</sup> *In re Bilski*, 545 F.3d 943, (Fed. Cir., 2008).

business method patents under *State Street*. Even though it affirmed the judgment below, it did so on an entirely separate ground from that adopted below, by stressing that this particular patent was at most an abstract idea, and thus did not fall within the traditional confines of section 101 on grounds that are applicable to all classes of patents. There is no responsible reading of this decision that treats it as having made any sharp inroads on the earlier definitions of business method patents.

Indeed, to the contrary, Section 18 flies in the face of *Bilski* by refusing to make any distinction between patents that claim an apparatus and those that claim only a purported financial process or manipulation. Thus, the Supreme Court noted with evident approval that the defect with the *Bilski* energy data patent was that it “is not implemented of a specific apparatus and merely manipulates [an] abstract idea and solves a purely mathematical problem without any limitation to a practical application, therefore, the invention is not directed to the technological arts.” 130 S. Ct. at 3224. It expressed approval, not disdain, for the apparatus patents that are caught under the Section 18(d) definition of business method patents. This distinction matters. The weaknesses of marginal business method patents are nowhere in evidence with DataTreasury’s imaging systems and processes, which bears no relationship to the tenuous business method patent invalidated in *Bilski*.

**PART IV. SECTION 18 VIOLATES ESTABLISHED PRINCIPLES OF CLAIM PRECLUSION AND THEREBY TAKES A PATENTEE’S PROPERTY WITHOUT JUST COMPENSATION.** Even if *Bilski* worked some mysterious transformation of the law, Section 18 would still be wholly unsound. The principle of claim preclusion (or *res judicata*) is intended to make sure to protect the finality of judgments in individual case even if the law should be changed thereafter. The law is in constant flux in many key areas, so that an exception for judgments that should not stand because of a change in legal principles is wide enough to get rid of *res judicata* in its entirety. All cases could always be opened up so that land titles would no longer be secure, decisions of no liability in tort cases could be reopened and the like. Outside the patent area that argument has never been accepted in general terms. The only recourse that any disappointed litigant is the set of limited procedures for reopening cases on grounds that some substantial new evidence has been found. That reexamination is wholly inappropriate here.

These considerations are not only of a prudential nature, they also have a key constitutional invention. There is no doubt that if Congress passed a piece of legislation that said that just invalidated all patents that had been adjudicated as constitutional, that action would count as a taking of private property subject to the protection of the Takings Clause. It would make no difference whether that patent were just invalidated or whether it were transferred to another person. Section 18 does not purport to make that transfer in just those terms. But any statutory command to relitigate a patent carries with it a real risk to the patent holder. If its odds of winning on the stacked procedures of Section 18 and Section 5 are say 25 percent, that is tantamount to the taking of a quarter interest in the patent. If the

litigation results in a cost free license to the challenger, that loss is equal to the fair market value of the destroyed license opportunity. Partial takings are covered by the takings clause as much as total ones.<sup>15</sup>

**PART V. THE PROCEDURES UNDER THIS SECTION ARE IN VIOLATION OF THE SEPARATION OF POWERS PROVISIONS CONTAINED IN ARTICLES I THROUGH III OF THE UNITED STATES CONSTITUTION.** One of the striking features of Section 18 is that in combination with Section 5 (which introduces a highly flawed set of procedures for both inter partes and post-grant review) is that it brings into the Patent and Trade Office functions that properly belong in a judicial setting. Thus Section 6 of the Act provides that the administrative judges who shall run these proceedings shall be appointed by the Secretary of Commerce, “in consultation” with the Director. There is no requirement of any Senate confirmation hearing for either a lifetime appointment for Article III judges or for a term appointment that is not required for Article I judges who sit in the bankruptcy and tax courts. Nor is there any statement as to the term for which these so-called judges are appointed, so that it is quite conceivable that they could receive special appointments to deal with only one or a very small number of cases.

Yet notwithstanding the utter want of any safeguards with respect to their appointments, Section 18 makes them the dominant players in these proceedings. More concretely, Section 18(d) sets up a set of criteria which allows those persons who are pursuing an administrative remedy under Section 18(c) to seek a stay of “a civil action alleging infringement of a patent under section 281 [which is the basic provision for bringing patent suits] which are highly favorable to the proponent of the stay. In effect the administrative tribunal gets precedence over the judicial one in the discharge of a judicial function. In this process, moreover, the role of the Federal Circuit is limited to reviewing these stay decisions.<sup>16</sup>

The factors that are relevant to the stay under Section 18 (c) all favor the parties seeking an administrative tribunal. Thus, counting against “the stay, or the denial thereof” is whether its grant “would unduly prejudice the nonmoving party or present a clear tactical advantage of the moving party.” The claimants in the infringement actions have no interest in staying their own actions, so that the effect of this provision is to create a de facto presumption in favor of the stay. It appears that a modest (as opposed to a “clear”) tactical advantage does not count as a reason to block the stay. The same is true of some prejudice against the nonmoving party so long as it is not “unduly” prejudiced. The usual presumption in all cases is that

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<sup>15</sup> See, *Kaiser Aetna v. United States*, 444 U.S. 164 (1979), which held that the United States took the private property of a marina owner whom it required to open its facilities to the general boating public. The taking was partial because the marina owner continued to have the right to use the facility by itself, but only by sharing it with all outsiders whose entry was authorized by the United States.

<sup>16</sup> S. 23 § 18(c)(2).

the regular courts should prevail over ad hoc administrative procedures for patents that have already gone through the basic process. There is little doubt that this section reverses that presumption, and in so doing, denies the patent holder the benefit of an Article III (and even and Article I) court in which to defend its position.

In addition, Section 5 does not establish any set procedures for the adjudication of claims before it, but empowers the Director to develop all the rules that are needed for deciding these cases out of whole cloth, without any statutory guidance at all. The Director has the final and nonreviewable power to decide whether the challenge to a particular patent will stay in the administrative arena or move into the courts.<sup>17</sup> That review is, moreover, required so long as the petition demonstrates that “it is more than likely than not that at least *one* of the claims challenged in the petition is unpatentable,”<sup>18</sup> after which it appears that *all* the claims brought, however weak, are now subject to this administrative review. The Director also has power to set rules that deal with matters of discovery<sup>19</sup> and joinder of parties,<sup>20</sup> and coordination of multiparty litigation.<sup>21</sup> In effect, the administrator has more power to fashion the rules for these adjudications than the federal courts have to modify the application of the Federal Rules of Civil Procedure, which require Congressional action for major modifications. It is flatly inconsistent with the American tradition of Separation of powers to extend to an administrative agency the power that is denied to the President and the Congress in setting up both Article I and Article III Courts.

**PART VI. SECTION 18 EXPOSES THE ENTERTAINMENT AND INFORMATION AND OTHER CRITICAL SEGMENTS OF THE UNITED STATES ECONOMY TO SERIOUS RISK OF INTERNATIONAL INTELLECTUAL PROPERTY PIRACY.** Historically, the United States has taken the clear position that it will apply a uniform standard to all patents across all industrial sectors. Section 18 of S. 23 departs from that standard practice by isolating business method patents for special treatment. If other nations also adopt ad hoc classification systems that compromise predictable enforcement of intellectual property rights in their home countries, it could compromise the property rights of United States companies and persons in those foreign countries. In hard economic times, the central premise of the patent system remains: predictable property rights are essential for economic growth, including investment, innovation and jobs.

Strong intellectual property rights have long been a lynch pin of U.S. trade policy. Consistently defending those rights has given the U.S. the moral authority and bargaining power to persuade other nations in international trade negotiations

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<sup>17</sup> See Section 5, contained new 35 U.S.C. § 324  
(e) NO APPEAL.— The determination by the Director whether to institute a post-grant review under this section shall be final and nonappealable.”

<sup>18</sup> Id. Section 324 (a)

<sup>19</sup> Id. Section 326.

<sup>20</sup> Id. Section 325(c)

<sup>21</sup> Id. Section 326.

to respect property rights around the world. During the extensive negotiations over the TRIPS (Trade Related Aspects of Intellectual Property) agreement, the United States successfully limited exceptions to TRIPS only to narrow situations involving extreme matters like protection of the public order found in Article 27 of TRIPS. A key part of that message was the decision to treat all patents the same, regardless of the area of technology. Once it is apparent that Class 705 patents may be subject to special treatment in the United States, this country will have forfeited the high ground in ways that could lead powerful, well-heeled interest groups outside the United States to introduce ad hoc exceptions that work for their advantage in their home countries. Countries like Argentina, Brazil, China, and India have long pushed for compulsory licenses for drug patents and for the easy piracy of copyrighted materials in the software and entertainment industries. It is dangerous to give them an opening to seize upon the narrow exceptions in the TRIPS agreement, such as Article 31,<sup>22</sup> to press their advantage. We are far better off if the rest of the world respects the position we follow at home that intellectual property rights should be taken only in extreme circumstances and then only on payment of just compensation. The ad hoc treatment of business method patents at home could invite our major opponents in international trade do the same to compromise intellectual property rights elsewhere.

The House should reject Section 18 of S. 23. Strong intellectual property rights are essential for economic growth, innovation, and jobs worldwide. As our national economy has increasingly shifted towards services, high technology, biotechnology, finance, and entertainment, the protection of strong intellectual property rights are especially important for economic growth, innovation, and jobs in the United States.

**CONCLUSION.** As a matter of simple prudence Congress should not authorize this radical transformation of the entire patent system without some detailed consideration of the consequences of that decision. Yet the procedures set out in Sections 18 and 5 make just those changes on the strength of threadbare arguments that do not withstand any serious examination insofar as they apply to the protection of individual patent rights and to the structure of administrative and judicial powers under the Constitution. No one wants to say that the current patent system is perfect. But it is perfectly clear that these two core provisions of the America Invents Act are major mistakes must be rejected in their current form.

I shall be happy to answer any further inquiries from the Committee on these provisions.

Sincerely yours,

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<sup>22</sup> Article 31 covers cases “of a national emergency or other circumstances of extreme urgency or in cases of public non-commercial use”

*Richard A. Epstein*

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