

No. 12-1184

In The
Supreme Court of the United States

—◆—
OCTANE FITNESS, LLC,

Petitioner,

v.

ICON HEALTH & FITNESS, INC.,

Respondent.

—◆—
**On Writ Of Certiorari To The
United States Court Of Appeals
For The Federal Circuit**

—◆—
**BRIEF OF AMICI CURIAE VERMONT, NEBRASKA,
ALABAMA, ALASKA, ARIZONA, ARKANSAS,
FLORIDA, GEORGIA, HAWAII, IOWA, INDIANA,
KANSAS, LOUISIANA, MAINE, MASSACHUSETTS,
MARYLAND, MICHIGAN, MINNESOTA,
MISSISSIPPI, MISSOURI, MONTANA, NEW
MEXICO, NORTH DAKOTA, OHIO, OREGON,
PENNSYLVANIA, SOUTH DAKOTA,
UTAH, WASHINGTON AND WYOMING
IN SUPPORT OF PETITIONER**

—◆—
WILLIAM H. SORRELL
Vermont Attorney General

BRIDGET ASAY
Counsel of Record

NAOMI SHEFFIELD
Assistant Attorneys General
109 State St.
Montpelier, VT 05609
(802) 828-5500
basay@atg.state.vt.us

JON BRUNING
Nebraska Attorney General
KATHERINE J. SPOHN
Deputy Attorney General
2115 State Capitol Building
Lincoln, NE 68509
(402) 471-2862
katie.spohn@nebraska.gov

[Additional Counsel Listed At End Of Brief]

QUESTION PRESENTED

Whether a district court, in exercising its discretion to award attorney fees to prevailing accused patent infringers in “exceptional cases” under Title 35, United States Code, Section 285, should use traditional equitable factors guided by the purposes of patent law to protect legitimate patent interests in reasonable ways rather than the Federal Circuit’s rigid test requiring both objective baselessness and subjective bad faith.

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INTEREST OF *AMICI CURIAE*

State attorneys general play a central role in protecting consumers and ensuring fair and honest commercial practices. In recent years, patent enforcement practices have become a real and substantial consumer protection problem. Indeed, state attorneys general across the country have received complaints about unfair and deceptive efforts to license and enforce patents.

The fact that businesses targeted by abusive patent enforcement practices have turned to state attorneys general for help is not surprising. In non-legal terms, claims of patent infringement sometimes look like extortionate scams. Patent holders claim that use of common, everyday technology infringes their patents: for example, scanning a document and sending it by email, creating a JPEG image, or using Wi-Fi. Patent holders at times direct their questionable demand letters to unsophisticated small businesses and nonprofits. Demand letters may threaten expensive litigation and seek substantial and unjustified licensing fees. Often the targeted entity – perhaps a coffee shop, a health care provider or a local choir group – knows nothing about patent law. In other cases, the target may be a start-up or small business, and a patent infringement claim – however questionable or baseless – may threaten needed financing or lead to cancelled projects. These targeted entities face an impossible choice: pay an expensive and unwarranted licensing fee or risk financially disastrous litigation. Many pay a licensing fee not because

the claim has merit but because any other option – getting legal advice or risking litigation – is too expensive.

State attorneys general can fight some of these tactics using consumer protection enforcement tools, but these efforts are limited and can only do so much. Businesses need the tools to protect themselves. If they choose to fight back, and possibly litigate, they need to know that the rules will apply evenhandedly and that the overzealous patent holder faces litigation risk too. This case provides an opportunity for the Court to strengthen one crucial tool: the ability of an accused infringer to recover attorneys' fees in a meritless infringement action. The Federal Circuit's standard is unjustifiably stringent and disfavors a party that successfully defends against alleged infringement.

Correcting the Federal Circuit's rigid and unfair standard will not end abusive patent enforcement practices. But it will help. Patent holders should not be able to extort unjustified licensing fees merely because of the high cost of defending patent suits. Allowing a party that defeats an infringement claim a reasonable opportunity to recover fees will make private parties more likely to challenge meritless patent claims. That, in turn, will help reduce these widespread and unfair practices.



INTRODUCTION AND SUMMARY OF ARGUMENT

The high cost of patent litigation unduly burdens businesses. Businesses accused of infringement pay licensing fees and settle cases because the cost is often far less than litigation. Alleged infringers pay even though they believe a patent is invalid or they know they are not infringing. They pay even though the patentee's claim construction is flawed and over-broad. If a patent is invalid or a claim of infringement is unreasonable, the patent system should encourage an accused infringer to challenge the allegations. But the high costs of litigation coupled with the low likelihood of recovering attorneys' fees means there is no benefit to fighting a bad patent or an over-broad assertion. It is less expensive to take a license or reach a settlement.

These distorted incentives have caused a significant increase in meritless patent enforcement actions – both litigation and aggressive and threatening licensing campaigns. Patent holders have little motivation to avoid making weak or meritless claims. Patentees typically only bear their own expenses, and sometimes not even those. And the legal rules in place do not adequately deter baseless claims. Indeed, patent holders can readily profit from making aggressive and indiscriminate claims of patent infringement; so much so, an industry has developed based on this business model.

Correcting the Federal Circuit's mistaken interpretation of 35 U.S.C. § 285, the fee-shifting provision, is essential to deterring baseless patent litigation. The Federal Circuit's standard favors patent holders and makes it too hard for a successful alleged infringer to recover attorneys' fees. That inflexible and unduly demanding standard encourages the indiscriminate assertion of patent claims.

The Court should dispense with both parts (objective baselessness and subjective bad faith) of the Federal Circuit's rigid two-prong test. Instead, the Court should adopt a fair and reasonable definition of an "exceptional" case under § 285, one that affords a district court discretion to award attorneys' fees based on a range of relevant factors. The relevant inquiry should not be whether the patentee's claims were frivolous, but whether the claims were objectively unreasonable and, given the totality of the circumstances, an award of attorneys' fees is appropriate. Allowing an accused infringer a reasonable opportunity to recover fees will make targets more likely to dispute baseless claims and patent owners less likely to assert them.



ARGUMENT

I. Current legal standards make it too hard to combat meritless patent infringement claims.

At one level, this case presents a straightforward question of statutory interpretation. Congress directed that in patent cases, a district court “in exceptional cases may award reasonable attorney fees to the prevailing party.” 35 U.S.C. § 285. The Federal Circuit’s rigid test, which requires clear and convincing proof that a patentee’s claims were *both* objectively baseless and brought in subjective bad faith, is not faithful to the statute’s text. *See* Pet. Br. 17-29. That alone calls for reversal.

But that understanding of this case, while correct, is incomplete. The exceptional-case standard is part of a larger set of legal rules that govern patent cases. Those rules, unfortunately, are allowing abusive patent enforcement practices to flourish. The costs are felt by businesses, consumers, courts – by everyone, that is, except those who profit from patent trolling.

The Court cannot, of course, even begin to address all of these issues in this one case. But the Court should approach this case with this broader context in mind. It is too easy for patent holders to exploit low-quality patents and extract money from businesses that are very likely not infringing. Addressing the standard for allowing alleged infringers

to recover attorneys' fees is a first step in addressing this larger problem.

A. Abusive patent enforcement practices are pervasive and harmful.

Abusive patent practices are closely linked to a business model known colloquially as “patent trolling.” A “patent troll,”¹ or more formally, a “patent assertion entity,” does not invent new technology, make or sell products, or provide services to clients. A PAE buys up patents from others and makes money solely by asserting infringement and extracting licensing fees and settlement payments.

Some common strategies drive the licensing and litigation efforts of PAEs:

- They rely on “low-quality” patents, *see* Letter from Amazon.com, Inc., AOL Inc., *et al.* to Senator Patrick J. Leahy, *et al.*, 2 (July 30, 2013),² often vague or broadly worded patents that purport to cover technology-related business methods, *id.*
- They form shell corporations that hide the true owner, *see, e.g.*, Tom Ewing & Robin Feldman, *The Giants Among Us*,

¹ In the classic fairy tale, the troll can extract a toll for crossing the bridge merely because the troll is too large and powerful to fight.

² Available at http://internetassociation.org/wp-content/uploads/2013/07/Letter-_73013.pdf

2012 Stan. Tech. L. Rev. 1, 4-8 (network of over 1,000 shells associated with a single PAE “makes it tremendously difficult to detect and trace the company’s activities”), and, unlike ordinary market competitors, have no products or services that might be at risk of a counterclaim, see Brian T. Yeh, Cong. Research Serv., R42668, *An Overview of the “Patent Trolls” Debate* 13 (2013).

- They have no assets other than the patent and few discoverable documents or witnesses, so they face little litigation risk, see Randall R. Rader, Coleen V. Chien & David Hricik, *Make Patent Trolls Pay in Court*, N.Y. Times, June 4, 2013.
- They send letters “to thousands of recipients indiscriminately and appear to target unsophisticated parties who would be unlikely to be involved in a patent dispute,” Democratic Staff of H. Comm. on Energy and Commerce, 113th Cong., *Memorandum regarding Hearing on “The Impact of Patent Assertion Entities on Innovation and the Economy”* (Nov. 13, 2013).
- They may look for targets that are particularly vulnerable and reach early settlements that fund subsequent litigation, see David Schwartz, *The Rise of Contingent Fee Representation in Patent Litigation*, 64 Ala. L. Rev. 335, 368-69 (2012).

- They “propose settlement amounts that are lower, often far lower, than the amount that it will cost an accused infringer to defend itself.” *Id.* at 370.
- They often target end users of technology rather than manufacturers because “[f]or patent holders whose rights are worth relatively little compared to the costs of litigation . . . serial nuisance filings against resellers or users quickly become more profitable than litigating on the merits against the original manufacturer.” Brian J. Love & James C. Yoon, *Expanding Patent Law’s Customer Suit Exception*, 93 B.U. L. Rev. 1605, 1613 (2013).

These abusive practices have a real cost. A new study estimates that patent assertions by PAEs cost about \$29 billion in 2011. See James Bessen & Michael Meurer, *The Direct Costs from NPE Disputes*, 99 Cornell L. Rev. (forthcoming 2014) (manuscript at 41). That figure includes the costs of non-litigated assertions, settlement costs and litigation costs, *id.* at 3-4, 15, but does not account for diverted resources, delays in new products, and loss of market share. *Id.* at 41.

The financial costs of abusive patent enforcement are felt by all types and sizes of businesses. Earlier this year, dozens of large companies called for Congress to adopt patent reform because “[w]asteful and often frivolous litigation is burdening businesses and innovators across America.” Amazon Letter, *supra*, at

1. The letter notes the “increasing threat of extortive demands based on low-quality patents.” *Id.* at 2.

Smaller businesses are equally hard hit. In fact, fifty-nine percent of companies sued for patent infringement are small and medium businesses. Bessen, *supra*, at 41. Their legal costs typically represent a higher percentage of overall revenues than large business targets. *Id.* For example, MyWebGrocer, a 200-employee business, has faced six or seven threatening letters from patent trolls over the last several years, and paid “well over \$100,000 in attorneys’ fees.” Dan D’Ambrosio, *Patent Trolls Take on Vermont Businesses*, Burlington Free Press, Nov. 7, 2013. The CEO of a five-person e-commerce startup told the Washington Post that after salaries, his largest expense is legal fees related to a patent lawsuit. He called it “the single worst thing to happen to me since I started the company.” Timothy B. Lee, *Here’s What It Feels Like to be Sued by a Patent Troll*, Washington Post, July 18, 2013.

And it is not just tech companies. Mom-and-pop businesses and non-profit organizations have also been threatened with patent litigation. *See, e.g.*, Drew Hendricks, *Three Measures Small Businesses Should Take to Avoid Patent Trolls*, Forbes.com (Sept. 30, 2013).³

³ Available at <http://www.forbes.com/sites/drewhendricks/2013/09/30/3-measures-small-businesses-should-take-to-avoid-patent-trolls/>

PAEs succeed in part because there is so little downside risk to their business model. Their litigation costs and risks are low: discovery demands are not burdensome, lawyers work on contingent fees, and the PAEs do not market their own products or services. *See, e.g., Yeh, supra*, at 13; Rader, *supra* (patent trolls have fewer costs because they have less discoverable documents, witnesses, etc. and they often defer costs through contingent fee arrangements); Ilene Knable Gotts & Scott Sher, *The Particular Antitrust Concerns with Patent Acquisitions*, 8 Competition Law Int'l 19, 36 (Aug. 2012) (non-practicing entities have advantage because they are not “subject to patent counterclaims”). In contrast, businesses targeted with patent infringement claims face substantial risk, even if the patents are dubious or the infringement claims implausible. Just getting a patent lawyer to provide advice may cost as much as the license fee. Litigation costs are overwhelming.

This uneven playing field gives PAEs an unfair advantage. It allows them to extort payments from companies that lack the will or resources necessary to fight. That outcome undermines the purpose of the patent system, which “is not reward of the individual but the advancement of the arts and sciences.” *Sinclair & Carroll Co. v. Interchemical Corp.*, 325 U.S. 327, 330-31 (1945).

PAEs operate within a legal framework that facilitates these abusive practices. The high standard for fee-shifting is only one example of a legal standard that unduly favors the patent holder. Other

examples include: (1) the Federal Circuit’s test for personal jurisdiction; (2) lenient pleading standards; and (3) the cost of litigating vague and ambiguous patent claims.

Personal jurisdiction. PAEs do not necessarily want to pursue litigation, but instead seek licensing fees based on a *threat* of litigation. PAEs count on the fact that an accused infringer may be willing to pay a licensing fee if the fee is less than the cost of litigation. See John M. Golden, “*Patent Trolls*” and *Patent Remedies*, 85 Tex. L. Rev. 2111, 2126 (2007). Suppose, however, the accused infringer wants to take on the PAE and “clear the air” of infringement charges by filing a declaratory judgment action. That option advances the societal interests of enforcing only *valid* patents against those persons who are *actually* infringing. See, e.g., *Lear, Inc. v. Adkins*, 395 U.S. 653, 670 (1969) (recognizing “the important public interest in permitting full and free competition in the use of ideas which are in reality a part of the public domain”); *Fogerty v. Fantasy, Inc.*, 510 U.S. 517, 527 (1994) (“a successful defense of a copyright infringement action may further the policies of the Copyright Act every bit as much as a successful prosecution of an infringement claim by the holder of a copyright”). Yet it rarely happens. See Aron Levko, Vincent Torres & Joseph Teelucksingh, PricewaterhouseCoopers, *A Closer Look: 2008 Patent Litigation Study: Damages Awards, Success Rates and Time-to-Trial* 10 (2008) (less than ten percent of patent cases filed annually are declaratory judgment actions); see also Megan M.

La Belle, *Patent Litigation, Personal Jurisdiction, and Public Good*, 18 Geo. Mason L. Rev. 1, 56 (2010) (“[O]f the thousands of patent cases filed in this country each year, declaratory judgment actions represent only a small percentage.”). One reason these actions are so uncommon is the Federal Circuit’s patent-specific interpretation of the “minimum contacts” test for personal jurisdiction.

Under current law, an accused infringer willing to file a declaratory judgment action against a PAE nearly always has to file in the jurisdiction where the PAE is incorporated or has its principal place of business. The fact that the PAE contacted the infringer, asserted infringement, and demanded a license fee is not enough. See *Avocent Huntsville Corp. v. Aten Int’l Co.*, 552 F.3d 1324, 1333 (Fed. Cir. 2008). The Federal Circuit has acknowledged that demand letters are purposefully directed at the forum and a declaratory judgment action arises out of the letters. *Silent Drive, Inc. v. Strong Indus.*, 326 F.3d 1194, 1202 (Fed. Cir. 2003). Even so, that court has refused to allow for personal jurisdiction in an action for a declaration of non-infringement based solely on the contacts of patent assertion letters. *Red Wing Shoe Co. v. Hockerson-Halberstadt, Inc.*, 148 F.3d 1355, 1360-61 (Fed. Cir. 1998).

This rule leads to troubling results. Because most products are sold in a national market, PAEs are free to forum shop – and they do. See, e.g., Chester Chuang, *Offensive Venue: The Curious Use of Declaratory Judgment to Forum Shop in Patent Litigation*, 80

Geo. Wash. L. Rev. 1065, 1073 (2012) (noting “rampant forum shopping”). PAEs can selectively litigate the validity and enforceability of their patents in jurisdictions that are most favorable to them. See Mark A. Lemley, *Where to File Your Patent Case*, 38 AIPLA Q.J. 4, 8-10 (Fall 2010) (noting, for example, that patentees win 55.1% of adjudicated cases in the Northern District of Texas, compared with only 21% in the District of New Jersey). An accused infringer, on the other hand, may have no option other than litigation in a distant forum. Indeed, in one recent case, a PAE not only threatened litigation but sent a draft complaint for a lawsuit in the accused infringer’s home district. Yet when the accused infringer responded by filing a declaratory judgment action, the district court dismissed the case for lack of personal jurisdiction. *Eng’g & Inspection Svcs., LLC v. IntPar, LLC*, 2013 WL 5589737 (E.D. La. Oct. 10, 2013).

Pleading standards. The lenient pleading requirements for patent cases make alleging infringement easy. The accused infringer, as a defendant, has little chance of avoiding discovery and substantial litigation costs in these cases, even if the infringement claims are baseless. Patent holders claiming infringement are insulated from the requirements of *Ashcroft v. Iqbal*, 556 U.S. 662 (2009) and *Bell Atl. Corp. v. Twombly*, 550 U.S. 544 (2007) because of Form 18 of the Federal Rules of Civil Procedure. “[T]o the extent any conflict exists between *Twombly* (and its progeny) and the Forms regarding pleadings

requirements, the Forms control.” *K-Tech Telecomms., Inc. v. Time Warner Cable, Inc.*, 714 F.3d 1277, 1283 (Fed. Cir. 2013) (“proper use of a form contained in the Appendix of Forms effectively immunizes a claimant from attack regarding the sufficiency of the pleading”); *R+L Carriers, Inc. v. DriverTech LLC (In re Bill of Lading Transmission & Processing Sys. Patent Litig.)*, 681 F.3d 1323, 1334 (Fed. Cir. 2012) (same).

As one Federal Circuit judge has noted, a “bare allegation of literal infringement” complies with the form. *McZeal v. Sprint Nextel Corp.*, 501 F.3d 1354, 1360 (Fed. Cir. 2007) (Dyk, J., concurring in part and dissenting in part), *quoted approvingly in K-Tech*, 714 F.3d at 1283. Consistent with the Federal Circuit’s reading of Form 18, an infringement complaint will survive a motion to dismiss if it includes:

- (1) an allegation of jurisdiction;
- (2) a statement that the plaintiff owns the patent;
- (3) a statement that defendant has been infringing the patent ‘by making, selling, and using [the device] embodying the patent’;
- (4) a statement that the plaintiff has given the defendant notice of its infringement; and
- (5) a demand for an injunction and damages.

K-Tech, 714 F.3d at 1283 (quoting *McZeal*, 501 F.3d at 1357). While “an implausible claim for patent infringement rightly should be dismissed,” *id.* at 1284, in practice a mere allegation of infringement is enough. *See, e.g., SHFL Entm’t, Inc. v. DigiDeal Corp.*, 2013 WL 5328437, at *3 (D. Nev. Sept. 20, 2013) (following *K-Tech*; denying motion to dismiss where plaintiff

“satisfied the requirements of Form 18”); *Redd Group, LLC v. Glass Guru Franchise Sys., Inc.*, 2013 WL 3462078, at *3 (N.D. Cal. July 8, 2013) (following *K-Tech*; denying motion to dismiss where complaint “literally satisfies the requirements” of the form).

This lesser pleading standard makes it difficult for the courts to dispose of baseless allegations of infringement at an early stage, before significant costs are incurred. “While the hurdle to state a claim for direct patent infringement has never been particularly high . . . it is now practically impossible to dispose of a direct infringement case at the motion to dismiss stage.” Richard Blakely Glasgow, *Pleading Edge*, Intellectual Property Magazine 40, at 41 (Dec. 2012/Jan. 2013). This puts additional pressure on alleged infringers to settle even weak infringement claims to avoid high-cost litigation. *Id.* (“Given substantial discovery costs, corporate defendants now face the tough decision of whether to settle marginal direct patent infringement claims before discovery or wait and attempt to dispose of those claims at the summary judgment stage, all the while incurring costs around every corner.”).

Vague patent claims. Vague and ambiguous patent claims are asserted against companies that must expend significant resources to evaluate whether the claims apply to their technology. Patent claims are invalid as indefinite if they do not “particularly point[] out and distinctly claim[] the subject matter which the inventor or a joint inventor regards as the invention.” 35 U.S.C. § 112(b). This is intended to

“guard against unreasonable advantages to the patentee” by making the inventor “inform the public during the life of the patent of the limits of the monopoly asserted, so that it may be known which features may be safely used or manufactured without a license and which may not.” *General Elec. Co. v. Wabash Appliance Corp.*, 304 U.S. 364, 369 (1938) (quotation omitted).

In *Exxon Research & Eng'g Co. v. United States*, 265 F.3d 1371 (Fed. Cir. 2001), the Federal Circuit weakened the indefiniteness requirements. Before *Exxon*, the court required “that the claims at issue [be] sufficiently precise to permit a potential competitor to determine whether or not he is infringing.” See *Morton Int'l, Inc. v. Cardinal Chem. Co.*, 5 F.3d 1464, 1470 (Fed. Cir. 1993). Although *Exxon* nominally retained that standard, the court reasoned that a claim is sufficient unless it is “insolubly ambiguous, and no narrowing construction can properly be adopted.” *Exxon*, 265 F.3d at 1375; see also *Biosig Instruments, Inc. v. Nautilus, Inc.*, 715 F.3d 891, 898 (Fed. Cir. 2013) (“A claim is indefinite only when it is not amenable to construction or insolubly ambiguous.” (quotation omitted)). Thus, “[i]f the meaning of the claim is discernible, even though the task may be formidable and the conclusion may be one over which reasonable persons will disagree, we have held the claim sufficiently clear to avoid invalidity on indefiniteness grounds.” *Exxon*, 265 F.3d at 1375. This low bar allows for more ambiguous patent claims. And that, in turn, means that patentees are more likely to

assert infringement based on unreasonably broad and vague claim construction.

In short, distorted financial incentives and a favorable legal climate have nurtured PAEs and facilitated their ability to profit from dubious patents. PAEs brought over sixty percent of the patent enforcement actions filed in 2012. *See* RPX Corporation, *2012 NPE Activity Report* 4 (2013). They prevailed in less than a quarter of the cases heard on the merits. Chris Barry, Ronen Arad, Alex Johnston, Alison Parent, Landan Ansell, and Mike Arnold, PricewaterhouseCoopers, *2012 Patent Litigation Study* 5 (2012) (based on statistics from 1995 through 2011, non-practicing entities (NPEs) have been successful 23% of the time). Another study puts the success rate even lower, finding that non-practicing entities won only 9.2% of cases litigated to judgment. John R. Allison, Mark A. Lemley & Joshua Walker, *Patent Quality and Settlement Among Repeat Patent Litigants*, 99 *Geo. L.J.* 677, 693-94 (2011). Yet patent trolls continue to prosper – and to file lawsuits. Last year saw the filing of a record 5,189 new patent cases. *Judicial Business of the United States Courts, 2012 Annual Report of the Director*, Table C-7;⁴ Barry, *supra*, at 6.

⁴ Available at <http://www.uscourts.gov/uscourts/Statistics/JudicialBusiness/2012/appendices/C07Sep12.pdf>.

B. The onerous fee-shifting standard for prevailing alleged infringers exacerbates abusive patent practices.

Awarding attorneys' fees to the prevailing party in a patent litigation suit deters both "blatant, blind, willful infringement of valid patents" *and* "the equally improper bringing of clearly unwarranted suits on obviously invalid or unenforceable patents." *Mathis v. Spears*, 857 F.2d 749, 754 (Fed. Cir. 1988). The legislative history confirms that Congress intended the fee-shifting provision "to enable the court to prevent a gross injustice to the alleged infringer." S. Rep. No. 1503, 79th Cong., 2d Sess. (1946), *reprinted in* 1946 U.S. Code Congressional Service 1386, 1387.

But it does not usually work that way. An accused infringer that seeks to recover some of the costs of fighting unfounded infringement allegations faces an uphill battle. Absent litigation misconduct or fraud on the Patent and Trademark Office, the accused infringer must show that the patentee's claim was *both* objectively baseless and subjectively made in bad faith. *See Brooks Furniture Mfg., Inc. v. Dutailier Int'l, Inc.*, 393 F.3d 1378, 1381 (Fed. Cir. 2005). That is, the accused infringer must prove first that "no reasonable litigant could reasonably [have] expect[ed] success on the merits." *Dominant Semiconductors Sdn. Bhd. v. OSRAM GmbH*, 524 F.3d 1254, 1260 (Fed. Cir. 2008) (quotation omitted). And after meeting that stringent standard, the accused infringer must further prove "that lack of objective foundation for the claim 'was either known or so

obvious that it should have been known' by the party asserting the claim." *Highmark, Inc. v. Allcare Health Mgmt. Sys., Inc.*, 687 F.3d 1300, 1309 (Fed. Cir. 2012), *cert. granted*, 2013 WL 1217353, 81 USLW 3562, 82 USLW 3177 (U.S. Oct. 01, 2013) (No. 12-1163) (quoting *In re Seagate Tech., LLC*, 497 F.3d 1360, 1371 (Fed. Cir. 2007)). As a practical matter, the standard is little different from the general proscription of Rule 11. *See* Fed. R. Civ. P. 11; *see also* *Raylon, LLC v. Complus Data Innovations, Inc.*, 700 F.3d 1361, 1368 (Fed. Cir. 2012) (applying the standard used to determine whether a claim was objectively baseless in evaluating Rule 11 sanctions).

The Federal Circuit describes the test as the same for both patentees and alleged infringers. *See Highmark*, 687 F.3d at 1309 ("This same objective/subjective standard applies for both patentees asserting claims of infringement and alleged infringers defending against claims of infringement.") (citing *iLOR, LLC v. Google, Inc.*, 631 F.3d 1372, 1377 (Fed. Cir. 2011)). As petitioner argues, however, that is not the case. *See* Pet. Br. 27-29. The objective part of the test is easier to satisfy for patentees. A successful patentee seeking a fee award must show "that the infringer acted despite an objectively high likelihood that its actions constituted infringement of a valid patent." *In re Seagate*, 497 F.3d at 1371. Proving an objectively "high likelihood" of infringement is not equivalent to proving that a claim of infringement was baseless – to proving, that is, that *no* reasonable litigant could have expected to succeed.

If the standards were truly equivalent, a prevailing accused infringer would have to show that the patentee's infringement claim had an objectively low likelihood of success.

As the Court has explained in the context of copyrights, “[p]revailing plaintiffs and prevailing defendants are to be treated alike” for the purposes of calculating attorneys’ fees. *Fogerty*, 510 U.S. at 534-35 (“Because the Court of Appeals erroneously held petitioner, the prevailing defendant, to a more stringent standard than that applicable to a prevailing plaintiff, its judgment is reversed[.]”). The fee-shifting provision in 35 U.S.C. § 285 applies to any prevailing party. Congress adopted a uniform standard and the courts should enforce it in a uniform manner. *See, e.g., Christiansburg Garment Co. v. EEOC*, 434 U.S. 412, 419 (1978) (refusing to assume that Congress intended to “distort” the “fair adversary process” “by giving the private plaintiff substantial incentives to sue, while foreclosing to the defendant the possibility of recovering his expenses in resisting even a groundless action unless he can show that it was brought in bad faith.”); *Ruckelshaus v. Sierra Club*, 463 U.S. 680, 691 (1983) (“[S]imilar attorney’s fee provisions should be interpreted *pari passu*.”). By adopting a standard that disfavors prevailing alleged infringers, the Federal Circuit has effectively re-written the statute.

The inequity in the current standard is not hypothetical. Patent holders are more likely than accused infringers to recover attorneys’ fees. *See* Writ. Pet. 30. Indeed, several recent Federal Circuit decisions show

how demanding the current standard is. The Federal Circuit has reversed a district court's finding of objective baselessness, in whole or part, three times in just over a year. See *Highmark*, 687 F.3d 1300; *Precision Links Inc. v. USA Prods. Group, Inc.*, 527 F. App'x 852 (Fed. Cir. 2013); *Checkpoint Sys., Inc. v. All-Tag Sec. S.A.*, 711 F.3d 1341 (Fed. Cir. 2013).⁵

This imbalance matters. Alleged infringers are more likely than patentees to succeed on the merits of a case. The vast majority of patent cases that are litigated to judgment are unsuccessful. Paul M. Janicke & LiLan Ren, *Who Wins Patent Infringement Cases?*, 34 AIPLA Q.J. 1, 5 (Winter 2006). Patent holders file many meritless cases. The accused infringer, however, has little economic incentive to challenge the validity or the scope of the patent.

The difficulty of meeting the standard for fee shifting discourages alleged infringers from challenging patentees even when a challenge is appropriate.⁶

⁵ The Federal Circuit affirmed a district court's finding of objective baselessness in *Taurus IP, LLC v. DaimlerChrysler Corp.*, 726 F.3d 1306 (Fed. Cir. 2013).

⁶ The experience of the petitioner in *Highmark Inc. v. Allcare Management Systems, Inc.*, No. 12-1163, confirms that the Federal Circuit's standard is unduly stringent. Highmark was targeted by a PAE. Following the "patent troll" business model, the PAE threatened expensive litigation and demanded a licensing fee. The district court described the PAE as engaging in "the sort of conduct that gives the term 'patent troll' its negative connotation." *Highmark, Inc. v. Allcare Health Management Systems, Inc.*, 706 F. Supp. 2d 713, 727 n.5 (N.D. Tex.

(Continued on following page)

Alleged infringers settle cases or pay licensing fees for meritless patent claims. See Robin Feldman, *Patent Demands and Startup Companies: The View from the Venture Capital Community* 49, available at http://ssrn.com/abstract_id=2346338 (quoting one company's spokesperson: "We spent millions to settle pretty much completely spurious claims. The common approach that these 'entities' took was: – make a claim – try to defend it as best they could – eventually offer to settle by observing that it would cost us \$3-5 million to fight it and we might lose, vs. the [\$]2-3 million they offer to settle initially . . . we'd work to negotiate them down to \$1-2 million, hold our nose, and pay.").

Less than twenty percent of patent litigation is resolved by a court on the merits. The vast majority of cases settle before judgment. See Allison, *supra*, at 689. The settlement rate is not surprising, given the incredible costs that alleged infringers face. Between 1985 and 2004, alleged infringers paid, on average,

2010), *vacated in part*, 732 F. Supp. 2d 653, *rev'd in part*, 687 F.3d 1300 (Fed. Cir. 2012), *cert. granted*, 2013 WL 1217353, 81 USLW 3562, 82 USLW 3177 (U.S. Oct. 01, 2013). The district court found that the PAE "engaged in questionable and, at times, deceitful conduct," *id.*, and pursued "meritless allegations after the lack of merit became apparent," *id.* at 730. Even against this backdrop, the Federal Circuit reversed the district court's fee award in substantial part. 687 F.3d at 1319. In the States' view, given the district court's findings and conclusions, Highmark should prevail even under the Federal Circuit's current standard. In any event, the district court's fee award in *Highmark* should be affirmed under a correct interpretation of the "exceptional case" standard.

\$2.46 million in defense-related expenses for patent litigation that went through trial. *See* Emily H. Chen, *Making Abusers Pay: Deterring Patent Litigation by Shifting Attorneys' Fees*, 28 Berkeley Tech. L.J. 351, 357 (2013). Settlement offers or royalty fees are commonly significantly less than litigation expenses. *See, e.g., Eon-Net LP v. Flagstar Bancorp*, 653 F.3d 1314, 1326-27 (Fed. Cir. 2011) (noting that patentee filed suit against over 100 alleged infringers and quickly settled for far less than litigation costs; defendant who did litigate expended \$600,000 and avoided paying \$25,000-\$75,000 in royalties). In fact, the Government Accountability Office has observed that some of the economic literature “suggests that accused infringers have an incentive to settle quickly to avoid the uncertainty of claim construction and high litigation costs.” *See* U.S. Gov’t Accountability Office, GAO-13-465, *Assessing Factors That Affect Patent Infringement Litigation Could Help Improve Patent Quality* 32 (2013).

On the other hand, the expenses of litigation are not felt as acutely by patentees seeking to enforce their patents because of contingency fee arrangements. *See* Schwartz, *supra*, at 346 (while amount of contingent patent litigation is unknown, “there was widespread agreement that the amount had increased in the last ten years”); *see also* Colleen V. Chien, *Turn the Tables on Patent Trolls*, *Forbes*, August 9, 2011, available at <http://www.forbes.com/sites/ciocentral/2011/08/09/turn-the-tables-on-patent-trolls/> (explaining that PAEs “lower their committed capital

by using contingent fee lawyers”). Contingency fee arrangements allow patentees to pursue litigation against alleged infringers at very low costs. That, in turn, drives aggressive and unjustified claims. Many observers have noted that “patentees are too often ‘pushing the envelope’ in quests for financial return on their investment in patents. They overvalue their patents and assign an unrealistic scope to the language of the patent claims, driven perhaps by what they thought the claims ought to have said.” Janicke, *supra*, at 39-40 (footnotes omitted).

The Federal Circuit’s fee-shifting standard compounds this problem, by making it too hard for accused infringers to recover attorneys’ fees. As explained below, the Court should adopt an evenhanded standard that allows either party, in an appropriate case, to recover after defeating an unreasonable claim.

II. The Court should overrule the Federal Circuit’s inflexible two-prong test and adopt a reasonable, evenhanded fee-shifting standard that promotes the goals of the patent system.

Patents are a time-limited monopoly designed to encourage innovation. *See* U.S. Const. art. I, § 8, cl. 8 (“To promote the Progress of Science and useful Arts, by securing for limited times to . . . Inventors the exclusive Right to their respective . . . Discoveries . . .”). This limited monopoly calls for “a proper

balance between exclusivity and competition.” Federal Trade Commission, *The Evolving IP Marketplace: Aligning Patent Notice and Remedies with Competition* 1 (2011). The Federal Trade Commission has observed that “[i]nvalid or overbroad patents disrupt that balance by discouraging follow-on innovation, preventing competition, and raising prices through unnecessary licensing and litigation.” *Id.*

The Court should construe § 285 in a way that promotes this balance. Making it easier for an accused infringer to recover attorneys’ fees in an exceptional case is consistent with the purposes of the patent system. An alleged infringer that stands up to unreasonable allegations of patent infringement should not be left with enormous legal bills. The possibility of recovering fees would provide an incentive for accused infringers to litigate – and even better, the risk of having to pay those fees may deter unreasonable claims in the first place.

This Court has acknowledged that patent litigation has value. In *General Motors Corp. v. Devex Corp.*, 461 U.S. 648 (1983), Justice Stevens explained that “a patent challenge in the courts permits a more informed decision regarding the merits of a particular patent. And, as we have long recognized, ‘It is as important to the public that competition should not be repressed by worthless patents, as that the patentee of a really valuable invention should be protected in his monopoly.’” *Id.* at 658 (quoting *Pope Mfg. Co. v. Gormully*, 144 U.S. 224, 234 (1892)) (Stevens, J., concurring).

The chief judge of the Federal Circuit has also acknowledged the risk of weak patent infringement claims, and has noted that they are becoming more prevalent. *See Rader, supra*. Chief Judge Rader has encouraged applying 35 U.S.C. § 285 to combat these weak claims, pointing out that lower courts “must look more closely for signs that a patent lawsuit was pursued primarily to take improper advantage of a defendant – that is, using the threat of litigation cost, rather than the merits of a claim, to bully a defendant into settling.” *Id.* Signs of this bullying behavior might include suing hundreds of end users rather than the makers of the allegedly infringing product, offering a fraction of defense costs as settlement, or refusing to stop pursuing licenses even after an unfavorable decision. *See id.*

For courts to take Chief Judge Rader’s advice and look more closely at the actions and motives of patentees in evaluating attorneys’ fee awards, there must be a fair standard for finding a case exceptional. *See* 35 U.S.C. § 285 (providing for discretionary award of attorneys’ fees only in exceptional cases). Fee awards cannot be limited to those cases where “no reasonable litigant could reasonably expect success on the merits.” *Dominant Semiconductors Sdn. Bhd.*, 524 F.3d at 1260 (quotation omitted). That stringent standard is rarely met, *see Chen, supra*, at 362, and is not a useful deterrent. Indeed, the Court should dispense with both the objective baselessness and subjective bad faith standards. Neither requirement is part of the statute. The Federal Circuit has

raised the bar too high. Fee awards are limited to “exceptional” cases, but exceptional does not mean frivolous or brought in bad faith.

The Court should instead hold that district courts have discretion to award fees where the patentee’s claim had an objectively low likelihood of success and a fee award is otherwise appropriate. That more flexible standard will allow a district court to consider other equitable factors that support a fee award, including the kind of abusive and bullying practices described by Chief Judge Rader. It will ease the burden on prevailing alleged infringers that seek attorneys’ fees, while adhering to the “exceptional” requirement of 35 U.S.C. § 285. Legitimate cases, where patentees reasonably believe that a valid patent has been infringed, will not have an objectively low likelihood of success. These patentees would not be subject to fee-shifting for simply being wrong. However, patentees that enforce broadly with little concern for the validity of the patent or the allegedly infringing conduct will assume the risk of their carelessness. If they choose to bring such exceptional cases, they will bear the financial burden if unsuccessful.

The fee-shifting standard is important not just for motivating alleged infringers to litigate weak patent claims. It matters, as well, to companies that must decide how to respond to patent enforcement letters. There is little data about the licensing arrangements that arise from patent letters, but without question, for every infringement suit filed, many

more demand letters are sent. *See* GAO-13-465, *supra*, at 27 n.51 (of the seventy-nine companies that reported receiving demand letters, two-thirds were never sued). Without a reasonable chance of recovering attorneys' fees, recipients of these letters often agree to licenses before a lawsuit is filed. *See* La Belle, *supra*, at 72 ("In recent years . . . many patent holders . . . have been using cease-and-desist letters to coerce alleged infringers into license agreements rather than to inform others of their patent rights or to urge the cessation of allegedly infringing activity."). The targets often never even evaluate the validity of the patent or the scope of the patentee's claims. There is no good measure of the costs incurred by such unlitigated assertion efforts.

Making attorneys' fees available to prevailing alleged infringers if the patentee's claims have an objectively low likelihood of success will begin to level the playing field. It will deter meritless claims and give accused infringers that choose to litigate some opportunity for redress. Correcting the distorted incentives that facilitate abusive patent enforcement practices will help align parties' interests with the purpose of patent rights – protecting a limited monopoly for valid patents that are enforced in accordance with their claims.



CONCLUSION

Consistent with 35 U.S.C. § 285, a district court should have discretion to award fees to a successful accused infringer if the patent holder's claims had an objectively low likelihood of success and relevant factors make a fee award appropriate.

Respectfully submitted,

<p>WILLIAM H. SORRELL Vermont Attorney General BRIDGET ASAY <i>Counsel of Record</i> NAOMI SHEFFIELD Assistant Attorneys General 109 State St. Montpelier, VT 05609 (802) 828-5500 basay@atg.state.vt.us</p>	<p>JON BRUNING Nebraska Attorney General KATHERINE J. SPOHN Deputy Attorney General 2115 State Capitol Building Lincoln, NE 68509 (402) 471-2862 katie.spohn@nebraska.gov</p>
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[Additional Counsel]

<p>LUTHER STRANGE Attorney General STATE OF ALABAMA</p> <p>MICHAEL C. GERAGHTY Attorney General STATE OF ALASKA</p> <p>THOMAS C. HORNE Attorney General STATE OF ARIZONA</p> <p>DUSTIN M. MCDANIEL Attorney General STATE OF ARKANSAS</p> <p>PAMELA JO BONDI Attorney General STATE OF FLORIDA</p>	<p>SAMUEL S. OLENS Attorney General STATE OF GEORGIA</p> <p>DAVID M. LOUIE Attorney General STATE OF HAWAII</p> <p>TOM MILLER Attorney General STATE OF IOWA</p> <p>GREGORY F. ZOELLER Attorney General STATE OF INDIANA</p> <p>DEREK SCHMIDT Attorney General STATE OF KANSAS</p>
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JAMES D. "BUDDY" CALDWELL Attorney General STATE OF LOUISIANA	MICHAEL DEWINE Attorney General STATE OF OHIO
JANET T. MILLS Attorney General STATE OF MAINE	ELLEN F. ROSENBLUM Attorney General STATE OF OREGON
MARTHA COAKLEY Attorney General COMMONWEALTH OF MASSACHUSETTS	KATHLEEN G. KANE Attorney General COMMONWEALTH OF PENNSYLVANIA
DOUGLAS F. GANSLER Attorney General STATE OF MARYLAND	MARTY J. JACKLEY Attorney General STATE OF SOUTH DAKOTA
BILL SCHUETTE Attorney General STATE OF MICHIGAN	BRIAN L. TARBET Acting Attorney General STATE OF UTAH
LORI SWANSON Attorney General STATE OF MINNESOTA	ROBERT W. FERGUSON Attorney General STATE OF WASHINGTON
JIM HOOD Attorney General STATE OF MISSISSIPPI	PETER K. MICHAEL Attorney General STATE OF WYOMING
CHRIS KOSTER Attorney General STATE OF MISSOURI	
TIMOTHY C. FOX Attorney General STATE OF MONTANA	
GARY K. KING Attorney General STATE OF NEW MEXICO	
WAYNE STENEHJEM Attorney General STATE OF NORTH DAKOTA	

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