

**Testimony of Anthony Peterman,**

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**before the**

**U.S. House of Representatives Judiciary Subcommittee on  
Courts, the Internet and Intellectual Property**

**regarding**

**“H.R. 1908, The Patent Reform Act of 2007”**

**April 26, 2007**

Mr. Chairman and members of the Subcommittee, my name is Anthony Peterman and I am the legal director for patents for Dell Inc. Dell welcomes the opportunity to appear before you today on this important topic. We commend you Mr. Chairman, Ranking Member Smith, Chairman Conyers, Subcommittee Ranking Member Coble and other Committee cosponsors of this bill for having introduced the "Patent Reform Act of 2007" and for your commitment to improving our patent system. You have signaled the overwhelming need for real and comprehensive reform by your thoughtful legislation and the expedition of your efforts so early in the new Congress.

The patent system is clearly under duress: warning flares have been going off for the past decade. At first, it was probably noticeable to only those of us dealing with patents and patent law every day. But, certainly over the past five years, ever more distant and neutral observers – whether the National Academy of Science, the Federal Trade Commission or the Antitrust Modernization Commission – all have noted with degrees of alarm the buckling of the foundations of the patent system as we know it: from a beleaguered PTO where patent quality has suffered from the shear volume and complexity of scientific advances, to the ever-increasing disputes over patent quality that have spilled over into an explosion of lawsuits in the courts, to the rare phenomenon of watching the Supreme Court increasingly taking over the role of "substantive arbiter" of legal doctrines fundamentally misconstrued at the appellate level.

Yes, it is time for patent reform. And that is why we commend all of you for your timely and significant work product contained in H.R. 1908.

H.R. 1908 addresses three major areas where we believe reform is now needed: (1) improving the quality of patents issued by the PTO; (2) re-establishing fairness and evenhandedness for all parties in how patent disputes are handled and enforced by the courts; and (3) clarifying certain areas of substantive law and patent law doctrine that have fallen away from fundamental precepts rooted in fairness and equity.

And for these reasons, Dell strongly supports the approach and substance of H.R. 1908. We look forward to working with as you proceed with your efforts. As I will describe in greater detail, there are a few areas in which some further clarification or changes to the language would be positive, specifically the section on venue. And, there are some issues not currently in the bill that we believe merit consideration, specifically repeal of Section 271(f).

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The computer and software industry is a creative engine that powers innovation and growth throughout our economy. The industry's products and services give individuals and organizations the tools they need to operate intelligently, efficiently and productively. Indeed, over the past thirty years, computers and software have become critical to our economic success, business competitiveness and personal quality of life. People worldwide rely on the industry's tools to communicate, to connect to the world, to get things done more efficiently in the workplace, and to more fully enjoy the arts, hobbies and leisure activities.

Patent law plays a central role in the computer industry's success. Companies from our industry consistently are among the largest recipients of US patents. Because our industry is at

the forefront of consistent, rapid change, it also provides a case study of the urgent need for Congress to act to modernize and improve our patent laws. At stake is the very thing that has made our economy strong: innovation.

The drafters of the Constitution recognized this over two hundred years ago: the patent law, by their specific intent and deliberate design, is the indispensable ingredient of innovation. What was true when our Constitution was drafted remains true today: a law works best when it respects the balance of interests affected by the law. In patent law, that balance is between the benefits accruing to each of us from scientific progress embodied in specific useful inventions, properly aligned with time limited statutory monopolies for inventors. We believe that this balance has been tilted in recent years, and Congress must act promptly to modernize the law.

Our economy is dynamic and strong, but we cannot and should not take that strength for granted. Today, technologies unknown just twenty years ago have become indispensable staples of our daily lives. Dell started only 23 years ago in 1984. The semiconductor chips, hard drives, software and myriad other technologies that make up the computers we sell today either did not exist even 10 years ago, or have evolved so far that they only resemble their technological ancestors.

And these changes are not limited to computers and software. Financial services, the family farm, telecommunications, alternative energy, are but few of the other pursuits that have seen this transformation.

As a key player in this changing technology market, Dell has a significant stake in patent quality and improvement. Internally, we run a patent process that receives 2,000 new ideas a year from an inventor base spread now across the world. The majority of those ideas are ones that we believe to be patentable according to our internal review process, although we select and

file applications on several hundred of the best ideas each year. Dell now holds over 1400 granted US patents on ideas ranging from hardware and software to manufacturing, custom configuration and internet commerce. Dell views the patent system is important and key for identifying and protecting these types of innovations in our market place. As such, we view strong quality patents and a balanced patent system as important to Dell and the market.

Unfortunately, Dell has seen things change in the past 5 years and clearly signal an imbalance primarily in the system of enforcement. Patent litigation costs have more than doubled from where they were 5 years ago. The increase is not due to something Dell has done in its products or in its processes or behaviors. Those have remained fairly similar, and we sell industry standard products. Instead, it is due to patent litigation being viewed as a lottery ticket for plaintiffs. Even with a low quality patent, a plaintiff has advantages both procedurally and economically. It is very difficult to prove a bad patent bad. And, in most cases, a plaintiff is free to claim damages that exceed the total cost of the component at issue -- for example, a claim for a one percent royalty on a \$600 computer or \$6 per computer where the patent involves a fifty cent component like a telephone modem. In the real world, it does not make sense to pay \$6 to sell a fifty cent component even if that fifty cent component is one of hundreds of computer components containing millions of transistors and lines of computer code. However, in the litigation world, people present this argument to the jury-- and it creates great leverage for the plaintiff. The law can be improved, and both sides can be helped to focus on a real-world analysis.

Restoring balance to this and other aspects of the patent system will increase the value of the good, strong patents, and will increase the ability for amicable resolutions of disputes while decrease the incentive for speculative legal activity.

Before turning to the specific elements of H.R. 1908, I would like to make a cautionary comment to try to place this debate in a helpful context and to avoid concerns that any changes to re-balance the patent system will be fatal to it.

There are those who would argue in the course of your consideration of H.R. 1908 that the law should remain as is. I expect they will argue that it is dangerous to address imbalances in how damages are calculated. Or that granting limited regulatory authority to the PTO – authority now granted to countless other government agencies – will result in abuse. Or that the changes in the way patents are reconsidered, both following grant and also when issues later arise, will harm American innovation. We urge you to reject these arguments. Changes to the law are needed.

They are the very same arguments this Subcommittee heard several years ago regarding the standard for injunctive relief. Throughout the current patent debate, we have heard alarmist arguments that any changes to the patent law are dangerous -- that our system is perfect as is. Perhaps the prime example is the issue of injunctions. In 2005– prior to the Supreme Court’s *eBay* decision –, you, Mr. Boucher and Mr. Smith and others proposed legislation to ensure the statutory standard on injunctions was respected by the courts. The problem you identified was clear: the law directs the courts to exercise discretion in issuing permanent injunctions, but the courts had turned the statutory “may” into a “shall”. Many opponents of this change, including in testimony at hearings before this Committee, asserted that such a change would be a major blow to incentives for innovation and would result in a huge decline in the value of patents.

But, as we all know, the unanimous Supreme Court decision in *eBay v. MercExchange* is almost exactly what you had proposed in the legislation. Yet today none of the predicted tragedies have come true.

In the coming weeks, the Supreme Court will issue opinions on two critically important cases: *Microsoft Corp. v. AT&T Corp.*, and in *KSR International Co. v. Teleflex Inc.* These two cases present issues that, as you Mr. Chairman noted in your floor statement introducing H.R. 1908, merit Congressional attention if they are not fully addressed by the Court.

## **I. OVERVIEW OF THE INDUSTRY**

### **A. PATENTS IN THE COMPUTER INDUSTRY**

As we enter the 21st Century, intellectual property is an ever more critical source of economic value to society, individuals, companies and governments. The increased importance of patents to technology companies has resulted from a mix of legal and marketplace developments.

The 1981 Supreme Court decision, *Diamond v. Diehr*, marked a turning point in the patentability of computer-implemented inventions. In that case, the Supreme Court held that a machine that transforms materials physically under the control of a computer program was patentable. The Court's decision clarified earlier rulings that had been interpreted to suggest that software programs would rarely qualify for patentability. Subsequent decisions from lower courts have further clarified the law in this area. As a result, U.S. patent applications from inventors in the software sector have steadily increased.

Equally important are marketplace trends. For example, in today's diverse technology marketplace, heterogeneity has become an important element of technology and network effectiveness. Unlike the early days of computing when consumers tended to purchase all their hardware and software from only a single firm, consumers now often build systems to meet their specific needs based on products sourced from different suppliers. The ability of these different

systems to work together is essential. In this context, patents enable technology companies to integrate systems and meet consumer's needs while ensuring a return for their inventions.

Finally, changes made by Congress, especially the creation of the Court of Appeals for the Federal Circuit in the early 1980's, have brought generally greater importance to patents and more consistent respect for the property right granted by a patent.

Today, patents are a key part of virtually every technology company's intellectual property portfolio. The reasons are simple:

- Patents provide critical protection for distinctive technologies that may have been difficult to innovate but could easily be replicated without the protections of a patent.
- Patents ensure that technology companies have the opportunity to be fairly compensated for their contributions to advances in their field of technology.
- At the same time, and reflecting the way in which our industry often operates, patent protection enables technology developers to license or otherwise share key technologies with customers, partners and even competitors, while still preventing third parties from "free-riding" on their innovation.
- Patents can encourage cross-fertilization of technology through cross-licensing.
- Collectively, patents provide a repository of accumulated knowledge that allows new generations of innovators to learn from the state of the art and, in some cases, design new solutions that further advance that body of knowledge.

## **B. REFORM IS TIMELY FOR THE INDUSTRY**

While patents are critical tools for the technology industry, there are aspects of the patent system that present on-going challenges for our industry.

The computer industry, like many high technology industries, is a field with an extremely high concentration of patents. For example, the Federal Trade Commission recently received testimony stating that there are more than 90,000 patents that relate generally to microprocessors. This concentration of patents within a technologic field presents specific challenges not only for the technology industry, but also for biotechnology and other sectors.

In addition, computers and software are examples of “system” products – they comprise thousands, even hundreds of thousands, of individually functioning components and features all assembled in a package for a customer. Because many of these features could be the subjects of a patent – or a number of patents -- it is often the case that thousands of patents may be relevant to a particular computer or software product. This phenomenon – sometimes referred to as “co-location of patents” – means that any single patent in some aspect of a function, feature or component may be a small part of the value of the intellectual in that feature or function. Yet, too often, what is supposed to be an award of a “reasonable royalty” is based not on the innovation, or even the feature of which the innovation is a part, but rather on a system as a whole that contains that and dozens or hundreds of other innovations.

Moreover, rapid technological change and the growth of our industry have resulted in large numbers of patent applications. This has put a tremendous strain on the resources of the Patent and Trademark Office, and the result is that poor quality patents – patents that never should have been granted – are being granted in increasing numbers.

In combination, these issues make our industry susceptible to the problems of poor quality patents and the uncertainties. We approach reform from this perspective.

## **II. PATENT QUALITY**

### **QUALITY PATENTS**

Dell supports the provisions of H.R. 1908 that provide essential improvements in patent quality. The bill clearly shows that you understand this problem, and the legislative changes set out in the bill would go a long way towards making this situation better.

The Federal Trade Commission and the National Academy of Sciences have both studied and reported on the impact poor quality patents on competition and innovation. A questionable patent may lead competitors to forego research and development in a particular area, fearful of the risks that may be involved. Poor quality patents may also require innovators to license unnecessarily thousands of patents.

Dell supports H.R. 1908 because it addresses the three key areas that will facilitate the issuance of higher quality patents:

- (1) Establishes post-issuance processes to provide a second chance to challenge and intercept bad patents;
- (2) Grants the PTO much needed regulatory authority to improve its operations, including curtailment of abusive continuation practices that lead to endless chains of patents with ever-broader claims; and
- (3) Increases the ability of examiners to consider prior art, and develop better processes for building a contemporaneous record that reflects the extent of the examination by the patent examiner.

### **Post-Issuance Processes**

Dell supports H.R. 1908 because it proposes specific and meaningful ways to improve the post issuance process.

Currently, the primary means of challenging the validity of an issued patent is through litigation, a costly and difficult approach. Dell supports the **post grant opposition** provisions of H.R. 1908 because they create a meaningful and balanced opposition procedure that enables third parties to challenge issued patents. Such a process would permit the Patent and Trademark Office to apply its expertise to take a careful look at any challenged patent in the context of an adversarial proceeding likely to bring out the strongest arguments in favor of, and against, continued existence of the patent. This process augments a patent's initial examination and provides a second, more granular filter through which a patent may pass if it is to be used against an alleged infringer.

The bill establishes a check on the quality of a patent immediately after it is granted, or in circumstances where a party can establish significant economic harm resulting from assertion of the patent.

We believe this second window based on a showing of economic harm is an indispensable element of a meaningful post grant system. In our industry, it is often very hard to tell whether a particular invention is relevant to our products. Often it takes years, as the market and technology evolves, to assess the relevance of patent. Thus, a single post grant window within 12 months of grant would do little good to weed out unjustified patents. In addition, we support the estoppel provisions of the bill. We believe that parties should be precluded from raising in subsequent proceedings **only** on those issues that were addressed and considered in the post grant process. We are aware that this rule may raise concerns about possible abuses. Thus, we fully endorse and support the bill's provisions requiring the Director prescribe regulations for sanctions for abuse of process or harassment and petitioners are stopped from raising the same arguments in court.

In addition, under current law, the *inter partes* reexamination process is so restricted as to severely limit its usefulness. In fact, since the inception of this process, the Patent and Trademark Office has received fewer than one hundred requests for *inter partes* reexamination. Dell supports the bill's provision updating the current law's estoppel provisions.

### **Availability and Consideration of Prior Art**

An important step toward better patent quality would be to improve the availability of prior art in the examination process. We strongly support H.R. 1908's provisions enabling third parties to submit relevant prior art to the examiner.

Under current law, members of the public with relevant prior art information have limited options to submit that information to the examiner. The prior art may be submitted, but without comment on the relevance of what may be hundreds of pages of carefully developed disclosure. Already overburdened examiners do not have time to sort through this material unaided by commentary. The result is that patents are often granted on the basis of incomplete prior art information as an examiner has only 17 hours, on average, to examine a patent. To address this issue, we support the provisions of H.R. 1908 enabling the public to submit prior art and other information relevant to patentability, together with commentary on that art and information.

### **Harmonization**

The Committee print includes a number of provisions harmonizing United States patent law with a worldwide first-to-file patent system. Dell supports this goal: Dell derives a substantial portion of its revenues from overseas and holds numerous patents in all major jurisdictions.

One aspect of conforming US laws to international practice is particularly important to Dell: the **definition of prior art**. We support the approach of the bill because it recognizes that prior art definitions should include materials that may have been difficult to access, but were nonetheless publicly available. Previous formulations of this language were in our opinion flawed. By shifting away from the current categories of prior art – especially subject matter that was used or offered for sale -- those provisions created the risk that subject matter already being used and commercialized within the United States will nonetheless be patentable by a third party. The injection of an inquiry whether subject matter was “in use” contemplates that subject matter that is harder to access, even if widely deployed, will be unavailable as prior art.

A number of groups have called for changes to eliminate so-called **subjective elements, such as duty of candor, inequitable conduct, and best mode**. We note that changes to these provisions are not included in the bill. Our judgment is that these provisions of the law serve an important purpose, namely to ensure that patent applicants act in full good faith with the PTO in the course of the application, examination and patent grant process. Any changes in these provisions should ensure that the duty of applicants to be fully forthcoming is neither diminished nor diluted.

### **Adequate Training and Funding**

Underlying any attempt to improve the quality of patent examination must be a commitment to adequate funding for the Patent and Trademark Office. The bill does not address directly this persistent issue, but we are aware of and appreciate the Subcommittee’s commitment on this matter. Adequate funding is inextricably tied in with permanently ending the practice of diverting patent fees to programs outside the scope of the core PTO mission.

