Take a little off the top: patent bills target hedge funds

Hedge funds' entry into the IPR forum is spurring potential legislative reforms. DLA Piper's Dr Erica Pascal and Peter Maggiore report

In politics, it's the rarest of issues that garners rapid bipartisan support for legislation. One item to do just that: hedge funds and patent reform. Specifically, hedge funds have been challenging pharmaceutical patents using the inter-partes review (IPR) process. Purportedly, the hedge fund's intent is to profit from the patent-owning company's falling stock price that results upon news of the IPR challenge. To date, hedge funds have filed 17 IPRs against pharmaceutical companies.

Heated debate regarding patent reform continues. However, curbing the use of IPR proceedings by hedge funds is seemingly one issue that is generally supported by many in the industry and legislature. There are three major pieces of proposed legislation before the Senate and House of Representatives that focus on the proposed revisions to IPR standing requirements, namely, who is entitled to bring an IPR challenge. These changes have the potential to curb hedge funds' use of the IPR procedures.

Current IPR standing requirements

IPR standing requirements are presently minimal. An IPR challenger need not be under threat of or subject to an infringement suit to file an IPR. Any entity or person, so long as it is not the patent owner, can institute an IPR. With a few discrete exceptions, that's it. This stands in stark contrast to standing requirements for declaratory judgment actions in US district court—where an actual or substantial controversy with sufficient immediacy and reality between the parties is a prerequisite. Even covered business method (CBM) review—another newly implemented post-grant proceeding before the Patent Trial and Appeal Board (PTAB)—requires that "the petitioner, the petitioner's real party-in-interest, or a privy of the petitioner has been sued for infringement of the patent or has been charged with infringement under that patent" before standing is proper.

One (likely unintended) result of the lack of IPR standing requirements is currently playing out as hedge funds, such as the Coalition for Affordable Drugs and its manager Kyle Bass, target pharmaceutical company patents with IPR petitions. Neither the hedge funds nor the identified real parties in interest (RPIs) are otherwise involved with the patents or the pharmaceutical industry. Bass claims the coalition's goal is a crusade to lower the cost of prescription drugs by targeting patents that "do not represent true innovation or invention", according to a statement he made to the House in April.

But the coalition has admitted to having an economic interest in the IPRs. While the PTAB has yet to rule on whether to institute these IPRs, the legislature has made clear how they would prefer such petitions be handled.

Proposed legislation

The three present pieces of legislation that could curb hedge funds' use of IPRs are all pending. Each proposes patent reform that either outright or indirectly aims to limit the parties who may bring an IPR challenge. The Support Technology and Research for Our Nation's Growth (STRONG) Patents Act (2015 S.632), sponsored by Senator Chris Coons, is pending in the Senate. The Protecting American Talent and Entrepreneurship (PATENT) Act (2015 S.1137), sponsored by Senator Chuck Grassley, is also under consideration in the Senate. In the House, Representative Bob Goodlatte has sponsored the Innovation Act (2015 H.R. 9). The Senate's PATENT Act proposes the least targeted approach whereas the STRONG Act directly takes on the standing requirements.

The STRONG Act was introduced to the Senate on 3 March—less than a month after the coalition and Bass filed their first IPR petition. It is the first proposed bill to tackle reform to IPR standing requirements. As the STRONG Act states in its Findings section: "Unintended consequences of the comprehensive 2011 reform of patent laws are continuing to become evident, including the strategic filing of post-grant review proceedings to depress stock prices and extort settlements."

Section 102(d) of the bill proposes specific amendments to IPR standing requirements to address this concern: "A person may not file with the office a petition to institute an inter-partes review of a patent unless the person, or a real party in interest or privy of the person, has been—(a) sued for infringement of the patent; or (b) charged with infringement under the patent."

Because neither the coalition nor any of its disclosed RPIs have been involved in any suit for infringement or charge of infringement, such a provision would foreclose IPR petitions to similarly situated hedge funds. It would also bring IPR standing requirements in line with present CBM requirements. Notably, the STRONG Act is agnostic to the motivations of the challenger. As such, while it would curb the hedge fund's activities, it could also prevent a company from challenging a patent that presents obstacles for product development, at least until the time the company was threatened with a suit.

As of now, the STRONG Act has received little attention and remains pending before the Senate's small business and entrepreneurship committee since a hearing on 19 March. Instead, the focus in the Senate has been squarely on the PATENT Act.

The PATENT Act—introduced on 29 April and approved by the Senate's judiciary committee on 4 June—provides a more indirect approach to addressing the use of IPRs by hedge funds. It neither directly mentions hedge funds, nor does it introduce an IPR standing requirement. Instead, it provides the PTAB with discretion whether or not to institute proceedings "if the director determines that institution would not serve the interests of justice".

This "interests of justice" language may ultimately curb hedge fund IPR filings if the PTAB sees these patent challenges as lacking merit or intended primarily for non-patent related consequences, such as affecting a company's stock value.

There is no right to appeal denial of institution of an IPR. As a result, the PTAB's discretion would prevail and leave hedge funds without a vehicle to challenge these patents.

Additionally, the PATENT Act proposes amending IPR regulations to include "an obligation substantially similar to … Rule 11 of the Federal Rules of Civil Procedure". This would impose an affirmative duty on counsel to certify that the IPR "is not being presented for any improper purpose".

But 37 C.F.R. §42.12 already provides the PTAB authority to issue sanctions for such improper purposes and for abuse of process, among other activities. Therefore, it is unlikely that the explicit addition of Rule 11 requirements would alter hedge fund actions in pursuing IPR petitions.

Drawing inspiration from the STRONG Act, the House's 9 June Manager's Amendment to the Innovation Act likewise includes a standing requirement targeted at hedge funds. Section 9 of the Innovation Act—which was approved by the House's judiciary committee on 11 June—states that: "Review may not be instituted unless the petitioner certifies that the petitioner and the real parties in interest of the petitioner—(a) do not own and will not acquire a financial instrument (including a prepaid variable forward contract, equity swap, collar, or exchange fund) that is designed to hedge or offset any decrease in the market value of an equity security of the patent owner or an affiliate…; and (b) have not demanded payment, monetary or otherwise … in exchange for a commitment not to file a petition … unless the petitioner or the real party in interest of the petitioner has been sued for or charged with infringement of the patent."

The Innovation Act conditions standing on what amounts to financial motivation. So long as the IPR petitioner doesn't hold one of the enumerated financial instruments and hasn't wielded IPR filings for purposes of extortion, then the standing exists. This schema would not de facto eliminate hedge funds from filing IPRs, but it would eliminate those with specific monetary motivations and interests.

Additionally, the Innovation Act's approach, unlike the STRONG Act, would leave intact the ability for companies to challenge patents prior to the threat of litigation that might present obstacles to product development.

Each of the proposed legislation pieces would likely change the composition of entities entitled to bring IPR challenges. However, as opposition mounts to other and more controversial issues involved in patent reform, the likelihood increases that the provisions aimed at curbing hedge funds will be the baby thrown out with the bathwater.

In the meantime, some biotechnology and pharmaceutical companies are looking to alternative methods to combat these challenges, including tacking hedge funds head on in the IPR process or in separate civil actions for abuse of process claims. Many of the hedge fund-filed IPRs are in the early stages of the procedure.

Will these challenges be shown to have any merit? The answer to that question may be the ultimate fact that determines hedge funds' future involvement in IPRs. **IPPro**

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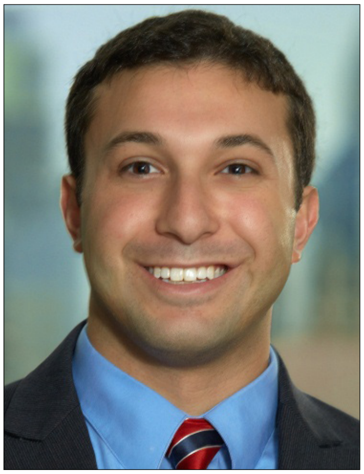

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