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THE IMPACT OF PATENT ASSERTION ENTITIES ON INNOVATION AND THE ECONOMY

HEARING

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

OF THE

COMMITTEE ON ENERGY AND COMMERCE

HOUSE OF REPRESENTATIVES

ONE HUNDRED THIRTEENTH CONGRESS

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THE IMPACT OF PATENT ASSERTION ENTITIES ON INNOVATION AND THE ECONOMY

THURSDAY, NOVEMBER 14, 2013

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS,
COMMITTEE ON ENERGY AND COMMERCE,
Washington, DC.

The subcommittee met, pursuant to call, at 2:00 p.m., in room 2123 of the Rayburn House Office Building, Hon. Tim Murphy (chairman of the subcommittee) presiding.

Members present: Representatives Murphy, Burgess, Blackburn, Scalise, Harper, Griffith, Johnson, DeGette, Lujan, Welch, and Tonko.

Staff present: Carl Anderson, Counsel, Oversight; Charlotte Baker, Press Secretary; Sean Bonyun, Communications Director; Matt Bravo, Professional Staff Member; Karen Christian, Chief Counsel, Oversight; Brad Grantz, Policy Coordinator, Oversight and Investigations; Brittany Havens, Legislative Clerk; Gib Mullan, Chief Counsel, Commerce, Manufacturing, and Trade; John Stone, Counsel, Oversight; Tom Wilbur, Digital Media Advisor; Brian Cohen, Democratic Staff Director, Oversight and Investigations; and Kiren Gopal, Democratic Counsel.

OPENING STATEMENT OF HON. TIM MURPHY, A REPRESENTATIVE IN CONGRESS FROM THE COMMONWEALTH OF PENNSYLVANIA

Mr. MURPHY. Well, good afternoon. We convene this hearing of the subcommittee on Oversight and Investigations to gain a better understanding of the impact that abusive patent assertion practices are having on businesses, jobs, and the economy.

Back in August of 1787 when James Madison was drafting the Constitution, he and Charles Pinckney offered amendments dealing with copyrights and premiums for the advancement of useful knowledge and discoveries. In September of 1787, the wording included in the Constitution in Article I, Section A, Clause A, discussed the powers to secure for unlimited times to inventors the exclusive rights to their discoveries. This is the basis of U.S. patent law, and patents and trademarks are covered in the Commerce Clause which makes this issue a defined jurisdiction of the Energy and Commerce Committee.

Now, let me state at the outset that a strong and fair patent system is essential to an innovative marketplace. Inventors and companies should be encouraged to research and develop ideas, technologies, and products and be rewarded for their risk and invest-

ment. In addition, I fully recognize that patent rights are only as valuable as the holder's ability to enforce them.

The intent of today's hearing is not to assess the current state of our Nation's patent system or to opine on the various legislative proposals that have recently been introduced or discussed in this area, nor is this hearing intended to be a comprehensive look at all the patent assertion activity that occurs in advance of litigation. This is about gathering facts about the nature and scope of this problem. Our purpose in holding this hearing is to learn more about a number of questionable practices that have recently proliferated and the significant direct and indirect costs they have imposed on businesses, large and small.

Specifically, most of the witnesses testifying today are representatives of companies from different industries who have received letters from various entities demanding licensing fees or threatening litigation over the purported use of patented technologies or products. Frequently, they are little more than form letters blasted off to hundreds or even thousands of recipients with the hope that some of them will quickly cave in order to avoid the prospect of expensive litigation. It has been estimated that the average patent trial can last over a year and cost upwards of $6 million. This is simply not a viable course of action for a small business, and unfortunately, this makes them attractive targets.

We will hear today about some of the more egregious types of demand letters and whether they even contain sufficient information to allow for an informed response. Most importantly, we will hear about how responding to such demanding letters impacts a business's ability to attract new capital, utilize new technologies, hire new workers and ultimately grow their company and our overall economy. One recent study from researchers at Boston University calculated that patent assertion activity directly cost defendants and licensees $29 billion in 2011. This figure represents a 400 percent increase since 2005 and does not even include the indirect costs to businesses such as diversion of resources, delays in new products, and loss of market share.

A number of other studies on patent assertion, entitled PAEs, have recently been conducted. We will hear from a number of individuals with significant experience in this area about how such practices have evolved, whether more egregious tactics are currently being employed and, if so, what can be done to stop them without weakening legitimate intellectual property rights, enforcement activities, and pre-litigation communications.

Further, the Federal Trade Commission announced in September that it will be conducting a formal inquiry examining the business practices of patent assertion entities in order to expand the empirical picture on the costs and benefits of PAE activity. We look forward to reviewing the results of this inquiry and in the meantime will continue to further our understanding of such practices. As always, we will follow the facts so that our oversight can inform any solutions that may be proposed to address the underlying problems relating to abusive demand letters and related practices. Today is a first step in that process. I look forward to hearing the examples and perspectives provided by our witnesses, and I look forward to hearing from those who may disagree with them in the near future.

I fully anticipate that we can work together on a bipartisan basis on these issues going forward.

[The prepared statement of Mr. Murphy follows:]

PREPARED STATEMENT OF HON. TIM MURPHY

We convene this hearing of the Subcommittee on Oversight and Investigations to gain a better understanding of the impact abusive patent assertion practices are having on businesses, jobs, and the economy.

Let me state at the outset that a strong and fair patent system is essential to an innovative marketplace. Inventors and companies should be encouraged to research and develop ideas, technologies, and products and be rewarded for their risk and investment. In addition, I fully recognize that patent rights are only as valuable as their holder's ability to enforce them.

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# # #

Mr. MURPHY. With that I recognize the Ranking Member of the Subcommittee, Diana DeGette, for an opening statement, and I know she has a high level of interest in this issue.

OPENING STATEMENT OF HON. DIANA DEGETTE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF COLORADO

Ms. DEGETTE. Thank you very much, Mr. Chairman, and I do believe we can work together in a bipartisan basis on this because it is a real concern, and it is a concern that has been increasing a lot. Several people have bills that they are planning to introduce, and I think this would give us some good facts as we look toward writing legislation.

In the past few years, a number of companies have emerged and their sole business model is to assert overly broad patent rights and use the threat of litigation to extort settlements. This is an abuse of the patent process which, as the Chairman accurately said, is a very important process, but recently we have seen the abuses getting worse and worse as these actors are targeting not just large corporations but also small businesses who are just using everyday technology like office scanners or wireless routers. The small businesses, nonprofits, and startups using these technologies lack the expertise and resources to litigate the questionable infringement claims, and frankly they are being singled out because they cannot afford to defend themselves. And so what they end up doing is paying money so they can return to focusing on their business.

Now, clearly, this is not acceptable. It is extortion, plain and simple, and it results in significant harm to inventors, small businesses, and start-ups. It costs the economy over $80 billion a year. And you know, I agree, the U.S. patent system is an incredible tool for innovation and economic growth. In theory, legitimate patent assertion entities could protect small inventors by enforcing their rights if in fact those rights are legitimate against more powerful companies. But in practice some of these firms transfer only a small amount of settlements or funds back to technology, inventers and producers. They have purchased these patents or acquired them in some way, and then they are asserting their rights over people who cannot afford to defend themselves. And that is why we have the name patent troll because of these predatory tactics.

One notorious patent troll, Inevado, sent over 13,000 demand letters to users of Wi-fi routers. Small businesses have received intimidating and harassing letters demanding costly settlements or licensing fees. Too many of these Mom-and-Pop establishments pay hefty settlement fees just to avoid protracted, multi-million dollar patent litigation.

Last week Nebraska's Attorney General testified in the Senate about an elderly gentleman, Mr. Eldon Steinbrink, who received a demand letter from MPHJ Technologies alleging infringing use of a scan-to-email patent through his work for Phelps County Emergency Management. Well, in fact, Mr. Steinbrink never worked for the county. He once served on the county board many years ago, and now he lives in a nursing home. Patent tolls like MPHJ fail to do even basic due diligence about their targets, and I think that is because frankly they just do not care. They hope somebody will pay the money.

So I think it is important that we find the right balance with patents, but I think we can all agree that these end users should

not be targeted at all by patent tolls and the abusive and harassing practices have got to stop.

And so, I think there is a lot we can do. The demand letter should be transparent. They should contain meaningful information. My colleague, Jared Polis, is looking at legislation that has more registration of people who are sending these letters out. There is a lot going on, and I think because of this Committee's history of protecting consumers and small businesses, this is the perfect place.

So I want to thank our witnesses. This is going to be a good hearing.

Ms. DEGETTE. And I want to yield my last minute to Mr. Welch if he would like to have it. Oh, do you want 5 minutes?

Mr. WELCH. Yes, that is good.

Ms. DEGETTE. Then I will yield back and he will just take our other 5 minutes.

Mr. WELCH. Thank you.

Mr. MURPHY. I do not think we have anybody else on our side with an opening statement and you are recognized. We are going to have votes soon if you want to——

Ms. DEGETTE. Go ahead.

Mr. MURPHY [continuing]. Take the next one.

Mr. WELCH. Well, just to——

Mr. MURPHY. Recognized.

OPENING STATEMENT OF HON. PETER WELCH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF VERMONT

Mr. WELCH. I do appreciate it, just a minute, Mr. Chairman. I appreciate the hearing. This is an unbelievable rip-off, obviously, and it is incredibly detrimental to large businesses and to small non-profits. And my concern is because in Vermont, we have just been getting hammered. MyWebGrocer, which is a start-up company doing really well, has 180 employers, they have had six patent troll attacks, and it has resulted in that company not being able to hire eight to ten people.

Then at the other end we have got a small non-profit where they provide help for disabled kids, and it is a hand-to-mouth operation. They are raising money from folks in the local community doing work that is incredibly important to those kids and to the parents. They got attacked by patent trolls. They are in no position to do it. They opened up the mail, and it is a demand letter, all formal, all threatening, all you are going to—this is the end of the world. And it creates enormous emotional anxiety as well as financial peril. And it is such a small community in Vermont where it is not just the big business and the small business. There is a real ripple effect in the community that the Attorney General in the State has taken the lead in bringing the first-in-the-Nation lawsuit against the patent troll, MPHJ Technologies based on our consumer protection laws. And the State itself, under Governor Shumlin, has passed a bill that makes it a civil offense if there are bad-faith assertions of patent infringement and allows victims to see actual and punitive damages.

So we are trying to act as a state, but this clearly is something that requires national attention. So I am so grateful to each of you

to be here today to help the Congress get focused, and you have got a bipartisan buy-in here in the halls of Congress. So we have got a chance to break the mold and actually get something that needs to be done, done. And with your help, we will succeed. Thank you. I yield back.

Mr. MURPHY. The gentleman yields back. Just for the members here, we know we are going to have votes probably about 20 of or a quarter of the hour. So we believe during that time between now and then we can get through all of your testimony and then try and start some questions. Immediately after votes we will reconvene and be able to continue on with other questions.

So I would now like to introduce the witnesses for today's hearing, quite a distinguished panel. Our first witness is Robin Feldman, the Director of the Institute for Innovation Law at the University of California Hastings College of Law. She has written extensively on patent assertion practices and how they have changed over time.

Our second witness is Charles Duan. He is the Director of the Patent Reform Project of Public Knowledge. Public Knowledge is dedicated to promoting technological innovation, protecting the rights of all users in technology and ensuring technology law serves the public interest.

Our third witness is Lee Cheng. He is the Chief Legal Officer at Newegg, Inc. Newegg is a global internet retailer that is the largest privately held e-commerce company in North America.

Our fourth witness is Daniel Seigle. He is the cofounder and Director of Business Operations at FindTheBest.com. FindTheBest is an online research engine that equips people with information and tools to make informed consumer decisions. I felt like I just did a commercial there.

Ms. DEGETTE. You did.

Mr. MURPHY. And act now and you get one more free. Next we have Justin Bragiel. He is a General Counsel for the Texas Hotel & Lodging Association. He manages and oversees the legal program servicing over 2,500 Association members. He serves as the primary legal counsel to over ten local lodging associations across Texas.

Our last witness is Jamie Richardson. He is the Vice President of Government and Shareholder Relations for White Castle Restaurants.

I will now swear in the witnesses. Now, you are all aware that the Committee is holding an investigative hearing, and when doing so has a practice of taking testimony under oath. Do you have any objections to testifying under oath? None of the witnesses have objected to that. So the Chair then advises you that under the Rules of the House and the Rules of the Committee, you are entitled to be advised by counsel. Do any of you desire to be advised by counsel during your testimony today? None of the witnesses have said they wanted to be advised by counsel. In that case, if you all please rise and raise your right hand, I will swear you in.

[Witnesses sworn.]

Mr. MURPHY. All right. Thank you. All answered in the affirmative. You are now under oath and subject to the penalties set forth in Title 18 Section 1001 of the United States Code. You will now

begin a 5-minute summary of your written statement beginning with Ms. Feldman. Welcome. You have 5 minutes.

TESTIMONY OF ROBIN FELDMAN, DIRECTOR, INSTITUTE FOR INNOVATION LAW, UNIVERSITY OF CALIFORNIA HASTINGS COLLEGE OF THE LAW; CHARLES DUAN, DIRECTOR, PATENT REFORM PROJECT, PUBLIC KNOWLEDGE; LEE CHENG, CHIEF LEGAL OFFICER, NEWEGG, INC.; DANIEL SEIGLE, DIRECTOR, BUSINESS OPERATIONS, FINDTHEBEST.COM; JUSTIN BRAGIEL, GENERAL COUNSEL, TEXAS HOTEL & LODGING ASSOCIATION; AND JAMIE RICHARDSON, VICE PRESIDENT, GOVERNMENT AND SHAREHOLDER RELATIONS, WHITE CASTLE SYSTEM, INC.

TESTIMONY OF ROBIN FELDMAN

Ms. FELDMAN. Mr. Chairman and esteemed members of the committee, I am honored to be here today. As an academic, I have studied patent assertion behavior both in the litigation context, and in the pre-litigation context.

And in recent years, a new business model of patent demands has exploded on the scene. It preys on people's fears of the costs and risks of litigation, and it takes place largely outside the courthouse with no judge, jury or regulator in sight. Much of the time, it is shrouded in nondisclosure agreements, so no one is allowed to talk afterwards.

The behavior is based on the following. There are millions of patents outstanding, and it is very difficult to know what any patent covers. It will cost about $1 million to $6 million dollars in litigation expenses to find out. And if you take the litigation route, there is a risk. If you lose, you could be subject to massive penalties for damages and you could also have your product shut down.

So with that leverage, here is a sample of some of the modern techniques that have appeared. The first is what one could call the peddler's bag. Suppose you are a computer manufacturer, and I claim that your manufacturing process infringes my gumball patent. Now, you may think that is pretty far-fetched. But suppose that I threaten to throw 50 more patents at you as well. You may be tempted to fight off the first, you may not have the stomach or the litigation budget to fight off all 50 of them. The cost of investigating 50 patents is substantial, also the risks of litigation. Maybe not the gumball patent but maybe something in there will stick. So perhaps it is better just to pay a license fee.

Another behavior is what I call the assault rifle technique. With this approach, patent assertion entities target a vast number of people, hoping to obtain moderate settlement amounts from as many of them as possible. For example, patent assertion entities have targeted small businesses for using scanner equipment they have purchased and coffee shops for using Wi-fi equipment. Those who receive the letters know nothing about the patents that are involved and have no idea how to respond to these demands.

Still another behavior is known as privateering. If I am a product company and I launch my products against a competitor, ordinarily that competitor will launch its products back at me and put my products at risk. So I might not bother. But in this new world of

entities that don't make any products, I have many options. I can transfer some of my patents to an assertion entity that could target my competitors. I could even structure the transfer so that I share in the returns. In that way, I damage my rivals, get a return on some of my patents, and my hands are clean.

These three are samples of the techniques that are being utilized, and as with many pressure sales techniques, the demand letters may say things like the settlement cost will go up if you consult a lawyer, if you ask for more information, if you wait until a lawsuit is filed or if you wait until others accept the offer. Some demand letters require that the company sign a broad nondisclosure agreement even to get basic information.

This leads me to one of the many troubling aspects of this behavior which is that much of it is shrouded in nondisclosure agreements and hidden behind layers of shell companies. This makes it very difficult for regulators to see bad behavior when it is occurring. It is also difficult to hold anyone accountable because the shells may have no meaningful assets at the end of the day.

Now, the impact of these patent demands on companies large and small is troubling. A recent study of mine showed that one in three startup companies has received patent demands and that most of these demands are coming from assertion entities that don't make any products. Other scholars have estimated that very little of the vast amount of money changing hands ever gets back to the inventors who actually filed for the patents. And really, it does not take fancy economics to know that time spent analyzing patent demands is time away from innovating, and money spent on patent demands is money not spent hiring workers.

In closing, I do want to stress one important issue. Patents are essential for innovation in this country, and patent rights are useless if they cannot be enforced. I am not talking about the legitimate protection of an invention. I am talking about shadow games that prey on people's fears and that exploit the system.

I have submitted several pieces of my research as my full testimony for the record, and I look forward to answering any questions. Thank you. *

[The prepared statement of Ms. Feldman follows:]

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*The full testimony has been retained in committee files and is also available at ***http://docs.house.gov/meetings/if/if02/20131114/101483/hhrg-113-if02-wstate-feldmanr-20131114.pdf***.

Summary of Testimony

Professor Robin Feldman

Before the House Committee on Energy & Commerce

Subcommittee on Oversight & Investigations

November 14, 2013

Mr. Chairman and esteemed members of the Committee. I am honored to be here today. I am Robin Feldman, Professor of Law and Director of the Institute for Innovation Law at the University of California, Hastings. As an academic, I have studied patent assertion behavior both in the litigation context, and in the pre-litigation context.

In recent years, a new business model of patent demands has exploded onto the scene. It preys on people's fears of the costs and risks of litigation, and it takes place largely outside the courthouse—with no judge, jury, or regulator in sight. Much of the time, it is shrouded in nondisclosure agreements, so no one is allowed to talk afterwards.

The behavior is based on the following: There are millions of patents outstanding, and it is very difficult to know what a patent covers. It will cost you between $1 million and $6 million dollars in litigation expenses to find out. And there is a risk. If you lose, you could end up paying a massive damage award or you could have your business shut down. With that leverage, here is a sample of some of the modern techniques that have appeared.

The first is what one could call the peddler's bag. Suppose you are a computer manufacturer, and I claim that your manufacturing infringes my patent on gumballs. That may seem pretty far-fetched to you. However, suppose, I threaten to throw 50 more patents at you as well. While you may be tempted to fight the first, you may not have the stomach or the litigation budget to fight all fifty patents. The process of analyzing those 50 patents is costly, let alone the risks of litigating the entire lot. If not the gumball patent, maybe something in there will stick, and it is probably just better if you take a license.

Another behavior is what I call the assault rifle approach. With this approach, patent assertion entities target a vast number of people, hoping to obtain moderate settlement amounts from as many of them as possible. For example, patent assertion entities have launched campaigns against thousands of small businesses for using scanner equipment they have purchased and against coffee shops for using Wi-Fi equipment. Those who receive the letters know nothing about the patents involved or about how to respond to the demands.

Still another behavior is known as privateering. Suppose I am a company that makes products. If I launch my patents against a competitor, my competitor will just launch its patents back at me, putting my business at risk. Thus, I may not bother. In the modern world of entities that do not make products, however, I have many options. I can transfer my patents to an assertion entity that can target my competitors. I could even structure the transfer so that I share in the returns. That way, I damage my rivals, get a return from my patents, and my hands are clean.

These three are samples of the techniques that are being utilized. As with many pressure sales tactics, the demand letters may say that the cost will go up if you consult a lawyer, if you ask for more information, if you wait until a lawsuit is filed, or if you wait until others take the offer. Some demands require that the company sign a broad nondisclosure agreement, even to get basic information.

Which leads me to one of the many troubling aspects of this behavior. Much of the behavior is shrouded in nondisclosure agreements and hidden behind layers of shell companies. This makes it difficult for regulators to see when bad behavior is occurring. It is also difficult to hold anyone accountable, because the shells may have no meaningful assets.

The impact of these patent demands against companies large and small is troubling. A recent study of mine showed that one in three startup companies has faced patent demands and that most of these demands are coming from assertion entities. Other scholars have estimated that very little of the vast amount of money changing hands ever gets back to the inventors who filed the patents. It does not take fancy economics to know that time spent analyzing patent demands is time away from innovating, and money spent on patent demands is money not spent on jobs.

In closing, I do want to stress one important issue. Patents are essential for innovation in this country, and patent rights are useless if one cannot enforce them. I am not talking here about the legitimate protection of an invention. I am talking about shadow games that exploit the system and prey on people's fears.

I have submitted several pieces of my research as my full testimony for the record, and I look forward to answering any questions.

Mr. MURPHY. Thank you for staying both under the time limit. I am impressed you have memorized most of your document. Thank you so much.

Mr. Duan, you are recognized for 5 minutes.

TESTIMONY OF CHARLES DUAN

Mr. DUAN. Thank you, Chairman. Mr. Chairman Murphy—sorry, is this on? Yes. Mr. Chairman Murphy, Ranking Member DeGette, and members of the subcommittee, thank you for inviting me to testify today on this important issue. My name is Charles Duan, and I am the Director of the Patent Reform Project at Public Knowledge.

As a bit of background, Public Knowledge is a nonprofit organization dedicated to ensuring that technology law serves the public interest. Prior to working at Public Knowledge, I served as a patent attorney where I both obtained patents and defended against demand letters. I also worked as a Silicon Valley software developer, and these experiences along with my conversations with various stakeholders inform my views on the patent system.

We are here today to discuss the role of patents in our innovation economy, and it is worth beginning from the beginning, I think. The principle behind the patent system is an exchange. Patents are granted to encourage inventors to contribute their inventions to the public. Our patent system ultimately must serve the public interest, and in many areas of our patent system, it does indeed work this way. But far too often scheming speculators and clever lawyers find ways to abuse patents and profit off of the system while detracting from the social good.

The most egregious among these abusers include patent assertion entities and so-called patent trolls. Instead of innovating and creating jobs for Americans, patent trolls manipulate the small businesses and individuals who actually innovate and create these jobs extorting unjustified fees through nuisance threats of litigation.

One of the ways they succeed in doing so is through the sending of demand letters. These letters assert that the recipient infringes a patent and then demand a settlement or a license fee. Abusive demand letters exploit at least two problematic techniques. First, many demand letters are vague, misleading and deceptive. They are threateningly intimidating and yet wholly uninformative, failing to explain what products infringed the patents, how they infringe or even why. Some of the letters that I have seen fail to demonstrate even basic knowledge of the businesses of the recipients. MPHJ, for example, which we have talked about, merely alleges that "a substantial majority—OK. Worse yet, some demand letters contain plain falsehoods and deceptions. I once represented this client who received a demand letter, and when we actually investigated the patent, we found that the patent had been invalidated in court. The sender simply bet that the targets would settle before those targets discovered that the patents were actually worthless.

The sender could win that bet because of the second exploited technique, sending letters to small, unprepared businesses. Small businesses lack the resources, funding, and expertise to fight an ex-

pensive and complex patent lawsuit and are often forced to succumb to the letter's demands. This is especially true of non-technology businesses, like the hotels, restaurants and retailers represented by my colleagues. Just to give a sense of the price comparison, at the start-up that I worked at, we ran our entire operation off of a couple hundred thousand dollars of angel investments. Now, $100,000 will buy you perhaps a single detailed analysis of a certain patent by a lawyer like myself. The full lawsuit will cost in the millions. This is an unfair situation that must be addressed.

These abuses take advantage of two-way symmetries of information. First, demand letter recipients lack information to react on an informed basis. Second, researchers and regulators lack information about the shrouded world of demand letters and the abuses therein. I'll present solutions for both.

The first solution I call demand letter transparency. Senders of demand letters in appropriate situations should be required to disclose relevant details of their campaigns. Those disclosed details should be aggregated into a searchable database accessible to individuals, businesses, researchers and regulators. All of these parties stand to benefit from demand letter transparency. The only parties who stand to lose are abusers of the patent system.

The second solution I call truth-of-demand letters. Congress has repeatedly dealt with misleading advertisements, loan offers and other solicitations by requiring solicitors to prominently disclose truthful, relevant information in the text of the message. A patent demand letter is no different. It is an uninvited solicitation to purchase an intangible product, namely a patent license. And it should be regulated as such. Senders ought to be required to disclose truthful, relevant information in their demands.

These are straight-forward reforms that would minimally burden legitimate patent owners, provide fairness to small business, aid regulators in crafting good policy and prevent abusive practices that ultimately detriments the public interest in promoting innovation. I urge Congress to consider them closely.

I thank the Committee for taking on this important and timely topic. Thank you for inviting me to testify, and I look forward to your questions.

[The prepared statement of Mr. Duan follows:]



Testimony of Charles Duan
Director, Patent Reform Project
Public Knowledge

Before the
U.S. House of Representatives
Committee on Energy and Commerce
Subcommittee on Oversight and Investigations

Hearing on
The Impact of Patent Assertion Entities
on Innovation and the Economy

Washington, DC
November 14, 2013

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Testimony of Charles Duan
Director, Patent Reform Project
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Before the
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Hearing on the Impact of Patent Assertion Entities on Innovation and the Economy

Chairman Murphy, Ranking Member DeGette, and members of the Subcommittee: thank you for holding this hearing and inviting me to testify today on this important issue. My name is Charles Duan, and I am the Director of the Patent Reform Project at Public Knowledge.

Public Knowledge is a nonprofit public interest organization whose primary mission is to promote technological innovation, protect the rights of all users of technology, and ensure that emerging issues of technology law, including patent law, serve the public interest.

By way of background, prior to taking on my current position at Public Knowledge, I was a practicing patent attorney, where I prosecuted over a hundred patent applications before the U.S. Patent and Trademark Office, and litigated dozens of patent cases. Many of my clients were small businesses who had received demand letters or threats of litigation of the sort we will be discussing in this hearing today. Prior to this, I was a software developer at a Silicon Valley startup, where we built a system for facilitating collaboration among science researchers. As a result of these and other activities, I have had experience both with the intricacies of patent law and with the practicalities of running a small technology business.

I. Patents Should Serve the Public Interest, But They Are Often Abused in Ways that Disserve the Public Interest

As members of the Committee are certainly aware, patent assertion entities, especially in their use of demand letters, affect small business in particular and the

innovation economy in general. To begin, it is worth starting at the beginning, with the fundamental basis for patents.

The patent system exists for a utilitarian purpose: to encourage invention and the creation of new technologies, and to ensure that those inventions and those technologies are available to all. This principle is enshrined in our very Constitution, which grants Congress the power to award patents, not for any reason, but specifically to "promote the Progress of Science and the useful Arts."[1] Numerous commentators have observed that the grant of a patent is a bargain: in exchange for receiving the temporary monopoly on an invention that a patent affords, the inventor must reveal the inner workings of that invention, so that the public may learn from it and recreate it themselves.[2] Our patent system, ultimately, must serve the public interest.

A patent system that worked this way, spurring information and disseminating knowledge while protecting small inventors, would be admirable and worthy of commendation. And in many areas our patent system does indeed work in this way. But far too often, scheming speculators and clever lawyers find ways to abuse patents, to profit off of the system while detracting from the social good.

The most egregious among these abusers are often what are called "patent assertion entities," or more colloquially, "patent trolls," because their business models focus on purchasing and asserting patents, rather than producing products or offer services.[3] Patent assertion entities argue that their patents are a property right with which they may do as they please regardless of the public interest, but their argument ignores the fundamental fact that patents must serve the public interest. It is the task of this Committee, of this government, and this society to

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[1] U.S. Const. art. 1, § 8, cl. 8.

[2] *See, e.g.*, Mark A. Lemley, *The Economics of Improvement in Intellectual Property*, 75 Tex. L. Rev. 989, 993 ("Intellectual property is fundamentally about incentives to invent and create.").

[3] Fed. Trade Comm'n, *The Evolving IP Marketplace: Aligning Patent Notice and Remedies with Competition* 8 n.3 (2011), *available at* http://www.ftc.gov/os/2011/03/110307patentreport.pdf.

discover, expose, and eliminate abuses of the patent system that only enrich the few to the detriment of the many.

II. Patent Demand Letters Are an Easily and Often Abused Aspect of the Patent System

The patent demand letter, where a patent assertion entity springs a possible patent infringement lawsuit on an unsuspecting business or individual and demands a settlement, is one such area ripe for, and rife with, abuse. Throughout the halls of Congress we have heard the sustained laments of small, innovative businesses that have fallen victim to this extortative practice.[4] A survey of technology entrepreneurs from Silicon Valley found that companies who had received such letters were forced to lay off employees, throw away products, or even close up shop in the face of these threats.[5]

It is simply inconceivable that the value of the patents being asserted outweighs the destruction of small businesses, widely recognized to be the engine of our economy. And this is borne out by the facts: when these sorts of patents are actually taken to court, almost 90% of them are losers.[6]

Demand letter abusers succeed because they take advantage of two techniques.

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[4] *E.g.*, Kate Tummarello, *Trade Groups Ask Congress to Tackle Patent Demand Letters*, The Hill, Nov. 6, 2013, http://thehill.com/blogs/hillicon-valley/189451-trade-groups-ask-congress-to-tackle-patent-demand-letters.

[5] Colleen V. Chien, New Am. Found., *Patent Assertion and Startup Innovation* 16-17 & fig. 3 (2013), http://newamerica.net/sites/newamerica.net/files/policydocs/Patent%20Assertion%20and%20Startup%20Innovation.pdf ("[A] significant portion of respondents...reported at least one significant operational impact from the assertions: a delay in hiring or other milestone, change in product, business pivot, exit, or loss of customers or revenue.").

[6] *See* John R. Allison et al., *Patent Quality and Settlement Among Repeat Patent Litigants*, 99 Geo. L.J. 677, 687 & tbl. 3 (2011).

A. Demand Letters Can Be Vague, Misleading, and Deceptive

First, because there is no requirement as to the content of a demand letter, they can be written to be threateningly intimidating and yet wholly uninformative. Oftentimes they list patent numbers and describe the patents in detail, but fail to explain what aspect of the patents are allegedly infringed. In some cases, the demand letter fails to even identify what products infringe the patent, leaving the targeted business in the Kafkaesque position of being accused of a wrong without knowing what wrong has been alleged.

Numerous examples of such vague, uninformative demand letters can be found. For example, the patent assertion entity MPHJ Technologies, who claims to hold patents on basic scanning technology, has sent out numerous demand letters to businesses.[7] Those letters do not identify what products of these businesses infringe MPHJ's patents. Those letters do not even allege that the businesses infringe MPHJ's patents at all. Instead, they provide a checklist of possibly infringing technologies. Indeed, the letters evince no knowledge about the targeted company at all; the basis for the threat is that "a substantial majority of companies like yours utilize systems" that MPHJ claims infringe.[8]

Worse yet, there is no requirement that the content of a demand letter be even truthful. Some demand letters contain plain falsehoods and deceptions, intended only to stoke fear where there is no legitimate claim. An example from my time as a patent attorney comes to mind. We represented a client who ran a small e-commerce website, and who had received a demand letter claiming that his website infringed a patent. The client ordinarily would not have been able to afford to pay our law firm to analyze the letter and the patents at issue, but we did so as a favor. When we looked into prior litigation over the patent, we discovered to our surprise

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[7] *See, e.g.*, Decl. Gregory J. Walkin Supp. Def.'s Opp. to Pl.'s Mot. for Prelim. Inj., *Activision TV, Inc. v. Pinnacle Bancorp, Inc.*, No. 8:13-cv-215 Ex. 4 (D. Neb. Sept. 10, 2013) (Doc. No. 23-5), *available at* https://trollingeffects.org/demand/isamai-llc-2013-06-16.

[8] *Id.* at 3.

that the patent had been invalidated in court. The sender of the letter, apparently, was betting that his targets would pay the settlements and never find out that the patents being asserted were actually worthless.

Thus, by sending demand letters with vague, misleading, or outright false statements, abusers of the patent system are able to threaten small businesses and erode our innovation economy, with no benefit other than to their own personal pocketbooks.

B. Small Businesses Often Lack the Resources to Defend Themselves Against Even Illegitimate Demand Letters

The second technique that allows demand letter abusers to succeed is sending letters to small, unprepared businesses. When a business receives a demand letter, it must weigh the demanded settlement amount, on the one hand, against the costs of fighting a lawsuit and the risk of loss, on the other.

For a large technology company, this is an ordinary calculation in the course of doing business. The company likely has a law firm on retainer, dedicated in-house counsel, and experience in previous patent cases. It can afford to analyze the patent, assess its validity and the claims of infringement, determine the risks of litigation, and make an informed decision on how to proceed.

A small business cannot afford to do any of these. The cost to hire attorneys simply to review the patents at issue can far outstrip the finances of a small technology startup. At the startup that I worked at, we ran our entire operation off of a few hundred thousand dollars of angel investments. As a patent attorney, it was not unreasonable to charge a hundred thousand for a detailed analysis of several patents. Attorney fees for full-blown litigation can cost in the millions.[9] These are simply not amounts that a small company, focusing its energy and

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[9] *See* Am. Intellectual Prop. Law Ass'n, *Comments to IPEC on Joint Strategic Plan on IP Enforcement* 3 (Aug. 10, 2012), http://www.aipla.org/advocacy/executive/Documents/AIPLA%20Comments%20to%20IPEC%20on%20Joint%20Strategic%20Plan%20on%20IP%20Enforcement%20-%208.10.12.pdf.

resources on building a competitive, innovative product, can drop every time it receives a threatening letter.

Furthermore, demand letters are being sent to those outside the technology sector. Retailers, restaurants, advertising agencies, real estate brokers, and all sorts of industries have started seeing patent demand letters in their mailboxes. These parties lack the experience necessary to make informed decisions about how to respond to such demand letters, and the abusers of the system take advantage of this naïveté to extract undue settlements.

C. Because Demand Letters Are Privately Sent, There Is a Dearth of Information About Their Use and Abuse

It is at this point that I would ordinarily recite statistics on the number of demand letters sent per year, the industries receiving them, the average settlement demands, and so on. Unfortunately this is not possible, because those statistics do not exist.

Demand letters are sent in private. The senders of the letters often have no desire to make their campaigns known, perhaps for fear of being exposed for their actions, perhaps to aid in their deception of victims. Some letter senders even build up facades of shell companies, thus further concealing their identities from scrutiny.

Of course, we know of the big examples of patent assertion entities, companies like Intellectual Ventures and Acacia, demand letter senders like Innovatio and MPHJ, the repeat players and public faces of this industry. We certainly can investigate them, and indeed the FTC has already announced its intention to investigate them using a § 6(b) study.[10] But for every one of those big names, there are potentially dozens or hundreds of smaller ones, owners of a handful of patents on a specific technology who use those patents to threaten unknown numbers of companies. These patent assertion entities can be large enough to stifle valuable industries, yet small enough to fly under the radar of government oversight.

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[10] 78 Fed. Reg. 61,352, 61,353 (2013).

Consider the case of a company called Activision TV,[11] a corporation in Florida that owns patents that purport to cover all sorts of digital signage, who has been sending out demand letters since at least August 2012. Activision's demand letter activities fit perfectly in the framework I have laid out so far. They target small businesses that are mere consumers of technology, such as grocery stores, banks, movie theaters, and jewelry stores.[12] The demand letters they send are some of the least informative, failing to identify any particular devices accused of infringement but rather generalizing that "Activision has learned that your organization uses remote control digital signage technology and/or related products."[13] Activision thus exemplifies the abuses of patent demand letters that we are discussing today.

Activision gained notoriety in the last few months, when it sued the Attorney General of Nebraska, Jon Bruning, to prevent him from intervening in Activision's demand letter campaign.[14] But prior to Mr. Bruning's intervention, Activision was essentially unknown to the media, to policymakers, and even to Mr. Bruning himself, who apparently had intended to intervene in a different patent assertor's case.[15] Stories like Activision's often go unnoticed, and companies like Activision can pursue their demand letter strategies unchecked and unregulated.

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[11] Activision TV is not related to the video game company named Activision.

[12] *See* First Am. Compl. ¶40, at 7, *Activision TV, Inc. v. Pinnacle Bancorp, Inc.*, No. 8:13-cv-215 (Aug. 19, 2013), *available at* http://journalstar.com/activision-v-pinnacle-bancorp-bruning-et-al-amended-complaint/pdf_e1e9b26e-0b26-5821-9d0c-41bab1338605.html.

[13] Letter from Farney Daniels, PC, to The Marcus Corporation re: Douglas Theaters in Lincoln, Nebraska's Infringement of Activision TV, Inc.'s U.S. Patent Nos. 6,215,441, 6,384,736, and 7,369,058, at 2 (Feb. 7, 2013), *available at* https://trollingeffects.org/demand/activision-tv-inc-2013-02-07-1.

[14] *See* Richard Piersol, *Bruning, Nebraska companies enveloped in patent litigation*, Lincoln Journal Star, Aug. 24, 2013, http://journalstar.com/business/local/bruning-nebraska- companies- enveloped- in- patent- litigation/ article_ aac06dd8-504f-5086-9878-3036c7c0fbc8.html.

[15] *See Bruning Clarifies Patent Dispute's Target*, Lincoln Journal Star, Sept. 13, 2013, http://journalstar.com/ap/national/bruning-clarifies-patent-dispute-s-target/article _c5a7e536- f71e- 5fa2- badf- 23c5510108c5. html. Additionally, a search of

The letter recipients also are not likely to reveal the threats against them. For one thing, those that are forced to accept settlements are often also forced to accept nondisclosure agreements. Also, victims of patent demand letters have a legitimate fear of being revictimized by other patent holders, and so naturally are reluctant to publicize their involvement in receiving the demand letter.

As a result, all we have to work with right now are intuitions and anecdotes. We must commend those efforts, like the Electronic Frontier Foundation's Trolling Effects site, the actions of state attorneys general in Nebraska, Minnesota, Vermont, and Massachusetts, the tireless research of journalists and academics, and the bravery of the few companies who have come forward with their stories and taken their stands. These efforts have given us valuable information on the scope of demand letter abuses and what they have caused.

But we should not be satisfied with these few stories. As a body that constructs policy based on evidence, Congress should be unsatisfied with this situation, where all the evidence points to substantial harm to the public interest occurring but where hard data is lacking. The first step to addressing demand letter abuses must be to investigate and discover those demand letter abuses in a comprehensive, systematic fashion.

III. The Public Has an Interest in Knowing About and Combatting Abusive Demand Letters

What is needed, to investigate and discover those demand letter abuses, is comprehensive information about demand letters themselves. This information comes in two forms, which translate to two legislative proposals. First, information about demand letter campaigns should be publicly disclosed, to guarantee transparency about the demand letter economy and inform the public about those who send such letters. Second, demand letters should themselves contain truthful disclosures, to prevent deception and provide fair notice to recipients of such letters.

Google News for "Activision TV" reveals no relevant articles other than those mentioning the lawsuit with Mr. Bruning.

Addressing these proposals should be the domain of Congress and relevant agencies. The Federal Trade Commission (FTC) has expertise in developing consumer protection rules, and the U.S. Patent and Trademark Office (USPTO) has expertise in administering the details of patent law, so it is appropriate for both to be involved in solving demand letter abuses. But as explained previously, those abuses are too wide-ranging to be solved by those agencies alone; Congress must establish the framework for such solutions. I offer two proposals that Public Knowledge supports to accomplish these needed protections of the public interest.

A. Proposal: Transparency Would Reveal Information About the Demand Letter Economy that Would Be Useful to Letter Recipients, Businesses, and the Public

First, we propose a transparency requirement, namely that Congress should mandate that, upon meeting certain threshold requirements, senders of demand letters must publicly reveal certain information about themselves and about their demand letter campaigns. At a minimum, they should identify:

- *The patents being asserted and proof of ownership of the patents.* This avoids situations where the sender of the demand letter asserts a patent that it does not even own.
- *The true entity asserting those patents.* This ensures that demand letter senders cannot use shell corporations and other such tactics to hide their identities from public scrutiny or mask the size of their campaigns.
- *Any litigation or proceedings involving the patents.* Among other things, this would deter situations like the one I related above where a patent owner was sending demand letters on an invalidated patent.
- *The number of demand letters being sent.* This would inform the public as to the size of various demand letter campaigns.

Furthermore, the USPTO should establish a searchable database of this and other collected information, so that letter recipients, related businesses, researchers, and the public can have transparent access to the disclosed information.

This transparency information about both patent assertion entities and the demand letters they send would be helpful for everyone, including individual consumers, small businesses, policymakers, and the public. Individuals and small businesses would benefit by being able to understand much more fully what they actually face when presented with a demand letter. Negotiation would occur on a much more level playing field. Those not targeted by demand letters would also better understand how to identify and work around patents and, thus, potentially avoid unnecessary and costly lawsuits. Finally, if patent assertion entities must publicly disclose information like the number of demand letters they send, ultimately they may even send fewer abusive demand letters to the economically vulnerable on the weakest of claims. Patent assertion entities that are currently taking a shotgun approach of demand first, investigate later, might select their cases more judiciously, thus reducing the prevalence of abusive demand letters.

Those interested in patent, competition, and consumer protection policy would likewise find the information useful. At a workshop exploring the impact of patent assertion entity activity on innovation and competition, the FTC recently noted that panelists and commenters identified potential harms but lacked empirical data that could enrich the debate regarding PAE activities.[16] Quality empirical data provided by demand letter transparency would thus empower various parts of the government, including the FTC, USPTO, the International Trade Commission, and the Executive Office of the President, to formulate sounder policies to preserve competition and protect consumers. Groups outside of government, too, would be more able to pinpoint accurately the problems with demand letter campaigns and suggest solutions tailored to protecting consumers while preserving a competitive and vibrant innovation economy.

Accordingly, demand letter transparency would have wide-ranging benefits, and we urge Congress to consider legislative proposals for such transparency.

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[16] *See* Press Release, *FTC Seeks to Examine Patent Assertion Entities and Their Impact on Innovation, Competition* (Sept. 27, 2013), *available at* http://www.ftc.gov/opa/2013/09/paestudy.shtm.

B. Proposal: Truth in Demand Letters Would Give Fair Notice to Letter Recipients and Deter Many Abuses

In addition to requiring transparency of demand letter campaigns to create a database of demand letter information, Congress should mandate, or authorize the FTC to mandate, that demand letters include certain minimum disclosures within the text of the letters themselves. Currently, demand letters can contain a great deal of bluster and intimidation, without any useful substance. A small company receiving such a letter often cannot afford to hire a lawyer to evaluate the letter's merits, and the weight of the threats may force that small company to pay an unjustified settlement fee. Abusers of the patent system are free to issue demand letters that conceal information, misrepresent the facts, and even outright deceive.

Congress would be justified in taking such actions in the same way that it has repeatedly been justified in taking actions against deceptive advertising and marketing practices in the past. Indeed, upon consideration one must realize that a demand letter, in essence, is simply an advertisement for a sort of product, namely a patent license. Just as Congress has demanded truth in advertising and truth in lending, Congress should demand truth in patent demand letters.

The purpose of such a mandate would be to provide fair notice to recipients of demand letters, particularly those unfamiliar with the intricacies of patent law, so that those recipients can adequately evaluate their options and make informed decisions. Such information should include:

- A link or reference to the USPTO's website on how to respond to demand letters[17]
- The specific patents, and specific claims of those patents, that are being asserted (and not a laundry list of possibly relevant patents or claims)

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[17] This website was ordered to be built by a Presidential Executive Action. *See* Press Release, *Fact Sheet: White House Task Force on High-Tech Patent Issues* (June 4, 2013), *available at* http://www.whitehouse.gov/the-press-office/2013/06/04/fact-sheet-white-house-task-force-high-tech-patent-issues.

- The particular products, services, and activities believed to infringe those patents, and the reasons why those products, services, and activities are believed to infringe
- Whether the patent has been licensed to any manufacturer or other entity, such that the letter recipient may have a patent exhaustion defense
- All the information required for the transparency disclosures above

By requiring demand letters to include this information, demand letter recipients are better served by having critical information before them at the time of receiving the letter, and the public is better served knowing that patents are being used for their merits rather than for their intimidation value.

IV. Conclusion

In closing, I would like to return to my initial thought, that patents are intended to serve the public interest. A properly granted patent should be an engine for innovation. Instead, though, abusers of patent demand letters have turned their patents into brakes on innovation, holding valuable small businesses back from their full potential, so that those abusers may extract pecuniary gain. The members of this Committee and this Congress should be champions of innovation, defenders of small businesses, and challengers of these abusers of the public good, and we call for swift action to implement reforms that will return our patent system to one that promotes the progress of science and the useful arts.

Thank you again for inviting me to testify, and I look forward to your questions.

Mr. MURPHY. Thank you, and I also appreciate you staying within the time as well.

Mr. Cheng, you are recognized for 5 minutes.

TESTIMONY OF LEE CHENG

Mr. CHENG. Thank you, Mr. Chairman and members of the subcommittee.

Patent trolling is a growing and uniquely American problem caused by loopholes in patent law that were estimated to cost the American economy over $80 billion in 2011 and probably a lot more today.

American businesses and consumers, who ultimately pay higher costs for everything because of patent trolling, need relief from Congress, and soon.

I am the Chief Legal Officer of Newegg.com, an internet retailer. We are members of the Consumer Electronics Association which represents the interests of over 2,000 members of the innovation industry. We deeply appreciate patents and innovation.

Newegg is a uniquely American success story, founded by four immigrants in 2000 on a shoestring budget to sell electronic products online. We are now the second largest online-only retailer, after Amazon. We employ almost 1,000 Americans. We have always been profitable in a notoriously low-margin business and achieve profitability largely by keeping our costs down. I work in a cube in a warehouse, we serve Folgers in our office, and everywhere I go I fly coach.

Upon joining Newegg in 2005, I was very surprised to get a number of demand letters asserting that we infringed someone's patents because we don't really make anything. We are a retailer, buying products from innovative companies and selling them to end user customers. The demand letters were generally vague, and the patents asserted against us covered common and obvious functionalities used in every single e-commerce web site, like the shopping cart or search boxes.

In one instance, a patent troll sent us a demand letter claiming we infringed six of their patents. After being told that our patent counsel said we didn't infringe on any valid patent claims, the troll told us that they had thousands of patents, that we likely infringed something and to just pay up. Many, if not most demand letters declare that the troll is the owner either of patents or patent portfolios without much if any analysis as to why the alleged infringer actually infringes. They allude to the high cost of litigation and suggest that it makes sense to resolve the issue early by having the infringer pay money to take a license. These letters may reference other companies who have taken such forced licenses to add credibility to a demand. And for a small company that gets such a letter, the only practical path is to pay up, and serially. Patent trolls and their contingency fee lawyers view small companies as sheep to be sheered every couple of months. And these demand letters can be crippling to a start-up company.

In Newegg's case, the trolls who hit us offered to settle for, initially, high six figures to low seven figures, and all of our co-defendants in the early cases settled, sometimes for millions of dollars. Not being a seasoned patent litigator or patent attorney, I

wasn't smart enough to not ask some basic questions like why do we have to pay millions of dollars for utter crap, and soon realized that patent trolling was a complete scam like securities class action litigation. Settling with trolls to avoid the cost and inconvenience of litigation might save a little bit of money up front but would encourage more and more lawsuits. Settling would simply feed the beast.

Since Newegg's profit margins are low, we simply could not afford to serially cut settlement checks. We also couldn't spend what our competitors spent on legal defense. We needed another path. I spent a lot of time and effort on ways lower defense costs without compromising quality.

I was very nervous when the jury for our shopping cart case in Texas came out of deliberations, and they could have awarded the troll $34 million. They didn't, and on appeal, we invalidated all of their patents. Despite being sued or threatened over 30 times in 8 years, Newegg has never lost a patent suit after appeal, and not surprisingly, smart trolls don't sue us anymore.

Unfortunately, we are the exception to the rule. Small companies and startups don't have the resources to fight. Large companies settle because it is cheaper to do so. The overwhelming majority of patent troll suits settle, even when the asserted patents are terrible quality or when a defendant likely does not infringe because of the high cost of defense.

Although our strategy of resisting frivolous lawsuits appears to be working, we remain committed to helping reform patent law. We stay in the fight because not long ago we were a small company and could not possibly have launched if our programmers had to look over their shoulders and pay millions of dollars every single time they wrote a line of code. Moreover, it is just the right thing to do.

Patents are legal monopolies, granted under a visionary piece of legislation to spur innovation to benefit society. The Patent Act was not passed to reward extortionists who are taking advantage of loopholes in patent laws to force honest, hardworking businesspeople and entrepreneurs to pay premiums to avoid the cost of litigation. It was passed to benefit society. Those who abuse patents do not deserve windfall profits.

Congress must step in. Common sense steps can be taken to increase the cost of abusively asserting patents and to allow small companies and startups to innovate and operate without fear. Provisions included in H.R. 3309, the Innovation Act, and also heightened requirements for demand letters would be a great start.

Thank you again for the opportunity to testify.

[The prepared statement of Mr. Cheng follows:]

United States House of Representatives
Committee on Energy and Commerce
Subcommittee on Oversight and Investigations

November 14, 2013

Testimony of Lee Cheng,
Chief Legal Officer and SVP of Corporate Development
Newegg.com

Mr Chairman, and Members and Staff of the Subcommittee.

Thank you for this opportunity to share Newegg's experiences and perspectives on the pernicious phenomenon known as patent trolling with all of you, and with the American people. Patent trolling is unfortunately a growing and uniquely American problem that was estimated to have cost the American economy over $80B in 2011 in legal fees, settlements, lost productivity and stifled entrepreneurism, due to loopholes in the patent laws. The cost is likely substantially more today.

The vast, vast majority of proceeds from this activity does not go to inventors, a few of whom are commonly trotted out by patent trolls to justify their unproductive activities; rather, it lines the pockets of lawyers and investors looking for easy money based on exploiting deficiencies in our legal system. American businesses and consumers, who ultimately pay higher prices for products and services subjected to patent trolling, need relief from Congress, and soon.

Before proceeding further, I'd like to submit for consideration that solutions to patent trolling should not focus on the *form* of the party asserting a patent, but on the *activity* itself—**abusive patent assertion**. Any entity or individual can be a patent troll by abusively asserting patents. I believe that *any* individual or any type of entity who (1) asserts bad quality patents, or (2) asserts patents to extract premium payments because defendants need to avoid the high cost of litigation, is a troll. Patent trolls take advantage of substantive and procedural deficiencies in law to extract a tax on all of society. Everyone pays the toll of the troll, even when they are not directly paying. Parties who abusively assert patents, then, are **Abusive Patent Asserters (APAs)** and that is the term I think should be used in place of any of the euphemisms that APAs are trying to get people to use, like Non-Practicing Entity (NPE) or Patent Assertion Entity (PAE), to confuse debate and stall reform.

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I am the Chief Legal Officer for Newegg.com, an internet retailer. We are members of the Consumer Electronics Association (CEA), which represents the interests of over 2,000 members of the innovation industry in Washington and runs the Consumer Electronics Show (CES), the largest showcase for technology products in the world.

We're a common but uniquely American success story, founded by four immigrants in 2000 to sell electronics products online. We are now the second largest online only retailer, after Amazon.com, with

about $2.75B in sales in 2012, and we proudly employ almost 1,000 Americans in three, and soon to be four, states. We have always been profitable in a notoriously low margin business, and we are able to achieve profitability by keeping our costs down—I work in a cube in a warehouse, we serve Folger's coffee in our office, and everywhere I go, I fly coach. Our growth has been achieved by focusing on treating our customers like family—we take that objective very seriously. We consistently garner some of the highest customer satisfaction ratings in both online retail and in retail generally. Our founder and 90% stockholder, Fred Chang, believes that making money should and will be the natural byproduct of doing right by our customers, and that is why we rely very heavily on repeat business, and word-of-mouth referrals, to grow. We have grown every year since we were founded.

Upon joining Newegg in 2005, I was surprised to get a number of demand letters asserting that we infringed someone's patents, and demanding a license payment, because we don't really make anything. Newegg is a retailer, buying products containing IP from innovative companies, and selling them to end user customers who appreciate technology products. The demand letters were most often vague and the patents asserted against us covered common, obvious and ubiquitous functionalities used by every e-commerce web site, like the "shopping cart," drop down menus, search boxes, and the like, that could be coded for any number of ways and which were often covered by many different patents.

In one instance, a corporate patent troll sent us a demand letter claiming we infringed 6 of their patents. After being told that our outside counsel had indicated that we did not infringe on any valid patent claims in those 6 patents, the troll told us that they had thousands of patents, that we likely infringed something, and to pay up. Many, if not most of the demand letters will declare that the entity is the owner/holder of either patents or patent portfolios, without much if any analysis as to why the alleged infringer actually infringes. They will allude to the high cost of litigation and suggest that it makes sense to "resolve" the issue early by having the infringer pay money take a license. These letters may reference other companies who have taken such "licenses" to add credibility to a demand. For a small company that gets such a letter, the only practical path is to pay up, and serially. Patent trolls and their contingency fee lawyers view small companies as sheep to be sheered every couple of months. These demand letters can be crippling to a startup.

Trolls generally "only" want an amount representing "small %" of all of a target's sales or profits, despite contributing NOTHING to anyone's success. It is important to keep in mind that a "license" from a troll for a naked patent, i.e. a patent that is not used as a basis for a useful product or service offered by the troll, does not help a company or entrepreneur build or grow their business—it only confers the right to not be sued or harassed on that specific patent.

In Newegg's case, the trolls who hit us offered to settle for, initially, high six to low seven figures, to "help us" avoid the exorbitant cost of defense. Most of our co-defendants settled, sometimes for substantial amounts. Not being a seasoned patent litigator or patent attorney, I didn't know better than to ask some basic questions, and soon realized that patent trolling was a complete scam. Settling with trolls to avoid the cost and inconvenience of litigation might save a little money on the front end, but would encourage more and more lawsuits. Settling would Feed the Beast.

Newegg was and is a high revenue business that would naturally be targeted by many scam artists, including patents trolls, as a deep pocket defendant. Since our margins were and are low, however, we simply could not afford to serially cut settlement checks the way other large revenue companies with high margins could. We also couldn't spend what our competitors spent to defend ourselves. As a result, I spent a lot of time and effort on every means to lower defense costs without compromising quality and to preserve our trial option. We used boutique law firms, we pulled a lot of e-discovery review and production work in-house, we used alternative fee arrangements that rewarded defense counsel with incentives for achieving great results, and we took risk by going to trial.

I was very nervous when that first jury in one of our cases in the Eastern District of Texas came out of deliberations in our 2010 shopping cart lawsuit. The jury could have awarded the troll, Soverain Software, $34M and royalties. They didn't, and on appeal to the Federal Circuit, we invalidated all 3 patents asserted, and reversed the whole $2.5M award. In 2011, we invalidated another cornerstone patent asserted by a corporate troll, and another in 2012 owned by Kelora Systems. Despite being sued or threatened over 30 times, we have never lost a patent suit after appeal. While we are about to go to trial next week against TQP, one of many shell companies controlled by notorious patent abuser Erik Spangenberg, in Marshall, Texas, next week, trolls largely don't sue Newegg anymore. They have far too many easier victims.

Unfortunately, we are the exception instead of the rule. Other patent troll victims, especially small companies and startups, do not have the resources to fight. Most large companies settle as well because it is cheaper to do so—the typical cost of defense, without using Newegg's cost-control methods, runs between $3-5M per lawsuit. The overwhelming majority of patent troll lawsuits settle, even when asserted patents are of terrible quality or when a defendant likely does not infringe, because of the high financial cost, and logistical burdens of defense.

Although our strategy of resisting frivolous lawsuits appears to be bearing fruit, we remain committed to helping reform patent law. As a practical matter, we do so because even if we are not directly hit by trolls, we are still paying. We pay every time vendors who settle with trolls charge us more, or when technology suppliers force us to sue them to get them to stand behind the IP rights they have sold or licensed to us when a troll sues us. Strategically, for a company that has built a business as the advocate for the end user technology customer, we continue to fight because the ultimate cost of patent trolling gets passed on to end user consumers, who cannot buy as many technology products.

As a matter of principle, we stay engaged in the fight because not long ago, we were a small company and could not possibly have launched if our programmers (already working in a dark and dingy warehouse because the proverbial garage was too expensive) had to look over their shoulders and pay money every time they wrote a line of code, which is exactly what abusive patent asserters want everyone to do. Finally, we stay in the fight because it is simply the right thing to do. We view it as our corporate duty and obligation.

Patents are legal monopolies, granted under a visionary piece of legislation to spur innovation that would **benefit society**. The Patent Act was not passed to reward extortionists who have identified and

are taking advantage of loopholes in the patent laws to force honest, hardworking businesspeople and entrepreneurs, to pay premiums to avoid the cost of litigation. It was passed to **benefit society**. Those who abuse patents do not deserve windfall profits simply because our legal system disadvantages defendants in patent cases, and contains little or no recourse for those defendants and no consequence for abusive patent asserters. Not curtailing abusive patent assertion allows inequity to perpetuate and will competitively disadvantage the American economy compared to the economies of countries that are not burdened with abusive patent litigation.

Congress must step in. Common sense steps can be taken to increase the cost of abusively asserting patents, and to allow small companies and startups to innovate without fear. Provisions included in HR 3309, the Innovation Act, would be a great start.

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Thank you again for the opportunity to testify. I would be happy to answer any questions you might have, and to provide what assistance I can to the Committee's work.

Mr. MURPHY. Thank you. Just made it. We are going to try and get through a couple more before we have to run to the floor and vote.

Mr. Seigle?

TESTIMONY OF DANIEL SEIGLE

Mr. SEIGLE. Chairman Murphy, Ranking Member DeGette, and members of the subcommittee, thank you very much for this opportunity to testify in front of you on this pivotal issue of the abuse of the patent system and demand letter reform.

I am Danny Seigle, Director of Operations at FindTheBest, a research platform that helps 20 million consumers and businesses each month get the information they need to make an informed decision on a variety of topics.

In the last 6 months, we have unfortunately received two demand letters. The first was from the shell company Lumen View. It is a 5-page document as you can see here. You would think in these 5 pages they could provide some details into how we actually infringe on their said patent. But aside from naming the patent and naming the feature that infringes, there are no specifics. The rest of the 5 pages are simply spent using threats to scare us into settlement. These threats include full-motion litigation that they are prepared if we defend ourselves, protracted discovery process and settlement escalations if we defend ourselves. In other words, if you try to defend yourselves, they will make it an expensive and time-consuming process for us.

The correct business decision for us would have been to accept their 1-day, special offer of $50,000 and have this issue go away. However, that is just blatant extortion. We were even told by the Plaintiff that this was the correct business decision and our investors and board members would have preferred we did this as well. However, our CEO, Kevin O'Connor, took a different stance. He decided to do what was right and personally finance litigation to prove that we were innocent and to call out the scam that was going on.

Yesterday morning the judge on the case denied the protective motion for the gag order that they filed against us. They wanted to silence us so we could not share this story with you today.

The second demand letter we received was a four-sentence demand letter as you can see here, all of four sentences. It simply states we infringe on their auto scrolling technology, names three possible patents and then gives a link to our homepage as evidence of infringement. These three patents have 78 claims. That is a lot of claims for a small company like ourselves to go through and figure out if we actually infringe or not. Without inside counsel and scarce resources, it takes a lot of time and effort for us to go and decide what the best course of action is. Additionally, they sent this letter certified mail so we could be in violation of willful infringement if we do not actually do our proper research. We had to hire an outside counsel to spend several thousand dollars investigating this to write a letter of reply. In our letter of reply, we asked for specifics because we can't figure out how we actually infringe. These vague tactics are all too common in these demand letters.

I wish I could say that our story was unique, but it is not. The only unique thing about our story is our public stance. We have heard from hundreds of people in similar situations like us that wish they had a voice, that wish they could talk out about this. They have been coerced into signing NDAs in order to settle, and their voice has been silenced. I am here today to represent them as well.

Comprehensive patent litigation reform is necessary, and demand letter reform is essential. Proper disclosure guidelines would greatly help companies like FindTheBest understand how we actually infringe, which claims we actually infringe on and provide details so we could actually research this in a matter to resolve the issue.

The FTC should also look into investigating several of these unfair, corrupt practices. It is very blatant there is no good-faith examples of how we actually infringe and how we infringe.

We did what was right. We fought this patent. We did not have to. In fact, taking the $50,000 settlement would have been the easy and less costly option, and I ask that you guys do what is right and stop this abuse of the patent system. Thank you.

[The prepared statement of Mr. Seigle follows:]

FindTheBest
Think like an expert

Testimony of Danny Seigle

Director of Operations, FindTheBest.com

Before the
U.S. House of Representatives
Committee on Energy and Commerce
Subcommittee on Oversight and Investigations

Hearing on
"The Impact of Patent Assertion Entities
on Innovation and the Economy"

Washington, D.C.
Nov. 14, 2013

I. Introduction

Chairman Murphy, Ranking Member DeGette, and Members of the Subcommittee:

Thank you for the opportunity to testify today on the pivotal issue of patent assertion entities harming innovation and our economy. I am Danny Seigle, Director of Operations at FindTheBest.com, an online research platform. Every month FindTheBest helps 20 million businesses and consumers make confident purchase decisions about smartphones, cars, colleges, nursing homes, financial advisors, and hundreds more products and services.

FindTheBest is a four-year-old company that employs 110 people in Santa Barbara, California. Our founder and CEO, Kevin O'Connor, previously co-founded and led DoubleClick, the first substantial online advertising technology firm. FindTheBest was built on the promise of helping people sort through information in ways that helped them understand it and make smart decisions. That's why we characterize FindTheBest as a research engine, rather than a simple search engine.

II. Lumen View Technology's Vague and Threatening Demand Letter

Before May 30, 2013, I had limited knowledge of the patent system and no knowledge of the unfair, deceptive, and corrupt practices of "patent trolls." I understand the politically correct terms would be "non-practicing entities" and "patent assertion entities,"

but after less than six months of suffering their coercion, fraud, and abusive legal gamesmanship, I feel qualified to call them trolls.

Patent trolls use vague, threatening demand letters to coerce companies like ours into settling baseless lawsuits, regardless of infringement, by abusing the legal system's high cost of defense. This became clear when I received our first demand letter, sent by Lumen View Technology, a troll that has filed more than 20 infringement lawsuits since 2012.

The demand letter from Lumen View Technology vaguely claims that FindTheBest's "Assist Me" feature infringes "one or more claims" of patent 8,069,073 (Exhibit A). A patent which Lumen View exclusively licenses for the purpose of bringing infringement allegations against companies.

The demand letter arrived in tandem with a lawsuit,[1] which narrowed our window for reply to 21 days after service of the complaint. This is an exceedingly short period of time--particularly for a resource-constrained startup without inside counsel, like FindTheBest--to familiarize ourselves with the patent, solicit outside counsel, assess infringement and validity, and determine the appropriate response.

As a young businessman receiving my first demand letter, I was shocked by the letter's vague and threatening language.

[1] Lumen View Technology LLC v. FindTheBest.com, Inc. Case No. 13 CV 3599

With the exception of naming the patent number and the feature of our site that allegedly infringes, the demand letter failed to provide any specifics, such as: (1) Which of the 9 claims are being asserted against FindTheBest; (2) The reasons Lumen View believed FindTheBest infringed; and (3) A description of the specific FindTheBest functionality that is allegedly infringing the patent. The absence of such details places the burden of researching all claims of the patent on FindTheBest, unnecessarily inflating our costs, while permitting the troll to mass-produce demand letters with the same boilerplate template –which is exactly what Lumen View did.

The 5-page Lumen View demand letter is predominantly comprised of scare tactics intended to compel settlement. Some of the excerpts from the demand letter, along with our interpretation, include:

- "Plaintiff is prepared for full-scale litigation to enforce rights. This includes all motion practice as well as protracted discovery." - **Interpretation**: If you try to defend yourself, we will make it very costly and time consuming.

- "If company engages in early motion practice...we must advise that it will force us to reevaluate and likely increase plaintiff's settlement demand... For each nondispositive motion filed by company, plaintiff will incorporate an escalator into its settlement demand..." - **Interpretation**: Regardless of merit, we will increase the settlement cost for each motion you file if you attempt to defend yourself.

- In the context of telling FindTheBest its document preservation obligations, Lumen View stated, "It should be anticipated that users may seek to delete or destroy information unrelated to the suit that they regard as personal, confidential or embarrassing and, in doing so, may also delete or destroy potentially relevant ESI [Electronically Stored Information]" - **Interpretation**: If you try to defend yourself, personal and embarrassing information may be disclosed during discovery.

- "You should take affirmative steps to prevent anyone with access to these systems from seeking to modify, destroy, or delete any ESI contained on their laptops, PCs, or personal smartphones" - **Interpretation**: You should confiscate personal smartphones from executives and other people knowledgeable on the subject matter.

When FindTheBest first received the Lumen View demand letter, I reviewed it with our CEO, Kevin O'Connor and we quickly realized that FindTheBest does not infringe. I decided to call Lumen View's counsel at Aeton Law, in hopes of resolving the matter and avoiding legal costs. I asked the plaintiff's lawyer several questions in reference to the patent and the basis for alleging infringement. He was either unwilling or unable to provide answers, simply repeating "no comment" in response to every question I asked. Rather than sharing the details I needed to properly respond to the demand letter, he repeatedly asked if we would like to discuss settlement negotiations.

From this phone call, it was clear that Lumen View had no interest in discussing the scope of the patent or the specifics of the alleged infringement. Instead, they were fixated on obtaining a settlement based on the cost of defense. For example, instead of providing a substantive basis for alleging infringement, the Lumen View's attorney stated that FindTheBest should pay Lumen View for a license simply as a "business decision." It was clear that they failed to perform any semblance of due diligence, negating any good-faith basis for the allegations.

For many small businesses in this situation, the pragmatic solution is to settle, and Lumen View offered a "one day settlement offer of $50,000," a bargain considering that the cost of defense would be, at a minimum, hundreds of thousands of dollars. It would have been financially prudent to settle, which our investors and our board encouraged, but we made the decision based on ethics and decided to fight this frivolous and fraudulent lawsuit. To protect our investors and focus our business resources on our product, our CEO pledged $1 million to finance the litigation.

To date this demand letter and lawsuit have cost FindTheBest countless days of employee time and approximately $160,000 in legal fees. We would rather dedicate these resources to hiring additional engineers, improving our product, and providing more value to the 20 million monthly consumers and businesses that utilize FindTheBest to make significant decisions.

Once it became clear to Lumen View that we were willing to defend ourselves against these baseless claims, the plaintiff and plaintiff's counsel became increasingly

aggressive. Continuing their unethical behavior, the plaintiff threatened to pursue criminal charges against our CEO for calling the co-inventors "patent trolls." The plaintiff's counsel told us that the only way the plaintiff would not pursue these criminal charges was if we settled the case by the end of the day. At this point, we identified a pattern of abuse and corruption and made the decision to file Racketeer Influenced and Corrupt Organization "RICO" charges against Lumen View Technology and the related parties.[2]

III. A Four-Sentence Demand Letter from Make Communications & Computing, LLC

FindTheBest received a second demand letter on Oct. 10, 2013 from Make Communications & Computing (MakeCom). The demand letter alluded to three patents describing "automatic scrolling technology" (Exhibit B). I am not entirely certain how automatic scrolling qualifies as novel or how the public benefits from such an "invention," but the USPTO decided this was patentable concept, so as the target of the demand letter, we must assume it is a valid patent and hire lawyers to respond.

This entire demand letter is a mere four sentences long. Opening with the declaration that "FindTheBest.com is using automatic scrolling technology on their web site," it states that we are "likely infringing on MakeCom Intellectual property" and names three possible patents that "require licensing for use." The only evidence of infringement

[2] FindTheBest.com, Inc. v. Lumen View Technology LLC et al. Case No. 13 CV 6521

provided is a link to our homepages for FindTheBest and our sister site FindTheData, accompanied by a demand that we "contact MakeCom immediately to discuss arrangement for obtaining the necessary license."

After reviewing the patents we concluded, once again, that we do not infringe. We responded to MakeCom requesting additional information including, (1) The particular claims of the 78 possible claims of the MakeCom patents on which FindTheBest is potentially infringing; (2) The specific reasons why MakeCom believes that FindTheBest is infringing, including the due diligence MCC engaged in prior to Oct. 10, 2013 to determine the alleged infringement, (3) The description of the specific functionality attributes of the FindTheBest website that MakeCom alleges are infringing; (4) The names of all parties with financial interest in the MakeCom patents; (5) The licensing fees or royalties that MakeCom believes FindTheBest should pay; and (6) The names of any other parties to whom MakeCom, or any other party with financial interest in the MakeCom patents, have sent communication alleging infringement of the MakeCom patents (Exhibit C).

MakeCom's cryptic and vague demand letter cost them less than $3 to send via certified mail, but costs FindTheBest thousands of dollars in legal fees and countless hours of time and effort.

IV. Conclusion: Demand Letter Reform is Necessary

I wish I could say that our story is unique, but it is not. The only unique thing about our story is our willingness to be vocal about these unethical and corrupt business practices. As Newegg, Rackspace, and other larger companies are proving, recipients of fraudulent demand letters that can afford to fight publicly should do so, as it has proven successful.

Most companies remain silent, as they are intimidated into signing non-disclosure agreements, and they are afraid that going public may negatively affect business or that patent trolls may retaliate with additional suits. The most recent court motion filed by Lumen View asked the judge for a gag order to silence us, a clear sign that Lumen View has something to hide about its own unscrupulous behavior.

Our decision to be vocal about this process has resulted in an outpouring of support from hundreds of companies, many of whom have shared stories of their own battles with patent trolls. I am here today not only as a representative of FindTheBest, but as a voice for others that do not have the resources to fight or were silenced with non-disclosure agreements. When FindTheBest decided to fight back, we never imagined that we would receive so much praise and admiration for defending ourselves against frivolous claims and doing what is right.

I joined FindTheBest because I wanted to be part of something that adds real value to people's lives. Patent trolls aren't adding value to society. They are attacking young companies, stifling innovation, and hindering economic growth in the process.

Comprehensive patent abuse legislation is absolutely necessary and it must include demand letter reform. Patent owners have received an extraordinary benefit from the government and the people, and they should be required to use it in good faith. Congress must require patent demand letters to include specifics about infringement claims and patent owners, or their agents, must have a duty of good faith regarding these assertions and their monetary demands.

FindTheBest could have chosen an easy option and settled these cases. Settlement would have been far less costly and time-consuming, but there's more to this issue than the cost and time involved. It's about doing what's right. If no one stands up for what's right, the abuse will continue, and society will suffer. I ask that you too do what is right, and put an end to these deceptive and unethical tactics that hurt the American economy, innovation, and ultimately consumers.

Thank you for your time and I look forward to answering your questions.



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VIA HAND DELIVERY

May 30, 2013

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c/o
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1332 Anacapa St., Suite 200
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RE: ***Lumen View Technology LLC v. FindTheBest.com, Inc.*, S.D.N.Y.**

Dear Mr. Seigle:

This firm represents Lumen View Technology LLC ("Plaintiff") in connection with U.S. Patent Number 8,069,073, entitled "System and Method for Facilitating Bilateral and Multilateral Decision- Making" ("the '073 Patent"). We write to you as Director of Operations for FindTheBest.com, Inc. ("Company") regarding Company's unlicensed use of subject matter covered by the claims of the '073 Patent.

Based on our examination, Company's AssistMe feature meets one or more claims of the '073 Patent, as more fully described in the Complaint attached hereto which already has been filed against Company in the United States District Court for the Southern District of New York (the "Suit"), and that Company has directed this infringing activity to residents in the State of New York.

A service copy of the Complaint is attached. The Complaint has been filed and served on the Company's New York registered agent listed above. Please note that a response to the Complaint ("Response") must be filed within twenty-one (21) days from the date of service or a default judgment may be entered against the Company.

If Company is interested in avoiding the need for filing responsive pleadings, you must contact us (prior to the due date of Company's Response) to discuss license terms. To facilitate such discussions, please be prepared to discuss the extent of the

Company's use of and revenues generated from the features described in the Complaint.

While it is Plaintiff's desire that the parties amicably resolve this matter, please be advised that Plaintiff is prepared for full-scale litigation to enforce its rights. This includes all motion practice as well as protracted discovery.

Should Company engage in early motion practice, however, we must advise that it will force us to reevaluate and likely increase Plaintiff's settlement demand. Please be advised that for each nondispositive motion filed by Company, Plaintiff will incorporate an escalator into its settlement demand to cover the costs of its opposition papers and argument.

Preservation Request

Please allow this correspondence to also serve as our request for preservation of evidence to include all documents, tangible things and electronically stored information ("EST") potentially relevant to the issues in this case. As used in this Preservation Notice, "you" and "your" refers to Company, and its predecessors, successors, parents, subsidiaries, divisions or affiliates, and their respective officers, directors, partners, agents, attorneys, employees or other persons occupying similar positions or performing similar functions.

You should anticipate that much of the information subject to disclosure or responsive to discovery in this matter is stored on your computer systems or other media and devices (including personal digital assistants, smart phones, BlackBerry, iPhone, voice messaging systems, online repositories and cell phones).

ESI should be afforded the broadest possible definition and includes (by way of example and not as an exclusive list) potentially relevant information electronically, magnetically or optically stored as:

- Digital communications (e.g., email, voicemail, instant messaging);
- Word processed documents (e.g., Word documents and drafts);
- Spreadsheets and tables (e.g., Excel worksheets);
- Accounting application data (e.g., Quickbooks, Peachtree data files);
- Image and facsimile files (e.g., PDF, TIFF, JPG, GIF images);
- Sound recordings (e.g., .WAV and .MP3 files);
- Video and animation (e.g., .AVI and .MOV);
- Databases (e.g., Access, Oracle, SQL, SAP);
- Contact and relationship management data (e.g., Outlook, ACT);
- Calendar and diary application data (e.g., Outlook PST, Gmail, blogs);

- Online access data (e.g., temporary internet files, history, cookies);
- Network access and server activity logs;
- Project management application data;
- Computer aided design; and
- Backup and archival files (e.g., ZIP and .GHO)

ESI resides not only in areas of electronic, magnetic or optical storage media reasonably accessible to you, but also in areas you may deem not reasonably accessible. You are obliged to preserve potentially relevant evidence from both of these sources of ESI, even if you do not anticipate producing such ESI.

The demand that you preserve both accessible and inaccessible ESI is reasonable and necessary. You will be asked in this litigation to identify all sources of ESI you decline to produce and demonstrate to the court why such sources are not reasonably accessible. For good cause shown, the court may order production of ESI even if it is not reasonably accessible. Accordingly, even ESI that you deem reasonably inaccessible must be preserved in the interim so as not to deprive Plaintiff of its right to secure this evidence or request that the court order it to be produced.

Preservation Requires Immediate Intervention

You must act immediately to preserve potentially relevant ESI including, without limitation, from six (6) years prior to the date of the filing of the Suit up to the present time, and ongoing, in any way relating to the products implicated by the '073 Patent.

Adequate preservation of ESI requires more than simply refraining from efforts to destroy or dispose of such evidence. You must also intervene to prevent loss due to routine operations and employ proper techniques and protocol suited to protection of ESI. You should be advised that sources of ESI that are altered and erased may very well be detectable and subject you to sanctions. You should also be advised that sources of ESI are altered and erased by continued use of your computers and other devices.

Consequently, alteration and erasure may result from your failure to act diligently and responsibly to prevent loss or corruption of ESI.

Suspension of Routine Destruction

We request that you immediately initiate a litigation hold for potentially relevant ESI, documents and tangible things, and to act diligently and in good faith to secure and audit compliance with this litigation hold. Your failure to do so is gross negligence. You are further directed to immediately identify and modify or suspend features of your information systems and devices that, in routine operation, operate to cause the loss of potentially relevant ESI. Examples of such features and operations include:

- Purging the contents of email repositories by age, capacity or other criteria;
- Using data or media wiping, disposal, erasure or encryption utilities or devices;
- Overwriting, erasing, destroying or discarding backup media;
- Reassigning, re-imaging or disposing of systems, servers, devices or media;
- Running antivirus or other programs affecting wholesale metadata alteration;
- Releasing or purging online storage repositories;
- Using metadata or stripper utilities;
- Disabling server or IM logging; and
- Executing drive or file defragmentation or compression programs.

Obligation to Guard Against Deletion

It should be anticipated that your employees, officers or others may seek to hide, destroy or alter ESI and you should act to prevent or guard against such actions. Especially where company machines have been used for Internet access or personal communications, it should be anticipated that users may seek to delete or destroy information unrelated to the Suit that they regard as personal, confidential or embarrassing and, in doing so, may also delete or destroy potentially relevant ESI. This concern is not one unique to you or your employees or officers. It is simply an event that occurs with such regularity in electronic discovery efforts that any custodian of ESI and their counsel are obliged to anticipate and guard against its occurrence.

You should take affirmative steps to prevent anyone with access to your data, systems and archives from seeking to modify, destroy or hide electronic evidence on network or local hard drives. With respect to local hard drives, a method of protecting existing data on local hard drives is through the creation and authentication of a forensically qualified image of the sectors of the drive.

With respect to specific ESI in relevant to the Suit, we understand that Your employees may have frequently used computers and smart phones. We also understand that employees regularly communicate via email. You should take affirmative steps to prevent anyone with access to these systems from seeking to modify, destroy, or delete any ESI contained on their laptops, PCs, or personal smart phones.

With respect to servers like those used to manage electronic mail (e.g., Microsoft Exchange) or networked storage (often called a user's network share), the complete contents of each user's network share and email accounts should also be preserved.

To the extent that officers, board members or employees have sent or received potentially relevant emails or created potentially relevant documents away from the office, you must preserve the content of the systems, devices and media used for these purposes. Similarly, if employees, officers or board members used online or browser-based email accounts or services (such as Gmail) to send or receive potentially relevant messages and attachments, the contents of these account mailboxes should be preserved.

Agents and Third Parties

Your preservation obligation extends beyond ESI in your care, possession or custody and includes ESI in the custody of others that is subject to your direction or control. Accordingly, you must notify any current or former agent, employee, custodian or contractor in possession of potentially relevant ESI to preserve such ESI to the full extent of your obligation.

System Sequestration

We suggest that with respect to certain individuals with significant knowledge of Company's products implicated by the '073 Patent, that you remove their ESI systems, media and devices from service to properly sequester and protect them. This may be the most appropriate and cost effective preservation step to ensure non-destruction of ESI.

We are available to discuss reasonable preservation steps of ESI in your possession, custody or control. However, you should not defer preservation steps pending such discussion because ESI may be lost or corrupted as a consequence of delay.

Should your failure to preserve potentially relevant ESI result in the loss, corruption or inability to produce evidence in this matter, such failure may constitute spoliation

of evidence and we will not hesitate to seek sanctions, court costs, or an independent action for spoliation where appropriate.

Thank you for your attention to this matter. We look forward to hearing from you as soon as possible.

Very truly yours,

[redacted]

of Aeton Law Partners

Attachments

Make Communications & Computing
PO Box 762
Los Gatos, CA 95031-0762

October 10, 2013

To: Mr. Kevin O'Connor, CEO
FindTheBest.com
PO Box 1259
Summerland, CA 93067-1259

Dear Mr. O'Connor:

Please be advised that FindTheBest.com is using automatic scrolling technology on their web-site, technology which we believe to be covered under MCC patents and therefore likely infringing on MakeCom Intellectual Property.

This technology is specifically protected under patents #7,308,653B2, #7,712,044B2, and #8,108,792B2 and requires a license for use. The following link to FindTheBest.com's home page shows the infringement:

http://www.findthebest.com/
http://www.findthedata.org/

Please contact MakeCom ((408) 560-1591) immediately to discuss arrangements for obtaining the necessary license.

With best regards

Catherine Lin-Hendel
Founder and CEO

Leventhal Law

November 8, 2013

Catherine Lin-Hendel
Make Communications & Computing
P.O. Box 762
Los Gatos, CA 95031-0762

Dear Ms. Lin-Hendel:

We received your October 10, 2013 letter asserting that our client, Findthebest.com, Inc. ("FTB"), is allegedly using automatic scrolling technology on its website that Make Communications & Computing ("MCC") believes is covered under U.S. Patent Nos. 7,308,653, 7,712,044, and 8,108,792 (the "MCC Patents") and demanding that FTB contact MCC to discuss entering into a license to use the technology covered by those patents.

As an initial matter, your letter lacks many important details that would facilitate our review of the MCC Patents and MCC's allegations of infringement. For example, the letter contains no information about:

- There are more than 75 claims between the three patents and you fail to identify the specific claims that MCC asserts FTB allegedly infringes.
- The specific reasons why MCC believes that FTB is infringing including the due diligence MCC engaged in prior to October 10, 2013, to determine purported infringement.
- A description of the specific functionality or attributes of FTB's website that MCC alleges are infringing the MCC Patents. Referencing a link to FTB's homepage as a description of infringement is meaningless.
- The names of all parties with financial interests in the MCC Patents.
- Licensing fees or royalties that MCC believes FTB should pay.
- The names of any other parties to whom MCC, or any other party with financial interests in the MCC Patents, have sent communications alleging infringement of the MCC Patents.

Without this critical information, it is difficult to fully evaluate MCC's claims of infringement against FTB. We have, however, reviewed the MCC Patents and the FTB website and concluded that FTB does not infringe the MCC Patents. Moreoever, we question the validity of the MCC Patents.

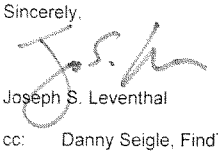
FTB takes allegations of infringement and abuse of the patent/legal system very seriously and will defend itself vigorously should MCC decide to pursue unfounded and frivolous litigation. In the most recent example, FTB is defending itself in litigation initiated by Lumen View Technology LLC (Case No. 13CV3599 pending in the U.S. District Court for the Southern District of New York), which has been the subject of extensive media coverage in print and online publications such as *ArsTechnica*, *The Washington Post*, *Bloomberg Business Week*, as well as many other business and legal industry blogs.

600 West Broadway, Suite 700 | San Diego, California 92101 | Phone: 619/356-3518 | Fax: 619/615-2082

Leventhal Law

We trust that our response resolves this matter to MCC's satisfaction.

Sincerely,



Joseph S. Leventhal

cc: Danny Seigle, FindTheBest.com, Inc.

600 West Broadway, Suite 700 | San Diego, California 92101 | Phone: 619/366.3518 | Fax: 619/615.2082

Mr. MURPHY. Thank you. Mr. Bragiel, you may take 5 minutes.

TESTIMONY OF JUSTIN BRAGIEL

Mr. BRAGIEL. Thank you, Mr. Chairman and members of the committee. My name is Justin Bragiel. I am General Counsel at Texas Hotel and Lodging Association. Thank you for inviting me to testify today.

We represent approximately 2,000 hotels across the great State of Texas, about 500 additional members on top of that. We have been in existence since 1903, and our mission is to advocate for and serve the Texas lodging industry.

Our members work and live all across Texas, but one region in particular of the State has been plagued recently by a great deal of patent litigation activity, and this is, for historical reasons the Eastern District of Texas, known often as the rocket docket, sees and hears more cases related to patents per capita than any other jurisdiction in the United States.

Our members sell a product we are all familiar with, hotel rooms, right? I represent the hotel industry. It is really simple. And so oftentimes I have been asked over the last couple of days, why are you going to Washington to testify on a patent issue? What in the world does a hotel do that is related to patents? Our members, our operators, don't understand patents. We don't file for patents when we build our lodging properties, nor when we operate them. But our members have been given and served with not only demand letters but actually lawsuits as well for failing to answer demand letters, simply for providing Wi-fi in the hotels to guests. We all understand that concept as well. Our guests expect and demand wireless technology. It is a part of this day and age in staying at a hotel. It is a very simple product that we offer. And yet, we have been sued, our members have been sued. Almost 100 hotels across the State of Texas were sued in the last 6 months or 9 months for allegedly infringing upon the Wi-fi patent held by one particular patent troll.

The letters start as a shakedown. Pay us $5,000. This is a significantly smaller sum, but a sum that would be attractive for an independent lodging operator to seize upon to settle. Pay us $5,000 as a licensing fee, and we won't file suit against you. If our member, our hotelier ignores that letter, they receive a lawsuit in the mail months later that alleges the hotel is continuing to infringe upon the patent holder's patent by providing Wi-fi to hotel guests, and a suit like this, as we have heard, can cost upwards of a million dollars to defend, $100,000 just to start the process with an IP attorney. And again, all our hotelier does is operate a hotel, right? We don't deal with patents. We have no way to know when we buy a wireless access point or a wireless router whether or not the manufacturer has provided all pertinent licensing on fees and patents to the patent holders. We don't know that. We are not in that business. We have no way of knowing which brands of equipment will be singled out. We have no way of identifying which one of our members will be targeted for a demand letter or a lawsuit. It is really incredible.

So I get calls every day from hoteliers across the State of Texas with legal questions. They ask the most basic legal questions you

can imagine oftentimes, and usually all of our questions are related to how can I avoid potential litigation, how can I avoid potential liability. I have no answer for any my members on this issue, none at all. There is not a brand of Wi-fi router or piece of equipment that I can tell them and assure them that they will not be sued for purchasing and operating. It is a real problem for us.

So we are here to ask for smart patent reform to look at this process. We need some protection for the end users here. We are not experts in the patent field, we are not. And, you know, to be targeted like this, it really is just a shakedown.

I am here for questions. Thank you so much for inviting me to testify.

[The prepared statement of Mr. Bragiel follows:]

Hearing: Subcommittee on Oversight and Investigations
The Impact of Patent Assertion Entities on Innovation and the Economy
Thursday, November 14, 2013

Witness: Justin Bragiel
General Counsel
Texas Hotel & Lodging Association
1707 West Ave., Austin, TX 78701
512-474-2996
jbragiel@texaslodging.com

Mr. Chairmen and Members of Congress:

I am Justin Bragiel; I am general counsel for the Texas Hotel and Lodging Association (THLA). Our organization was founded in 1903, and we represent over 2,000 hotels across the State of Texas. Our member properties range in size from small one-room bed-and-breakfasts, to the largest convention center hotels with thousands of rooms. THLA is the largest state hotel association in the nation in both the number of hotel properties and hotel rooms we represent. It is my pleasure to advocate for our industry, and we appreciate the opportunity to testify before the Subcommittee.

Marshall, Texas is home to the Eastern District of Texas, a federal judicial district that has become synonymous with patent lawsuits. Referred to colloquially as the "rocket docket," the Eastern District of Texas often hears the most patent cases per capita. As a result, the Eastern District has developed an expertise in patent cases, and many patent lawsuits originate there.

Abuse of the patent litigation process by patent assertion entities (PAEs) has long been an issue for technology-related firms, and estimates from our coalition indicate this abuse costs the U.S. economy about $80 billion every year in lost revenues and productivity. Recently, some PAEs have taken to targeting innocent product purchasers with allegations of patent infringement. Over the last year, almost 100 hotels in Texas have been subjected to lawsuits over alleged patent infringement by, simply because the hotel operates wireless internet devices (i.e. providing WiFi to hotel guests)

The effect on our industry has been detrimental and problematic. It is easy to put yourself into the shoes of a hotelier. Our guests expect WiFi internet connections at our lodging properties, and hotel brands require their franchisees to provide it. The hotelier contacts a vendor, purchases a wireless router or access point off the shelf, and installs it on the property. Months or years later, the hotelier receives a federal civil complaint, alleging that her operation of a WiFi device is infringing upon a PAE's patent. The complaint is accompanied by a simple demand: Pay the PAE $5,000, or risk going to trial. Defending a patent lawsuit can cost hundreds of thousands of dollars due to the complexity of the case. Meanwhile, our hotelier has done nothing more than purchase a device off the shelf, install it, and operate it exactly as the manufacturer intended.

Our member hotel properties do not have expertise in electrical engineering. It is not possible for us to verify whether a device manufacturer has licensed all appropriate patents before we purchase the device. We do not even know what devices and device manufacturers may be covered by a given

patent. Our business is selling hotel rooms and taking care of guests, yet we are being shaken down and forced into a settlement, simply for purchasing an electronic device.

We need smart reform in addressing the PAE problem. Under the current system, it is not possible for us to predict which hoteliers will be sued for which technology, which brands of devices to buy or avoid, how much the PAE will demand in settlement, or whether the device manufacturer will intervene and defend us. Instead, this is a drag on our business, and in addition to the settlement, it is costing us lost productivity and revenue.

The American hotel and lodging sector is an essential part of the U.S. economy. Over 600,000 Texans are employed in the travel and tourism industry, and we are an essential component of both the U.S. and Texas economy. Reforming PAE abuse will help ensure our long-term viability and give our industry predictability and economic grown.

Thank you.

Justin Bragiel
General Counsel
Texas Hotel & Lodging Association

Mr. MURPHY. Thank you. I think we can—do you have a full 5 minutes you need because we will have to come back then and——

Ms. DEGETTE. OK. I am going to go vote.

Mr. RICHARDSON. I have time to do this.

Mr. MURPHY. All right. I will do it. Real quick then, thank you. Go ahead.

TESTIMONY OF JAMIE RICHARDSON

Mr. RICHARDSON. Chairman and Ranking Member DeGette and esteemed members of the committee, thank you so much for the chance to testify on behalf of White Castle and the National Restaurant Association.

For us, White Castle is a family-owned business. It started in 1921 in Wichita, Kansas. Today we are based in Columbus, Ohio. But throughout our entire history, it has been a history of famous firsts. So we are big believers in intellectual property rights and understand the importance of this debate when it comes to patents.

But for White Castle specifically, what we have been faced to deal with in the past year are four specific patent troll cases that we have had to face. And a lot of it has to do with how we connect with our customers. So we have lots of new technologies that we are trying to employ. For instance, the CR codes, the QR codes, that will go on a package that make it easy to scan and to find out for a customer how to link to information, we got a letter about that, asking that we refrain from using that further. We had a second one show up because we inserted a link into a customer email, to once again make it easier for customers to get the information they crave and received a letter on that. Most recently we received a letter about having our White Castle logo appear on a White Castle map on our mobile app that we have created for our phone with a firm claiming that they own the patent to place a logo on a map. And most discouraging of all is we are trying to be compliant with things like menu labeling that require that we soon post nutritional information on our menu boards. We have started to look at digital menu boards. Along the path towards implying digital menu boards, we didn't even get the benefit of a demand letter, we got a suit filed by one of the patent trolls. And that is what we are going to call them at White Castle because that is what they are to us. And in that suit it claimed that we can't transfer information electronically to our digital menu boards, that that is an infringement.

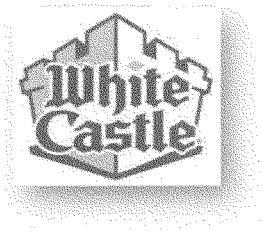
Unfortunately for us, we are small. We are a medium-sized fast-foot chain. We are a family-owned business. We don't have the dollars to litigate. We have got two very gifted attorneys internally. They are awesome, but we have to rely on outside counsel when these patent cases come up to try to get the right guidance to understand where we can go with it.

So what it has caused us to do, it has stopped us in our tracks when it comes to moving forward in talking to our customers. So the patent trolls are living under the bridge to tomorrow, and as we are trying to progress and move forward, they are slapping duct tape over our face and not allowing us to share with our customers what's really going on in providing the information that they want.

So it is a real issue for us. We have chose not to pursue these technologies. We have had to set them on the shelf. We can't afford to get involved in some type of settlement. Who knows how high that is going to go, nor can we risk litigation because we are not going to bet the White Castle system and the 10,000 people who rely on us for their livelihoods and the communities that rely on us because some folks have decided that it is OK to not obey the law and just go outside of that on their own.

So thank you for the chance to share.

[The prepared statement of Mr. Richardson follows:]





Statement for the hearing
"The Impact of Patent Assertion Entities on Innovation and the Economy"

Before the United States House of Representatives
House Energy & Commerce Subcommittee on
Oversight & Investigation

By Mr. Jamie Richardson
Vice President, Government and Shareholder Relations
White Castle System, Inc.

On behalf of the
National Restaurant Association

November 14, 2013

Chairman Murphy, Ranking Member DeGette, and esteemed members of this subcommittee, thank you for the opportunity to testify regarding patent assertion entities' impact on innovation and the economy.

I am Jamie Richardson, Vice President of Government, Shareholder and Community Relations at White Castle System, Inc. (White Castle). It is an honor to share our perspective, on behalf of our company and the National Restaurant Association.

White Castle System, Inc.

Currently based in Columbus, Ohio, White Castle first opened its doors in 1921 in Wichita, Kansas. To this day, we are a family-owned, privately-held company. The majority of our nearly 10,000 team members work in our 406 restaurant locations across 12 states. We have built several locally-based divisions to supply each restaurant, including bakeries, meat processing plants, frozen food plants and manufacturing plants that, together, produce everything we offer to White Castle customers.

White Castle is the Taste America Craves - We believe good business, great food, and responsible citizenship should all go together. Our dedication to serving our community isn't just a company priority – it's a personal commitment. It is through this commitment that White Castle has consistently been a front-runner in providing our customers with the offerings they crave. We have prided ourselves on a number of "firsts" ever since we opened our doors in 1921 as the nation's first fast food hamburger chain. White Castle was the first fast food chain to offer carry out or "to go" food packages, the first fast food chain to sell a million and then later on a billion burgers, the first fast food chain to get our product on grocery store shelves, and more recently the first fast food chain to have a website, and the first fast food hamburger chain to offer online ordering.

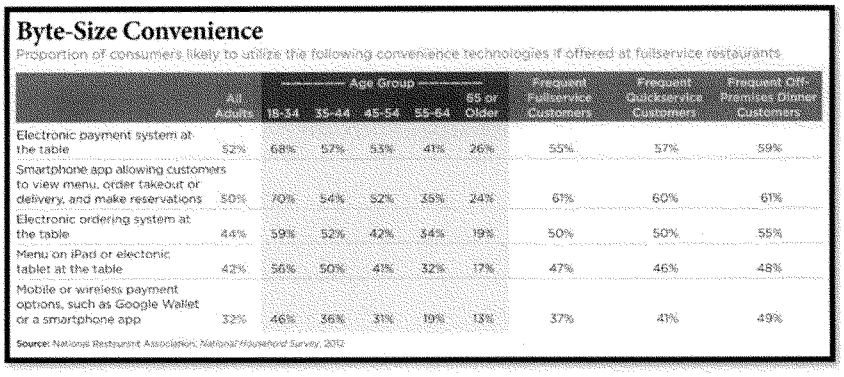
At White Castle, we have employed some of these newer "firsts" in an effort to enhance the restaurant experience for our loyal customers. Unfortunately, it is these newer "firsts" that have come under fire from frivolous patent assertion entity claims – claims which are impacting our business decisions and inhibiting our ability to provide our customers with the experience both we and they want. In order for us to continue to strive as a leader, job-creator, and innovator in the industry, it is critical that we have the ability to integrate these new technologies without the daily fear of receiving frivolous patent assertion litigation demands. The same holds true for the restaurant and foodservice industry more broadly as consumer demand for new, innovative technologies and an enhanced restaurant customer experience continues to grow.

The Restaurant and Foodservice Industry

The National Restaurant Association is the leading trade association for the restaurant and foodservice industry. Its mission is to help members establish customer loyalty, build rewarding careers, and achieve financial success.

The industry is comprised of 980,000 restaurant and foodservice outlets employing 13.1 million people who serve 130 million guests daily. The simple fact is that restaurants are job-creators. While small businesses comprise the majority of restaurants, the industry as a whole is the nation's second-largest private-sector employer, employing about ten percent of the U.S. workforce. The industry also accounts for roughly 4% of the nation's GDP with an estimated $660 billion in annual sales.[1]

National Restaurant Association data shows that restaurant operators are investing millions of dollars in new technologies to provide customers with the technology and choice they crave. Roughly 50% of all combined full-service and limited-service restaurants plan to spend a bigger share of their budgets this year on customer-facing technology such as Wi-Fi, iPads/tablets, and smartphone apps.[2] Many of these products and features, or the technology processes affiliated with them, have been the target of patent assertion entity infringement claims in the industry, which is impacting individual operator's decisions to bring these customer value-add products to market.



Byte-Size Convenience

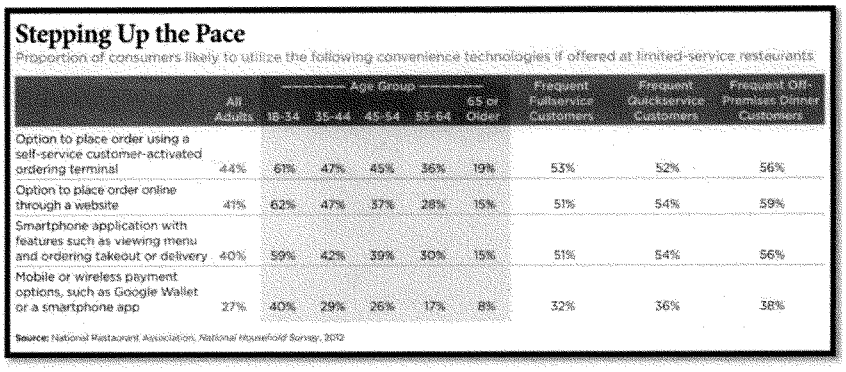
Proportion of consumers likely to utilize the following convenience technologies if offered at fullservice restaurants

	All Adults	Age Group 18-34	35-44	45-54	55-64	65 or Older	Frequent Fullservice Customers	Frequent Quickservice Customers	Frequent Off-Premises Dinner Customers
Electronic payment system at the table	52%	68%	57%	53%	41%	26%	55%	57%	59%
Smartphone app allowing customers to view menu, order takeout or delivery, and make reservations	50%	70%	54%	52%	35%	24%	61%	60%	61%
Electronic ordering system at the table	44%	59%	52%	42%	34%	19%	50%	50%	55%
Menu on iPad or electonic tablet at the table	42%	56%	50%	41%	32%	17%	47%	46%	48%
Mobile or wireless payment options, such as Google Wallet or a smartphone app	32%	46%	36%	31%	19%	13%	37%	41%	49%

Source: National Restaurant Association, National Household Survey, 2012

[1] 2013 Restaurant Industry Forecast.
[2] National Restaurant Association, Restaurant Trends Survey, 2012.

The ability for operators to bring these technologies to market will be critical as restaurateurs compete in an effort to fulfill consumer demand for new technologies. For example, if the technology was provided by a full-service restaurant, 50% of all adults would use a smartphone app to view a menu, order takeout or delivery, or make reservations. That number is a staggering 70% for adults ages 18 to 34. For limited-service restaurants, that number is 40% and 59% respectively. In short, these are technology features customers want.[3]



Stepping Up the Pace

Proportion of consumers likely to utilize the following convenience technologies if offered at limited-service restaurants

	All Adults	Age Group 18-34	35-44	45-54	55-64	65 or Older	Frequent Fullservice Customers	Frequent Quickservice Customers	Frequent Off-Premises Dinner Customers
Option to place order using a self-service customer-activated ordering terminal	44%	61%	47%	45%	36%	19%	53%	52%	56%
Option to place order online through a website	41%	62%	47%	37%	28%	15%	51%	54%	59%
Smartphone application with features such as viewing menu and ordering takeout or delivery	40%	59%	42%	39%	30%	15%	51%	54%	56%
Mobile or wireless payment options, such as Google Wallet or a smartphone app	27%	40%	29%	26%	17%	8%	32%	36%	38%

Source: National Restaurant Association, National Household Survey, 2012

The Problem & Specific Examples

White Castle and many other restaurant and foodservice companies have seen an increasing number of patent assertion entity infringement claims related predominately to new technologies and technological processes. Patent trolls often seek to extort settlements, knowing that it will be expensive and time consuming for businesses to fight the baseless claims in court. Patent assertion entities stifle innovation and inhibit the implementation of customer facing technologies at the store or e-commerce level, while draining necessary time and money from businesses.

In addition to the tangible cost, there are opportunity costs both to the business and consumer. These frivolous patent assertion entity (PAE) demands stifle retailers' ability to utilize and consider new forms of technology that consumers demand and deserve. Ultimately, PAEs' conduct harms everyone through higher prices and less innovation to the detriment of job-creating industries like ours and the customers we serve.

[3] National Restaurant Association, National Household Survey, 2012

White Castle is an end-user of the technologies in question. We have major, upfront, challenges when we receive a demand from a PAE. First, the initial demand letter is very obscure. Often, it is unclear what type of settlement a PAE is seeking or the basis of their claim. For example, we have a difficult time discerning whether or not the PAE is asking for a one-time fee or a separate license for every use. Furthermore, we almost always have to have the patent infringement claims examined by an outside patent specialist to understand if the patent infringement claim is legitimate, including whether or not such a patent exists and whether or not it is valid. At White Castle, we have some in-house legal resources, but the necessity of seeking outside counsel to investigate these PAE demands is expensive, and potentially cost prohibitive for other operators in the industry. Improved transparency in these initial demand letters would help provide a first line of defense in determining the legitimacy of PAE claims.

Second, we do not always receive a demand letter before a PAE files a suit against us. This has been our experience with one PAE. This type of litigious behavior is a bullying tactic, and an activity that can hopefully be curbed by responsible and meaningful patent litigation reform. Such reform would shift the economic dynamics that empower PAEs to employ these tactics with very limited financial risk, while preserving the ability of legitimate patent holders to bring rightful claims.

Third, many of the PAE demands we receive negatively impact our business decision-making processes, and stifle innovation by limiting our ability to employ emerging technologies in everyday aspects of our business. Specific examples of PAE demands that have impacted our ability to communicate with customers include claims against inserting a hyperlink in Shop Alerts promotions or the sending of tweets containing URLs to White Castle followers via our Twitter Feed.

Other patent infringement claims have prevented us from using White Castle's logo to pinpoint locations on our website restaurant locator. Additionally, PAEs challenged White Castle's use of QR codes on our packaging during a recent promotional campaign by inferring the use of QR codes by White Castle caused our customers to potentially use unlicensed software to scan the QR code. Both of these examples have major implications for the future of our promotional and loyalty programs, development of our website, and enhancement of our mobile smartphone app.

Impact of PAEs on Business and Innovation

White Castle's entire approach to marketing has changed as a result of threatening PAE demands. Rather than pay fees to patent trolls, or spend significant resources to hire outside patent counsel, we have refrained from utilizing the alleged infringed activities. The unfortunate byproduct is that our use of QR codes and hyperlinks will be limited in the future despite the value those basic technologies can bring to our customers. Creative website designs will be passed up. And, we may make the strategic decision to cease using digital menu boards despite the potential business efficiencies they create for our operators and customers by allowing us to

provide real-time up-to-date information about our latest products, promotions, and offering. Where we continue to utilize any of these, or similar technologies in social media, advertising, or other parts of the business, we will proceed with extreme caution treating unchartered territory like a field of landmines.

As a result of PAE demands, commonplace, everyday business risks have turned into expensive liabilities. Existing PAE demands, and the threat of further PAE demands, have significantly impacted White Castle's approach and willingness to utilize third-party technology providers. For example, we seek broader indemnification provisions in our agreements and we are less willing to take a chance on emerging technologies or new providers if the potential for a PAE claim exists.

If we at White Castle have modified our approach to partnering with third-party technology providers, there are certainly others in our industry doing the same. Suppliers of the technology services who are threatened by these types of dubious PAE litigation claims cannot shed the shadow of doubt cast upon their enterprise. This stifles the growth of entrepreneurs that are trying to gain a foothold in the industry. All of this results in the stifling of profitability, ingenuity, and growth, three things that we desperately need in an economy that is straining to grow.

Conclusion:

It is clear that PAE demands are negatively impacting innovation and the economy as evidenced by White Castle's experience and that of others within our industry.

On behalf of our customers, the industry, and the 13.1 million employees who depend on us for their very livelihood, we strongly encourage Congress to seek PAE reforms that create transparency; remove barriers to innovation so the free market for new, emerging technologies can flourish; and to provide end-users of technology critical relief from egregious PAE demand tactics. In a letter to Congress (Attachment #1), thirty-six state restaurant associations joined the National Restaurant Association in calling for meaningful and responsible patent reforms that begin with increased demand letter transparency.

Thank you, once again, Chairman Murphy, Ranking Member DeGette and members of this subcommittee for holding this critical hearing. This is a vital step in shedding light on the growing problem of PAEs and the negative affect they have on business, innovation, and the economy. We urge Congress to pass meaningful reforms, without delay, so White Castle, and others in the restaurant and foodservice industry can continue to invest in our business, our employees, and our loyal customers by enabling the seamless rollout of innovative, new technologies that improve business efficiencies and meet consumer demand. Thank you.

NATIONAL RESTAURANT ASSOCIATION

November 12, 2013

Chairman Bob Goodlatte
United States House of Representatives
Judiciary Committee

Ranking Member, John Conyers, Jr.
United States House of Representatives
Judiciary Committee

Chairman Fred Upton
United States House of Representatives
Energy & Commerce Committee

Ranking Member, Henry Waxman
United States House of Representatives
Energy & Commerce Committee

Chairmen Goodlatte and Upton and Ranking Members Conyers and Waxman:

On behalf of our nation's restaurant and foodservice industry, the National Restaurant Association strongly supports reforms to provide technology end-users with relief from abusive patent assertion entities' (PAEs or patent trolls) demands. The restaurant and foodservice industry consists of roughly 980,000 locations nationwide with estimated sales of $660 billion accounting for roughly 4% of our nation's GDP. The industry is also the 2nd largest private employer in the United States with over 13.1 million employees. Roughly 90% of the industry consists of small business owners.

This time last year, very few industry members had heard of patent trolls. Unfortunately, since then, our industry has been increasingly barraged with ill-founded patent infringement litigation demand letters challenging the use of basic technologies in our establishments, on our websites, and on individuals' smartphones. Many of the technologies that have come under fire from patent trolls are ones that provide extensive value-added services to our customers, such as in-store Internet WiFi access, online nutrition calculators, and restaurant locators on websites and in store-branded smartphone applications. The restaurant industry is constantly evolving to provide exceptional service to our customers. In the process, we work closely with innovative entrepreneurs in the technology space. Unfortunately, even the threat of litigation deters restaurants from partnering with new and innovative third-party technology providers. We in no way wish to inhibit small inventors and other patent holders' ability to bring legitimate claims, but trolls, with frivolous claims, provide no value to the overall economy and must be tempered from steering valuable resources and time away from job-creating industries.

NATIONAL RESTAURANT ASSOCIATION

It is critical to create a more equitable and transparent environment that changes the economic dynamics for patent trolls. Currently, there is very little risk or exposure for patent trolls who send frivolous patent infringement demand letters. In order to shift these economic dynamics, patent litigation reform and increased transparency on demand letters are key reform priorities for our industry, along with any other reasonable solutions that make it more difficult for patent trolls to prey on end-user companies, such as restaurants.

When a business receives a litigation demand letter, it has to weigh the validity of the patent infringement claims and make a decision about how to respond to the letter. Often, it is easier to settle even baseless infringement claims rather than fight the patent trolls because of the extensive time and resources it would take to litigate the claim. For all businesses, and particularly small businesses, the first step in this decision-making process is determining the legitimacy of the patent assertion entity's claims. Demand letters often lack the information and transparency necessary for business owners to research and make a simple assessment about whether the patent infringement claim has merit. Requiring additional information and transparency on the actual demand letters, as well as increased information online at a trusted third-party website about pending patent litigation and patent troll companies, will help provide small business owners with a first line of defense to assess the validity of many of the patent infringement claims they are seeing at an increasingly alarming rate.

We are pleased that Senator Leahy and others have encouraged the Federal Trade Commission to utilize its existing authority and powers to combat abusive patent troll behavior, including egregious demand letter practices. We are hopeful that legislators will make demand letter transparency a top priority for any patent reform legislation as Congress moves forward. The bottom line is that patent trolls and their frivolous litigation demand letter claims are drain on business and the economy, and it is critical that we reform the system to make it more difficult for the patent trolls to prey on industries like ours who add value to the communities we serve.

Sincerely,

National Restaurant Association
Alabama Restaurant & Hospitality Alliance
Arizona Restaurant Association
Arkansas Hospitality Association
California Restaurant Association
Colorado Restaurant Association
Delaware Restaurant Association
Florida Restaurant & Lodging Association
Georgia Restaurant Association
Iowa Restaurant Association



Idaho Lodging & Restaurant Association
Illinois Restaurant Association
Louisiana Restaurant Association
Restaurant Association of Maryland
Michigan Restaurant Association
Mississippi Hospitality & Restaurant Association
Nebraska Restaurant Association
New Hampshire Lodging & Restaurant Association
New Jersey Restaurant Association
New Mexico Restaurant Association
New York State Restaurant Association
North Carolina Restaurant & Lodging Association
North Dakota Hospitality Association
Ohio Restaurant Association
Oklahoma Restaurant Association
Oregon Restaurant & Lodging Association
Pennsylvania Restaurant & Lodging Association
Rhode Island Hospitality Association
South Carolina Restaurant & Lodging Association
South Dakota Retailers Association – Restaurant Division
Tennessee Hospitality Association
Texas Restaurant Association
Utah Restaurant Association
Vermont Chamber of Commerce
Virginia Hospitality & Travel Association
West Virginia Hospitality & Travel Association
Wisconsin Restaurant Association

Mr. MURPHY. Thank you. I appreciate your winding that up. We have zero time left, so we have to run to the floor and vote real quick. I will be back here within half-an-hour, so don't go too far away, and we will be right back. Thank you.

[Recess.]

Mr. MURPHY. Thank you. We are reconvening this hearing of the Oversight and Investigation hearing on patent assertion practices, and thank you for your patience, panelists, as we move forward with this.

A number of my colleagues are on the floor in speeches, et cetera. We will go through and perhaps I might ask if it is a matter that we will go through our questions back and forth, but if I have a couple extra questions on behalf of other members, I don't think we will be going much more than probably a half-an-hour behind.

Ms. DEGETTE. That is fine, and you know, this Committee has a history of allowing questions in writing. And Mr. Chairman, if you would agree to that, unfortunately, most of the rest of the Democrats probably won't be back because we have a Democratic Caucus meeting right now, and I don't know what the Republicans have going.

But I know that Members on this Subcommittee are very concerned about this issue. So if we could allow members to submit written questions, that would be wonderful.

Mr. MURPHY. I absolutely will. And so what I will do is I will take 5 minutes, yourself and then if——

Ms. DEGETTE. Sure.

Mr. MURPHY [continuing]. Go to a colleague there and I may ask couple other questions with unanimous consent. We will proceed from there. See how nice we get along? This is an important issue to all of us.

Well, obviously from the panelists here, and I will start with myself for 5 minutes, you have similar perspectives on the impact of these demand letters that had on your companies or on businesses in general. They are rather remarkable, the vagueness of them and the content and the impact they have.

For those of you who have actually received demand letters, is this a recent phenomenon? Who can speak to that? Who received this? Mr. Cheng, did you receive one of those letters? Is this a recent issue?

Mr. CHENG. Well, we have been getting them for about 8 years. So it depends on what you define as recent, right? So it somewhat coincided with my arrival at Newegg, but I had nothing to do with it.

So we crossed the billion dollar revenue mark right around that time. Historically trolls, they just had such a wide field, easy pickings, that they would literally go down lists of the largest or the largest companies or the most accessible companies. Getting your name as the fastest-growing company in the Los Angeles Business Journal was going to make you—that is what they based their demand letters on. And in recent years, as the trolling industry has demonstrated how lucrative trolling can be, more and more companies are getting demand letters.

In some areas, the volume of demand letters is actually declining with larger trolls. They just go straight to litigation because under

the Medtronic, there is case law that states that a demand letter that is very detailed will give a prospective defendant the right to file declaratory judgment action in a venue not of the troll's choosing.

So with larger defendants, sometimes the trolls will actually just go straight to litigation now. But for the smaller companies and start-ups, in all likelihood, their demand letter volume is increasing.

Mr. MURPHY. Ms. Feldman, why have these trends gone the way they have, with more of these taking place and with the kind of problems that have been described here today?

Ms. FELDMAN. I think some very clever and very sophisticated people figured out how to game the system. Once that had happened, it was so lucrative that everyone became interested in jumping on the bandwagon.

In the start-up study that I mentioned, most of those who financed start-up companies say that these demands have increased dramatically in the last 5 years against the portfolio companies.

Mr. MURPHY. Ms. Feldman, you are an attorney, correct?

Ms. FELDMAN. I am a professor.

Mr. MURPHY. Anybody here who is an attorney in this? Mr. Duan, you are an attorney. Why hasn't the Bar Association brought up ethics concerns against those who just do this without information and just move forward?

Mr. DUAN. Well, I think there are a number of concerns, you know. Number one, as I think a number of the witnesses have alluded to, we often don't know who is behind a lot of these sorts of things. They hide behind shell companies, we don't know all who is really behind a lot of the demand letters. So it would be hard for the bar to go after them.

Now, in terms of what the lawyers are sending out, they are sending out letters that are threatening, they are sending out letters that are uninformative. But they are not sending out letters that are illegal. Everything that they are saying is just communication, and there is nothing wrong with communication. The problem is that the underlying demands, which are being made not by the law firms themselves but by the companies that are being represented by the law firms, those are the aspects that are problematic.

Mr. MURPHY. But what separates a good-faith request or good-faith letter from one that is a trolling one?

Mr. DUAN. Well, I think it starts from the investigation that goes behind the letter. In my practice, if we thought that there was infringement of a legitimate patent, we would look at the products, we would identify what features the product infringed, why they infringed, we looked carefully at the patents to make sure that everything was set and then we would have a conversation.

What I think we are seeing with a lot of these demand letters, they are taking the shotgun approach that Professor Feldman talked about. We are not seeing the sort of investigation. I think I mentioned that MPHJ has sent out letters that don't even talk about what the business itself does to infringe. The simply say that businesses like yours infringe. So therefore you should pay us a licensing fee. You know, I think there are plenty of examples. If you

take a look at some of the demand letters on EFF's Trolling Effects Web site, you'll see plenty of examples of letters that really evince no knowledge of what the company does, why they think the products infringe, what they think is wrong and what they want the companies to do. And that is where the abuse comes in.

Mr. MURPHY. Real quickly, Ms. Feldman, I have just a few seconds left, you testified that in recent years a new business model of patent demands have developed. Can you expand on what this old business model entailed, why it has changed, what impact this change has had on businesses and consumers?

Ms. FELDMAN. Yes, traditionally most patents didn't garner a return. It is very difficult to translate a patent into an actual product. It normally takes lots of patents and lots of knowhow to do that. The Patent Office has about 18 hours over a period of 2 years to look at patents, and these patents may have dozens of claims in them.

So no one really worried that lots and lots of patents were being granted because the ones we cared about ended up in court. With a new business model, all of these patents, each individual ones, can be separated out and launched against companies. It is that particular business model that is wreaking havoc for companies across the country.

Mr. MURPHY. Thank you. I see my time—I appreciate it. I now recognize Ms. DeGette for 5 minutes.

Ms. DEGETTE. Well, following up on that, Ms. Feldman, and then what happens? So there are all these patents that were granted. The review, the patent examiner was minimal in many cases. So there are a lot of patents, and a lot of them are duplicative, right?

Ms. FELDMAN. Yes, and also a legitimate patent doesn't mean that you are launching it at an appropriate target.

Ms. DEGETTE. Right.

Ms. FELDMAN. You may have a valid patent. You are just sending it indiscriminately to lots of people.

Ms. DEGETTE. And it doesn't mean that the people who you are targeting have in any way infringed against that patent, right?

Ms. FELDMAN. That is right.

Ms. DEGETTE. And most of these patents that we are talking about here are patents that have been obtained by these third parties. So it is not like it is the inventor who filed the patent application and had it granted. It is some third party, right?

Ms. FELDMAN. It is true, although there is a new approach that appear to be happening which is let's file patents and see if we can go after companies with these.

The key question is, are there products being made or are you just knocking on the door of existing companies asking for a handout?

Ms. DEGETTE. Right. When Mr. Duan and Ms. Feldman, when you were answering that question, I was reading one of the letters that Mr. Cheng was referring to where it says FindtheBest is using automatic scrolling technology on their Web site, technology which we believe to be covered, and it doesn't even say specifically what that is, right?

Mr. CHENG. It is actually——

Ms. DEGETTE. Oh, it is Mr. Seigle?

Mr. CHENG [continuing]. Seigle's letter——

Ms. DEGETTE. Sorry.

Mr. CHENG [continuing]. But we have gotten letters like that, too.

Ms. DEGETTE. Yes. Sorry, Mr. Seigle.

Mr. SEIGLE. Yes. When you get this letter, and you are not a legal expert like me, you have to start investigating this, and there are 78 claims in those three patents and you have noticed they don't mention which claims we can be infringing on.

Ms. DEGETTE. Right.

Mr. SEIGLE. So there is no due diligence on their part. There is no reason to believe they have a good-faith reason to believe we infringe. They just take this template, insert company name, insert link to home page and send it out.

Ms. DEGETTE. Yes. I can see that. Mr. Chairman, I don't know if these are in the record, but I would like to put these two letters that Mr. Seigle had referred to in the record because it is frightening.

And you know, even if you are a legal expert, if you look at these—I am sure you sent them along to your lawyer, and then the lawyer is having to—because I myself am a lawyer, and I used to represent companies before I came to Congress, and I had clients who got letters like this. And we had to comb through the patents, and it is even confusing to the lawyers.

This goes back, Mr. Chairman, to what you were asking about, why doesn't the Bar Association enforce this. Oftentimes if the patent trolls are the legal owners of these patents, then it is really legally a matter for the court to decide whether or not they are infringing. And it is really a problem.

I wanted to ask both you, Mr. Duan, and you, Professor Feldman, what separates a so-called patent troll from a legitimate company asserting its patent? Can we really come up with a bright line here?

Ms. FELDMAN. I think the question to focus on is whether there are new products coming out of this. There has been a lot of attention on patent trolling, and no one wants to be the bad guy and everyone wants to draw a definition that says I am not a bad guy, that is over there. And you can parse these in many different ways, but it all comes back to, it seems to me, grant patents in order to get new products out for society and strengthen the economy. And the question is, where are the new products of this activity? Is any of that coming out of here or is this just a tax on current production? You have to pay it in order to go about your business.

Ms. DEGETTE. What do you think, Mr. Duan?

Mr. DUAN. So I agree. I think there is a very simple definition for what a patent troll is. A patent troll is somebody who uses patents to abuse the system to reduce social value for their own personal profit.

Ms. DEGETTE. OK, but that is not a legal standard.

Mr. DUAN. I understand that it is not a legal standard. I think that when we look at what we want to do in terms of regulation, right, we shouldn't be focusing on how are you making your money. We should really be focusing on, what is the behavior that you are taking advantage of, right?

In this case, the behavior that they are taking advantage of in order to threaten people in detriment to society is they are sending out letters that really don't provide information, that basically just tax companies that are actually producing and on the flipside, they don't produce anything themselves.

Ms. DEGETTE. Well, there are a lot of suggestions different people have, both in front of the Judiciary Committee and this committee and in the Senate, so I would ask both of you and also the rest of the panel, if you have ideas for things we can do in statute to help prevent this kind of behavior, to set that bright line, that would be really helpful to us. And I yield back. Thank you, Mr. Chairman.

Mr. MURPHY. Thank you, yield back. Now we will go to the gentleman from Virginia, Mr. Griffith, for 5 minutes.

Mr. GRIFFITH. Thank you, Mr. Chairman. Following up on that, Mr. Seigle, I was intrigued with some of your comments in regard to what Ms. DeGette was just talking about, some ideas. And I believe, if I remember your testimony correctly, what you indicated was that if you were going to send a letter of this nature, because you might have a legitimate claim, then make it a requirement that that claim be stated up front. Did I understand that correctly and would you expand on that, please?

Mr. SEIGLE. That is correct. If they actually had proof that they did proper due diligence to have a reasonable belief that we infringed, we would happily discuss the infringement contentions with them and try to come to a resolution if they were in good faith. It is very clear from the letters we have been getting that they do not have that good-faith intention. It is spray and play, although the demand letters are all the same, just with a different company name.

Mr. GRIFFITH. And so all they say we have reason to believe that you may have violated——

Mr. SEIGLE. Yes.

Mr. GRIFFITH [continuing]. The terms of our patent and therefore pay up?

Mr. SEIGLE. And then when we called them at Lumen View, it was very clear they hadn't even been to our Web site, didn't really understand the functionality, didn't even understand their patent that well, too. So it is very hard to deal with the situation when they are actually more concerned on the cost of defense as their main reason for exercising these demand letters as opposed to the merits of the infringement.

Mr. GRIFFITH. Right. Of course, it is not always easy to figure that out, and somebody may have a legitimate claim. Even though their motives may not be great, they may actually have a legitimate claim. But it does seem to me that we ought to be able to work out some language probably in the Judiciary Committee, but perhaps we can in this Committee as well figure out some language that ought to be included in that letter that would be a requirement that you notify the company prior to filing a lawsuit. I don't think you can say necessarily the first letter, but you could say that prior to filing a lawsuit on such a claim, you have to provide the defendant company or defendant individual, whichever it may be, with the following information and then go A, B, C, D, E to ba-

sically, to state a reasonably articulate theory of why you think you have been damaged.

Mr. SEIGLE. Yes, and at a very minimum, the claims and the patent that they are actually inserting, there are usually lots of claims on a given patent. In our case, they don't mention which claims. And so that has an undue amount of work and time and effort on our part to then have to research every claim. So at a minimum, they should disclose which claims, provide some evidence of due diligence, screen shots from your Web site, what evidence they have to believe that you infringe, and with that, we are OK with those. That shows they have a good intent to potentially resolve this issue. It is this type of behavior that we think needs to stop, and I think a lot of it is just because it is so easy to send a demand letter. There should be some minimum standards of what that should entail.

Mr. GRIFFITH. Well, I appreciate that very much. Mr. Richardson, you indicated that you all had gotten a letter for just linking a site? Was it the site that they were upset about or the fact that you used linking technology because I am surprised——

Mr. RICHARDSON. Yes——

Mr. GRIFFITH [continuing]. Every Member of—if it is linking technology, I am surprised every Member of Congress hadn't gotten a letter. I link stuff through my Web site every day.

Mr. RICHARDSON. You never know. Today's mail might not be here yet.

Mr. GRIFFITH. Well, that is a good point.

Mr. RICHARDSON. That is exactly what the claim was, and it was insertion of a hyperlink, a URL into Tweets, into a customer e-mail, just to make it easier to direct our customers who had opted in, who wanted this information, an easier path to get to it.

Mr. GRIFFITH. Wow. And then of course there is the safety factor because not only are there more requirements in regard to service of food as your industry does with White Castle and lots of other fast-food chains out there, people want to know what all those ingredients are. And it is not only the calorie intake, it is, you know, what are you actually putting in there because food allergies are on the rise. And you are saying that you got a letter on trying to do something like that, too, that you had to put on the shelf because you just couldn't afford to the price of litigation?

Mr. RICHARDSON. Very similar to that because as we are looking at new menu board technologies to make it easier to share that nutritional information or to change a price or change an offer, the claim there was that that was a violation actually because of how we were using the internet to send the information digitally. We would be OK if we wanted to put it on a jump drive and drive from Columbus to Louisville. But not to be able to use the internet to do that just didn't seem to make much sense to us. But that is one where they didn't even send us a letter. It went straight to litigation as others have referenced.

Mr. GRIFFITH. Wow. That is incredible. I will tell you that that is of great concern because particularly for the smaller chains or the Mom and Pops, you know, they just don't have the ability to get that information out there if they can't put it on the internet. And that is a real problem that will affect their businesses.

Mr. Chairman, I appreciate you doing this hearing. I appreciate all our witnesses being here. This is a subject area—I, too, am a lawyer, but this was—but I never represented corporations. Unless they were small Mom and Pops, I didn't do this kind of work. But I really appreciate this has been an eye-opening hearing, and thank you so much for doing it. I yield back.

Mr. MURPHY. The gentleman yields back. I now recognize Mr. Lujan for 5 minutes.

Mr. LUJAN. Mr. Chairman, thank you very much. Mr. Chairman, I appreciated it very much a point that you made in your written testimony about focusing on the abuse of activity itself rather than the form of the party involved. The point that I would like to make is your promotion of the term abusive patent asserter as opposed to the more commonly used terms of non-practicing entity and patent assertion entity because national labs-universities fall into that category. And so I am hopeful that as we talk about developing our legislation that we are very careful to go after the bad actors and make a clear differentiation between universities and the national labs coming from a State that has two national labs and a district that has what I would describe as the strongest and best national lab in the country.

But with that being said, Mr. Cheng, to you and to all of the witnesses, I would like your thoughts on that as we target this area, what can we do in that specific arena, or are you seeing activity coming from any entities such as those that I have described?

Mr. CHENG. Big picture, Congressman Lujan, I think that reform efforts at some point have to take the economic incentive to engage in abusive patent litigation away or they have to give the victims this type of litigation some recourse. Presently the system is very, very asymmetrically stacked, both substantively and procedurally against parties that get demand letters and parties that get sued. It is very easy not just to crank out demand letters but also to crank out lawsuits. Filing a lawsuit is actually not much more expensive, a form lawsuit not much more expensive than sending out a demand letter. And in all sorts of different ways, in the ways for example a shell entity can be created to file lawsuits and issue demand letters with no recourse for the victims at all, even when they win, right? I mean, there are opportunities I think for Congress to take a look at what is being done by these abusive patent asserters.

In my written testimony that you cited, my goal is to focus not on the form of the sinner but on the sin itself. We love the sinners or you know, we could, but it is their actions and activities that actually are causing a lot of harm to society. It is causing companies and entrepreneurs not be able to start their companies, not be able to spend money on creating jobs and making products that your constituents use.

Mr. LUJAN. OK. Anyone else? Mr. Seigle?

Mr. SEIGLE. I agree that educational institutions are in this weird area where they are not practicing entities, but I believe their belief in creating this technology is to license it out so that it can become a product and help spur innovation and help consumers. When I have been lobbied on The Hill the last couple of days, I have heard that the University of California school system

has been against patent reform, and as a graduate of the University of California at Berkeley, I am not so happy with that. But I think they have a good faith in what they are doing with their patents, and I would be OK with them having exclusion for being an educational institution.

Mr. LUJAN. I appreciate that, Mr. Seigle.

Ms. FELDMAN. Sir, may I comment?

Mr. LUJAN. Professor?

Ms. FELDMAN. Yes.

Mr. LUJAN. Dr. Feldman, Ms. Feldman?

Ms. FELDMAN. Thank you. The universities have a unique position as keepers of the academic flame and also recipients of taxpayer money. There is increasing pressure on universities to transfer their patents to those who would assert patents in licensing and litigation. The Association of University Technology Managers has just announced that it is going to rethink its policy of not transferring patents to non-practicing entities, and that can be troubling. So in any legislation you draft, you might want to be careful about how you craft it because if you leave out universities and joint ventures, you may create large loopholes for those who would simply purchase from, purchase rights from or join hands and hide behind universities for their activities.

Mr. LUJAN. Very important point. I appreciate that, Professor Feldman. Mr. Bragiel?

Mr. BRAGIEL. We would like to see some protections for end users. You know, again, our operators don't manufacture the technology. They just purchase it off a shelf and then installed at their property and operate it for the public.

So some sort of protection that provides protection for the end user would be fantastic. It is not just the hotelier that could be sued for a Wi-fi infringement. It could be you or I for purchasing a Wi-fi product and operating it out of our household. Allegedly we would be violating that same patent.

So we would like to see some sort of reform that involves protecting the end users, having us last in line for a lawsuit for technology we don't understand, we don't manufacture, we just merely purchase and use.

Mr. LUJAN. I appreciate that. As my time has run out, Mr. Chairman, I want to commend both the majority and minority staff for the witnesses that we have today and would invite their input and recommendations to the Committee that we could get to the FTC with the upcoming study in 2013, and I think it would be great if the FTC would actually invite the witnesses to sit down and have serious conversations with them to include those aspects of the study's law.

So thanks again, Mr. Chairman, to you and to the staff and Ranking Member DeGette.

Mr. MURPHY. Thank you. The gentleman's time has expired, and he yields back.

Speaking of the FTC, so let me follow up on that. I want to—just so you know that they are going to be conducting a formal inquiry, touch on many of the issues you have discussed today. Has any one of you had a chance to review the proposed scope of the FTC inquiry?

Ms. FELDMAN. I have looked at it.

Mr. MURPHY. Ms. Feldman? Can you talk about that?

Ms. FELDMAN. I think it is an important step. We can't solve what we can't see, and much of this is shrouded in non-disclosure agreements. I applaud those who are here and willing to speak because people have been afraid to share their experiences for fear that they will be targeted by those who propagate these lawsuits.

The FTC action contemplates looking at 25 patent assertion entities. That is a start, but it is a small piece of the puzzle. My own view is that it will probably take several types of steps so there is low-hanging fruit that can be addressed now, and then there will probably be some longer-term efforts once we understand the problem better once the FTC has finished its investigation.

Mr. MURPHY. Have any of you met with the FTC in this issue?

Ms. FELDMAN. I have spoken to staff members.

Mr. MURPHY. Have you have done that? Let me ask this of other people or two. Are there any specific issues you have encountered prior to litigation that you think the FTC should prioritize or other areas you think are receiving less attention that they should, especially those who have been involved with litigation? Mr. Seigle, is there anything that you think they should prioritize?

Mr. SEIGLE. What I was most surprised about prior to litigation was just how deceptive they are. It is very much a corrupt behavior. They threatened criminal charges against us for calling them patent trolls at one point. So behavior like that, where it is very clear just how corrupt and unfair it is, I think you will see a lot of it out there. It would be interesting for the FTC to investigate that, and I think specifically a demand letter registry would be interesting as well because I don't think anyone knows the complete scope of how many demand letters have been out there because there is no way to track it.

And if you are given a patent, you are basically given a golden ticket, the right to have a monopoly, and with that responsibility comes the right to act in good faith. And I think it would be reasonable to have them register all the demand letters they send because we are giving them that monopoly.

Mr. MURPHY. Thank you. Mr. Bragiel, do you have some comments on this in terms of what the FTC should look at?

Mr. BRAGIEL. Yes, and again, I think, some sort of protection for end users here is really key, some sort of regulation by the FTC would be helpful that prohibited this sort of predatory behavior on behalf of patent trolls prior to filing a lawsuit, be that a registry, be that some sort of a system or mechanism in place that prevents them from filing just masses of lawsuits. This is a numbers game for my clients. These patent trolls will sue hundreds of individuals and corporations all with one form letter just swapping out the name of the company. So some sort of regulation that prohibits that type of behavior from occurring would be very beneficial to us. We would see quite a bit fewer lawsuits filed, I think, in the State of Texas.

Mr. MURPHY. Mr. Richardson, can you talk about any comments you would want the FTC to pay attention to?

Mr. RICHARDSON. Yes, we would echo the sentiment that it needs to be focused on the end user. A registry is a great idea, but we

think it is a two-step, that it is real important to look at the demand letter as well and to get the clarity and understand that. You know, in our instance to echo that sentiment, one of the things we have had to deal with is using outside counsel, but our legal cost is a percentage of—our legal cost has gone from a quarter of 1 percent for patent-related issues to 20 percent in the most recent year. So it is real cost.

And Congresswoman, you referenced abuse, and the victims of the abuse are our customers and our team members and it is not just the companies, it is our neighborhoods that are suffering as a result of this.

Mr. MURPHY. Curious, what does it add to the cost of your products, all this?

Mr. RICHARDSON. You know, at this point, the real cost is opportunity cost because we are avoiding moving forward with the technology because that is our only defense. So we haven't had the big lawsuit or had any big settlements. But it is holding us back. That is the big issue.

Mr. MURPHY. Then let me ask you this. Are there other areas outside of technology that have been impacted by these recent patent assertions? Anybody?

Ms. FELDMAN. So in this start-up demand study, 70 percent of those who financed start-ups said that they had seen this in technology, but the 30 percent said that they are seeing it in life sciences as well. We know anecdotally that we are also seeing it everywhere, Mom-and-Pop stores, restaurants, coffee shops across the board. It started in technology, but it seems to have spread.

Mr. MURPHY. Thank you. Mr. Cheng?

Mr. CHENG. Yes, Mr. Chairman, we are a retailer, and it is all over—they have been targeting retailers for a couple of years already. They are hitting logistics companies. It is literally anybody with a business they think they can get money from.

But if I could have your indulgence and just to echo and expand on what Mr. Bragiel was saying earlier in terms of protections for end users I think is some sort of regulation that could expand the doctrine of exhaustion to help at least end users at least have a defense up front to patent infringement assertion as long as they are licensing or purchasing technology or products in good faith from another party. That would be very, very helpful.

Mr. MURPHY. Thank you very much. I see my time has expired. I really wanted to ask Mr. Richardson if square burgers were patented but——

Mr. RICHARDSON. The five holes are.

Mr. MURPHY. Five holes, thank you. OK. Thank you. Ms. DeGette?

Ms. DEGETTE. Thank you. Mr. Chairman, just a couple of questions. Mr. Richardson, you talked about Congress doing something about the demand letters, and that is I think a good idea. Some people have suggested that the FTC should establish a demand letter database. I am wondering what our witnesses think about that. Let us start with you, Ms. Feldman.

Ms. FELDMAN. I think some type of registry would be very important. Patent is supposed to be a notice system, and a lot of those in assertion behavior claim that the way they are asserting their

patents is something that is private to them. But what you claim as your territory is something that everybody should have notice of.

Ms. DEGETTE. Right. Yes.

Ms. FELDMAN. And that is important. These non-disclosure agreements are very corrosive for getting information about what's happening.

Ms. DEGETTE. Mr. Duan, what do you think?

Mr. DUAN. So I agree. I think that it is important that we have this sort of information about the demand letter economy, about what sort of assertion is going on. I think it helps out a lot of parties. It helps out the businesses that receive the demand letters because they are able to see, you know, a lot of the facts that they may not be presented with immediately. It helps related businesses in that they can see what sort of patents have been asserted, and they know what sort of technologies they should look at and what sort of technologies they should avoid if they have to avoid infringements. It helps researchers obviously because they will be able to do better studies, and I think it helps lawmakers like you.

Ms. DEGETTE. Well, it would help regulate them, too.

Mr. DUAN. Because——

Ms. DEGETTE. There are unfair trade practices going on, right?

Mr. DUAN. I think that is the first step. I definitely applaud the FTC for taking on their six-piece study of patent assertion.

But you know, I think an important point to realize is that for every one of these big patent assertion entities that we are talking about, there are dozens or hundreds of much smaller ones, the ones we have been talking about today that would just fly under the radar. The FTC would never find out about them, Congress would never find out about them. The only people that would find out about them are the people who receive the letters.

Ms. DEGETTE. Well, unless you had a demand letter database.

Mr. DUAN. Exactly.

Ms. DEGETTE. Yes.

Mr. DUAN. And I think that is the importance of that——

Ms. DEGETTE. Mr. Cheng, you are nodding your head yes.

Mr. CHENG. In complete agreement, and also I think one of the other benefits of a demand letter registry is simply to let victims know they are not alone.

Ms. DEGETTE. Yes.

Mr. CHENG. A lot of people who get these letters, they don't know what to do, they don't know who to turn to. It is going to help defendants in some cases organize a legitimate defense against sometimes truly, truly craptastic patents.

Ms. DEGETTE. Mr. Seigle, let me ask you and others as well, if there was a demand letter database and you knew about it, then I would assume if you got a demand letter, that would help you try to figure out——

Mr. SEIGLE. That would be an absolute huge help. When I got my first demand letter, I went and searched for the docket to see who else they had sued, and I reached out to 20 people on LinkedIn. We formed a joint defense group. It took a lot of time and effort to email them all individually, see where they were, and of course, the litigation. If that was made available and easy, it would have saved me a lot of time.

And ironically, when I reached out to them, their reply was that was so smart of you to try to pull us together. I didn't think of that, which, I know it sounds funny, but it is actually what happens.

I have heard from the meetings they have had on The Hill that the U.S. PTO or FTC doesn't want to have to deal with the administration or technology burden of hosting a registry. I would like to offer that at FindTheBest, we are a data company. We deal with data a lot, and we can easily do that and we would be happy to work with the public sector and host that for them.

Ms. DEGETTE. Well, you know there is some debate about whether the PTO is the office to do it or the FTC, and the FTC is more used to taking issues like this. Mr. Bragiel, what do you think?

Mr. BRAGIEL. Well, like everyone else on the panel I think that is a good first step. But from our standpoint it is not just the demand letters we are dealing with. There are actual lawsuits that have been filed. And so, some of those, most of those were preceded by a demand letter, but either way, the lawsuit was going to be filed because it is relatively inexpensive to file a lawsuit and extract a $5,000 settlement from my member at that point.

In our case, it wasn't difficult to organize. They are all members of mine. So I know who these folks are that have been sued. They all called my office, you know, immediately upon receiving the lawsuit. But the question was once they'd been sued, they have to individually defend themselves so we couldn't do some sort of joint, mass defense like a reverse class action. And so, we were forced to inform clients that they should consider settlement.

So but you know, again, it is always good to know who is after you, right, and it is good to know who is behaving in this sort of behavior. And there is so much in terms of hiding behind shell corporations and whatnot that this would lend some transparency to that. So we would support that.

Ms. DEGETTE. Mr. Richardson, you are the one that started the conversations about the demand letters. So what do you think about this?

Mr. RICHARDSON. As a family-owned business, for us it is about mutual gain through voluntary exchange. That is how for the past 92 years we have built our business. And patent trolls don't use that business model, they use coercion. So anything, the registry, other things that can shed more light on it, we think turn the tables and start to get us back to an even keel and bring more truth to the situation.

Ms. DEGETTE. Thank you. Thanks to all of you for coming. This is a good hearing.

Mr. MURPHY. Thank you. Mr. Griffith, you are recognized for 5 minutes for final questions.

Mr. GRIFFITH. Thank you, Mr. Chairman. I would be interested in hearing from any of you in regard to—and I think it was the hotel folks that said, they were being sued for using Wi-fi. They bought it from Best Buy or other provider, from a manufacturer, but they purchased it. The hotel purchases the Wi-fi unit, installs it and then they are the ones getting sued. And I am wondering if anybody has looked at seeing if one of the manufacturers or the big retailers would be willing to support some of these defense law-

suits, either by warranty of their product or in some other way. Has anybody heard anything in that regard?

Ms. FELDMAN. Some of the larger manufacturers have tried to step into court and defend these lawsuits, and they have been rebuffed. They are not allowed to because those who are bringing the demands are smart enough not to see the big guys, they just see the little guys. And so they can't get in there. So rule along those lines would be important.

Mr. GRIFFITH. So perhaps we as a Congress, it may not be our Committee but as we as a Congress look at this, we may want to look at some standing issues and create some special standing for the manufacturer if they are the folks who put it into the Wi-fi in the example that we are using.

Ms. FELDMAN. I think the other——

Mr. GRIFFITH. They would have the right to come in and defend themselves or defend their product in such a suit.

Ms. FELDMAN. I think that is right, sir, and the key issue is to get only interested parties in the courtroom or in whatever the bargaining room is. So one of the problems is you can't figure out who is behind these letters, so some type of disclosure of who has a beneficial interest in these companies, then you could figure out that perhaps you actually did buy something that comes with a license or regulators could see what's happening behind the scenes. There is just no way to penetrate through all these shells and figure out where it is coming from.

Mr. GRIFFITH. And also, correct me if I am wrong and I know we have got a couple of attorneys on the panel, but if we bring all the parties to the table, wouldn't we be able to use collateral estoppel res judicata and then future litigations and then shut it down nationwide if we got one, good lawsuit on the Wi-fi situation? What do our lawyers have to say about that? Yes, sir.

Mr. DUAN. I think that is correct, and that is the reason that you don't see them going after the big manufacturers. They could just go after the company who makes the Wi-fi router, right? If they did that, they would get one settlement, that would be the end and there would be no further lawsuits.

Instead, they can go after as many people as they want by never touching the manufacturers. And this is really what creates the incentive for a lot of these abusive companies to go after end users rather than to go after the manufacturers. The fact that instead of having just one lawsuit that you fight and, maybe you win, maybe you lose, you have an endless stream of revenue.

Mr. GRIFFITH. All right.

Mr. BRAGIEL. If it is not Wi-fi today, it is our lock system tomorrow we are afraid or that treadmill in our fitness center. Where does this end? That is where we are with this, and you know, if we settle one case, does that make us a target for additional patent trolls that may say we are an easy target?

Mr. GRIFFITH. And once they find that you are not an easy target, then they go after the individual consumers who may have purchased the same product for their home.

Mr. BRAGIEL. That is correct.

Mr. GRIFFITH. They may not be asking for the $5,000, but they might very well be asking for $150 or $200. And I can assure you, most households are not prepared to receive a letter of that nature.

I have about a minute-and-a-half left. Does anybody have something that we haven't touched on today that they would like to bring up? Yes, sir?

Mr. CHENG. In touching on the subject of getting manufacturers—people upstream to stand behind their product, one of the unfortunate side-effects of patent trolling is the fact that a lot of suppliers have actually stopped honoring their indemnification obligations. We have actually had to sue one of our technology platform providers because after being sued twice, after they honored the first indemnity obligation, they just decided it was too expensive to keep stepping up.

And so even though we are not being—I have submitted this in my written testimony—even though we are not really being sued anymore, we are still in the game because we are still paying. We are still paying, and our customers are still paying. And patent trolling is a toll on everybody.

Ms. FELDMAN. I would like to stress the important role that this committee has to play. According to the figures in the White House report this summer, conservative estimates show that 90 percent of this activity never proceeds to the courthouse. And so the committee has an important role to play in establishing what are fair and reasonable business practices as opposed to deceptive practices in this particular area of commerce.

Mr. GRIFFITH. Thank you very much. I yield back, Mr. Chairman.

Mr. MURPHY. Thank you, and I want to thank everyone for being part of this hearing today and also to note that you have stepped forward and gave some valuable information. And those of you who were willing to come forward in this I think also inspired, hopefully inspired, many other businesses not only to step forward when they have these concerns, do the kind of things you have done to reach out and form some coalitions to fight this but also shine some light on this for those who did not even know it was coming. And I hope that we will continue this.

I ask unanimous consent that written opening statements from the members be introduced in the record, and without objection the documents will be entered into the record.

So in conclusion, once again, I thank all the witnesses and all the members who attended today. I remind members they have 10 business days to submit further questions for the record, and I hope you will be willing to respond to those letters. Thank you very much, and please respond promptly to them.

With that, this hearing is adjourned.

[Whereupon, at 4:00 p.m., the subcommittee was adjourned.]

[Material submitted for inclusion in the record follows:]

PREPARED STATEMENT OF HON. FRED UPTON

Today's hearing will examine certain practices relating to "patent assertion," or the practice of bringing—or threatening to bring—a lawsuit against an organization who is allegedly infringing on a patent. Litigation related to patent infringement has dramatically spiked in recent years. According to the Government Accountability Office, from 2010–2011, the number of these lawsuits increased by one-third.

A report released by the White House in June stated that as many as 100,000 companies were threatened last year with patent infringement lawsuits.

Members of both the House and Senate have proposed legislation to address patent assertion litigation. Our purpose today is somewhat different. We are taking a step back to get the facts about what happens before these patent suits are filed. Each of the companies testifying today has received something called a "demand letter" from a patent assertion entity. Typically, these letters claim that the company is infringing on a patent and ask the company to either settle and pay a licensing fee—or prepare to be sued.

For some of these companies, dealing with these demand letters and the threat of litigation has drained resources that could have been spent on innovation, expanding their companies, and hiring additional employees. In many cases, identifying the specific patent at issue, and who is behind the demand letter, is a challenge, complicating a company's ability to defend itself and determine whether to settle or fight the claim. What entities are sending these demand letters? What patents are being asserted? Do these demand letters specify the particular patent at issue and the alleged infringement? What effects and costs do these demand letters and litigation threats have on your companies? These are a few of the issues we want to address today, so we can get a better understanding of the facts relating to these letters, and how they affect the companies who receive them.

I think all of us recognize that protecting patents and inventions is important. Bringing a lawsuit to protect a patent, to protect an invention, is warranted in many cases. Those types of cases—where a valid patent is being asserted and protected—seem to be a very different thing from the recent rash of demand letters that are vague, do not contain simple information about the patent at issue or the alleged infringement, and contain threats to sue unless a company pays up. As job creation and innovation are threatened, we want to figure out today what separates legitimate patent disputes from the types of demand letters and actions that seem to be brought simply to exact a settlement payment.

# # #

PREPARED STATEMENT OF HON. G.K. BUTTERFIELD

The importance of patents is highlighted in our Constitution and integrated into our country's legal framework. Patents are designed to spur innovation and stimulate commerce, but more frequently the system is being manipulated to impede progress.

A 2011 piece on National Public Radio titled "When Patents Attack!" discussed the ongoing problem of patent assertion entities using intimidating demand letters to make opaque patent claims and collect on settlements from other businesses. According to the NPR program, "our patent system sometimes seems to be discouraging rather than encouraging innovation in high tech businesses."

NPR aired follow up piece in May showing that the problem has increased in scope. Much of the testimony submitted for today's hearing shows that patent assertion entities are now sending demand letters with contrived patent claims to a wide variety of businesses from the high tech to lodging.

We must find ways protect small businesses and consumers from deceptive and malicious practices while ensuring legitimate patent claims are protected.

THE COMMITTEE ON ENERGY AND COMMERCE

MEMORANDUM

NOVEMBER 12, 2013

TO: Members, Subcommittee on Oversight and Investigations

FROM: Committee Majority Staff

RE: Hearing on "The Impact of Patent Assertion Entities on Innovation and the Economy."

On Thursday, November 14, 2013, the Subcommittee on Oversight and Investigations will hold a hearing entitled "The Impact of Patent Assertion Entities on Innovation and the Economy." The Subcommittee is investigating recent trends in patent assertion practices to gain a better understanding of their impact on businesses, both large and small, and on fostering an innovative marketplace. This hearing will focus on the perspective of companies that have received demand letters from patent assertion entities and highlight their related experiences in advance of litigation.

I. WITNESSES

One panel of witnesses will testify:

Mr. Justin Bragiel
General Counsel
Texas Hotel & Lodging Association

Mr. Lee Cheng
Chief Legal Officer
Newegg, Inc.

Mr. Charles Duan
Director of the Patent Reform Project
Public Knowledge

Ms. Robin Feldman
Director of the Institute for Innovation Law
University of California Hastings College of the Law

Mr. Jamie Richardson
Vice President, Government and Shareholder Relations
White Castle System, Inc.

Mr. Daniel Seigle
Director of Business Operations
FindTheBest.com

II. BACKGROUND

Recently, there has been significant interest and activity in Congress on issues relating to patent assertion entities ("PAEs"), pejoratively known as "patent trolls." While it may be impossible for everyone to agree on the universe of firms that rightfully fit the description, generally, PAEs are entities that purchase the rights to patents not with the goal of developing or bringing the underlying technologies to market, but to assert the patents against companies or individuals that are bringing technologies to market and seek revenue in return.[1]

The first step that a PAE usually will take is to send a "demand letter" to a company or an individual stating that a product or technology they are selling or using is infringing upon a patent or series of patents owned by the PAE. Oftentimes, these letters provide little detail about the patents or claims being infringed, yet threaten to initiate litigation unless a licensing fee is agreed upon within a short timeframe. Many of these cases do not reach the court room since, according to the recipients of these demand letters, the licensing fees or settlement amounts are often well below the cost of hiring lawyers, commencing costly discovery, and taking them to trial. These decisions are particularly difficult for small businesses or startup companies because of the significant costs. It has been estimated that the average patent trial can take longer than a year and costs from one to six million dollars.[2] In fact, according to one recent study, PAE activity cost defendants and licensees $29 billion in 2011—a 400% increase since 2005.[3]

PAEs emphasize that they are simply enforcing their intellectual property rights. It also has been argued that PAEs fill a unique role in compensating inventors. Inventors can then apply the royalty fees or cash payments received up front from PAEs towards research and development and potentially commercialization. In other words, PAEs can absorb some of the risk inventors or startup companies take when investing time and money in developing products or technologies that may not ultimately reach the market. This secondary market, therefore, can incentivize innovation that otherwise would not have been financially justified.[4]

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[1] In addition to firms that simply buy patents from others in order to assert them for profit, there are numerous other types of entities that own patents without intending to develop products based on the underlying patented technologies. While not the focus of this hearing, such "non-practicing entities" (NPEs) include universities or companies that research, develop, and then sell their technologies to other companies for use in their commercially available products. *See* U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-13-465, INTELLECTUAL PROPERTY: ASSESSING FACTORS THAT AFFECT PATENT INFRINGEMENT LITIGATION COULD HELP IMPROVE PATENT QUALITY, AT 2-3 (Aug. 2013).

[2] *See* Colleen V. Chien, *Of Trolls, Davids, Goliaths, and Kings: Narratives and Evidence in the Litigation of High-Tech Patents*, 87 N.C. L. Rev. 1571, 1605 (2009).

[3] *See* James Bessen & Michael Meurer, *The Direct Costs from NPE Disputes*, Boston Univ, School of Law Working Paper No, 12-34 18-19 (2012).

[4] *See* BRIAN YEH, CONG. RESEARCH SERV.. R42668, AN OVERVIEW OF THE "PATENT TROLLS" DEBATE, at 7-8 (Apr. 16, 2013).

Several studies by the Federal Trade Commission (FTC) and independent experts suggest, however, that any such beneficial effects are outweighed by the costs.[5] Innovation is hindered when startup companies divert their time and money to responding to demand letters or litigating related claims. Further, there is evidence that venture capitalists and other investors are considering the likelihood that an entity will be engaged in such activities when making investment decisions.[6]

On September, 27, 2013, the FTC announced that a formal inquiry known as a 6(b) study had been approved that would "expand the empirical picture on the costs and benefits of PAE activity."[7] In addition, a number of related legislative proposals recently have been introduced in both the House and Senate addressing potentially abusive patent assertion practices.

III. ISSUES

The following issues may be examined at the hearing:

- How do companies respond to demand letters? What are their options?
- What type of details does a typical demand letter include? What should they include to allow for greater transparency and more informed decision-making?
- How do companies communicate and/or negotiate with PAEs in advance of litigation?
- How do PAEs impact a business's ability to grow? How do they influence decisions whether to invest in certain products or technologies?

IV. STAFF CONTACTS

If you have any questions regarding this hearing, please contact Karen Christian, John Stone, or Carl Anderson with the Committee staff at (202) 225-2927.

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[5] *See* FED. TRADE COMM'N, THE EVOLVING IP MARKETPLACE: ALIGNING PATENT NOTICE AND REMEDIES WITH COMPETITION 50-51 (2011). *See also* James Bessen et al., *The Private and Social Costs of Patent Trolls*, REGULATION 26 (2006).
[6] *See* Eric Savitz, *Cuban Says Vringo Stake Hedges Patent Risk in Other Investments*, FORBES, Apr. 17, 2012.
[7] Fed. Trade Comm'n., *FTC Seeks to Examine Patent Assertion Entities and Their Impact on Innovation, Competition*, Sept. 27, 2013.

FRED UPTON, MICHIGAN
CHAIRMAN

HENRY A. WAXMAN, CALIFORNIA
RANKING MEMBER

ONE HUNDRED THIRTEENTH CONGRESS

Congress of the United States
House of Representatives
COMMITTEE ON ENERGY AND COMMERCE
2125 RAYBURN HOUSE OFFICE BUILDING
WASHINGTON, DC 20515–6115
Majority (202) 225–2927
Minority (202) 225–3641

December 9, 2013

Ms. Robin Feldman
Director of the Institute for Innovation Law
University of California Hastings College of The Law
200 McAllister Street
San Francisco, CA 94102

Dear Ms. Feldman:

Thank you for appearing before the Subcommittee on Oversight and Investigations on Thursday, November 14, 2013, to testify at the hearing entitled "The Impact of Patent Assertion Entities on Innovation and the Economy."

Pursuant to the Rules of the Committee on Energy and Commerce, the hearing record remains open for ten business days to permit Members to submit additional questions for the record, which are attached. The format of your responses to these questions should be as follows: (1) the name of the Member whose question you are addressing, (2) the complete text of the question you are addressing in bold, and (3) your answer to that question in plain text.

To facilitate the printing of the hearing record, please respond to these questions by the close of business on Monday, December 23, 2013. Your responses should be mailed to Brittany Havens, Legislative Clerk, Committee on Energy and Commerce, 2125 Rayburn House Office Building, Washington, D.C. 20515 and e-mailed in Word format to brittany.havens@mail.house.gov.

Thank you again for your time and effort preparing and delivering testimony before the Subcommittee.

Sincerely,

Tim Murphy
Chairman
Subcommittee on Oversight and Investigations

cc: Diana DeGette, Ranking Member, Subcommittee on Oversight and Investigations

Attachment

Robin Feldman
Professor of Law
Harry & Lillian Hastings Chair and Director, Institute for Innovation Law
University of California Hastings College of the Law

Response to Questions for the Record
Subcommittee on Oversight and Investigations
"The Impact of Patent Assertion Entities on Innovation and the Economy"

The Honorable G.K. Butterfield:

1. Ms. Feldman, one suggested approach to reduce abuses in our patent law system is improving letter transparency. However, Mr. Richardson mentioned in his testimony that sometimes patent assertion entities file lawsuits without sending demand letters.

> **a. If demand letters become more regulated but are not required in order to file lawsuits, could that incentivize patent assertion entities to file lawsuits without sending letters?**

Yes, if demand letters are regulated, lawsuits are not regulated, and demand letters are not required prior to filing a lawsuit, some parties might chose to go straight to the courthouse. Ideally, one would want to require transparency of patent demands, both in the context of demand letters and in the context of lawsuits. In the current environment, however, in which there is no judge or regulator in sight for demand letters, patent assertion entities can so easily take advantage of fear and of the power of subtly deceptive information.

FRED UPTON, MICHIGAN
CHAIRMAN

HENRY A. WAXMAN, CALIFORNIA
RANKING MEMBER

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December 9, 2013

Mr. Charles Duan
Director of the Patent Reform Project
Public Knowledge
1818 N Street, N.W.
Suite 410
Washington, D.C. 20036

Dear Mr. Duan:

Thank you for appearing before the Subcommittee on Oversight and Investigations on Thursday, November 14, 2013, to testify at the hearing entitled "The Impact of Patent Assertion Entities on Innovation and the Economy."

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Thank you again for your time and effort preparing and delivering testimony before the Subcommittee.

Sincerely,

Tim Murphy
Chairman
Subcommittee on Oversight and Investigations

cc: Diana DeGette, Ranking Member, Subcommittee on Oversight and Investigations

Attachment



The Honorable Tim Murphy
U.S. House of Representatives
Committee on Energy and Commerce
Subcommittee on Oversight and Investigations
2125 Rayburn House Office Building
Washington, DC 20515-6115

January 6, 14

Dear Chairman Murphy,

Thank you again for inviting me to testify at the November 14, 2013 hearing entitled "The Impact of Patent Assertion Entities on Innovation and the Economy." At your request, attached below are responses to the additional questions for the record submitted by members of the Subcommittee.

If you have any further questions or if I can be of further assistance, please do not hesitate to contact me.

Sincerely,

Charles Duan
Director, Patent Reform Project
Public Knowledge

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Public Knowledge

THE HONORABLE G.K. BUTTERFIELD

QUESTION 1A: Mr. Duan, you indicate in your testimony that one of the strategies employed by patent assertion entities is to send patent demand letters to small businesses. The majority of businesses in eastern North Carolina are small businesses, so this is particularly troubling to my constituents.

Are there any strategies that small businesses can employ to avoid being targeted by patent assertion entities?

ANSWER: First, I appreciate your recognition of, and fully agree with you on the value of, small businesses. I have worked with North Carolina technology businesses in my practice as an attorney, and they are among the most innovative in the world.

Unfortunately, the single most effective strategy that small businesses can use to avoid being targeted by patent assertion entities is to hide from them. A company that stays out of the public radar is much more difficult to target for patent infringement. And this is exactly what we see happening: small businesses that receive demand letters or pay settlements to patent assertion entities fastidiously avoid making those facts known, lest other patent assertion entities target those small businesses as well. The Application Developers Alliance famously has a member who will talk about his experiences defending against patent assertion only in a dark room with a disguised voice.

The traditional advice, of conducting a freedom to operate patent search prior to embarking on a project, is simply infeasible, particularly for these small businesses.

Public Knowledge

Such a patent analysis can cost tens or hundreds of thousands of dollars, because of the large number of patents to be searched and analyzed. This amount overwhelms the budget of most small businesses, especially in their early stages prior to investing in product development.

Furthermore, even the most comprehensive search will only reveal patents that could legitimately be asserted; it would not reveal a patent that an unscrupulous patent assertion entity would wrongly overstretch to attempt to cover a wide swath of products not properly contemplated by that patent. But it is that latter case that is the most worrisome for small businesses, as the illegitimate case is the most complex to understand, most costly to defend, and most destructive to innovation.

A third option is for a small business to join a group or collective that provides supportive services for those accused of patent infringement. Some of these organizations are forming, in both the for-profit and the non-profit sectors. I hope that they are successful, but there is a real question as to whether they will be. A similar idea was proposed several years ago, for insurance companies to offer insurance for patent assertion, but this idea has largely fallen to the wayside because the costs of patent assertion were too high and too unpredictable to be reasonably insured.

Again, though, for small businesses to protect themselves from patent assertion entities, it is necessary for those small businesses to have knowledge about those patent assertion entities. Knowing about the potential threats can help a business identify less risky avenues to take, and can support that business with valuable information and strategy should the business be targeted by a patent assertion entity. This is why we strongly support provisions for greater transparency and disclosure.

Public Knowledge

QUESTION 1B: If a small business receives a demand letter and cannot verify the legitimacy of the letter internally, what options besides hiring a private attorney does the small business have to verify the letter?

ANSWER: To begin, it is worth considering just how many steps go into verifying a demand letter. A full analysis would include numerous steps:

1. Identifying the patent being asserted
2. Computing the expiration date of the patent and determining whether all maintenance fees have been paid
3. Verifying the ownership of the patent, through the Patent Office chain of title records
4. Reading the claims of the patent to determine the invention being asserted by the letter
5. Reviewing the specification (text) of the patent, as well as the file history (procedural record) from the Patent Office, to determine the meaning of the claims of the patent
6. Searching for any litigation or administrative procedures involving the patent, to determine if the patent has been interpreted, held invalid or unenforceable, or otherwise considered
7. Identifying products and/or services of the business that may infringe the patent
8. Assessing whether those products and/or services infringe the claims of the patent based on the determined meaning of those claims
9. Searching for and analyzing any prior art that may invalidate the patent

Public Knowledge

If multiple patents are identified in the letter, then some or all of these steps must be performed repeatedly for each patent.

Some of these steps can be performed by the business itself without much difficulty. For example, steps 2 and 3 are based on publicly available data that can be accessed from the Patent Office website (although the lack of a requirement for recording patent transfers means that the step 3 analysis may be incomplete). Step 6 can also be done by the business itself, but it is currently difficult to do so due to a lack of a central repository for this information—which is why the transparency and disclosure provisions we propose would help those businesses.

The remaining steps generally require some legal knowledge to assist in interpreting relevant patent documents. The ordinary course, as you observe, is to hire an attorney to do so. Legal clinics may offer a lower-cost alternative in some appropriate situations, and law schools and organizations are taking steps to offer these.

Additionally, it is worth noting that many of these steps (e.g., steps 4–6 and 9) are independent of the business's activities. Thus economies of scale can be introduced. For example, multiple companies who receive demand letters could share the cost of a patent validity analysis. However, this opportunity only becomes available when those companies have the resources to identify others who have received similar demand letters, making demand letter transparency a first step to accomplishing this.

Public Knowledge

QUESTION 2: Mr. Duan, studies show that patent assertion entities that manipulate our patent system to their benefit cause significant economic damage and deter innovation.

(a) How are patent demand letters from patent assertion entities hurting consumers?

(b) How are patent litigation abuses hurting consumers?

ANSWER: Both abusive demand letters and patent litigation abuses harm consumers. They do so in at least two ways.

First, they raise costs for the businesses that develop and produce innovative new products. When a business receives a demand letter or faces patent litigation, it must expend resources, including money, employees, and time. In the best case, the business is large enough to absorb those costs, and consumers face increased costs for products and services. But it is all too common for abusive demand letters and abusive patent litigation to be directed toward small businesses who cannot absorb those costs. Small businesses may be forced to remove useful features from products, lay off creative employees, or even exit their business lines due to these threats, and research has shown that all of these happened. In such cases, consumers do not merely face higher prices; they face fewer products, less innovative products, and less access to technology.

Obviously business litigation is an important aspect of our justice system, and in cases of legitimate infringement a business ought to be equipped to react appropriately. But abusive demand letters and abusive patent litigation are not designed to simply vindicate legitimate rights. Instead, they are designed to be as expensive as possible, to force those businesses on the receiving end into settlement.

Public Knowledge

This is why demand letters do not identify infringing products, leaving the business to guess at the reason for the demand letter. This is why abusive litigators demand enormous volumes of documents during litigation, to tie up business operations with discovery procedures. This is why patent assertion entities use Patent Office procedures to obtain dozens of patents on the same invention, forcing defendant lawyers to perform and bill hours of duplicative, brute-force work. All of these threaten productive businesses with enormous costs. These costs are passed on to consumers, either in higher prices for products or in lost products.

The second effect on consumers is more subtle. A key feature of our modern information revolution is that computer technology makes innovation accessible to the average person to a degree never before seen. In the days of Edison, innovators needed a lab, access to machinists, specialized materials, and other such resources not often available to the ordinary consumer. Today, a basic home computer and an Internet connection suffice to create the newest software tool or business. Every person who has recorded a macro in Microsoft Word, set up a home network in a unique configuration, or found any other clever use for a computer has invented something. Many of the great technology companies today arose out of someone just tinkering with an idea on a home PC. The line between consumer and innovator is blurring.

Patent abuses threaten to curtail this homegrown innovation. Lawsuits over basic technologies, such as MPHJ suing scanner users, Innovatio suing WiFi users, and Lodsys suing iPhone app developers, threaten to discourage basic uses of consumer technologies. Although ordinary consumers have not been sued for infringement yet, nothing in the law prevents this, and there is historical precedent: in the late 1800s, farmers across the country were threatened with patent infringement over using basic

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farm tools and equipment, until Congress stepped in and revised the patent laws to curb such practices.

Thus, in addition to increasing costs for consumers, patent abuses threaten those consumers for their very act of using technology. We hope for a vibrant, productive society where we can all have access to the greatest technologies. Patents, when abused, can shatter that hope. We ask Congress to step in and act, to protect that bright future that technology promises us all.

FRED UPTON, MICHIGAN
CHAIRMAN

HENRY A. WAXMAN, CALIFORNIA
RANKING MEMBER

ONE HUNDRED THIRTEENTH CONGRESS

Congress of the United States
House of Representatives
COMMITTEE ON ENERGY AND COMMERCE
2125 RAYBURN HOUSE OFFICE BUILDING
WASHINGTON, DC 20515–6115
Majority (202) 225-2927
Minority (202) 225-3641

December 9, 2013

Mr. Lee Cheng
Chief Legal Officer and Corporate Secretary
Newegg, Inc.
16839 Gale Avenue
City of Industry, CA 91745

Dear Mr. Cheng:

Thank you for appearing before the Subcommittee on Oversight and Investigations on Thursday, November 14, 2013, to testify at the hearing entitled "The Impact of Patent Assertion Entities on Innovation and the Economy."

Pursuant to the Rules of the Committee on Energy and Commerce, the hearing record remains open for ten business days to permit Members to submit additional questions for the record, which are attached. The format of your responses to these questions should be as follows: (1) the name of the Member whose question you are addressing, (2) the complete text of the question you are addressing in bold, and (3) your answer to that question in plain text.

To facilitate the printing of the hearing record, please respond to these questions by the close of business on Monday, December 23, 2013. Your responses should be mailed to Brittany Havens, Legislative Clerk, Committee on Energy and Commerce, 2125 Rayburn House Office Building, Washington, D.C. 20515 and e-mailed in Word format to brittany.havens@mail.house.gov.

Thank you again for your time and effort preparing and delivering testimony before the Subcommittee.

Sincerely,

Tim Murphy
Chairman
Subcommittee on Oversight and Investigations

cc: Diana DeGette, Ranking Member, Subcommittee on Oversight and Investigations

Attachment

Newegg Inc.
Phone: (626) 271-9700
Fax: (626) 271-9465
Address: 16839 E. Gale Ave., City of Industry, CA 91745



VIA First Class Mail and Email

Brittany Havens, Legislative Clerk
United States House of Representatives
Committee on Energy and Commerce
2125 Rayburn Home Office Building
Washington, DC 20515
Email: Brittany.havens@mail.house.gov

Dear Ms. Havens:

This answer is in response to the following inquiry of **The Hon. G.K. Butterfield** relating to the hearing of the Subcommittee on Oversight and Investigations held on November 14, 2013, entitled "The Impact of Patent Assertion Entities on Innovation and the Economy":

1. Mr. Cheng, we've heard today about the high costs associated with settling patent disputes or going to trial. We have also heard from you and others that the cost of patent trolling can be passed on to customers.

a. How have abusive patent assertion entities impacted Newegg customers and your company's ability to grow?

Answer:

Newegg customers have been deprived of the benefit of millions of dollars of funds, and thousands of hours of employee and executive time, that Newegg has had to use to defend itself against meritless patent assertions where the abusive asserters have targeted obtaining settlements based on the high cost of defense. Those funds and time could have been spent on hiring additional employees, building out business infrastructure and research and development aimed at improving customer experience and convenience. We have had to take time away from all of those societally beneficial activities to prove, in every instance, what we knew with a high level of certainty almost as soon as we received a claim or lawsuit: that the patents being asserted should not have been granted in the first place, and the claim of infringement was most likely without merit.

Newegg has never lost a patent lawsuit after appeal and we fight meritless claims because we believe that a pattern of settling for short term benefit and convenience would simply make us a more frequent target for other abusive patent asserters. We further believe that fighting meritless lawsuits is simply the right thing to do and a corporate duty—someone has to stand up, and to say no, to the abuse of patents and our legal system.

Sincerely,

/s/ Lee Cheng

Lee Cheng, Chief Legal Officer

FRED UPTON, MICHIGAN
CHAIRMAN

HENRY A. WAXMAN, CALIFORNIA
RANKING MEMBER

ONE HUNDRED THIRTEENTH CONGRESS

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December 9, 2013

Mr. Danny Seigle
Director of Operations
FindTheBest
P.O. Box 1259
Summerland, CA 93067

Dear Mr. Seigle:

Thank you for appearing before the Subcommittee on Oversight and Investigations on Thursday, November 14, 2013, to testify at the hearing entitled "The Impact of Patent Assertion Entities on Innovation and the Economy."

Pursuant to the Rules of the Committee on Energy and Commerce, the hearing record remains open for ten business days to permit Members to submit additional questions for the record, which are attached. The format of your responses to these questions should be as follows: (1) the name of the Member whose question you are addressing, (2) the complete text of the question you are addressing in bold, and (3) your answer to that question in plain text.

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Thank you again for your time and effort preparing and delivering testimony before the Subcommittee.

Sincerely,

Tim Murphy
Chairman
Subcommittee on Oversight and Investigations

cc: Diana DeGette, Ranking Member, Subcommittee on Oversight and Investigations

Attachment

FindTheBest
Think like an expert

101A Innovation Place
Santa Barbara, CA 93108

December 20th, 2013

House of Representatives
Committee on Energy and Commerce
Responses to Questions submitted by G.K. Butterfield regarding November 14, 2013 hearing entitled
"The Impact of Patent Assertion Entities on Innovation and the Economy"

Question: How have abuses in the patent assertion impacted the way you and your start-up peers think about owning patents?

At FindTheBest we do not waste our time, effort, and money in applying for patents. We believe it is a better use of our limited resources to build new features and improve our product to provide our 20 million monthly visitors with a more valuable experience.

It is our belief that a patent is **NOT** an invention, but rather a piece of paper written by a lawyer that will most likely never be read by anyone. Real invention is building a valuable product and bringing it to market.

Question: How have those abuses impacted the ability of startups to gain investors and venture capital funding?

Litigation is risky and costly, two things that venture capital firms are not looking for when making investments. We have spoken to dozens of companies that were forced to settle cases regardless of actual infringement in order to attract investors and others who were unable to find investors willing to take on the additional risk.

We were lucky enough to close our most recent funding round ($11M Series-B) prior to receiving any demand letters. Had we received a demand letters before closing the round, we would have been required to disclose this to investors and there would have been a large possibility of watching those investors walk away from the deal or attempt to delay the deal until a resolution was reached.

When we first spoke to our investors about the demand letters we received, they suggested we settle our patent suit. It was their belief that accepting the plaintiff's one day special settlement offer of $50,000 would have been the most prudent business decision. It was at this point that our CEO decided to personally finance the ligation, an alternative not available to most companies. We were ultimately successful in our litigation and invalidated the patent brought against us under section 101.

Sincerely,

[redacted]

Danny Seigle

Director of Operations, FindTheBest.com

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