

UPDATE: PATENT DEMAND LETTER PRACTICES AND SOLUTIONS

HEARING BEFORE THE SUBCOMMITTEE ON COMMERCE, MANUFACTURING, AND TRADE OF THE COMMITTEE ON ENERGY AND COMMERCE HOUSE OF REPRESENTATIVES ONE HUNDRED FOURTEENTH CONGRESS FIRST SESSION

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UPDATE: PATENT DEMAND LETTER PRACTICES AND SOLUTIONS

THURSDAY, FEBRUARY 26, 2015

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON COMMERCE, MANUFACTURING, AND
TRADE,
COMMITTEE ON ENERGY AND COMMERCE,
Washington, DC.

The subcommittee met, pursuant to call, at 10:17 a.m., in room 2322 of the Rayburn House Office Building, Hon. Michael C. Burgess (chairman of the subcommittee) presiding.

Members present: Representatives Burgess, Lance, Harper, Guthrie, Olson, Kinzinger, Bilirakis, Brooks, Mullin, Schakowsky, Clarke, Kennedy, Cárdenas, and Pallone (ex officio).

Also present: Mr. Massie.

Staff present: Charlotte Baker, Deputy Communications Director; Leighton Brown, Press Assistant; James Decker, Policy Coordinator, Commerce, Manufacturing and Trade; Graham Dufault, Counsel, Commerce, Manufacturing and Trade; Melissa Froelich, Counsel, Commerce, Manufacturing and Trade; Kirby Howard, Legislative Clerk; Paul Nagle, Chief Counsel, Commerce, Manufacturing and Trade; Olivia Trusty, Professional Staff, Commerce, Manufacturing and Trade; Michelle Ash, Democratic Chief Counsel, Commerce, Manufacturing and Trade; Lisa Goldman, Democratic Counsel, Commerce, Manufacturing and Trade; Tiffany Guarascio, Democratic Deputy Staff Director; and Jeff Carroll, Democratic Staff Director.

Mr. BURGESS. The Subcommittee on Commerce, Manufacturing, and Trade will now come to order.

The Chair recognizes himself for 5 minutes for the purposes of an opening statement. And I certainly want to welcome everyone on our panel to the hearing, to provide an update on patent demand letters, the practices and possible solutions.

OPENING STATEMENT OF HON. MICHAEL C. BURGESS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS

Unfortunately, abusive patent demand letters are not a new problem, and they are not new to this subcommittee. Patent trolls continue to send demand letters in bulk to induce victims to pay unjustified license fees rather than fight back. Last year, under Subcommittee Chairman Terry, this subcommittee held an oversight hearing, a legislative hearing, and eventually produced and marked up draft legislation targeting bad-faith demand letters. As this subcommittee learned through its process, the act of defining

a so-called troll is a difficult task. In protecting companies from trolls, legislation must also not prevent legitimate patent holders from protecting their rights from being infringed upon by other actors. But a task that is difficult is not a task that is impossible, and I have a sincere belief that in the realm of patent demand letters, like so many other areas under the jurisdiction of this subcommittee, can effect a bipartisan agreement and legislation.

So here we are in the new year, in a new Congress, and we renew the effort to forge ahead to achieve this goal. We again take aim to solve a small piece of the patent world that has caused some of the greatest consternation. I sincerely believe that a targeted solution to this problem is the best one, and I hope that our hearing today will restart the conversations on how best to stop this activity, yet allow legitimate patent holders to proceed.

The truth is that the destructive business model of the so-called patent troll has largely skated just beyond the reach of law, and as a result, crime pays. And because Federal law has been slow to keep up with the evolving world of patent trolls, even in a subject area where Federal jurisdiction is clearly delineated in the Constitution's Article I enumerated powers of Congress, the States now have felt an obligation to begin looking at ways to protect their constituent companies. Protection of intellectual property rights is a Federal issue. Indeed, Article I, Section 8, clause 8 clearly envisions Congress as having both the power and the duty to promote the Progress of Science and useful Arts, by securing for limited Times to authors and inventors the exclusive rights to their respective writings and Discoveries. It would appear from the stories we have all heard about patent trolls that the protection of these rights is not being considered. This committee wishes to change that equation.

I am especially concerned about the effects these fraud schemes have on small businesses. When a business receives a demand letter, especially one that is intentionally vague or misleading, many small business owners simply lack the tools necessary to distinguish a bogus assertion from a legitimate infringement claim. However, the United States Patent Office lists three Web sites; Stand Up To the Demand, ThatPatentTool, and Trolling Effects, as resources that companies can use to protect themselves. There is work going on beyond this subcommittee to address some of this—these issues. For example, a number of Web sites have popped up for demand letter recipients to verify the legitimacy of infringement claims against them. Eighteen States have also enacted legislation, and a handful of State attorneys general have brought cases under their consumer protection laws.

As we will discuss today, it may be that State efforts to curb patent abuses are on uncertain legal footing due to preemption of the First Amendment doctrines that were developed by the Federal courts. These doctrines are designed to protect the fair assertion of patent rights, and any legislation this subcommittee produces must allow legitimate assertions. It is my intention that this committee can work with companies who own large patent holdings to address this issue. As many companies have seen, illegitimate claims could ultimately undercut the value of legitimate patents. To help us strike the proper balance, we will hear from experts in the field as

well as representatives from both abusive demand letter victims and a large patent holder. We hope this information—this will inform the direction of whatever legislation this subcommittee ultimately produces. I hope that we may use last year’s draft, the Targeting Rogue and Opaque Letters Act, as a place to begin the discussion. One area where we will need to focus on is how the bad faith standard in that legislation would work with the required disclosures in the Act. Further, how those required disclosures fit with the prohibited bad acts included in the draft legislation, and I hope that is an area we can examine closely. The subcommittee is eager to work with the panelists before us and others to address this problem.

I thank the witnesses for their testimonies, and I certainly look forward to the discussion today.

[The prepared statement of Mr. Burgess follows:]

PREPARED STATEMENT OF HON. MICHAEL C. BURGESS

I want to welcome everyone to our hearing to provide an update on patent demand letter practices and solutions. Unfortunately, abusive patent demand letters are not a new problem, and they are not new to this committee. Patent trolls continue to send demand letters in bulk to induce victims to pay unjustified license fees rather than fight back.

Last year, this subcommittee held an oversight hearing, a legislative hearing, and eventually produced and marked up draft legislation targeting bad-faith demand letters. As this committee learned through its process, the act of defining a “troll” is a difficult task. In protecting companies from trolls, legislation must also not prevent legitimate patent holders from protecting their rights from being infringed by other actors. But a task that is difficult is not a task that is impossible. I have a sincere belief that the realm of patent demand letters, like so many other areas under the jurisdiction of this committee, can result in bipartisan agreement and legislation.

Thus, in a new year, in a new Congress, we renew the effort to forge ahead to achieve such a goal. We again take aim to solve a small piece of the patent world that has caused some of the greatest consternation—patent trolls. I sincerely believe that a targeted solution to this problem is the best one, and hope that our hearing today will restart the conversations on how to best to stop patent trolls yet allow legitimate patent holders to proceed.

The truth is that the destructive business model of the trolls has largely skated just beyond the reach of law—and as a result, it still pays to be a patent troll. And because Federal law has been slow to keep up with the evolving world of patent trolls—even in a subject area where Federal jurisdiction is clearly delineated in the Constitution’s Article I enumerated powers of Congress—the States have felt an obligation to begin looking at ways to protect their constituent companies.

Protection of intellectual property rights is a Federal issue. Indeed, Article I, Section 8, clause 8 clearly envisions Congress as having both the power and the duty to “promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries.” It would appear from the stories we have all heard of patent trolls that the protection of these rights is being abused. This committee wishes to change that equation.

I am especially concerned about the effects these fraud schemes have on small businesses. When a business receives a demand letter—especially one that is intentionally vague or misleading—many small business owners lack the tools necessary to distinguish a bogus assertion from a legitimate infringement claim. However, the U.S. Patent and Trade Office lists three Web sites—Stand Up To the Demand, ThatPatentTool, and Trolling Effects—as resources companies can use to protect themselves.

There is work going on beyond this subcommittee to address some of these issues. For example, a number of Web sites have popped up for demand letter recipients to verify the legitimacy of infringement claims against them. Eighteen States have also enacted legislation and a handful of State attorneys general have brought cases under their consumer protection laws. As we will discuss today, however, it may be

that State efforts to curb patent abuses are on uncertain legal footing due to preemption and First Amendment doctrines developed in Federal courts.

These doctrines are designed to protect the fair assertion of patent rights, and any legislation this subcommittee produces must allow legitimate assertions. It is my intent that this committee can work with companies who own large patent holdings to address this issue. As many companies have seen, illegitimate claims could ultimately undercut the value of legitimate patents.

To help us strike the proper balance, we will hear from experts in the field as well as representatives from both abusive demand letter victims and a large patent holder. We hope this will inform the direction of whatever legislation this subcommittee ultimately produces. I hope that we may use last year's draft, the Targeting Rogue and Opaque Letters—or "TROL"—Act, as a place to begin these discussions.

One area we will need to focus on is how the "bad faith" standard in that legislation would work with the required disclosures in the Act. Further, how those required disclosures fit with the prohibited bad acts included in the draft legislation is also an area I hope people will look at closely.

This subcommittee is eager to work with the panelists before us and others to address this problem. I thank the witnesses for their testimonies and I look forward to our discussion today.

Mr. BURGESS. And the Chair now recognizes the subcommittee ranking member, Ms. Schakowsky, from Illinois for 5 minutes for the purpose of an opening statement.

OPENING STATEMENT OF HON. JANICE D. SCHAKOWSKY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF ILLINOIS

Ms. SCHAKOWSKY. Thank you, Mr. Chairman. And much of what I will say will echo the things that you have said. The—along the lines of the problems of patent trolls. I see the rise of these entities as a serious threat to consumers and businesses all across the country, and I want to explore whether we can strengthen existing protections against them as well.

Patent assertion entities typically purchase patents and then assert that those patents have been infringed, sending vague and threatening letters to hundreds or even thousands of end users, typically, small businesses or entrepreneurs. Those businesses are told that they can pay the patent troll to continue using the technology. And considering the cost and resources needed to vet and fight a patent infringement claim, although the chairman did point out some resources that are available, many small businesses do choose to settle the claim by paying the troll. Others investigate and fight the claims, draining precious resources and stunting the growth of their businesses.

It costs patent trolls virtually nothing to send patent demand letters, but they have cost American businesses tens of billions of dollars in recent years. At best, patent trolls are misleading, and at worst, they are extortionists.

This is fundamentally a fairness issue. As the subcommittee charged with protecting consumers and promoting fair business practices, we must work to reduce frivolous patent claims. I am glad that the FTC is using its existing authority to order injunctions on patent assertion entities that are determined to engage in unfair deceptive acts or practices. I believe that if we legislate on this issue, we should include new authority for the FTC to collect civil penalties for those abuses.

While we should also make sure that important consumer and business protections are guaranteed and enforced at the State level, including Illinois, remain in place. Federal legislation could also ensure the transparency and baseline standards are required for patent demand letters.

There are many ideas about how to increase transparency, including proposals to require information in patent demand letters, about the patent-alleged infringement that—the patent that is allegedly infringed, and the technology used that allegedly infringes on the patent.

As we consider acting on this issue, we must also recognize that many patent infringement claims are reasonable efforts, as the chairman mentioned, reasonable efforts to protect intellectual property. We also need to be careful to make sure that universities, research institutions, and others that develop and hold patents, but may not develop products for sale, are not unfairly labeled as patent trolls. We should not undermine the ability of innovators to develop and defend their patents.

I look forward to hearing the ideas of the panel about how we could move forward with legislation, and how it should be structured to make sure that patent demand letters are more fair and transparent moving forward.

And I thank you again, Mr. Chairman, for holding this hearing. I yield back.

Mr. BURGESS. The gentlelady yields back.

This is the point where the Chair would normally recognize the chair of the full committee, but seeing that—and I do want to explain to our witnesses, there is a concurrent subcommittee hearing downstairs, and we may well see Members come in and out today, and it is not a sign of disrespect, it is a sign of there is just a lot of work to be done this morning.

Mr. Mullin, would you seek time for an opening statement?

Mr. MULLIN. No, thank you.

Mr. BURGESS. Gentleman does not seek time.

Chair recognizes the ranking member of the full committee, Mr. Pallone, for purposes of an opening statement, 5 minutes.

OPENING STATEMENT OF HON. FRANK PALLONE, JR., A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW JERSEY

Mr. PALLONE. Thank you, Mr. Chairman.

The patent system plays a crucial role in promoting innovation. It provides an incentive to inventors to make costly and time-consuming investments in research and development of new inventions. At the same time, the system requires that the inventions be disclosed so that others can build upon the inventions. Unfortunately, there are a number of problems with the patent system, and reforms are needed.

I have long pushed to reduce the backlog of patent applications at the Patent and Trade Office, but we also need to work to address the concerns that some applications are being approved for inventions that are not truly new or non-obvious. In addition, the patent litigation system must be streamlined.

While most patent-related issues are under the purview of the Judiciary Committee, and I look forward to its action on patent system reform, the Energy and Commerce Committee is responsible for efforts to curb fraud. And one part of the patent litigation area in need of attention is the rise of so-called patent trolls, and the sometimes fraudulent demand letters they send to small businesses. This trolling activity is a problem. Patent trolls do not invent, make or sell anything. Instead, they buy up large numbers of patents, often of suspect validity, and then send demand letters or bring law suits using the complexity of the patent system and the high cost of litigation as leverage to force licensing fees or settlements. It is not fair to the targets of these predatory tactics, nor does it serve the interests of true innovators.

And efforts to combat abusive demand letters have already begun. Some State attorneys general have taken legal action to protect their citizens from unfair and deceptive demand letters. In addition, 18 States have already enacted legislation to tackle this abusive activity. Furthermore, the FTC brought an administrative complaint against MPH Technologies, a well-known patent troll. That case was recently settled through a consent order that prohibits MPHJ from making deceptive statements in its demand letters.

Last Congress, this committee held three hearings, and the subcommittee marked up a bill which I believe included problematic language. Among other things, it created a knowledge standard, one not typically needed to prove fraud, and it preempted stronger State laws. I am happy that this issue is being given a fresh review this Congress in an effort to get the language right and work in a bipartisan fashion. If we as a Congress choose to legislate in this area, we need to make sure that we are furthering the interests of the consumer, end users and small businesses, while protecting the vitality of the patent system.

So today's hearing presents an opportunity to hear from witnesses about how big is the problem of fraudulent demand letters, and whether there is an appropriate legislative fix. And I look forward to hearing the witnesses' thoughts on this issue, and their ideas for possible solutions.

I yield back.

Mr. BURGESS. The gentleman yields back.

This concludes opening statements.

We want to welcome all of our witnesses, and thank you for agreeing to testify before the subcommittee today. Our witness panel for today's hearing will include Ms. Laurie Self, the Vice President and Counsel of Government Relations, will be testifying on behalf of Qualcomm; Mr. Vince Malta, Liaison for Law Policy at the National Association of Realtors; Mr. Paul Gugliuzza, close enough, Associate Professor at Boston University School of Law; and Ms. Vera Ranieri, Staff Attorney for the Electronic Frontier Foundation. We welcome you all to the committee.

And, Ms. Self, we will start with you. You are recognized 5 minutes for the purpose of an opening statement.

STATEMENTS OF LAURIE SELF, VICE PRESIDENT AND COUNSEL, GOVERNMENT AFFAIRS, QUALCOMM; VINCE MALTA, 2015 LAW AND POLICY LIAISON, NATIONAL ASSOCIATION OF REALTORS; PAUL R. GUGLIUZZA, ASSOCIATE PROFESSOR OF LAW, BOSTON UNIVERSITY SCHOOL OF LAW; AND VERA RANIERI, STAFF ATTORNEY, ELECTRONIC FRONTIER FOUNDATION

STATEMENT OF LAURIE SELF

Ms. SELF. Thank you. Chairman Burgess, Ranking Member Schakowsky and Members of the subcommittee, thank you for the opportunity to appear today to discuss patent demand letters. My name is Laurie Self, and I am Vice President and Counsel, Government Affairs for Qualcomm. Qualcomm is a member of the Innovation Alliance, a coalition of research and development focused companies that believe in the critical importance of maintaining a strong patent system.

Qualcomm is a major innovator in the wireless communications industry, and the world's leading supplier of chipsets that enable 3G and 4G smartphones, tablets and other devices. Qualcomm's founders are the quintessential example of American inventors in the garage who build one of the world's foremost technology companies. Today, the technologies invented by our engineers help make nearly everything you do with your smartphone—help everything you do with your smartphone, from browsing the internet, to sharing videos, to using GPS navigation. We are an invention hub for the mobile age, having spent more than \$34 billion on R and D since the company was founded in 1985. Through the broad licensing of our patented technologies, Qualcomm has helped foster a thriving mobile industry that accounts for more than one million jobs, and \$548 billion of U.S. gross domestic product. Qualcomm itself has more than 31,000 employees, the vast majority of whom are engineers based in the United States.

It is worth noting that Qualcomm is not a plaintiff in any pending patent litigation, but we are a defendant in several patent infringement law suits, some of which were brought by so-called patent assertion entities. However, I am not here to criticize or defend PAEs, but instead to address what we believe should be the proper focus of any patent demand letter legislation; namely, targeting abusive demand letter activities without unintentionally damaging important patent rights.

Notice letters play an important role in the patent system for both patent holders and accused infringers. Patent law encourages, and sometimes requires patent holders to take reasonable steps to notify others of possible infringement. Meaningful patent protection including the ability to provide notice is a key factor for companies like Qualcomm in deciding whether to invest in new products and technologies. Qualcomm appreciates the committee's interest in curtailing abusive demand letter activities. At the same time, we urge the committee to be cautious so as to not inadvertently hinder legitimate patent enforcement practices. A demand letter law that makes patent notification or enforcement too burdensome, too costly or too risky may deter appropriate notice activity. If valid patent owners are afraid to seek compensation for use of their inventions,

the whole patent-based system of incentivizing innovation is undermined.

Qualcomm supports the Demand Letter Bill that passed this committee in July 2014, the Targeting Rogue and Opaque Letters Act. The TROL Act includes several key features that are necessary to strike the appropriate balance. First, the bill clarifies rather than expands the FTC's existing authority under Section 5 to address abusive demand letters.

Second, the bill is limited to situations in which the sender has engaged in a pattern or practice of mailing bad faith demand letters to consumers. The pattern or practice requirement appropriately targets the mass mailing of deceptive demand letters, and it is consistent with the FTC's Section 5 authority. An explicit bad faith requirement is necessary to protect patent holders' constitutional rights. Patent property rights are rooted in Article I of the Constitution, and the First Amendment provides strong protections for patent demand letters. As courts across the country have recognized, pre-law suit communications implicate both the freedom of speech and the constitutional right to petition the Government. To conform with the constitution, legislation must avoid punishing patent holders for good faith conduct. By clarifying the FTC's enforcement authority under Section 5, the bill is limited to communications sent to consumers, including mom and pop retailers, which protects those most vulnerable to abusive demand letters, while reducing the risk that the FTC will be drawn into business-to-business disputes.

Third, the bill clearly describes the conduct that will be considered unfair and deceptive, and does not impose overly burdensome disclosure requirements.

Fourth, the bill preempts State demand letter laws that allow State attorneys general to bring enforcement actions under the Federal statute.

With nearly 20 State legislatures having passed such bills over the past 2 years, and another dozen considering such a bill now, it would be extremely burdensome to subject patent owners to a patchwork of different demand letter requirements in every State. Preemption is appropriate and necessary in the demand letter context because unlike the TROL Act, many of these State demand letter laws are overly broad in scope, highly burdensome to patent owners, and risk penalizing ordinary commercial and pre-litigation communications, which are protected under the First Amendment.

These four features are critical to Qualcomm's support, and we urge the committee to retain these requirements and limitations in the bill. Qualcomm looks forward to working with the committee in its efforts to achieve a balanced and narrowed-tailored bill.

Thank you for allowing me to testify today, and I look forward to answering your questions.

[The prepared statement of Ms. Self follows:]

Statement of
Laurie Self
Vice President and Counsel, Government Affairs
Qualcomm Incorporated
Before the
Subcommittee on Commerce, Manufacturing, and Trade
Committee on Energy and Commerce
United States House of Representatives
114th Congress, 1st Session
February 26, 2015

Introduction

Chairman Burgess, Ranking Member Schakowsky and Members of the Subcommittee, thank you for the opportunity to appear today to discuss patent demand letters. My name is Laurie Self, and I am Vice President and Counsel, Government Affairs for Qualcomm Incorporated. Qualcomm is a member of the Innovation Alliance, a coalition of research and development-focused companies that believe in the critical importance of maintaining a strong patent system that supports innovative enterprises of all sizes.

Qualcomm and the Innovation Alliance applaud the House Energy and Commerce Committee for their work last year to achieve a meaningful, balanced bill on the issue of demand letters that will address the abusive behavior that small businesses and retail interests face. We support the approach taken in the Targeting Rogue and Opaque Letters Act, which passed this Subcommittee on July 10, 2014. We believe the Act appropriately targets abusive behavior rather than particular types of patent owners, while maintaining the integrity of legitimate patent enforcement practices for all patent holders.

Qualcomm, Patents and Innovation

Qualcomm's founders are the quintessential example of the storied American "inventors in the garage" who built one of the world's foremost technology companies on the foundation of highly innovative technology and strong patent rights. Since our founding in 1985, Qualcomm has evolved into a leading innovator in the wireless communications industry, and a recognized pioneer in the development of 3G and 4G wireless technology.

Qualcomm designs, has manufactured on its behalf, markets, and sells products and services based on these and other digital communications technologies. Our products consist principally of integrated circuits (also known as chips or chipsets) and system software used in mobile devices and in wireless networks. Seventy percent of our 31,000 employees (65 percent of whom are engineers) are based in the United States. Qualcomm invests about 20% of its annual revenue in research and development. Since the company was founded in 1985, Qualcomm has spent more than \$34.2 billion on R&D. For the 2013 fiscal year alone, R&D expenditures totaled approximately \$5 billion. As we develop new technologies, we patent them to protect that investment. In the United States alone, Qualcomm has approximately 13,000 issued patents and approximately 10,000 pending patent applications.

Through ongoing investments in research and development (R&D) and broad licensing of our patented technologies, Qualcomm facilitates billions of dollars in exports, while creating thousands of well-paying jobs for U.S. workers. Moreover, through our R&D investments and licensing program, Qualcomm has helped create a thriving mobile ecosystem. Qualcomm's core wireless technologies are integral to 3G and 4G mobile phones, tablets, e-readers, mobile applications, and a host of other wireless devices and services. Qualcomm is the world's leading supplier of chipsets that enable these 3G and 4G devices.

Qualcomm is not a plaintiff in any currently pending patent litigation. At present, we are a defendant in several patent infringement lawsuits, some of which were brought by so-called patent assertion entities (PAEs) asserting questionable infringement claims based on patents of dubious validity. However, the objective of my testimony is neither to criticize nor defend PAEs. Rather, I am here today to testify regarding what Qualcomm believes should be the proper focus of the Committee's legislation—abusive demand letter conduct—and the best way to target such conduct without unintentionally damaging important patent protections.

Qualcomm is pleased that the bill previously proposed by this Committee has a number of strengths that other proposed measures relating to demand letters do not have. For example, the TROL Act focuses on those engaged in a pattern or practice of sending unfair and deceptive demand letters to consumers or end users. Additionally, the bill contains reasonable disclosure requirements, specifically sets forth the conduct that would be considered unfair and deceptive, and does not give the Federal Trade Commission discretion to regulate demand letter content. As drafted, the bill successfully focuses on the bad faith actors that are the cause of the problem and does not contain broad provisions that undermine the appropriate exercise of patent rights.

Notice letters and licensing communications are an important part of the U.S. patent system

A strong patent system, which has its roots in Article 1, Section 8 of the U.S. Constitution, is an essential part of America's economic success, contributing to economic growth, higher income, and more jobs. Strong patent rights incentivize investments in technological innovation. IP-intensive industries account for more than one third of U.S. GDP, and directly or indirectly support approximately 40 million jobs. It is critically important to maintain a strong patent system that promotes innovative enterprises of all sizes.

Notice letters play an important role in the patent system. Indeed, as the Supreme Court has explained, "[p]atents would be of little value if infringers of them could not be notified of the consequences of infringement." *Virtue v. Creamery Package Mfg. Co.*, 227 U.S. 8, 37-38 (1913).

Patent law encourages patent holders to take reasonable steps to notify others of existing or pending patent rights and their possible infringement. In some instances, federal patent law requires patent holders to send notice letters to accused infringers to preserve their patent enforcement rights and ability to collect damages. Notice letters and licensing communications can also serve the interests of accused infringers. Once a patent holder has made its rights known, the accused infringer can determine whether to cease the allegedly infringing activities, negotiate a license, or decide to continue its activities based on an assessment of non-infringement or invalidity. Moreover, knowledge that new products or products in development may practice the patent or patents of another allows potential infringers an opportunity to design around existing intellectual property while still producing a product that is socially and economically beneficial, or even perhaps improve upon the invention or invent an alternative.

Any demand letter legislation must be careful not to discourage legitimate patent-related communications, which are integral to the functioning of the patent system and the resolution of patent disputes, including possible resolution without resorting to litigation.

Abusive demand letters

We have all heard stories of the mass mailing of bad faith patent demand letters by PAEs or “patent trolls” to small businesses, consumers, and technology end users. Through the indiscriminate sending of bad faith demand letters, some bad actors have co-opted and distorted an otherwise legitimate patent enforcement practice in an attempt to extract payment from groups of people who are generally unfamiliar with the patent system.

Qualcomm understands and appreciates the Committee’s interest in curtailing the abusive activities of these bad actors. At the same time, we urge caution and balance to ensure that efforts to address this problem do not inadvertently harm legitimate patent enforcement practices.

Unnecessarily broad legislation will cause unwanted “collateral damage”

A demand letter law that is too broad or too punitive may deter appropriate and useful efforts to provide notice of patent infringement activity and runs the risk of undermining incentives to innovate. The value of a patent rests in the patent holder’s ability to enforce it in a meaningful way. Innovators must assess their ability to enforce and license the intellectual property relating to their inventions when deciding whether to make the significant investments necessary to develop and/or commercialize new products and technologies. The availability of meaningful patent protection is also key to the development of business partnerships and cooperative relationships in key technology areas. Making notification obligations or enforcement of patent rights too burdensome, too costly, or too risky will adversely affect the dynamics of innovation investment. Accordingly, any legislation should target remedying the problem of abusive mass demand letter campaigns, without harming patent holders engaged in legitimate patent enforcement activities.

An effective solution does not require sweeping legislation or an expansion of the FTC’s authority to police the enforcement-related communications of all patent holders. Indeed, the FTC already has the authority to protect consumers from unscrupulous actors who engage in the mass mailing of blatantly unfair or deceptive demand letters. Indeed, the FTC has taken action against such bad actors under its existing authority. Last year, the FTC investigated and charged a PAE, MPHJ Technology Investments, with making deceptive representations when asserting its patent rights. A bill that injects the FTC into private disputes over the validity or worth of patents would adversely affect both patent holders and accused infringers. Private disputes and negotiations do not need to be regulated in this manner.

The TROL Act properly clarifies, rather than expands, FTC authority. The proposed legislation draws a clear line between deceptive shakedown scenarios warranting FTC enforcement and

routine individualized patent correspondence between companies, the vast majority of which is legitimate. FTC enforcement authority granted by the bill is limited to those situations in which the sender has engaged in a pattern or practice of mailing bad faith demand letters to recipients likely to lack a familiarity with patent law or the resources necessary to evaluate and respond to a demand letter.

By clarifying that certain practices are unfair or deceptive under the Federal Trade Commission Act, the bill furthers the goal of protecting those most vulnerable to abusive demand letters while reducing the risk that the FTC will be drawn into individual disputes between patent owners and potential licensees or alleged infringers. The “pattern or practice” requirement is appropriate because the purported need for demand letter legislation stems from just this kind of activity—the mass mailing of demand letters by patent trolls. The “bad faith” requirement is necessary to capture the requirements of current case law and protect patent holders’ First Amendment rights. These requirements are consistent with the requirements imposed on the FTC by Section 5 of the Federal Trade Commission Act and existing case law. Indeed, limiting the bill to instances in which there is a “pattern or practice” of behavior is not only consistent with the FTC’s Section 5 authority, but similar provisions can also be found in other specific FTC statutes. Inclusion of these requirements will help to strike the correct balance between identifying the situations in which FTC can and should take action, and protecting the rights of patent holders.

Furthermore, if Congress is going to legislate in the area of demand letters, Congress should specifically describe the conduct that would be considered unfair and deceptive. This clarity is necessary to prevent the bill from being misinterpreted and to put patent holders on notice of what type of conduct is prohibited.

Legislation should avoid overly burdensome disclosure requirements

The TROL Act avoids imposing overly burdensome disclosure requirements that fail to account for the realities of patent enforcement and licensing negotiations. Not all licensing communications involve a handful of patents and a small number of commercially available accused products. Often, licensing negotiations involve a portfolio of hundreds or thousands of patents and numerous different devices, product models, or manufacturing processes. Some or all of these potentially infringing devices, product models, or processes may not be available to the patent holder. Even assuming such information is readily available to a patent holder, requiring disclosure of highly detailed information in a demand letter (such as an identification of each asserted claim and each accused product model or process, and a detailed explanation of how each claim is infringed) would impose an undue burden on patent owners and could result in voluminous communications. For some patent holders, particularly small inventors, start-ups and those lacking extensive resources to devote to patent enforcement, such a burden would be enormous, expensive and impractical, and could impair their ability to enforce their intellectual property rights.

Legislation should protect good faith conduct and the constitutional rights of patent holders

We ask that the Committee refrain from creating a framework under which a patent holder could be punished for good faith conduct. Indeed, the First Amendment affords broad protection for activities relating to the enforcement and communication of patent rights, and courts have repeatedly held that a patent holder should not be penalized for communicating its patent rights or an allegation of infringement in good faith. The proposed legislation accomplishes this goal through the inclusion of an affirmative defense for mistakes made in good faith.

The real consumer protection threat posed by demand letters results from the sending of bad faith communications to unsophisticated recipients. The appropriate goal of the legislation should be to identify, and empower the FTC to address, only those demand letters that are sent in bad faith.

Federal preemption of state demand letter laws is necessary for clarity and uniformity

Congressional demand letter legislation must preempt state demand letter bills. Patent law has long been the exclusive province of the federal government. However, over the past two years, almost twenty states have passed legislation relating to patent demand letters. At least a dozen others are considering legislation this year. These state bills contain disparate requirements and prescriptions. Ensuring compliance with federal legislation, as well as a patchwork of state laws, will make enforcement of patent rights extremely burdensome and, for some patent holders, prohibitively expensive, which in turn will chill the sending of patent-related communications, even those communications which are entirely legitimate and made in good faith.

Furthermore, some of the recently passed state bills contain provisions that could be subject to abuse by accused infringers. For example, many state bills allow the recipient of a demand letter to pursue a private cause of action against a patent holder and seek tens of thousands of dollars in punitive damages. As a result, patent holders may find themselves the target of private plaintiffs threatening or instituting litigation in order to extract nuisance settlements. Provisions of this nature are likely to incentivize, rather than prevent, vexatious litigation. The federal government is best positioned to address the problem through balanced legislation that will be applied uniformly throughout the nation.

Conclusion

Qualcomm respects the Committee's efforts to find a sensible solution to the problem of abusive demand letters. As noted, the TROL Act has a number of strengths. For example, the bill appropriately focuses on those engaged in a pattern or practice of sending unfair and deceptive demand letters. It correctly focuses on letters sent to consumers. The bill sets forth reasonable, but not unduly burdensome, disclosure requirements. It specifically describes the conduct that would be considered unfair and deceptive, and does not give the FTC discretion to regulate demand letter content.

It is critical to retain these requirements and limitations. Qualcomm could not support a bill that expands the FTC's authority, punishes good faith conduct, imposes onerous disclosure requirements, or fails to preempt the litany of state laws that impose an assortment of differing rules on patent owners.

Qualcomm looks forward to working with the Committee in its efforts to achieve a balanced and narrowly tailored bill. Thank you for allowing me to testify today, and I look forward to answering your questions.

Mr. BURGESS. Gentelady yields back. Thank you for your testimony.

The Chair recognizes Mr. Malta 5 minutes for the purposes of an opening statement please.

STATEMENT OF VINCE MALTA

Mr. MALTA. Chairman Burgess, Ranking Member Schakowsky, and Members of the subcommittee, my name is Vincent Malta. I am the broker of record for Malta and Company in San Francisco, California. I serve as the 2015 National Association of Realtors' Liaison for Law and Policy, and I am here to testify on behalf of the one million members of NAR.

I am also here representing United for Patent Reform Coalition, a broad and diverse group of Main Street, high tech and manufacturing companies that have united to urge the passing of strong, commonsense patent reform.

In the real estate industry, patent trolls have targeted Realtor brokers, agents and multiple listing services for implementing simple Web site technologies. Here are 5 examples where patent trolls have alleged infringement. First, the Real Estate Alliance Ltd. Filed an infringement law suit against a broker and other unnamed defendants, charging that zooming in to locate points on a map was an infringement. The case was eventually dropped after 2 years.

Second, a company called Civix-Ddi LLC charged that providing a searchable data base of property listings infringes its patents. Civix have targeted not only multiple listing services in the real estate industry, but Microsoft, Expedia, Move and other companies. NAR decided to settle this case for \$7.5 million, fearing that the cost of letting the case go to trial would be exponentially more expensive.

Third, Data Distribution Technologies charged that a number of real estate firms were in patent violation by providing updates to consumers when properties matched their search criteria are coming on the market. This patent is undeniably abstract because it describes what any real estate professional already does. The real estate companies had to expend time and money to challenge the validity of this abstract patent, finally settling after 2 years.

The Austin Board of Realtors received a demand letter alleging patent infringement for having a drop-down menu on their Web site.

And finally, NAR members received abusive demand letters from the MPHJ Technologies troll that notoriously sent over 16,000 demand letters to businesses, demanding payment for using basic scan-to-mail technology.

Simply put, these patent trolls make everyday business practices potential law suits. Patent trolls typically start by sending form demand letters to dozens, hundreds, or even thousands of businesses at a time. They claim these businesses are infringing on patents, but provide little to no evidence. Typically, the sender will list a patent number only, with no reference to which claim within the patent is alleged to have been infringed. The letters are often intentionally vague, and demand a licensing fee or threaten litigation. If the business does speak with a lawyer, they are often ad-

vised to pay the fee rather than risk very costly infringement law suits. This essentially is a junk mail approach that is clogging up our legal system. NAR members and other small businesses rightfully feel extorted by this process.

In 2013, more than 2,600 companies were sued by patent trolls, representing 60 percent of all patent infringement cases brought that year. Small and medium-sized companies paid on average \$1 ⅓ million dollars to settle patent troll cases, and \$1.7 million on average in court defense costs for patent troll litigation. Economists estimate that in 2011, patent trolls cost operating companies \$80 billion in direct and indirect costs. That is more than the \$66 billion State budget of Illinois, and in 2013, almost reaches the \$96 billion State budget in Texas. This is a serious problem for the American business community, in particular, small businesses who lack the resources to fight these pointless battles. NAR's most recent surveys indicate that more than half of all realty firms have less than 25 agents.

In the last Congress, this subcommittee passed legislation aimed at addressing demand letter abuse. NAR and the Coalition appreciated the subcommittee's work on the Targeting Rogue and Opaque Letters Act. As the subcommittee considers legislation in this Congress, we ask that you consider a few essential guidelines. Fundamentally, patent demand letters must be held to a practical standard of transparency. They must specify the relevant patent claim at issue, they must detail all businesses allegedly infringed, they must include a description of the patent troll's investigation of the alleged infringing activity, and they must disclose the real parties and interest to the dispute. This minimum information will help recipients to thoughtfully review whether infringement allegations merit an agreement to license.

In conclusion, NAR and the United for Patent Reform Coalition urge Congress to act swiftly to enact meaningful demand letter reform for the good of our Nation's small business community, and while demand letter reform is crucial, as an important first step towards broader patent reform, it requires comprehensive and multifaceted reforms.

Thank you for your consideration of our views.

[The prepared statement of Mr. Malta follows:]



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TESTIMONY OF

**VINCE MALTA
2015 LAW & POLICY LIAISON
NATIONAL ASSOCIATION OF REALTORS®**

**ON BEHALF OF
THE NATIONAL ASSOCIATION OF REALTORS®
AND
THE UNITED FOR PATENT REFORM COALITION**

BEFORE THE

**UNITED STATES HOUSE ENERGY AND COMMERCE
COMMITTEE
COMMERCE, MANUFACTURING AND TRADE SUBCOMMITTEE**

**HEARING TITLED
UPDATE: PATENT DEMAND LETTER PRACTICES AND
SOLUTIONS**

FEBRUARY 26, 2015

REALTOR® is a registered collective membership mark which may be used only by real estate
Professionals who are members of the NATIONAL ASSOCIATION OF REALTORS®
and subscribe to its strict Code of Ethics.



Summary

The National Association of REALTORS® (NAR) and the United for Patent Reform Coalition wish to see Congress pass strong, common sense patent reform legislation that addresses crucial issues to the American business community.

Patent trolls have targeted REALTOR® brokers, agents and multiple listing services for implementing technologies on their websites that simply provide a computerized means for delivering real estate services that consumers have always received from our members. For example, patent trolls have alleged infringement of a method of providing a searchable database of property listings, locating points of interest on a map, and providing updates to consumers when properties matching their search criteria come on the market. Our members also receive demand letters from the MPHJ Technologies troll that notoriously sent over 16,000 demand letters to businesses demanding payment for using basic “scan to email” technology.

Patent trolls typically operate through an opaque and interconnected network of shell companies; they send form demands to hundreds or even thousands of businesses at a time claiming with little to no evidence that they are “infringing” their patents. Very often, the sender has conducted no prior investigation as to whether the recipient of the demand is actually using the method or technology in question.

Congress should require that patent demand letters include truthful, basic information including the relevant patent claims at issue; how the business has allegedly infringed, including a description of the patent trolls investigation into the alleged infringing activity, and the real parties in interest to the dispute. Legislation should ensure that it does not limit Federal Trade Commission authority to enforce against deceptive and unfair trade practices and should clearly state that false statements in demand letters violate the FTC Act.

Introduction

Chairman Burgess, Ranking Member Schakowsky, and members of the subcommittee; my name is Vincent Malta. I am the broker of record for Malta & Company in San Francisco California. I serve as the 2015 National Association of REALTORS® Liaison for Law and Policy. I am here today to testify on behalf of the over one million members of the National Association of REALTORS® who were each impacted by a patent troll in 2007 and many of whom continue to be targeted today. I'm also here on behalf of the United for Patent Reform Coalition. United for Patent Reform is the preeminent national voice for the strongest possible patent litigation reform legislation. The members of United for Patent Reform are a broad and diverse group of Main Street, high tech, and manufacturing companies—from brick-and-mortar retail stores to Wi-Fi technology providers from automobile manufacturers to home builders and real estate professionals—that have united in making sure Congress passes strong, common sense patent reform.

Last year's efforts on patent litigation reform were a good start and we thank Congress for its work on this matter. Now we have another opportunity to get it done. We need this subcommittee, together with your Congressional colleagues, to pass multi-faceted patent reform that addresses crucial issues to America's businesses. We believe any bill passed by Congress must address seven key issues: reforming abusive demand letters; making trolls explain their claims; protecting innocent customers; making patent litigation more efficient; stopping discovery abuses; making abusive trolls pay; and providing less expensive alternatives to litigation. Today we will focus on addressing abusive demand letters.

PATENT TROLLS HARM BUSINESS AND THE ECONOMY

Abusive patent litigation remains a serious threat for REALTORS® and main street businesses of all sizes across the country. REALTORS® are often end users of technology and, as a result, have been inundated by abusive and deceptive patent demand letters by patent assertion entities (PAEs), commonly referred to as “patent trolls.” These patent trolls use vague allegations of infringement and overly broad patents, threats of litigation, and licensing fee demands in an effort to extort payments from real estate businesses across the country. Real estate firms vary widely in size, but the overwhelming majority of realty firms are very small entities. NAR’s most recent surveys indicate that more than half of all realty firms have less than twenty-five agents and that the typical REALTOR® is affiliated with an independent realty firm with only one office.

Patent trolls often prey on small businesses of all kinds, which do not have the resources to fight such false claims. Fighting these claims has a real cost: for REALTORS® it means less capital and fewer resources available for investing back into our businesses that in turn drive economic growth.

In 2013, more than 2,600 companies were sued by patent trolls representing 67 percent of all patent infringement cases brought that year.¹ Small and medium sized companies paid on average \$1.33 million to settle patent troll cases and \$ 1.75 million in average in court defense costs for patent troll litigation.² Economists estimate that in 2011, patent trolls cost operating companies \$80 billion in direct and indirect costs.³ The numbers show that the patent troll problem for American business is real and a solution is urgently needed.

American businesses of all sizes and from all industry sectors are being held hostage by frivolous lawsuits and overly broad allegations made by patent trolls. This must change. The time is now to

¹ RPX Litigation Report 2013

² Colleen V. Chien, Santa Clara University School of Law Startups and Patent Trolls

³ James Besson & Michael J. Meurer, Boston University Study “The Direct Costs from NPE Disputes”

take back the patent litigation system and return it to its original purpose: fostering innovation and investment that benefits the entire economy.

NAR and the United for Patent Reform coalition seek the following reforms:

Reform abusive demand letters: Require that patent demand letters include truthful, basic information that describes the allegations and the patent owner with specificity. Patent trolls send vague and deceptive letters alleging patent infringement to demand unjustified payments from innocent individuals and businesses. Vague demand letters should not be used to bully innocent businesses into paying what amounts to protection money.

Make trolls explain their claims: Require patent owners to explain in detail the basis for the alleged infringement when they file a complaint. Current law does not require that a patent holder explain how a patent is infringed, or even identify the product involved, which makes it nearly impossible someone who has been sued to evaluate the case and decide how to proceed.

Protect innocent customers: Ensure that claims between a patent owner and a manufacturer proceed before claims between the patent owner and the manufacturer's end users. Under current law, anyone can be sued for infringement for simply using a product, system or method. We don't want to change that. Instead, it simply makes sense for cases against end users to be stayed in favor of cases involving the manufacturer.

Make patent litigation more efficient: Make patent litigation more efficient so that weak cases can be dismissed before expensive discovery. Requiring patentees to explain and judges to decide what a patent means at the beginning of a case—the Markman hearing—narrows the case to the actual legal issues in question, drives early resolutions and avoids unnecessary and expensive discovery.

Stop discovery abuses: Require trolls to pay for the discovery they request beyond core documents so that they cannot run up costs just to force a settlement. Since trolls don't actually make or create anything, they have few documents to produce and no incentive to be reasonable in their discovery requests. Making trolls responsible for the costs of their discovery requests that go beyond the core documents needed to decide most patent issues will stop unreasonable demands made for negotiation leverage.

Make abusive trolls pay: Require that a losing party who brings a frivolous case pay the other side's attorney's fees—and make sure the troll can pay. Trolls currently have few barriers to litigation with no significant costs. A stronger presumptive fee-shifting statute and a mechanism to ensure court ordered fee shifting is enforceable will deter nuisance suits.

Provide less expensive alternatives: Maintain and improve administrative alternatives to litigation. Ensuring access to efficient and fair mechanisms to re-examine questionable patents will reduce litigation abuses and strengthen the patent system.

PATENT DEMAND LETTERS TARGET MAIN STREET BUSINESSES

Patent trolls continuously expand their reach to small businesses, which are unfamiliar to the complex world of patent litigation and lack the resources and expertise to properly defend themselves. Businesses facing the daunting and costly prospect of litigation are left to either take time away from their work priorities to research and respond to a typically vague demand letter or simply succumb to the demand to avoid being sued. Unfortunately, due to the intentionally vague nature of these letters along with the calculated demands, many businesses view settlement as the only rational business decision.

In the real estate industry, patent trolls have targeted REALTOR® brokers, agents and multiple listing services for implementing technologies on their websites that simply provide a computerized means for delivering real estate services that consumers have always received from our members. For example, patent trolls have alleged infringement of a method of providing a searchable database of property listings, locating points of interest on a map, and providing updates to consumers when properties matching their search criteria come on the market. Our members also received demand letters from the MPHJ Technologies troll that notoriously sent over 16,000 demand letters to businesses demanding payment for using basic "scan to email" technology.

Homebuilders have received demand letters from a company alleging to own a patent on a moisture removal process used in home construction. Unfortunately, the process described in the patent is one that anyone using a dehumidifier, fan, heater or dryer could unintentionally run afoul of while attempting to remove water from a construction site.

Mr. Jim's Pizza based in Farmers Branch, Texas was sued alongside 50 others in the restaurant industry for allegedly violating a patent that relates to online search engines featuring their store information on a map. Again, all of these patent trolls provided businesses with over broad descriptions of the patents at issue and vague allegations of infringement.

Numerous other examples like these exist in nearly every sector of our economy. America's patent system has long served to foster innovation while rewarding inventors for their contributions to progress and innovation. Unfortunately today, the actions of rogue actors increasingly undermine the patent system and unduly burden many of our country's small businesses.

DEMAND LETTERS ARE VAGUE UNFAIR AND DECEPTIVE

Patent trolls typically operate through an opaque and interconnected network of shell companies, send form demand letters to dozens, hundreds, or even thousands of businesses at a time claiming with little or no evidence that they are “infringing” the troll’s patents. Typically, the sender will list a patent number only—with no reference to which claim within the patent is alleged to infringe. The letters are often intentionally vague, providing little in the way of factual allegations as to how the business has infringed the patent in question. Very often the sender has conducted no prior investigation as to whether the recipient of the demand is actually using the method or technology that is alleged to infringe. The letters go on to demand a “licensing fee” or threaten litigation.

Patent trolls are notoriously savvy. The license demand is often calculated to be an amount that is more advantageous for the demand letter recipient to pay rather than incur the expenses of investigating the vague allegations or consulting with a lawyer. If the business does take the step to speak with a lawyer, they are often advised to pay the fee rather than risk a ruinous patent infringement lawsuit. When discussing the matter with the business, patent trolls typically emphasize the threat of litigation and future cost burdens to the business and not the merits of the patent or alleged infringement. NAR members and other small businesses rightfully feel extorted by this process.

DEMAND LETTER REFORM MUST WORK FOR THOSE TARGETED BY ABUSE

In the last Congress this Subcommittee passed legislation aimed at addressing demand letter abuse. NAR and the Coalition appreciates the Subcommittee’s work on the Targeting Rogue and Opaque Letters Act (“TROL Act”), a bill aimed at strengthening enforcement and reducing the number of bad faith demand letters that our businesses receive. As the subcommittee considers legislation in

this Congress we ask that you consider the following three priorities: 1) require specificity and transparency in patent demand letters 2) take care not to limit the Federal Trade Commission's (FTC) enforcement authority and 3) Make clear that false statements are FTC Act violations.

Patent Demand Letters Must be Made More Transparent

Fundamentally, patent demand letters must specify the relevant patent claims at issue; how the business has allegedly infringed, including a description of the patent troll's investigation of the alleged infringing activity, and the real parties in interest to the dispute. This minimum information will help recipients to thoughtfully review whether infringement allegations merit an agreement to license.

As detailed earlier in this testimony, patent trolls send vague and deceptive letters alleging patent infringement to demand unjustified payments from individuals and businesses. Vague demand letters should not be used for extortion.

Do Not Limit Enforcement Authority

The Subcommittee should ensure that legislation does not limit Federal Trade Commission authority to enforce against deceptive and unfair practices in any way whatsoever. Instead, legislation should clarify and sharpen FTC authority, but should not expand or contract its authority. This is especially important since the TROL Act from last Congress preempted state action.

False Statements Are FTC Act Violations

False statements in demand letters are inherently unfair and deceptive. Legislation addressing abusive demand letters should clearly state that false statements violate the FTC Act.

CONCLUSION

Deceptive demand letters alleging patent infringement represent a real and significant threat to American businesses. Patent trolls intentionally target small businesses and end user customers of technology precisely because the lack the resources and expertise to defend against the intentionally vague claims of infringement contained in many demand letters. Policymakers can have a positive and important impact on reducing patent litigation abuse, thus redirecting billions of dollars to productive use to grow the American economy, all without compromising the rights of legitimate patent holders. NAR and the United for Patent Reform Coalition urge Congress to act swiftly to enact meaningful demand letter reform, which will deter the patent troll business model of extracting settlements by sending deceptive settlement demands. Thank you for your consideration of our views.

UNITED for PATENT REFORM

A diverse group of American businesses have united in making sure Congress passes strong, common sense patent reform. It's time we take back our patent system from trolls. Learn more at UnitedforPatentReform.com or follow [@U4PatentReform](https://twitter.com/U4PatentReform) on Twitter.



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INTELLECTUAL PROPERTY LAW

Alexander Solo
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2013

Re: [REDACTED]
Notice of Infringement of United States Patent No. [REDACTED]

Dear Sir or Madam:

We are intellectual property counsel to [REDACTED] ("[REDACTED]"). [REDACTED] is the owner of U.S. Patent No. [REDACTED] ("the [REDACTED] Patent") entitled "[REDACTED]." (Attached hereto)

By way of background, the [REDACTED] Patent relates to a system that provides agents and/or users with an online searchable real estate database where the agents and/or users can save their searches, their favorite properties, and their notes and receive update messages when new properties matching their criteria come on the market or the status of properties that they are monitoring changes. This invention is very valuable in the real estate industry because a vast portion of new real estate buyers begin their searches for a new home online. These users also rely on message updates to keep abreast of new listings or changes to the properties they are interested in.

It is our belief that the websites and services offered and promoted by [REDACTED] [REDACTED] namely the system found on the website [REDACTED] use, induce others, or contribute to the performance of one or more of the claims of the patent. Accordingly, by this letter, we are putting you on notice that we and [REDACTED] believe that [REDACTED] directly and indirectly infringes the [REDACTED] Patent.

A non-exclusive license under the [REDACTED] Patent is available on fair and reasonable terms. We invite you to schedule a meeting to open discussions regarding licensing the [REDACTED] Patent.



General Counsel
[REDACTED] 2013
Page 2

In the meantime, if you have any questions about the [REDACTED] Patent, the technology covered by the [REDACTED] Patent, and terms for resolution, please do not hesitate to contact us.

Sincerely yours,

LERNER, DAVID, LITTENBERG,
KRUMHOLZ & MENTLIK, LLP

ALEXANDER SOLO

AS

Enclosure - Patent No. [REDACTED]

cc: [REDACTED]

[REDACTED]

Mr. BURGESS. Gentleman yields back. Chair thanks the gentleman for his testimony.

Professor Gugliuzza, you are now recognized for 5 minutes for the purposes of an opening statement.

STATEMENT OF PAUL R. GUGLIUZZA

Mr. GUGLIUZZA. Chairman Burgess, Ranking Member Schakowsky, Members of the subcommittee, thank you for inviting me to testify. My name is Paul Gugliuzza, and I am an associate professor of law at Boston University School of Law.

My research focuses on patent law and patent litigation. Most relevant to this hearing, I have spent the past 2 years studying the issue of patent demand letters, focusing in particular on efforts by both State governments and the Federal Government to address the problem of unfair and deceptive conduct in patent enforcement.

To briefly summarize my conclusions, a small number of patent holders, often called bottom feeder patent trolls, have been abusing the patent system. These patent holders blanket the country with thousands of letters demanding that the recipients purchase a license for a few thousand dollars, or else face an infringement suit. The letters are usually sent to small businesses, nonprofits that do not have the resources to defend against claims of patent infringement. And the letters often contain false or misleading statements, calculated to scare the recipient into purchasing a license without investigating the merits of the allegations.

In response to this troubling behavior, legislatures in 18 States have adopted statutes that, generally speaking, outlawed bad faith assertions of patent infringement. These statutes, however, may be unconstitutional. The U.S. Court of Common Pleas Appeals for the Federal Circuit, which hears all appeals in patent cases nationwide, has held that patent holders are immune from civil claims challenging their acts of enforcement unless the patent holder knew that its infringement allegations were objectively baseless. This rule could provide patent holders with nearly absolutely immunity from liability under the new statutes. In fact, the rules already immunize two notorious trolls; Innovatio IP Ventures and MPHJ Technology Investments, from legal challenges to their enforcement campaigns under State consumer protection laws.

Although the Federal circuit has sometimes called this immunity rule a matter of the Federal Patent Acts' preemption of State law, this rule could also limit the ability of the Federal Government to regulate patent enforcement behavior. This is because the Federal circuit's decisions are not grounded in the Constitution's Supremacy Clause, which is the usual source of preemption doctrine, but in the First Amendment right to petition the Government. Unlike the Supremacy Clause, the First Amendment limits the power of the Federal Government, not just State governments. Accordingly, patent holders may also be able to invoke this immunity to thwart Federal initiatives to fight patent trolls, including any legislation this committee might consider.

To be clear, no court has yet addressed the constitutionality of the new State statutes. Moreover, as I discuss in more detail in my written statement, there is a strong argument that the Federal circuit's immunity doctrine is wrong as a matter of law, policy and

historical practice. So it is entirely possible that the Federal circuit can revise its immunity doctrine to accommodate greater regulation of patent enforcement conduct. Indeed, the Federal circuit keeps close watch when Congress is considering amending patent law, and in the past decade, the court has repeatedly revised its case law to align with proposed legislation.

This hearing provides a welcome occasion to discuss the innovative steps that State governments have taken to combat unfair and deceptive patent enforcement. Any bill advanced by this committee should, in my view, capitalize on the respective strengths of State governments and the Federal Government in this area. The strengths of State governments include, first, the quantity of law enforcement resources that could be provided by dozens of States attorneys general offices cooperating to fight abusive patent enforcement. And second, the accessibility of State governments to the small businesses, nonprofits and local governments most likely to be targeted by deceptive campaigns of patent enforcement. By contrast, Federal legislation on patent demand letters would provide the benefits of legal uniformity and predictability for patent holders about whether or not their enforcement actions are legal. In addition, as I explained in my written testimony, Federal legislation could clarify difficult jurisdictional issues that currently arise in cases challenging the lawfulness of patent enforcement conduct.

If this committee determines that Federal legislation is warranted, that legislation should, in my view, specifically condemn bad faith assertions of patent infringement. Until the Federal circuit adopted its objective baselessness requirement, courts had applied a bad faith standard for nearly a century, striking an appropriate balance between the goals of punishing extortionate schemes of patent enforcement, and respecting patent holders' rights to make legitimate allegations of infringement.

Thank you again for inviting me to testify, and I would be pleased to answer any questions the committee might have for me.

[The prepared statement of Mr. Gugliuzza follows:]

Statement of Paul R. Gugliuzza
Associate Professor of Law
Boston University School of Law

Committee on Energy and Commerce
Subcommittee on Commerce, Manufacturing, and Trade
U.S. House of Representatives

Hearing: "Update: Patent Demand Letter Practices and Solutions"

February 26, 2015

Introduction

Chairman Burgess, Ranking Member Schakowsky, and Members of the Subcommittee: Thank you for inviting me to testify. My name is Paul Gugliuzza. I am an associate professor of law at Boston University School of Law. I testify in my individual capacity, not representing my institution.

My research focuses on patent law and patent litigation. Most relevant to this hearing, I have spent the past two years studying the issue of patent demand letters, focusing in particular on efforts by both state governments and the federal government to address the problem of unfair and deceptive conduct in patent enforcement.¹

To briefly summarize my conclusions: A small number of patent holders, often called “bottom feeder” patent trolls, have been abusing the patent system. These patent holders blanket the country with thousands of letters demanding that the recipients purchase a license for a few thousand dollars or else face an infringement suit. The letters are usually sent to small businesses and nonprofits that do not have the resources to defend against claims of patent infringement. And the letters often contain false or misleading statements designed to scare the recipient into purchasing a license without investigating the merits of the allegations. In response to this troubling behavior, legislatures in eighteen states have recently adopted statutes that, generally speaking, outlaw bad faith assertions of patent infringement.

¹ For an in-depth discussion of this research, see Paul R. Gugliuzza, *Patent Trolls and Preemption*, 101 VA. L. REV. (forthcoming 2015), available at <http://ssrn.com/abstract=2539280>.

These statutes, however, may be unconstitutional. The U.S. Court of Appeals for the Federal Circuit, which has exclusive jurisdiction over appeals in patent cases in the federal courts, has held that patent holders are immune from civil claims challenging acts of patent enforcement unless the patent holder knew that its infringement allegations were objectively baseless. This rule could provide patent holders with nearly absolute immunity from liability under the new statutes. In fact, as I discuss in more detail below, the rule has already immunized two notorious trolls, Innovatio IP Ventures and MPHJ Technology Investments, from legal challenges to their enforcement campaigns under state consumer protection and deceptive trade practices laws.

Although the Federal Circuit has sometimes called this immunity rule a matter of the federal Patent Act's "preemption" of state law, the rule could also limit the ability of the *federal government* to regulate patent enforcement behavior. This is because the Federal Circuit's decisions are not grounded in the Constitution's Supremacy Clause, which is the usual source of preemption doctrine, but in the First Amendment right to petition the government. Unlike the Supremacy Clause, the First Amendment limits the power of the federal government, not just state governments. Accordingly, patent holders may also be able to invoke this immunity to thwart federal initiatives to fight patent trolls—including any legislation this Committee might consider.

To be clear, no court has yet addressed the constitutionality of the new state statutes. Moreover, as I discuss in more detail below, there is a strong argument that the Federal Circuit's immunity doctrine is wrong as a matter of law, policy, and historical practice. So, it is entirely possible that the Federal Circuit could revise its immunity doctrine to accommodate greater regulation of patent enforcement conduct. Also, to the extent that cases challenging patent enforcement conduct proceed in state court, those state courts are not required to follow the Federal Circuit's expansive immunity doctrine.

This hearing provides a welcome occasion to discuss the innovative steps that state governments have taken to combat unfair and deceptive patent enforcement. Any bill advanced by this Committee should, in my view, capitalize on the respective strengths of state governments and the federal government in this area. The strengths of state governments include: (1) the quantity of law enforcement resources that could be provided by dozens of states' attorneys general offices cooperating to fight abusive patent enforcement, (2) the accessibility of state governments to the small businesses, nonprofits, and local governments likely to be targeted by deceptive campaigns of patent enforcement, and (3) the ability of targeted organizations to act as private attorneys general under both the new state statutes and other state consumer protection and deceptive trade practices laws. By contrast, federal legislation on patent demand letters would provide the obvious benefits of legal uniformity and greater predictability

for patent holders about whether or not their enforcement actions are legal. In addition, as I explain in more detail below, federal legislation could clarify difficult jurisdictional issues that currently arise in cases challenging the lawfulness of patent enforcement conduct.

If this Committee determines that federal legislation is warranted, that legislation should, in my view, specifically condemn “bad faith” assertions of patent infringement. Until the Federal Circuit adopted its “objective baselessness” requirement, courts had applied a bad faith standard for nearly a century, striking an appropriate balance between the goals of punishing extortionate schemes of patent enforcement and respecting patent holders’ rights to make legitimate allegations of infringement.

I. The Problem: Bottom Feeder Patent Trolls

In the past decade, scholars and policymakers have fixated on “patent trolls” or, less pejoratively, nonpracticing entities (NPEs). NPEs are often criticized because they do not manufacture products or provide services. Instead, they exist primarily to enforce patents. But the NPE business model is not inherently nefarious. Research universities, for example, usually cannot commercialize the patents obtained by their faculty, so they license the technology to others and sometimes sue for infringement. NPEs can also help monetize inventions by those who cannot afford to assert their patents in litigation, such as individual inventors and start-up companies.

In the past few years, however, a species of “bottom feeder” trolls has emerged. These trolls send out hundreds or thousands of demand letters at one time, relying on the high cost of patent litigation in the hope of eliciting a nuisance-value settlement, that is, a settlement payment that is less than the amount it would cost to investigate the infringement allegations.² Bottom feeders target small businesses, nonprofits, and even local governments, knowing that those organizations are unfamiliar with patent litigation and likely cannot afford to defend against infringement claims.³

One well-known bottom-feeder troll is the company MPHJ Technology Investments. In 2012 and 2013, MPHJ sent letters to over 16,000 small businesses throughout the United States.⁴ The letters accused the recipients of infringing a patent that covers the use of an office scanner to send documents via email. MPHJ demanded that each recipient purchase a license for about \$1200 per employee or else face an infringement suit in federal court.

Another bottom feeder who has engaged in a mass enforcement campaign is Innovatio IP Ventures. Beginning in 2011, Innovatio sent letters to over 8,000 businesses throughout the United States, including bakeries, hotels, and restaurants, claiming that

² See Mark A. Lemley & A. Douglas Melamed, *Missing the Forest for the Trolls*, 113 COLUM. L. REV. 2117, 2126 (2013).

³ See Colleen Chien & Edward Reines, *Why Technology Customers Are Being Sued En Masse for Patent Infringement and What Can Be Done*, 49 WAKE FOREST L. REV. 235, 235 (2014).

⁴ Samples of these letters can be found in a complaint for unfair competition filed by the Federal Trade Commission, *In re MPHJ Tech. Investments, LLC*, No. 142-3003 (Nov. 6, 2014), available at <http://www.ftc.gov/enforcement/cases-proceedings/142-3003/mphj-technology-investments-llc-matter>, archived at <http://perma.cc/T93Z-SVJL>.

those businesses infringed its patents by providing customers with wireless Internet access.⁵ Innovatio demanded that the recipients purchase licenses for about \$2500 each or risk being sued for patent infringement.

The demand letters sent in these mass enforcement campaigns are often rife with false or deceptive statements. MPHJ, for instance, obscured its identity by sending letters through eighty-one shell companies with nonsensical names such as DolVol, GanPan, and JitNom. To intimidate recipients into quickly purchasing a license, MPHJ threatened to sue if the recipient did not respond within two weeks. But, in fact, MPHJ never sued any of the targets of its mass enforcement campaign. Likewise, both Innovatio and MPHJ falsely claimed that many other businesses had already purchased licenses to their patents.

II. State Governments Respond

State legislatures across the country have responded to these troublesome patent enforcement tactics. In the past two years, legislatures in eighteen states have adopted statutes outlawing false or bad faith assertions of patent infringement, and nearly a dozen additional states are currently considering similar legislation.⁶ The most popular model for state legislation is a statute first adopted in Vermont, which, in May 2013

⁵ See *In re Innovatio IP Ventures, LLC Patent Litig.*, 921 F. Supp. 2d 903, 907 (N.D. Ill. 2013).

⁶ For a regularly updated list of state legislative actions, see *Patent Progress's Guide to State Patent Legislation*, PATENT PROGRESS, <http://www.patentprogress.org/patent-progresss-guide-state-patent-legislation> (last visited Feb. 22, 2015), archived at <http://perma.cc/4VXD-DF6E>.

became the first state to adopt legislation specifically regulating patent enforcement.⁷ Since then, thirteen other states have adopted statutes modeled after Vermont's, with some minor variations.⁸ And the Council of State Governments included the Vermont statute in its most recent volume of suggested state legislation.⁹

The core provision of the Vermont statute states, simply: "A person shall not make a bad faith assertion of patent infringement."¹⁰ The statute then lists several factors that courts "may consider . . . as evidence that a person has made a bad faith assertion of patent infringement," including:

- The demand letter does not contain: the patent number, the name and address of the patent holder, or "factual allegations concerning the specific areas in which the target's products, services, and technology infringe the patent."
- The demand letter lacks the information noted above, the target requests the information, and the patent holder fails to provide the information "within a reasonable amount of time."
- The patent holder has previously filed or threatened to file lawsuits and those threats lacked the information noted above or were found by a court to be meritless.
- Prior to sending the demand letter, the patent holder did not conduct an analysis comparing the claims of the patent to the target's

⁷ Interestingly, the United Kingdom has recognized a civil claim for persons targeted with groundless threats of suit for patent infringement since 1883. For a discussion of this so-called "threats action," see U.K. LAW COMM'N, PATENTS, TRADE MARK AND DESIGN RIGHTS: GROUNDLESS THREATS (Apr. 2014).

⁸ The states that have followed Vermont's model include Alabama, Georgia, Idaho, Louisiana, Maine, Maryland, Missouri, New Hampshire, North Carolina, Oregon, South Dakota, Utah, and Virginia.

⁹ See Suggested State Legislation, COUNCIL OF STATE GOVERNMENTS, <http://www.csg.org/programs/policyprograms/SSL.aspx> (last visited Feb. 22, 2015), archived at <http://perma.cc/3U5Y-P876>.

¹⁰ VT. STAT. ANN., tit. 9, § 4197(a).

products, services, or technology, “or such an analysis was done but does not identify specific areas in which the products, services, and technology are covered by the claims in the patent.”

- The demand letter demands payment of a license or a response “within an unreasonably short period of time.”
- The patent holder “offers to license the patent for an amount that is not based on a reasonable estimate of the value of the license.”
- “The claim or assertion of patent infringement is meritless, and the person knew, or should have known, that the claim or assertion is meritless.”
- “The claim or assertion of patent infringement is deceptive.”¹¹

In addition to the Vermont model, two other types of state patent-demand-letter statutes exist. First, Wisconsin has adopted a statute that outlines in detail the information that a demand letter must include, such as the name of the patent owner, an identification of each patent claim being asserted, an identification of the allegedly infringing product or service, and “[f]actual allegations and an analysis setting forth in detail” the patent holder’s theory of infringement.¹² The Wisconsin statute can be violated in two ways: First, if the letter lacks any of the required information, the target may notify the sender that the letter is incomplete. If the sender does not provide the missing information within thirty days, the sender violates the statute.¹³ Second, a

¹¹ *Id.* § 4197(b). The statute also lists several factors suggesting that an infringement assertion was *not* made in bad faith, many of which are simply the opposite of the factors listed in the text. *See id.* § 4197(c).

¹² Wis. STAT. § 100.197(2)(a).

¹³ *Id.* § 100.197(2)(c).

demand letter violates the Wisconsin statute if it “contain[s] false, misleading, or deceptive information.”¹⁴

A third and final model of state legislation has been adopted in Illinois, Oklahoma, and Tennessee. Rather than prohibiting false or bad faith assertions of patent infringement, these statutes outline specific acts or omissions that violate the statute, such as “falsely stat[ing] that litigation has been filed” against the recipient, seeking compensation for infringement of a patent that has been held invalid or has expired, or failing to include “factual allegations concerning the specific areas in which the [recipient’s] products . . . infringe[] the patent.”¹⁵ The statutes also make clear that it is not unlawful to notify others of or to seek compensation for patent infringement, so long as the patent owner “is not acting in bad faith.”¹⁶

All of the state statutes provide for enforcement by state officials, such as the state attorney general. And most of the statutes create a private right of action for the targets of unlawful infringement assertions. The remedies available in those private suits include equitable relief, compensatory damages, treble damages, and attorneys’ fees.

In addition to these new state statutes, attorneys general in several states have begun to use their powers under consumer protection and deceptive trade practices

¹⁴ *Id.* § 100.197(2)(b).

¹⁵ *E.g.*, OKLA. STAT. tit. 23, § 112(A).

¹⁶ *E.g.*, *id.* § 112(B).

laws to fight bottom-feeder trolls. Vermont's attorney general, for instance, sued MPHJ in May 2013, alleging that MPHJ's demand letters violated Vermont's general consumer protection statute.¹⁷ (The suit was filed two weeks before Vermont's demand letter statute took effect.) Around the same time, the attorney general of Nebraska began an investigation into whether a law firm representing MPHJ and Activision TV, another NPE, had violated Nebraska's consumer protection and deceptive trade practices statutes.¹⁸ And the attorneys general of New York and Minnesota have negotiated agreements with MPHJ to curb its enforcement activity.¹⁹

III. Constitutional Limits on State Governments and the Federal Government

These new state statutes and state law enforcement actions challenge the conventional wisdom that patent law is the domain of the federal government alone. Indeed, the website of the U.S. Patent and Trademark Office now counsels persons who receive demand letters that are "deceptive, predatory, or in bad faith," to, among other things, "fil[e] a complaint with your state attorney general's office."²⁰ Doctrines of

¹⁷ See Consumer Protection Complaint at 1-8, *Vermont v. MPHJ Tech. Investments, LLC*, No. 282-5-13wncv (Vt. Super. Ct. May 8, 2013), available at <http://www.atg.state.vt.us/assets/files/Vermont%20v%20MPHJ%20Technologies%20Complaint.pdf>, archived at <http://perma.cc/93X8-G6NS>.

¹⁸ See Letter from Jon Bruning, Attorney Gen. of Neb., to M. Brett Johnson, Partner, Farney Daniels LLP (July 18, 2013), available at <http://ipwatchdogs.com/cases/NE-cease-desist.pdf>, archived at <http://perma.cc/FQ9Y-WSGV>.

¹⁹ See Investigation by Eric T. Schneiderman, Att'y Gen. of the State of New York, of MPHJ Tech. Investments, LLC, Assurance No. 14-015, at 12-19 (Jan. 13, 2014); Julie Samuels, *Minnesota: Patent Trolls are Not Welcome Here* (Aug. 21, 2013), ELEC. FRONTIER FOUND., <https://www.eff.org/deeplinks/2013/08/minnesota-patent-trolls-are-not-welcome-here>, archived at <http://perma.cc/D2P7-4VGD>.

²⁰ *I Got a Letter . . .*, U.S. PATENT & TRADEMARK OFF., http://www.uspto.gov/patents/litigation/I_got_a_letter.jsp (last visited Feb. 22, 2015), archived at <http://perma.cc/Y3RL-S3D3>.

federal constitutional law developed by the Federal Circuit, however, may invalidate the new state statutes and limit the enforcement authority of state officials. Moreover — and most importantly for the purpose of this hearing — those same doctrines may also limit the legislative power of Congress and the enforcement authority of the federal government.

A. Judicially Created Immunity for Patent Holders

For decades, persons accused of patent infringement have tried to assert civil claims against overzealous patent holders. Those claims are sometimes grounded in state law (for example, claims for unfair competition or for tortious interference with business relations) and other times grounded in federal law (for example, claims for unfair competition under the Lanham Act or for violations of the civil RICO statute). The Federal Circuit, however, has held that patent holders are mostly immune from civil liability for their enforcement behavior. According to the Federal Circuit, to strip a patent holder of this immunity, the plaintiff must prove not only the elements of its state or federal claim, it must also prove, by clear and convincing evidence, (1) that the patent holder's infringement allegations were "objectively baseless," meaning that no reasonable litigant could have expected to succeed, and (2) that the patent holder made its infringement allegations with knowledge of their inaccuracy or with reckless disregard for their accuracy.²¹

²¹ *Globetrotter Software, Inc. v. Elan Computer Grp., Inc.*, 362 F.3d 1367, 1377 (Fed. Cir. 2004).

Although no court has yet applied this standard to the new state statutes, it seems to ensure that most tactics employed by bottom-feeder trolls will remain legal. To begin with, the rule requires a plaintiff to show that the patent holder's *infringement allegations* were objectively baseless.²² Accordingly, false statements about matters peripheral to the infringement claims, such as misrepresentations about how many other persons have purchased licenses to the patents, will *not* strip a patent holder of immunity.²³

Moreover, it is very difficult to prove that infringement allegations were objectively baseless. The issue of infringement often turns on the judge's interpretation of the patent's claims. Those decisions are notoriously unpredictable,²⁴ making it hard to say that any given infringement allegation was so unlikely to succeed that it was objectively baseless. Also, an accused infringer who seeks to show that a patent is invalid must prove invalidity by clear and convincing evidence.²⁵ Thus, even if a patent probably does not satisfy validity requirements such as novelty and nonobviousness, this high burden of proof could still give the patent holder a reasonable hope of success.

²² See *id.* ("A plaintiff claiming that a patent holder has engaged in wrongful conduct by asserting claims of patent infringement must establish that *the claims of infringement* were objectively baseless." (emphasis added)).

²³ See, e.g., *In re Innovatio IP Ventures, LLC Patent Litig.*, 921 F. Supp. 2d 903, 922 (N.D. Ill. 2013) (dismissing claims challenging patent enforcement conduct where the alleged false statements "[were] all peripheral to the question of infringement"); *Activision TV, Inc. v. Bruning*, No. 8:13-CV-215, slip op. at 13 (D. Neb. Sept. 2, 2014) (applying Federal Circuit law, noting that "the crucial issues to establish objective[] baselessness involve validity and infringement").

²⁴ See Dan L. Burk & Mark A. Lemley, *Fence Posts or Sign Posts? Rethinking Patent Claim Construction*, 157 U. PA. L. REV. 1743, 1744-46 (2009).

²⁵ See *Microsoft Corp. v. i4i Ltd. P'ship*, 131 S. Ct. 2238, 2242 (2011).

That is sufficient under Federal Circuit law to immunize the patent holder from liability. In my research, I have conducted an extensive survey of Federal Circuit cases applying this immunity rule, and I have found that it is extremely rare for a plaintiff to prevail on a claim challenging patent enforcement conduct.²⁶

Most disturbingly, two federal district courts have relied on the Federal Circuit's immunity doctrine to shelter Innovatio and MPHJ. After Innovatio began its enforcement campaign against users of wireless Internet routers, the manufacturers of the routers (Cisco, Motorola, and Netgear) sued Innovatio, asserting a claim under the federal RICO statute and several claims under California state law.²⁷ The complaint alleged that Innovatio had made numerous false statements in its letters, including statements that it had "successfully licensed thousands of business locations under the . . . patents" and that "the validity of many claims of the . . . patents ha[d] been confirmed by both the Federal Circuit and the United States Patent Office, via both judicial and re-examination proceedings."²⁸ On Innovatio's motion to dismiss, the court

²⁶ By my count, since 2004, the Federal Circuit has barred the plaintiff's claim in all but one case raising an immunity issue. See *Matthews Int'l Corp. v. Biosafe Eng'g, LLC*, 695 F.3d 1322, 1332 (Fed. Cir. 2012); *Contech Stormwater Solutions, Inc. v. Baysaver Techs., Inc.*, 310 F. App'x 404, 409 (Fed. Cir. 2009); *800 Adept, Inc. v. Murex Sec., Ltd.*, 539 F.3d 1354, 1372 (Fed. Cir. 2008); *Judkins v. HT Window Fashion Corp.*, 529 F.3d 1334, 1339 (Fed. Cir. 2008); *Dominant Semiconductors Sdn. Bhd. v. OSRAM GmbH*, 524 F.3d 1254, 1264 (Fed. Cir. 2008); *GP Indus., Inc. v. Eran Indus., Inc.*, 500 F.3d 1369, 1375-76 (Fed. Cir. 2007); *Serio-US Indus., Inc. v. Plastic Recovery Techs. Corp.*, 459 F.3d 1311, 1321 (Fed. Cir. 2006). But see *Breckenridge Pharm., Inc. v. Metabolite Labs., Inc.*, 444 F.3d 1356, 1369 (Fed. Cir. 2006) (reversing summary judgment, holding that "the question of whether [the patent holder's] statements . . . were 'objectively baseless' is genuinely disputed").

²⁷ *Innovatio*, 921 F. Supp. 2d at 906.

²⁸ *Id.* at 920-21.

accepted the plaintiffs' allegations as true but still dismissed the complaint.²⁹ Although the plaintiffs alleged that Innovatio had lied in its demand letters, the court reasoned that Innovatio was immune from civil liability because the plaintiffs did not plead that Innovatio's *infringement claims* were objectively baseless,³⁰ as the Federal Circuit requires.

Likewise, a federal district court in Nebraska enjoined that state's attorney general from pursuing a state-law case against MPHJ because the attorney general did not allege that MPHJ's theories of validity and infringement were objectively baseless.³¹ The attorney general argued that MPHJ had made "false and misleading representations" in its demand letters, such as statements that many businesses had already purchased a license and that it intended to file suit against recipients who did not purchase a license.³² But the court held that to strip MPHJ of immunity, the attorney general had to show that MPHJ's *theories of validity and infringement* were objectively baseless, which the attorney general had not done.³³

²⁹ *Id.* at 922.

³⁰ *Id.* at 921.

³¹ See *Activision TV, Inc. v. Bruning*, No. 8:13-CV-215, slip op. at 13-14 (D. Neb. Sept. 2, 2014).

³² See *id.* at 13.

³³ *Id.* at 11, 13-14.

In short, it is not hyperbole to say that, under the Federal Circuit's immunity doctrine, patent holders have a "legal right to lie" in their demand letters.³⁴ It is these (legally protected) lies that are motivating increased interest by state governments in regulating patent enforcement.

B. Limits on the Power of the Federal Government?

Courts and commentators sometimes call the immunity enjoyed by patent holders a matter of "preemption" because it is most frequently invoked when an alleged infringer relies on state law to challenge a patent holder's behavior in enforcing a federal patent.³⁵ The term "preemption" suggests that the source of the immunity doctrine is the Constitution's Supremacy Clause, which limits the power of state governments, not the federal government. In more recent cases, however, the Federal Circuit has made clear that its immunity doctrine stems not from the Supremacy Clause alone, but from the First Amendment,³⁶ which *does* limit the power of the federal government. As a consequence, the immunity doctrine seems to apply equally to state governments and the federal government, and patent holders may be able to claim

³⁴ Steven Seidenberg, *Infringe Benefits: Patent Trolls Getting First Amendment Protection*, A.B.A. J., May 2014, http://www.abajournal.com/magazine/article/patent_trolls_are_getting_first_amendment_protection_for_demand_letters, archived at <http://perma.cc/LQ82-JSV5>.

³⁵ See, e.g., *Hunter Douglas, Inc. v. Harmonic Design, Inc.*, 153 F.3d 1318, 1338 (Fed. Cir. 1998); David Lee Johnson, Note, *Facing Down the Trolls: States Stumble on the Bridge to Patent-Assertion Regulation*, 71 WASH. & LEE L. REV. 2023, 2027 (2014).

³⁶ *Globetrotter Software, Inc. v. Elan Computer Grp., Inc.*, 362 F.3d 1367, 1377 (Fed. Cir. 2004) ("Our decision to permit state-law tort liability for only objectively baseless allegations of infringement rests on both federal preemption and the First Amendment.").

immunity from federal initiatives to fight patent trolls, too—including any legislation this Committee might consider adopting.

IV. An Argument Against Broad Immunity

It is not, however, a foregone conclusion that patent holders will be able to claim broad immunity from government efforts to regulate unfair or deceptive demand letters. To the extent that challenges to patent enforcement conduct proceed in state court, such as the Vermont attorney general's suit against MPHJ, those courts could develop a different, narrower immunity rule than the Federal Circuit has developed, for state courts are not bound to follow Federal Circuit law. Indeed, there is a strong argument based on law, policy, and historical practice that the Federal Circuit has erred in granting patent holders such broad immunity for their enforcement conduct.

To begin with, the Federal Circuit has arguably misconstrued the relevant law. The Federal Circuit has derived its immunity test from the requirements imposed by the Supreme Court on plaintiffs who seek to inflict antitrust liability on defendants based on those defendants' pursuit of litigation.³⁷ This doctrine, often called the *Noerr-Pennington* doctrine (or *Noerr* doctrine, for short),³⁸ stems from the Supreme Court's interpretation of the federal antitrust statute, the Sherman Act, in the light of the First Amendment's Petition Clause, which protects "the right of the people . . . to petition the

³⁷ *Id.* at 1375.

³⁸ The doctrine's name stems from the cases in which the Supreme Court first developed it. See *E. R.R. Presidents Conf. v. Noerr Motor Freight, Inc.*, 365 U.S. 127 (1961); *United Mine Workers of Am. v. Pennington*, 381 U.S. 657 (1965).

government for a redress of grievances.”³⁹ But the Federal Circuit’s reliance on *Noerr*’s view of the Petition Clause is a mistake: Letters sent from one private party to another, such as letters threatening patent infringement litigation, are simply not “petition[s]” to “the government” within the meaning of the First Amendment.

By looking to history, the Federal Circuit could better strike a balance between protecting patent holders from liability when they make legitimate allegations of infringement and punishing patent holders when they employ unfair or deceptive tactics. At the time the Federal Circuit was created in 1982, the lower federal courts had—for nearly a century—been addressing the precise question of when a patent holder may be held liable for its enforcement conduct. Those courts enjoined patent holders from making infringement assertions in bad faith—exactly the behavior that many of the new state statutes condemn.⁴⁰ But the Federal Circuit has largely ignored that long line of decisions, instead demanding that anyone challenging patent enforcement conduct prove that the infringement allegations were objectively baseless.

Historically, the courts treated bad faith as a flexible standard with both subjective and objective components.⁴¹ Under this equity-based immunity standard—as opposed to the rigid “objective baselessness” test mandated by the Federal Circuit—the

³⁹ U.S. Const. amend. I.

⁴⁰ See, e.g., *Emack v. Kane*, 34 Fed. 46, 50-51 (C.C.N.D. Ill. 1888).

⁴¹ See Mark S. Bicks, *Threatening to Sue for Patent Infringement: Unfair Competition and Antitrust Consequences*, 59 J. PAT. OFF. SOC’Y 302, 303-04 (1977) (“The good faith involved refers to a state of mind and, in this context, means that the speaker sincerely and reasonably believes in the truth of his statements.”).

government could impose reasonable restrictions on patent enforcement, enjoining enforcement campaigns where, for instance, the patent holder threatened a large number of accused infringers⁴² or failed to follow its threats with actual lawsuits.⁴³ At the same time, cases in which courts enjoined enforcement conduct under the traditional standard were usually egregious and often involved claims that were objectively weak on the merits.⁴⁴ Accordingly, a good faith immunity standard—as opposed to the Federal Circuit’s “objective baselessness” rule—would protect patent holders’ ability to provide legitimate notice of their patent rights while offering the government some leeway to punish deceptive behavior.

V. What Can Congress Do?

If, as the Federal Circuit claims, broad immunity for patent holders is mandated by the First Amendment, it might appear as if there is little Congress can do to regulate demand letters. However, I believe Congress can still play an important role in this area. To begin with, this hearing can serve the important function of bringing a problematic line of cases to the attention of both the Federal Circuit and the Supreme Court. This Committee’s discussion could encourage the Federal Circuit to reconsider its case law.

⁴² *E.g.*, *Int’l Indus. & Devs., Inc. v. Farbach Chem. Co.*, 241 F.2d 246, 247-48 (6th Cir. 1957).

⁴³ *E.g.*, *Adriance, Platt & Co. v. Nat’l Harrow Co.* 121 F. 827, 829-30 (2d Cir. 1903).

⁴⁴ *E.g.*, *Emack*, 34 Fed. at 49.

Such a response to the work of a congressional committee would not be unprecedented. Several scholars (including myself) have observed that the Federal Circuit keeps close watch when Congress considers amending patent law and have found numerous examples of the court revising its case law to align with proposed legislation.⁴⁵ For instance, in the mid-to-late 2000s, Congress considered several bills to restrict plaintiffs' choice of venue in patent cases. While those bills were pending, the Federal Circuit—for the first time ever—ordered a district court to transfer a patent case to a more convenient venue.⁴⁶ After that initial decision, the Federal Circuit issued several more opinions ordering transfer.⁴⁷ To date, the core venue statute remains unchanged.⁴⁸

Likewise, during roughly the same time period, Congress was considering proposals to limit damages in patent cases. While those proposals were pending, the Federal Circuit issued several decisions increasing its scrutiny of damages awards. For instance, the court conducted a close review of the facts supporting a jury's royalty calculation, overturning a nearly \$358 million award against Microsoft as unsupported

⁴⁵ See Paul R. Gugliuzza, *The Federal Circuit as a Federal Court*, 54 WM. & MARY. L. REV. 1791, 1827-28 (2013); see also Jonas Anderson, *Congress as a Catalyst of Patent Reform at the Federal Circuit*, 63 AM. U. L. REV. 961, 966-69 (2014).

⁴⁶ See *In re TS Tech USA Corp.*, 551 F.3d 1315, 1321-22 (Fed. Cir. 2008); see also 28 U.S.C. § 1404(a) ("For the convenience of parties and witnesses, in the interest of justice, a district court may transfer any civil action to any other district or division where it might have been brought . . .").

⁴⁷ See generally Paul R. Gugliuzza, *The New Federal Circuit Mandamus*, 45 IND. L. REV. 343, 346 (2012).

⁴⁸ See 28 U.S.C. § 1400(b).

by the evidence.⁴⁹ The court also rejected the much-maligned “25 percent rule of thumb” as a starting point for the hypothetical negotiation used to calculate a reasonable royalty.⁵⁰ Thus, the fact that the Committee is holding this hearing and considering legislation to regulate patent demand letters could spur the Federal Circuit to reconsider its immunity doctrine.

In addition, this hearing draws attention to the important efforts of state governments to combat abusive patent enforcement. The proliferation of state statutes and state law enforcement activities raises the question of whether, going forward, this problem is best solved through state-federal cooperation or whether patent law should remain the federal government’s exclusive domain.

Congress could, if it so chooses, expressly preempt state law in this area pursuant to the Supremacy Clause. A single, federal statute governing patent enforcement has some obvious benefits: It would provide a uniform legal standard to govern all patent enforcement efforts undertaken anywhere in the country. A uniform legal standard should, in theory, allow patent holders to better predict whether their actions are lawful or not.

But the benefits of legal uniformity should not be overstated. Several scholars (myself included) have recently questioned whether uniformity is a sufficiently important policy goal in the patent system that it should outweigh the benefits of

⁴⁹ *Lucent Techs., Inc. v. Gateway, Inc.*, 580 F.3d 1301, 1324-36 (Fed. Cir. 2009).

⁵⁰ *Uniloc USA, Inc. v. Microsoft Corp.*, 632 F.3d 1292, 1315 (Fed. Cir. 2011).

interjurisdictional dialogue and experimentation.⁵¹ It is likely no coincidence that, since states began adopting anti-troll statutes, the frequency of mass enforcement campaigns seems to be decreasing. State-by-state regulation in this area may have significant deterrence value: Rather than defending against, say, one investigation brought by the Federal Trade Commission, a patent holder might be forced to defend against multiple lawsuits in multiple states, brought by both private plaintiffs and state attorneys general.

State law enforcement agencies also provide substantial enforcement resources. The ability of dozens of states' attorneys general offices, joining together, to monitor and punish deceptive patent enforcement behavior likely dwarfs what the federal government could do. And state governments are more accessible than the federal government to those most likely to be targeted by bottom-feeder trolls: small businesses, nonprofits, and local governments. Vermont's pathmarking statute, for instance, was the product of a grassroots effort: businesses and non-profits in the state that had received demand letters from trolls approached their state legislators and attorney general and, together, they drafted Vermont's statute.

An approach to regulating demand letters that emphasizes the respective strengths of state governments and the federal government would be optimal. One

⁵¹ See Paul R. Gugliuzza, *Patent Law Federalism*, 2014 WIS. L. REV. 11, 48-51; Craig Allen Nard & John F. Duffy, *Rethinking Patent Law's Uniformity Principle*, 101 NW. U. L. REV. 1619, 1623 (2007); Lisa Larrimore Ouellette, *Patent Experimentalism*, 101 VA. L. REV. (forthcoming 2015) (manuscript at 7-13), available at <http://ssrn.com/abstract=2294774>.

important strength of federal regulation, which has not been widely discussed, is that it could provide certainty about which courts can hear cases involving unfair or deceptive patent demand letters. The federal district courts have exclusive subject-matter jurisdiction over cases “arising under” patent law,⁵² meaning that state courts cannot hear those cases. But difficult questions occur when a plaintiff asserts a state-law claim that implicates federal patent law, such as the Vermont attorney general’s consumer protection lawsuit against MPHJ. MPHJ was able to delay that suit for nearly a year by arguing that the state had improperly filed the case in state court.⁵³ If Congress were to enact a federal statute governing patent demand letters, cases involving claims under that statute would be—without question—subject to the federal courts’ exclusive subject-matter jurisdiction.

A federal statute governing patent demand letters could also reduce uncertainty on matters of personal jurisdiction. The courts of a particular state may exercise jurisdiction over a defendant only if the defendant has “certain minimum contacts” with that state “such that the maintenance of the suit does not offend traditional notions of fair play and substantial justice.”⁵⁴ Typically, the personal jurisdiction of a federal court is the same as the jurisdiction of the courts of the state in which the federal court

⁵² 28 U.S.C. § 1338(a).

⁵³ A federal district court ultimately rejected MPHJ’s jurisdictional argument and sent the case back to state court. *See Vermont v. MPHJ Tech. Investments, LLC*, No. 2:13-CV-170, 2014 WL 1494009, at *1 (D. Vt. Apr. 15, 2014).

⁵⁴ *Int’l Shoe Co. v. Washington*, 326 U.S. 310, 316 (1945).

sits.⁵⁵ And the Federal Circuit has held that a patent holder who merely sends cease-and-desist letters into a state does *not* create the required minimum contacts with that state.⁵⁶ This rule enables litigants such as MPHJ to argue that the act of sending demand letters into Vermont is not sufficient to allow a court sitting in Vermont—state or federal—to exercise jurisdiction over it.⁵⁷ Under MPHJ’s reading of the Federal Circuit’s case law, which is not unreasonable, any litigant who wishes to challenge its demand letter practices must travel to MPHJ’s home state of Texas. Congress, however, has the power to authorize the federal courts to exercise personal jurisdiction on a nationwide basis.⁵⁸ Thus, a federal statute on unfair or deceptive patent demand letters could ensure that a patent holder who blankets the country with letters could be sued in any federal district court in the United States.

Assuming Congress chooses to adopt a federal statute regulating demand letters, what conduct, exactly, should it outlaw? Setting aside for the moment the constitutional constraints discussed above,⁵⁹ the concept of “bad faith” should, in my view, be at the core of the statute. As discussed, a long line of pre-Federal Circuit case law provides substantial guidance to courts in making bad faith determinations.

⁵⁵ See FED. R. CIV. P. 4(k)(1)(A).

⁵⁶ See, e.g., *Red Wing Shoe Co. v. Hockerson-Halberstadt, Inc.*, 148 F.3d 1355, 1361 (Fed. Cir. 1998); see also Megan M. La Belle, *Patent Litigation, Personal Jurisdiction, and the Public Good*, 18 GEO. MASON L. REV. 43, 47-48 (2010) (critiquing this line of cases).

⁵⁷ See Defendant MPHJ Tech. Investments, LLC’s Motion to Dismiss at 6-13, *Vermont v. MPHJ Tech. Investments, LLC*, No. 2:13-CV-170 (D. Vt. filed Sept. 17, 2013).

⁵⁸ See FED. R. CIV. P. 4(k)(1)(C).

⁵⁹ See *supra* Part III.

Because of that already-existing case law, I would argue that there is no need for the statute to define bad faith in great detail. A long list of statutory factors, or a complicated statutory definition, would obscure the basic, equitable purpose of the bad faith inquiry.⁶⁰

Conclusion

Thank you again for inviting me to testify. In my statement, I have sought to highlight that patent holders might currently enjoy an unduly broad immunity from civil liability for their enforcement conduct. Although this immunity could limit the power of Congress to take action against those who abuse the patent system, I hope this hearing will encourage further discussion, both in Congress and in the courts, about the proper scope of protection for patent holders and about whether the states or the federal government are best situated to solve this important problem. I would be pleased to answer any questions the Committee might have for me.

⁶⁰ See RICHARD A. POSNER, REFLECTIONS ON JUDGING 86-87 (2013) (critiquing multifactor legal tests because they obscure the core purpose of the relevant law).

Mr. BURGESS. Gentleman yields back. The Chair thanks the gentleman for his testimony.

Ms. Ranieri, you are recognized for 5 minutes for the purposes of an opening statement.

STATEMENT OF VERA RANIERI

Ms. RANIERI. Mr. Chairman, Ranking Member Schakowsky, and Members of the subcommittee, thank you for the opportunity to be here today.

For those of you who aren't familiar with my organization, the Electronic Frontier Foundation, or EFF, we are a nonprofit organization dedicated to protecting consumer interests, innovation and free expression in the digital world. As part of that work, we regularly advocate for reform of the patent system in courts, Congress, and at the Patent and Trademark Office. EFF is greatly encouraged by Congress' interest in the important issue of deceptive and abuse patent rule demand letters, and its impact on consumers and small businesses.

EFF is one of the few nonprofit legal services organizations that small businesses and innovators can turn to in order to get help when faced with a patent troll demand letter. Unfortunately, we cannot help everyone, and more importantly, because of a lack of meaningful, manageable legal options, we are too often unable to help push back against those who use deceptive patent demand letters in order to extract money from their victims.

The problem of abusive patent rule demand letters is a result of a perfect storm of circumstances. Patent owners sending these letters use vague and overbroad patents that likely never should have issued, in order to confuse and obfuscate. Patent owners rely on the eye-popping cost of litigation in order to intimidate, and patent owners take advantage of their victims' relative lack of experience with technology and the legal system to ensure improper claims of infringement go unchallenged. For example, in 2011, a company known as Eclipse IP sent demand letters to various retailers alleging infringement of patents on tracking packages through the use of UPS tracking. Eclipse demanded licenses in the hundreds of thousands of dollars. Seeing their customers being targeted, UPS filed a declaratory judgment of non-infringement and invalidity, but before the court could address whether Eclipse's claims of infringement had merit, Eclipse filed what is known as a covenant not to sue. In doing so, Eclipse ensured that its patent rights would not actually be litigated, that is, they did everything in their power to stop the court from deciding the merits of its claims. Eclipse apparently merely wanted to extract settlements from its victims, despite assertions in its demand letter that it would engage in litigation if its licensing demands were not met. Since 2011, Eclipse has sued over 100 companies and presumably sent letters to countless others.

Letters and actions like Eclipse's are all too common. Other letters employ tactics such as not mentioning licenses that likely exhaust patent rights, or use complex and vague nonsense terms from the patent in order to make infringement claims that would never have been apparent to someone reading the patent. Dealing with even the most frivolous of letters takes time and money away

from what small businesses should be doing, which is growing their business and creating jobs.

I could tell many more stories, but most demand letters never see the light of day. Recipients of letters from patent trolls are often afraid of speaking out, and no wonder, by speaking out, they worry they would become an even bigger target and subject to even larger demands they cannot afford. Patent trolls use this fact to hide their practices from scrutiny and from lawmakers and the public.

Deceptive and unfair patent troll demand letters must be addressed, but it is important to address them in a way that makes sense. Specifically, Congress should not limit the ability of State attorneys general to protect their citizens, whether that be through State laws addressing abusive demand letters, or through their own little FTC acts. State AGs are often the closest to the problem, and in the best position to address deceptive practices targeted at their citizens. Second, Congress should allow for flexibility in the law. Overly rigid rules regarding what constitutes bad faith will allow patent trolls to comply with the letter of the law but not the spirit. As a lawyer, I can assure you that we are enterprising people. If there is a loophole to be found, we will find it. Flexibility is key to ensuring patent trolls don't find new ways to deceive their targets.

Finally, in order to protect technology end users such as retailers and tracking—such as retailers implementing tracking technology, or the coffee shop offering Wi-Fi, Congress should mandate disclosure requirements. Through these disclosure requirements, Congress can better understand the scope of the problem, and agencies such as the PTO, the FTC, and nonprofit organizations such as EFF, can better target those practices and those patents that are being abused.

Addressing the deceptive patent troll demand letter problem is an important piece of broader patent reform. In tandem with other measures, we can limit the ability of patent holders to use patents that never should have been issued, to extort undeserved money from those who just want to pursue their livelihoods.

Thank you, and I look forward to your questions.

[The prepared statement of Ms. Ranieri follows:]



ELECTRONIC FRONTIER FOUNDATION

**Committee on Energy & Commerce
Subcommittee on Commerce, Manufacturing, and Trade
U.S. House of Representatives**

**Hearing
“Update: Patent Demand Letter Practices and Solutions”**

**Testimony of Vera Ranieri
Staff Attorney
Electronic Frontier Foundation**

February 26, 2015



SUMMARY OF TESTIMONY

Patent troll demand letters continue to frustrate and intimidate small businesses and innovators. Through the use of vague statements and legalese, and by exploiting asymmetries in information and resources, patent trolls sending unfair and deceptive letters have been able to receive undeserved “licenses” from their victims with relative impunity.

All of this often happens in the shadows. Recipients of letters from patent trolls are often afraid of speaking out, believing that may make them a bigger target. Patent trolls use this fact to hide their practices from scrutiny by lawmakers and the public.

The Electronic Frontier Foundation is encouraged by Congress’ efforts to address this problem through legislation targeting the deceptive and unfair business practices of patent trolls who send these letters. We hope that in enacting any legislation, Congress gives tools to all those who can stop deceptive business practices, and leaves flexibility in the law to ensure new tactics can be addressed as they arise. We also urge Congress to view efforts to curb unfair patent troll demand letters as an essential part of, but not a substitute for, broader reform that targets the true source of patent trolls’ power.

The Electronic Frontier Foundation also encourages Congress to enact disclosure requirements that would allow lawmakers, and the public more generally, the ability to better understand how demand letters negatively impact our innovation economy.



ELECTRONIC FRONTIER FOUNDATION

**Full Testimony of Vera Ranieri
Electronic Frontier Foundation
Before the House Energy & Commerce Committee Subcommittee on Commerce,
Manufacturing, and Trade
February 26, 2015**

Chairman Burgess, Ranking Member Schakowsky, and members of the subcommittee, thank you for holding this hearing and inviting me to testify today about deceptive practices by Patent Assertion Entities (“PAEs”). We are greatly encouraged by your interest in this important issue and its impact on consumers and small businesses.

I am a Staff Attorney at the Electronic Frontier Foundation, a non-profit civil liberties organization that has worked for almost 25 years to protect consumer interests, innovation, and free expression in the digital world. Founded in 1990, EFF represents more than 25,000 active members. Many of those members are small businesses, innovators, and tinkerers who often find themselves facing unfair patent litigation or demands. Through litigation, the legislative process, and administrative advocacy, EFF seeks to represent those members’ interests and promote a patent system that facilitates, rather than impedes, what the Constitution defines as “the Progress of Science and useful Arts.”

Defining the Patent Troll Demand Letter Problem

For more than a decade, a crucial part of EFF’s work has been addressing the rising problem of PAEs, sometimes also known as non-practicing entities (NPEs) or, colloquially as patent trolls or patent bullies. These entities usually neither make nor sell anything but litigation and paperwork. Rather than relying on patents to protect their ability to bring new products to market, they acquire and use patents solely to sue, or threaten to sue, unsuspecting businesses. As Judge Posner of the Seventh Circuit Court of



Appeals explained, patent trolls “are companies that acquire patents not to protect their market for a product they want to produce—patent trolls are not producers—but to lay traps for producers, for a patentee can sue for infringement even if it doesn’t make the product that it holds a patent on.”¹

One tactic is to use the threat of patent litigation to extort settlements in the form of letters demanding “licensing deals.” These “licensing deals,” however, are not the kind of responsible technology transfer that benefits consumers. Rather, they are intended to extract rents from legitimate businesses who have no idea, until they get a demand letter, that they might be infringing any patent and, very often, little ability to investigate the claim and fight back where appropriate.

EFF previously testified on the problem of patent troll demand letters in 2013. Unfortunately, little has changed for small businesses and innovators since then.

A. Patent Troll Demand Letters Are Used To Threaten and Intimidate Consumers and Small Businesses

Patent trolls continue to cause enormous harm to innovators and consumers, not to mention job creators. Companies that actually create products, services, and jobs find themselves under siege by trolls wielding vague and overbroad patents to launch or threaten expensive litigation. Addressing this conduct, and finding solutions to curb further abuse, is a priority for this Congress, as it should be. The harm to consumers,

¹ Richard A. Posner, *Why There Are Too Many Patents in America*, The Atlantic (July 12, 2012), <http://www.theatlantic.com/business/archive/2012/07/why-there-are-too-many-patents-in-america/259725/>.



however, does not only arise out of actual lawsuits; an often-invisible part of the problem comes from dangerous and irresponsible demand letter campaigns.

Specifically, patent trolls often send letters with vague and threatening language to small businesses and innovators knowing that it is likely the recipients have little, if any, experience with patent law or the judicial system more generally. These demand letters often lack basic detail of what the recipient does to allegedly infringe the patent at issue, if the specific patent is mentioned at all. Where the letters do mention the patents, they often list patent numbers without detailing which parts of the patent—which typically comprises many pages of dense technical content and legalese—are relevant. The recipient of the letter, often an entrepreneur focused on building her business, likely has few connections that would be able to help them understand the legitimacy of the claim. Where the companies do have legal counsel, those lawyers may not be patent specialists. Indeed, the demand letters often tell small businesses that they must speak to a more specialized lawyer, one who may charge significant amounts of money just to evaluate the claims..

Some of the language used by patent trolls to intimidate the targets of their letters includes:

- “As background, our firm practices nationally and specializes solely in patent litigation and licensing”²
- “We believe you will find that Landmark’s patent teaches technologies which are contributing significantly to [redacted] bottom line[.]”³

² Letter from Activision TV, Inc., (Mar. 1, 2013), *available at* <https://trollingeffects.org/demand/activision-tv-inc-2013-03-01>.



- “As your organization almost certainly uses in its day-to-day operations [the patented technology], you should enter into a license agreement with us at this time. If you believe you are in the unusual position of not have a system [that practices the patented technology], please contact us so we may discuss means for confirming that....The materials we likely would require could include copies of the user manuals for your office copying/scanning equipment, along with the IP addresses and 2012 daily activity logs for each of them, as well as the registry of each of the email servers and file servers used in your company.”⁴
- “As you may know, a United States patent grants its owner the right to exclude others from using products that fall within the scope of the claimed invention and collect damages not less than a reasonable royalty.”⁵

Those familiar with patent law—or even the legal system more generally—might recognize many of these statements as bluster. To those unfamiliar with the system, however, the threats are confusing, opaque, and esoteric.

This is intentional. Patent trolls exploit asymmetry of information. As an example, letters often include a “deadline” to respond by, leaving implicit the “or else.”⁶ The recipient has no legal obligation to reply, but she might not know that. In fact, the senders often include “draft complaints” and other enclosures in an attempt to threaten real

³ Letter from Landmark Technology, LLC, (July 23, 2013), *available at* <https://trollingeffects.org/demand/landmark-technology-llc-2013-07-23>.

⁴ Letter from HarNol, LLC/MPHJ Technologies, (Jan. 17, 2013), *available at* <https://trollingeffects.org/demand/harnol-llc-2013-01-17>.

⁵ Letter from Treehouse Avatar Technologies, (July 30, 2013), *available at* <https://trollingeffects.org/demand/treehouse-avatar-technologies-inc-2013-07-30>.

⁶ *See, e.g.*, Letter from Lodsys, (July 15, 2011) (“We are interested in reaching a negotiated non-litigation licensing arrangement with you for all of your uses of the Lodsys Patents under your brand name and would like to discuss this matter with you within 21 days of your receipt of this letter”), *available at* <https://trollingeffects.org/demand/lodsys-llc-2011-07-15>.



litigation in order to make the claim even more immediate, threatening, and intimidating, even though the patent holders may have no intention of actually bringing a suit in court. And this is no surprise, as the letters' targets are often individuals and small companies whose entire annual revenue would not cover the cost of a lawyer's time to obtain the information necessary to respond to the letter.

If the target does consult a lawyer, moreover, she will quickly learn something else: the tremendous costs of patent litigation are, put simply, more than most people could ever afford. If taken to verdict, defending a lawsuit can easily cost several million dollars.⁷ Even if the case is dismissed early, legal costs will often run into the six and seven figures.⁸ It is no wonder many customers and small businesses feel compelled to pay the troll.

Even though a demand letter is not a legal complaint, and even if it makes specious claims, the serious costs it can impose have been well-documented. As one study found:

Patent demands can be costly to resolve, and particularly so for small companies. The overwhelming majority of companies said that resolving the demand required founder time (73%) and distracted from the core

⁷ See American Intellectual Property Law Association, *Report of the Economic Survey* (2013) (reporting median litigation costs for lawsuits brought by NPEs to be between \$600,000 and \$4 million, depending on the amount in controversy); see also Jim Kerstetter, *How Much is That Patent Lawsuit Going to Cost You?*, CNET, (Apr. 2, 2012), http://news.cnet.com/8301-32973_3-57409792-296/how-much-is-that-patent-lawsuit-going-to-cost-you.

⁸ *Id.*; see also Colleen V. Chien & Edward Reines, *Why Technology Customers are Being Sued En Masse for Patent Infringement & What Can Be Done*, Santa Clara Univ. Sch. of Law Working Paper No. 20-13, at 3 (Aug. 2013) ("Chien & Reines"), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2318666.



business (89%); most experienced a financial impact as well (63%). However, responses and the costs of these responses ran the gamut; for example, 22% of those surveyed said they “did nothing” to resolve the demand.⁹

The serious problem of patent troll demand letters is part of a larger trend: an explosion of patent troll litigation. The number of patent suits filed by PAEs has increased, on average, by 22% *per year* since 2004.¹⁰ Indeed, there were more cases filed by PAEs in *one month* in January 2015 than in the *entire year* of 2004.¹¹ Since 2002, litigation at the hands of patent trolls has grown from just five percent of total patent litigation to a majority of all patent cases.¹² Moreover, patent trolls are targeting smaller companies, such as startups, that lack the resources to defend against patent suits and thus have no choice but to pay extortionate settlement demands.¹³ The burden of patent troll litigation falls particularly hard on small companies. Professor Colleen Chien recently

⁹ Colleen V. Chien, *Startups and Patent Trolls*, 17 Stan. Tech. L. Rev. 461, 472 (2014) (“Chien 2014”).

¹⁰ See *Litigations Over Time*, PATENT FREEDOM, <https://www.patentfreedom.com/about-npes/litigations/> (last visited Feb. 23, 2015).

¹¹ Compare *id.* (showing 235 cases filed by PAEs in 2004) with UNIFIED PATENTS, *January 2015 Patent Dispute Report*, <http://unifiedpatents.com/january-2015-patent-dispute-report/> (last visited Feb. 23, 2015) (showing 250 cases filed by PAEs in January 2015 alone).

¹² James Bessen, Jennifer Ford and Michael Meurer, *The Private and Social Costs of Patent Trolls*, Boston Univ. School of Law, Law and Economics Research Paper No. 11-45 (“Bessen 2011”) at 7, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1930272; Colleen V. Chien, *Patent Assertion Entities*, Presentation to the December 10, 2012 DOJ/FTC Hearing on PAEs, (“Chien Slides”), at slides 23-24, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2187314.

¹³ Chien 2014 at 464-65.



found that at least 55 percent of unique defendants in patent troll suits have revenues under \$10 million per year.¹⁴

Of particular note, the patent troll problem is quite often a software patent problem. Software patents are an attractive tool for patent trolls because they are notoriously difficult to understand and interpret, which means that unscrupulous patent owners can claim that their patent covers a wide range of technology.¹⁵ It is no coincidence that more than 65 percent of troll suits involve software-related claims.¹⁶ And those same “fuzzy boundaries” provide allow patent holders to send menacing demand letters to a broader range of unsuspecting targets.

The harms caused by patent troll demand letters are not abstract. They affect real people everyday. In one case, Innovatio IP Ventures, sent over 13,000 letters to small businesses such as cafes and hotels demanding payment for providing Wi-Fi.¹⁷ In a campaign EFF believes was fundamentally unethical and deceptive, Innovatio targeted users of millions of devices that were already protected by patent licenses.¹⁸ Another troll called MPHJ sent over 16,000 letters to small businesses demanding payment for using

¹⁴ *Id.* at 461.

¹⁵ In other words, “software patents have ‘fuzzy boundaries’: they have unpredictable claim interpretation and unclear scope . . . and the huge number of software patents granted makes thorough search to clear rights infeasible, especially when the patent applicants hide claims for many years by filing continuations. This gives rise to many situations where technology firms inadvertently infringe.” Bessen 2011 at 24.

¹⁶ See Brian J. Love, *An Empirical Study of Patent Litigation Timing: Could a Patent Term Reduction Decimate Trolls Without Harming Innovators?* 161 U. Penn. L. Rev. 1309, 1344 (2013).

¹⁷ Chien & Reines at 19-20.

¹⁸ *Id.* at 19.



basic “scan to email” technology.¹⁹ To hide who was really behind this campaign, MPHJ set up a dizzying array of shell companies.

MPHJ presents an important case study of the difficulty presented by the patent troll demand letter problem. After MPHJ’s activities came to light, several manufacturers of the accused products challenged MPHJ’s patents at the Patent Office in *inter partes* review proceedings.²⁰ Those proceedings led to the invalidation of most of the claims in the challenged patents.²¹ Furthermore, MPHJ recently settled with the FTC after the FTC investigated MPHJ’s demand letter writing campaign.²² Despite MPHJ being hobbled, it has asked a court to allow it to continue to send demand letters.²³

Most troubling, the letters MPHJ wants to send continue the practice of exploiting asymmetry of information. In particular, although they admit that they do not have information that the recipient is infringing (nor could they, given the limited scope of the sole remaining claim it asserts), they ask the recipient “whether [it] would be willing to

¹⁹ See Susan Decker, *Notorious ‘Patent Troll’ MPHJ will Ease Tactics: FTC*, BLOOMBERG BUSINESS (Nov. 6, 2014), <http://www.bloomberg.com/news/articles/2014-11-06/notorious-patent-troll-mphj-will-ease-tactics-ftc>.

²⁰ See, e.g., *Ricoh Americas Corp. et al. v. MPHJ Tech. Invs., LLC*, IPR2013-00302 (filed May 23, 2013); *Hewlett-Packard, Co. v. MPHJ Tech. Invs., LLC*, IPR2013-00309 (filed May 24, 2013).

²¹ *Id.*

²² See *In re MPHJ Tech. Invs., LLC et al.*, FTC File No. 142 3003, Agreement Containing Consent Order, available at <http://www.ftc.gov/system/files/documents/cases/141106mphjagree.pdf>.

²³ See *MPHJ Tech. Invs., LLC v. Sorrell*, Case No. 2:14-cv-00191-wks, First Am. Compl. and Assoc. Exhs., ECF No. 18 (D. Vt. filed Dec. 29, 2014).



provide us with information sufficient to confirm whether [the] company is making use of the invention[.]”²⁴

As with letters that demand a response date, this sort of language relies on the relative lack of sophistication regarding the legal system to imply recipients have a duty to MPHJ that does not exist. Recipients who lack legal counsel may feel they are required to provide information to MPHJ and, as a result, will waste time and resources assisting MPHJ with its fishing expedition.

B. The Difficulty In Information Sharing Exacerbates the Problem

Massive PAE demand-letter campaigns like these lead to additional problems surrounding the sharing of and reporting on information. Because the demands by definition exist pre-complaint, they usually create no public record. And once a license or settlement is signed, it most likely will include a non-disclosure provision leaving the recipient unable to share its experience. This causes two problems: asymmetry of information and underreporting.

The asymmetry of information problem is simple: the PAE knows all about its claims and options, while the recipient knows very little. Without simple facts about the alleged threat it faces, such as who is really behind the demand and whether the PAE’s history makes it likely to further pursue its threats, a demand recipient is unable to assess its risk. It is left with a set of undesirable choices: to hire a lawyer, to pay the PAE to go away, or to do nothing and simply hope the PAE disappears. In most instances, the PAE

²⁴ *Id.* at ECF No. 18-13.



risk was not one that the recipient bargained for when it bought the product at issue or started its business, yet it finds itself with no choice but to face it.

For example, just a few weeks ago EFF heard from a small four-person business that had received a demand letter. The letter threatened a lawsuit and demanded a settlement payment that was more than the salary of many people in this country. Although the letter was lengthy and included copious amounts of legal and technical jargon, one key fact was conspicuously absent: the accused product was almost surely licensed as a result of an infringement lawsuit the troll had previously brought against the supplier of the accused product. The patent owner surely knew this, yet sent the letter anyway, likely hoping the recipient would never find out.

Fortunately, with our pro bono assistance, this small business was able to respond appropriately. But a small non-profit like EFF cannot help everyone, and not everyone will know to reach out. Had we not been contacted, it is unclear what would have happened. Most likely, the small business would be forced to settle and pay the troll to go away, never knowing that the troll *had likely already been paid* and was asserting frivolous claims.

The second problem is underreporting. Because the vast majority of the deals entered into between PAEs and their targets are not public, the exact scope and contours of PAE activity is difficult for policymakers and others to properly understand.



To combat these concerns, in 2013 EFF, along with a broad coalition, launched Trolling Effects, a database to collect demand letters.²⁵ The site allows demand letter recipients to post the documents online, find letters received by others, and research who is really behind the threats. The site also features comprehensive guides to the patent and additional relevant information. Finally—and most importantly—all of the information is freely available, not only to those who receive PAE demands, but to academics, policy makers, and the general public.

Unfortunately, our experience thus far with Trolling Effects has confirmed that many demand recipients are reluctant to publicly share their letters. This has to do in large part with the public nature of the database and the fact that, even with redactions, it is virtually impossible to safely anonymize letter recipients. Demand recipients, both large and small, often chose to keep their identity hidden.²⁶ Larger, more established companies fear that making these demands public “paints a target on their back.” Smaller companies and individuals are often even more afraid. It appears that ensuring more thorough transparency will require action from Congress.

²⁵ See TROLLINGEFFECTS, <https://www.trolingeffects.org>.

²⁶ Professor Robin Feldman came to a similar conclusion: “for a number of years, companies have been reluctant to speak to reporters or researchers, partly out of fear of retaliation by large players with large patent portfolios.” Robin Feldman, *Patent Demands & Startup Companies: The View from the Venture Capital Community* (Oct. 28, 2013), UC Hasting Research Paper No. 75 (“Feldman”) at 36, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2346338.



Statutory Intervention is Necessary to Protect Consumers

While questions of patent law usually find themselves before the Judiciary Committee, this Committee should consider and correct the negative impact that demand letter-sending practices have on consumers. Below, we set forth some potential targeted legislative solutions.

A. Defining Relevant Practices that Violate Consumer Protection Statutes.

Section 5 of the FTC Act declares unlawful “unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce.”²⁷ Abusive demand letters are both an unfair method of competition and a deceptive practice. A law explicitly identifying improper demand letter tactics as unfair methods of competition would more clearly trigger not just Section 5, but many similar state law provisions already on the books.

The FTC Act was enacted to protect consumers from the type of demand-letter practices many PAEs have lately practiced. By statutorily defining certain of those practices as “unfair methods of competition” or “unfair or deceptive acts or practices,” Congress could better ensure that existing Section 5 protections were applied to demand letters. For instance, the following demand-sending behaviors might be explicitly addressed:

- Demands falsely threatening litigation;²⁸

²⁷ 15 U.S.C.A. § 45(a)(1).

²⁸ See, e.g., The Federal Fair Debt Collections Practices Act, 15 U.S.C. § 1692(e), limiting the scope of threats that can be made in a debt collection letter.



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- Demands sent without specifically listing the patents and claims that are allegedly infringed;
- Demands sent without listing the products and services that allegedly infringe those patents;
- Demands sent without any clear indication of who owns the patent at issue;
- Demands sent following a failure to perform any pre-demand investigation into the recipient; and
- Demands sent to businesses with the direct knowledge that those businesses can neither afford to take a license or defend themselves in federal court.

PAEs routinely send demands that do all of these things. Recipients lack the information they need to assess their liability, with means they may feel they have little choice but to take an unearned license. Such business practices are unfair and deceptive, and they should be regulated by consumer protection statutes. As the Commission itself has stated, it can target “[c]onduct that results in harm to competition, and in turn, in harm to consumer welfare, [which] typically does so through increased prices, reduced output, diminished quality, or weakened incentives to innovate.”²⁹

²⁹ Statement of Commissioner Joshua D. Wright, Proposed Policy Statement Regarding Unfair Methods of Competition Under Section 5 of the Federal Trade Commission Act (June 19, 2013) at 7, *available at* <http://www.ftc.gov/speeches/wright/130619umcpolicystatement.pdf>.



Defining the types of practices that PAEs like MPHJ rely on as unfair or deceptive allows the FTC and various states with statutes similar to Vermont's to take advantage of existing statutory frameworks and end the dangerous PAE demand-sending campaigns. Moreover, it would present no risk to companies who engage in responsible licensing practices and technology transfer, who could easily obtain the information necessary to pursue their business interests fairly.

To be clear, the FTC has already recognized it has the power under Section 5 to respond to misleading and deceptive patent demand letters.³⁰ But making such authority explicit will encourage FTC investigations and enforcement, and will make explicit to those sending letters that they risk such action.

It is vitally important, however, that Congress ensure that states are able to address behavior occurring in their states through their own patent troll demand letter laws or "little-FTC Acts." Specifically, Congress should not pre-empt state laws which may address issues those states have encountered with patent trolls.

Relatedly, Congress should not discourage or prohibit enforcement of the FTC Act by state agencies. As often the primary contact for those targeted by patent trolls, State Attorneys General are often the most aware of improper activity occurring in their jurisdiction. Indeed, several State Attorneys General have been very active in attempting

³⁰ See, e.g., *In re MPHJ Tech. Inv., LLC et al.*, Docket No. C-142 3003, FTC Compl., available at <http://www.ftc.gov/system/files/documents/cases/141106mphjcmpt.pdf>.



to limit patent troll demand letters in their states.³¹ These Attorneys General should be encouraged. Congress should not take away flexibility from State Attorneys General and state laws that are invaluable resources in helping ensure patent troll demand letters do not extract undeserved payouts from hard-working small businesses and consumers.

Congress should also ensure that any law passed to address patent troll demand letters allows for flexible applicability based on changing tactics. Patent trolls will likely act quickly to try to find “loopholes” in any restrictions placed on their improper letter writing campaigns. Thus flexibility is vitally important to ensure that the FTC and State Attorneys General can react to changing deceptive practices.

Importantly, any definition of “bad faith” in sending demand letters, if included, should be by way of examples (using “such as” language), rather than through an exhaustive list. It is difficult for Congress to anticipate all ways that a PAE might engage in deceptive conduct through a demand letter. Thus, there is a risk that an exhaustive list of potentially actionable conduct will exclude some kinds of harmful and deceptive representations or omissions.³² For these reasons, Congress should draft legislation that allows the FTC, State Attorneys General, and the Courts to review practices made by a

³¹ See Pamela M. Prah, *State AGs target patent trolls to protect business*, USA Today, (Nov. 25, 2013), available at <http://www.usatoday.com/story/news/nation/2013/11/25/state-ag-patent-trolls/3696889/>.

³² To be clear, there is little or no risk that an open-ended definition will be read too broadly to capture legitimate, non-deceptive demand letters because such letters are generally given protection by the First Amendment. See, e.g., *Sosa v. DIRECTV, Inc.*, 437 F.3d 923 (9th Cir. 2006). Nevertheless, the First Amendment does not protect sham litigation, nor does it protect intentionally deceptive demand letters. See *Rock River Commc'ns, Inc. v. Universal Music Grp., Inc.*, 745 F.3d 343, 353 (9th Cir. 2014).



patent troll and determine whether they are abusive in light of the totality of the circumstances.

Finally, it is important that any bill to address patent troll demand letters does not become a replacement for broader reform. Patent trolls are able to send demand letters because of the high costs associated with litigation and the overly broad, vague, and invalid patents issued by the Patent Office. Without fundamental reform to address these issues, PAEs will continue to exploit the system for their undeserved gains.

B. Creating Public Registries of Relevant PAE Information

Because a patent is a government-granted monopoly, the government may impose conditions on that grant. Indeed, it does that all the time by requiring that certain conditions be met before a patent is granted and that patent holders keep their records up-to-date by, for instance, reporting on changes in ownership. Likewise, a patent holder should be required to provide certain information to the Patent Office when it asserts infringement of that patent in a letter, just as Courts report the assertion of patents in litigation.

Patent owners could be required to report information such as how many demand letters have been sent regarding a specific patent; identification of all parties who stand to benefit financially from any resulting license; identification of any obligation to license the patents at issue on fair or reasonable terms; and how many times the holder has filed suit based on the patent at issue.

There are various reasonable triggers that could require such reporting, such as a certain number of letters sent in a set period of time or notification to the Patent Office of a threshold number of letter recipients.



At a minimum, reporting this information to the Patent Office would make it public (assuming the Patent Office provided it in a publicly-accessible database, which it should be required to do). This information would fundamentally change the unfair information asymmetry facing demand recipients—armed with more facts, they will be better able to assess their options.

Collecting the information might also assist the Patent Office in initiating *sua sponte* review of certain patents. If the Office has information regarding which patents are most often used as weapons by PAEs, it might prioritize those for such review. Indeed, in a world with literally millions of existing patents, it makes sense to focus challenges on those that pose the greatest threat to consumers.³³ It is not until those patents are asserted in demands that we can ascertain just which patents will cause harm. Requiring reporting to the Patent Office will help the Office determine which patents it should target for additional review.³⁴ (The potential for Patent Office review of existing patents may likewise serve as an incentive for demand-letter recipients to provide information as well.)

It is not just the Patent Office that may decide to subject existing patents to additional review (indeed, this is a very rare practice, though there is no reason it could not happen more). Better public information would improve the ability of third parties—including public interest groups like EFF or the manufacturers of the accused products—

³³ Dan L. Burk & Mark Lemley, *Policy Levers in Patent Law*, 89 Va. L. Rev. 1575 (2003).

³⁴ See Chien & Reines at 6.



to identify patents that deserve legal challenge. EFF alone has made more than 15 third-party patent challenges to patents and patent applications. These challenges require significant resources, both financial and otherwise, and it is helpful to know which patents pose the greatest threat to consumers, end-users, and those who may not be in a position to put forth such a challenge themselves.

In the alternative, the FTC could also house a similar registry of patent demands. It already does this in various other contexts, such as the Do Not Call Registry. When a certain threshold number of demands are sent involving a particular patent, or from a particular sending party, the FTC might initiate an investigation. Similar to a registry at the Patent Office, one at the FTC might be made up of patent holders self-reporting or consumers submitting information on the demands they receive. Given the FTC's expertise in consumer-facing issues, it would be well-equipped to house the latter type of registry; given the Patent Office's expertise in dealing with patent owners, it might focus on the former.

Conclusion

EFF has grave concerns about the impact that PAE activities are having on consumers. Today's hearing is important particularly because PAEs conduct the vast majority of their business behind a veil of secrecy. Individual consumers, small start-ups, and ordinary Americans find themselves facing patent troll threats everyday, yet even the most basic information on those threats is often unattainable. Just having us here today to talk about this problem is a crucial step toward solving it. We encourage Congress to continue this important conversation and consider legislative proposals that would limit



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the harm to consumers from PAE activity, including particularly the direct harm that comes from demand letters.

Mr. BURGESS. Gentelady yields back. The Chair thanks the gentelady and all the witnesses for their testimony this morning. Very informative, very helpful. Professor, I am now reminded why I didn't go to law school. But complex discussion, and certainly the issues you bring before us are of importance.

Chair now moves to the questioning part of the hearing. I want to recognize myself 5 minutes for questions.

Also, just an observation. When this issue came up in previous Congress, when Chairman Terry was in charge of the subcommittee, I think it actually to the—before the Rules Committee, and we had a Member who appeared before the Rules Committee and said he was conflicted because some days he was asserting he was a patent troll, other days he was not, and defending a patent. So it did underscore for me how there could be actually people on both sides of the issue.

But let me just ask this question to start off for the entire panel. I would like to get everyone's thoughts on this. And, Ms. Self, we will start with you and then move down the panel. How does the—has the concept of bad faith been applied in patent law, and how should it apply to the demand letter context?

Ms. SELF. I think the concept of bad faith is critical in the patent demand letter context because it prevents the use of antitrust or Section 5 enforcement authority in a manner that would violate the patent owner's constitutional rights, and as has been said, those rights include First Amendment rights of free speech, rights to petition, but also the right to communicate about your patent is fundamental to your ability to enforce your patent.

If you think about how patent owners sort of alert the world to the fact that they have a patented invention, and this has been true from the first, you know, the first days of our patent system, you make a public disclosure of the patent application as kind of a quid pro quo, if you will, for the right to enforce your patent, but your ability to enforce your patent is dependent on communication. If you are stifled in your ability to communicate about your patent, to make good faith communications about your patent, then effectively your patent is not enforceable.

So bad faith is really critical to delineate the kind of conduct that would be appropriate for FTC enforcement. And I think it is also important to send a signal to State enforcement authorities that legitimate patent demand correspondence should not be the subject of State enforcement activity or Federal enforcement activity.

So bad faith is really the cornerstone, if you will, in our ability to strike that right balance between protecting the interests of recipients who may be receiving these deceptive communications, but also supporting the vast majority of legitimate communications that are really fundamental to our innovation economy.

Mr. BURGESS. I might come back to you because you brought up the issue of pattern of practice, but I want to go down the panel for just a moment.

Mr. Malta, the concept of bad faith?

Mr. MALTA. Chairman Burgess, I am a Realtor and my members sell the American dreams. And entrepreneurs in the coalition are hard-working business people that are trying to provide services to Americans every day.

The concept of bad faith is a legal one, and that involves an attorney, and that involves time and money, and I can give you examples of what our members have gone through just on its face. This is not about stifling innovation, this is about stopping deceptive practices. So when I hear bad faith it means that my members will have to go to an attorney, seek counsel. I have many small business members as well as in the coalition. So that does not resolve the issue, especially for the small business people of America.

Mr. BURGESS. And, Professor, defining bad faith?

Mr. GUGLIUZZA. Yes, fortunately, there is a lot of judicial case law applying in bad faith standard. At the time the Federal circuit was created, which is back in 1982, the lower Federal courts for nearly a century had been addressing this question of when may a patent holder be liable for its enforcement conduct, and they had enjoined patent holders from making infringement allegations in bad faith. But the Federal circuit has largely ignored that long line of decisions, instead demanding that anybody who challenges patent enforcement conduct prove that the infringement allegations were objectively baseless.

Historically, you know, the courts treated bad faith as sort of a flexible standard that had both subjective and objective components. So under the standard, courts—you would see courts enjoining or punishment enforcement campaigns, for example, where the patent holder threatened a large number of accused infringers, or threatened law suits but failed to actually ever file them. But at the same time, I think these cases where enforcement conduct was punished were usually egregious and they often involved claims that were objectively weak on the merits. And so I think a good faith standard, particularly when it is grounded in that pre-Federal circuit case law, would protect patent holders' ability to provide legitimate notice of their patent rights, but also offer the Government some leeway to punish the most deceptive and problematic behavior.

Mr. BURGESS. And, Ms. Ranieri, on the concept of bad faith?

Ms. RANIERI. The Electronic Frontier Foundation, as a digital civil rights and civil liberties organization, is a strong believer in the First Amendment. At the same time, I would like to echo what Professor Gugliuzza, apologies, said, that I believe the Federal circuit has narrowly ruled in a way that is inconsistent with precedent and the law, and I believe its ruling about what constitutes bad faith is overly narrow.

There is room within the Constitution to regulate bad faith behavior, as well as respecting First Amendment rights. I would echo Professor Gugliuzza's statements that the courts are very good at determining what bad faith is, and I think we should leave it to them and also to agencies who are used to seeing bad faith behavior to figure out what exactly the contours of that is.

Mr. BURGESS. My time has expired. I thank the panelists for their responses.

Recognize Ms. Schakowsky 5 minutes for questions please.

Ms. SCHAKOWSKY. Thank you, Mr. Chairman.

So States have, up until now, been leaders in the effort to combat abusive patent trolls. Currently 18 States including mine, Illinois, have enacted legislation regulating patent demand letters, and

some State attorneys general have initiated legal action against patent trolls under their consumer protection authority. Under both the new patent demand letter laws and general State consumer protection laws, many State attorneys general have certain remedies available to them, including equitable relief, civil penalties and attorneys fee.

The TROL Act that passed out of the subcommittee last Congress included a provision that would preempt the State laws that regulate patent demand letters.

So first, Ms. Ranieri, you testified that Federal legislation, in fact, should not preempt State laws that address issues those States have encountered with patent trolls. So why is it important do you think that we not preempt State laws?

Ms. RANIERI. Thank you. That is a good question. One of the most important reasons that this Government should not preempt State patent troll demand letter laws is that people who receive these letters often don't know who to turn to, and the first person they often turn to are the State AGs and the State agencies. And they are often the first line of defense for people to protect themselves. The State AGs have the most experience with what their citizens are receiving, and they are in the best position to see new developments in the patent troll demand letters, and to see the new deceptive practices as they arise, and legislate against that type of activity.

Ms. SCHAKOWSKY. So have we seen any instances where there has been any problem with the fact that State attorneys general have been exercising that authority?

Ms. RANIERI. None that I am aware of.

Ms. SCHAKOWSKY. OK. Professor, let us establish how your name is actually pronounced. Say it again.

Mr. GUGLIUZZA. Good, because I was about to apologize to the committee because I feel like this issue has sort of taken over the entire hearing.

Ms. SCHAKOWSKY. No, I think we should apologize. Go ahead.

Mr. GUGLIUZZA. It is Gugliuzza.

Ms. SCHAKOWSKY. OK, Gugliuzza. OK.

Mr. GUGLIUZZA. Very good.

Ms. SCHAKOWSKY. The benefit of preemption would be to provide a uniform legal standard. In your testimony though you raised the question of whether uniformity is, in fact, an important enough policy goal that it should outweigh the benefits of State laws on demand letters. I am wondering if you could expand on the benefits—also expand on the benefits of not preempting State laws.

Mr. GUGLIUZZA. Sure. You know, one of the benefits, as Ms. Ranieri mentioned, obviously, is the enforcement capabilities of dozens of States attorneys general offices might bring to the table. The other is the accessibility of the State governments or some of these small organizations that might be targeted. And then third, you know, I think the—in terms of forming the substance of a law, I think, you know, what we can see from some of these States' statutes are maybe some examples that might be informative to Congress if you were to decide to legislate federally. So allowing these ideas to percolate among the State legislatures allow the States to try to figure out, you know, how do we draw the line from

the—between the bad actors and the patent holders who are asserting their rights legitimately. I think the State legislation can shed a lot of light on those questions.

Ms. SCHAKOWSKY. Thank you.

Ms. Ranieri, in addition to the issue of preemption, you testified that Congress should not prohibit or discourage enforcement of the FTC Act by States. Can you expand on why State enforcement in this instance is so critical?

Ms. RANIERI. I think it is for the similar reasons that I just mentioned, and also that Professor Gugliuzza also mentioned. State AGs have resources that the FTC might not have. The FTC might only have the ability to go after the worst actors, but that doesn't mean that there are others that are abusing the system. And State AGs provide a secondary line of defense in order to go after those who are targeting particular citizens in those States.

Ms. SCHAKOWSKY. And last to you as well. The last Congress TROL Act limited the remedies available to State attorneys general to an injunction and compensatory damages on behalf of recipients who suffered actual harm. Would the limitation of remedies discourage States from enforcing patent demand legislation?

Ms. RANIERI. It may, and I think that is a definite concern that this committee should have. Importantly, this sort of regulating unfair and deceptive practices is usually considered to be an equitable sort of action. Courts are very good at fashioning under-equitable remedies; the type of remedy that is appropriate given the circumstance. And it may, if absent, more punitive consequences to patent hold demand letters, they may just shift their activities, seeing no actual consequence to their bad activities.

Ms. SCHAKOWSKY. Thank you. Clearly, this will be an issue that we will want to discuss further among our members, so I thank you.

And I yield back.

Mr. BURGESS. Chair thanks the gentlelady. The gentlelady yields back.

The Chair would like to recognize the attendance of a Member who is not a member of the subcommittee, but Mr. Tom Massie from Kentucky, from the Bluegrass State, and a noted and world-famous inventor. We welcome your presence here today. Thank you.

The Chair would now recognize Mr. Mullin from Oklahoma for 5 minutes for questions, please.

Mr. MULLIN. Thank you, Mr. Chairman. And just so I don't mess up your last name, Paul came and introduced himself to me earlier. He is from the great State of Oklahoma, went to Bishop Kelley in Tulsa, Oklahoma, and I guess your parents still live in Bixby?

Mr. GUGLIUZZA. That is correct.

Mr. MULLIN. And so it is always good to see a friendly face in town.

My first question would be for Mr. Malta. We just heard the conversation about our attorney generals, and so I am going to kind of stay on that focus. My own State of Oklahoma has laws specifically against abuse of patent demand letters. I want to make sure that my constituents are also protected from these type of letters,

and if our committee drafts legislation prohibiting these types of letters, should attorney generals be able to enforce those laws?

Mr. MALTA. Our members believe that, yes, that they should, and that there—that we are more concerned about the outcome as to the protections because our members are in all 50 States. So if you are arguing preemption, et cetera, that at least there be some immediate baseline standard that is created, and that if States want to come and they want to make laws that are even more restrictive, by all means, go ahead, but we want something done in the very near term that affects our members in all 50 States.

Mr. MULLIN. My next question is for Ms. Self. What if Qualcomm was hit from a law suit, let us say, from Oklahoma's attorney general then Vermont's attorney general, then say Illinois' attorney general, should a company be exposed to liability from every State enforcement agency? If not, why not?

Ms. SELF. Thank you for that question. Sorry, thank you for that question. And before I respond to that specific question, let me just say something about the preemption issue and the way the TROL Act was structured last year, at least. It did permit State attorneys general to bring enforcement actions under the Federal framework that was set out in the statute, and it would have, to your question, allowed more than one State attorney general to bring an action, assuming that the Federal Trade Commission had not already brought an action. And we thought that that was a balanced approach to the problem. The challenge that we are seeing at the State level with nearly 20 laws that have passed, and another dozen or so that are pending, is that you are seeing a patchwork, if you will, of demand letter laws that all include different standards, different penalties. Some are very broad in scope. They don't clearly delineate the kind of activity that would fall within the demand letter. Sixteen out of eighteen would include a private cause of action. And, you know, to the point that was made about enterprising lawyers, I think it is inevitable that you will see a cottage industry evolve around harassing inventors under these laws. So the preemption language of the bill is really critical to make sure that you have a nationwide uniform framework that provides consumers, recipients with the guidance they need to understand what is deceptive behavior. And again, I think the bill does a good job of delineating what is deceptive statements in the context of a demand letter, as well as required disclosures, but it also puts the millions of small inventors in this country on notice as to what is appropriate or inappropriate.

And so as we think about traditional State enforcement under unfair trade practices laws, we have to keep in mind that these are communications involving patent rights. These are rights that are rooted in the Constitution, they are dependent on the ability of the patent owner to exercise their First Amendment rights. And so this is really a very different dynamic than the normal activities that State enforcement authorities focus on.

So we think the approach of the TROL Act is really the right approach, and it protects all interests in a balanced way.

Mr. MULLIN. Thank you. And I will try to be quick on this last question for Mr. Malta. The Realtors that you represent are exactly the type of small businesses that are near and dear to my heart.

Could you please tell us specifically the type of information that needs to be included in a demand letter that would allow businesses that receive them to understand what they are accused of, and to what extent they need to take legal action on?

Mr. MALTA. OK, thank you. Yes, in creating greater transparency, 4 items, OK. First one, specify the relevant patent claim that is at issue. Very basic. Secondly, detail how a business has allegedly infringed the patent. Thirdly, include a description of the patent troll's investigation of the alleged infringing activity. And fourth, disclose the real parties in interest to the dispute, as many of these letters come from attorneys and they don't state who the party in interest is that is trying to enforce the claim, or enforce their patent.

Mr. MULLIN. Thank you.

I yield back.

Mr. BURGESS. Chair thanks the gentleman. Gentleman yields back.

The Chair now recognizes the gentlelady from—Ms. Clarke from New York for 5 minutes for questions please.

Ms. CLARKE. I thank you, Mr. Chairman. And I would like to thank our witnesses for their testimony this morning.

In addition to serving on the Energy and Commerce Committee, I also serve on the Small Business Committee in our House, and our small business community lists fear of patent litigation as one of the biggest issues they face. So I am pleased that we are taking up this issue today.

Frequently, patent trolls target end users of patented technology, such as small, local businesses who have simply purchased or use off-the-shelf products like a wireless router or scanner. These small businesses often lack expertise in patent law, and have few resources. When faced with the cost of defending even perfectly reasonable behavior, they find it is cheaper just to make a payment to settle the case.

Ms. Ranieri, to what extent do patent trolls target the little guy, small businesses, startup, and mom and pop establishments, and what are some examples of everyday products that patent trolls are now claiming infringe their intellectual property?

Ms. RANIERI. Thank you. The extent of the problem isn't known, but I can tell you as a legal services lawyer, I receive about one call a week. And to be clear, these are the people that have managed to find us. There are so many more people out there that don't realize that they should be contacting people like—or—and organizations like EFF. So unfortunately, the full scope of the problem isn't clear, but to be clear, it is a problem.

The type of activity that we have seen is, for example, one of the patent trolls that we are looking at right now has accused people of using maps as infringing their intellectual property. This patent troll has gotten licenses, it appears, from litigations that they filed and settled, which usually, in patent litigation that means a settlement has occurred, has gotten licenses from everybody down the spectrum from handset carriers to the cell phone companies, to the makers of applications, and now they are targeting even smaller parties in the play—in the space. We believe that these patent rights have been fully exhausted, but because of the cost of litiga-

tion, the cost of figuring out whether those patent rights have been exhausted, these trolls can continue to be able to assert patent infringement with essentially impunity.

So the problem is large, and we believe it requires action, and we also believe that it needs the disclosure requirements so we can understand the true scope of its effect on our innovation economy.

Ms. CLARKE. Let me ask you then, what options do small businesses or startup companies currently have when they receive a vague threatening demand letter, and do patent holders, other than trolls, routinely target end users? Could there be legitimate reasons to send demand letters to end users?

Ms. RANIERI. The large number of letters that we have seen targeted at end users are from patent trolls. I have yet to see letters that don't come from patent trolls. They may exist, but I have not yet seen one. And, sorry—

Ms. CLARKE. What options.

Ms. RANIERI. What options. Unfortunately, there aren't many right now. The cost of litigation for a small business of under \$10 million in revenue, the cost of litigation through trial is over \$1 million. When that means that employees might have to be laid off, and research and development can't happen, this is the cost to the patent troll—or to the alleged infringer, sorry. And unfortunately, as a lawyer, what ends up happening is that if someone comes to us, oftentimes we can only advise them to settle because it just is not possible, given the current available options, to actually fight back and show that they aren't violating anyone's rights.

Ms. CLARKE. Can you take a moment and sort of speak to the cost of patent litigation, and the feasibility of a small business mounting an adequate defense?

Ms. RANIERI. Sure. So on a whole to our economy, it is estimated to cost in the billions of dollars, and those are often tangible costs. And intangible costs are things such as time—

Ms. CLARKE. Um-hum.

Ms. RANIERI [continuing]. And stress, taken away—or—and taking people away from growing their business. The options that are currently available to those receiving demand letters, those who are end users who are implementing technology made by others, if they have connections with the companies that make these products that are accused of infringement, sometimes they can get help through the companies. That—I—like in the example that I mentioned before, UPS stepped up to protect its customers, and that was a great thing for UPS to do. Unfortunately, for many of these companies, they don't have the connections to do that. They don't have the resources and the knowledge to know that that is something that they should try to do. And oftentimes, there are no other viable options.

Even filing an inter partes review at the Patent Office, which we commend these new procedures and we encourage them, even to get in the door, not even lawyer fees, which, as a lawyer, and I am sure many of you are lawyers—

Ms. CLARKE. Um-hum.

Ms. RANIERI [continuing]. We know are extremely expensive, filing an inter partes review is over \$20,000. That is the salary of a

worker, that is money that could go in towards building a business. Many businesses just simply do not have this money.

Ms. CLARKE. I thank you. And I yield back. Thank you, Mr. Chairman.

Mr. BURGESS. The gentlelady yields back. The Chair thanks the gentlelady.

The Chair recognizes the gentleman from Florida, Mr. Bilirakis, 5 minutes for questions please.

Mr. BILIRAKIS. Thank you, Mr. Chairman. I appreciate it so very much, and I thank the panel for their testimony.

Patent demand letters reform is an important part of curbing abusive practices that hurt legitimate businesses, as you know. However, I am concerned that overly broad definitions of patent assertion entities in other provisions that have been proposed, such as fee shifting and joinder, will limit our Nation's research universities, and their ability to have patented research discoveries transferred to start up receiving venture funding that can develop and commercialize these early discoveries.

The University of South Florida, just outside of my district in Tampa, Florida, is a world leader in university-based patents, licenses and startup companies, and is a major regional economic hub and job creator in our area.

Again, Ms. Ranieri and Professor Gugliuzza, excuse me if I mispronounce, what do you believe is the appropriate balance to ensure that the technology transfer process thrives, while simultaneously implementing the real reform targeted at bad actors with no intention to commercialize innovations?

Mr. GUGLIUZZA. Thanks. I think a lot can be done by sort of looking at—as I was talking about the history—a long history of courts prohibiting bad faith assertions of patent infringement. A lot can be looked at by looking at some of the examples that courts have condemned in the past. They look extraordinarily similar to what we see these bottom-feeding patent trolls doing today; sending out massive amounts of demand letters, targeting the customers of the firms that actually manufacture the allegedly infringing technology, making claims that they couldn't—making claims that they could not have possibly investigated the merits of.

So, you know, I think if you look back at those types of cases, you actually can see there is a very clear line between, you know, what is really abuse—so abusive as to be considered in bad faith, and the efforts of, say, an operating entity or legitimate efforts by a company to try to license their patents or resolve a dispute before it goes to court. Those lines have been drawn by courts for over 100 years, and I think they are lines the courts can continue to draw.

Mr. BILIRAKIS. Thank you.

Ms. RANIERI. I would agree with Professor Gugliuzza, and I understand your question to be how do we allow for legitimate letters and still legislate against the bad faith letters. And I think what is important to know is that those who are sending legitimate letters, they include the patent numbers in their letters where possible. They will include why they believe someone is infringing, and they will include information so as to allow the parties to really understand the scope of the claims, and why there is a claim of infringement or why the patent is not invalid. This is the activity

that patent—bad faith patent demand letters don't include. And so I would agree with Professor Gugliuzza that there is a long line of cases that see this distinction and make the distinction, and I don't think legitimate patent holders should be concerned about any legislation against bad faith letters.

Mr. BILIRAKIS. Thank you. Anyone else on the panel like to respond to that question? OK, thank you. I will move on if that is OK.

Ms. Ranieri and Professor Gugliuzza, what factors do you believe should be prioritized when determining standards for demanding—demand letters that would address the abusive patent troll practices, while still preserving the legitimate patent holder's ability to negotiate license agreements with potential infringers?

Mr. GUGLIUZZA. Just very briefly, a couple of factors that I think we have talked about so far. One is to the number of letters that have been sent out, right? If a patent holder is sending one letter to one specific company, well, it seems fairly likely that that letter is based on some sort of investigation that gives the patent holder a good faith belief that that recipient is infringing. When you send out, as MPHJ did, 16,000 letters to users of common office scanners, it is extremely unlikely that MPHJ has actually investigated the allegedly infringing conduct.

So the number of the letters can be a nice source of indication of whether the investigation has happened, and also the specificity with which the letters both describe the patent claims, and also the allegedly infringing technology.

Mr. BILIRAKIS. Thank you.

Ms. RANIERI. I hesitate to give a complete list of factors, and the reason is this. Oftentimes what we see as—when letters are shown to us is that it is not one statement in isolation that is a problem, it is the totality of the letter that makes clear that the patent holder has not done an investigation, is trying to extract money. For example, references to the extreme cost of litigation, and I have seen letters with actual links to tables showing the recipient how much money they can receive.

Litigation does cost a lot of money, that is true, but it is the fact that they put these statements in there, along with a—other vaguely threatening language that together be—makes us recognize a bad faith letter. So I hesitate to say these certain things make a bad faith letter, it is oftentimes when we see it all together that we can tell that this is not being set—sent for legitimate purposes.

Mr. BILIRAKIS. Thank you very much.

I yield back, Mr. Chairman. Appreciate that.

Mr. BURGESS. Chair thanks the gentleman. Gentleman yields back.

The Chair recognizes the gentleman from Massachusetts, Mr. Kennedy, 5 minutes for questions please.

Mr. KENNEDY. Thank you, Mr. Chairman. I want to thank the witnesses for testifying today and for your attention to an important topic.

Professor Gugliuzza, thanks for bringing the Boston weather with you. I wish you would have left it at home, but nevertheless, appreciate it.

I want to flush out a little bit of a conversation we have had in the—before as well. My First Amendment law, while being a lawyer, is perhaps a little shaky. So there has been, I think some testimony that has touched already on the Noerr-Pennington doctrine, which touches on immunity of parties who are petitioning the Government for certain types of liability. Generally speaking, it is my understanding that this doctrine began in an antitrust base, but it has been steadily expanded over the course of case law throughout the years.

So, Professor, starting with you, with regard to the Noerr-Pennington doctrine, I think that there are two open areas here, right? One is, does it apply to patent demand letters, and does it apply in the consumer protection context? And I was hoping you can just start with those—kind of that basic framework.

Mr. GUGLIUZZA. I have some comments that hopefully are sort of somewhat responsive to it. So the Noerr-Pennington doctrine, you are correct, that it was initially developed by the Supreme Court as an interpretation of the Sherman Act, in light of the First Amendment, right? So what happens in these cases was, defendants to law suits would turn around and sue the original plaintiffs and say, you know, you are a plaintiff, you have sued me and, you know, you have your—you have market power, you are a monopolist and, therefore, your law suit against me is anticompetitive and violates the Sherman Act. And what the court said was, well, you know, under the Sherman Act, litigation activity is actually not antitrust—illegal under the antitrust laws, the reason being twofold. One, the Sherman Act was intended to regulate business activity, not litigation activity. And two, to make unlawful the conduct of filing a law suit would potentially violate the First Amendment right to petition the Government. Right?

The issue—the main issue that I see in applying that line of cases to these patent demand letters is that a patent demand letter between two private companies is just not a petition to the Government, it is a private communication among two private parties. So I think that is one main problem with extending, you know, main problem of constitutional law with extending First Amendment petition clause protection to these letters.

Mr. KENNEDY. And so given that is the case though, but you are asking the—it is between two companies, but you are asking the Government to enforce a patent—a protection action, right, that patent—

Mr. GUGLIUZZA. Yes.

Mr. KENNEDY [continuing]. In that context?

Mr. GUGLIUZZA. But the law can, you know, there are lots of consumer protection laws that are similar, that I think were similar to what this committee is considering. The example that I like to invoke is the Fair Debt Collection Practices Act.

Mr. KENNEDY. Um-hum.

Mr. GUGLIUZZA. Right? When an attorney, acting as an attorney, sends a letter that is an act of debt collection, it may even be the filing of a law suit, right, those actions under the Fair Debt Collection Practices Act aren't subject to Noerr-Pennington immunity. Courts have largely—have upheld the fair—the constitutionality of the Fair Debt Collection Practices Act. So I think, you know, a

similar statute that condemns patent enforcement activity, much like debt collection activity, should be on the same solid constitutional footing.

Mr. KENNEDY. And then, Ms. Ranieri, could you just give a little bit—you were talking about the totality of the circumstances of the letters and such a moment ago, but in your review of the legal literature, do you believe that the general content of demand letters is protected speech?

Ms. RANIERI. So as I mentioned, EFF is a digital civil rights and civil liberties organization, and the First Amendment is very important to us. At the same time, I don't believe that the Noerr-Pennington doctrine extends as far as the Federal circuit would have it, and in fact, this recent Supreme Court decisions just won last year, the legal underpinnings of the Federal circuit's decision applying the Noerr-Pennington doctrine to the demand letters was recently questioned in another case on a related issue, and I believe there is room within the First Amendment, respecting First Amendment rights, to allow for regulation of demand letters.

To be clear, what we think the First Amendment does is it makes sure that legitimate patent holders can enforce—can send demand letters, but what it doesn't protect is bad faith assertions, false statements, that are within the demand letter.

Mr. KENNEDY. And you think that the—you think that case law or legislation can be developed that is going to be sufficiently narrowly tailored that will provide for a definition of good faith that the courts would uphold?

Ms. RANIERI. I think what actually could happen is that Congress could leave open the definition of bad faith, and courts themselves will narrowly tailor it to make sure that it is consistent with the First Amendment.

Mr. KENNEDY. Professor?

Mr. GUGLIUZZA. I agree, and I think it is very possible that the courts, especially seeing the interest from Congress on this particular issue, would be very—would try very hard to interpret any legislation consistent with the First Amendment.

Mr. KENNEDY. Thank you both. Thank you all.

Yield back.

Mr. BURGESS. Chair thanks the gentleman.

Chair now recognizes the gentleman from Texas, Mr. Olson, 5 minutes for questions please.

Mr. OLSON. I thank the Chair. And welcome to our witnesses. Ms. Self, Mr. Malta, Ms. Ranieri, and certainly no disrespect, but can I call you Professor G? Is that OK, because—

Mr. GUGLIUZZA. You may.

Mr. OLSON [continuing]. If I try pronouncing it with my thick Texas tongue, I am going to be exposing myself to a lawsuit for cruel and unusual punishment. All people here watching on TV, so Professor G is OK? Great.

My first question for all the panelists, and starting off with you, Professor G, as you know, there are 18 States right now that have State laws that fight abusive patent letter demands. The lovely State of Texas is one of the 32 that doesn't have those such laws, but they are being authored right now and this issue is on the table. And so they are in session for 140 days every 2 years, so it

is a brief window of time here. So put your cowboy hat on and come to Texas. How would you best like me to advise the people there what should they do, what should they not do if Texas steps out and does—some laws fighting abuse patent demand letters? Yes.

Mr. GUGLIUZZA. So, you know, I think the concerns we have been talking about about, you know, the difficulty and sort of fragmentation of different States have different legal standards for demand letters is certainly a valid one, particularly for large, innovative firms. I think one thing that your State might consider is looking to the Vermont statute as an example. It has been sort of the most influential of the statutes. It has been adopted by 13 other States. It sets out very simply that it is unlawful to make a bad faith assertion of patent infringement, and it sets out some factors under which courts may determine whether an assertion is in bad faith or is not. And so I think if Texas were to do that, it would be joining a fairly large cohort of other States that have adopted similar legislation.

Mr. OLSON. OK. Thank you.

Ms. SELF. Can I—

Mr. OLSON. Ms. Self, can you comment? Anything you can advise our legislature?

Ms. SELF. Yes, and in fact, just so you know, we have actually been in conversation with the State legislatures in Texas to talk about this very issue.

Mr. OLSON. Expected. You guys are great. That was expected.

Ms. SELF. Let me just say that—so we do think, again, sort of following the model of the TROL Act, that there is, you know, a version of State legislation that would appropriately balance the interests of potential recipients of these letters and the very large number of small patent holders that could potentially get, you know, unintentionally get caught up in legislation of this type. I think the challenge with the—with some of these State demand letter bills that we have seen, as I said previously, over breadth in terms of capturing activity that could just be normal commercial communications, and I should say that I, with all due respect, disagree with the Professor's analysis of Noerr-Pennington. I think there is a lot of scholarship and case law that affirms that the First Amendment does extend to pre-litigation communications, particularly when you are talking about the enforcement of a property right. But again, the private cause of action that is included in the Vermont statute, and several other statutes, is really troubling. And so one of the pieces of advice that we have extended to folks in Texas is do not include a private cause of action. You are going to create far more problems than you can—are trying to solve by subjecting small inventors to harassment. And again, as with the structure of the TROL Act, to clearly delineate activity that is objectively deceptive; trying to enforce a patent that has expired, claiming you are the owner of a patent when you are not, and limiting affirmative disclosures to the kind of information that small inventors can reasonably disclose, because it is important to keep in mind that the vast majority of inventors in this country are also small businesses—

Mr. OLSON. Yes.

Ms. SELF [continuing]. And they may not have all of the information that they need to know whether, in fact, infringement is occurring, or the nature of that infringement, particularly when you are talking about negotiations or discussions with much larger product manufacturers.

So finding a balance that protects both the interests of small patent owners as well as small business owners, small end users, I should say, is really—should really be the goal in any State. And again, just to reiterate my previous context—contents—or comments, rather, sorry, we believe that the structure of the TROL Act is that right balance, and again, it would permit State attorneys general, in Texas and other States, to enforce against deceptive activity under that framework.

Mr. OLSON. Thank you. And, Mr. Malta, no intention to put you between two different people on different sides of the issue, but you are right there, my friend. How about your comments? What can I take back home?

Mr. MALTA. Comments are, get it done.

Mr. OLSON. Well, that is easy—

Mr. MALTA. And if you get it done in the State of Texas, then perhaps that will provide the patchwork that will force the Federal Government to finally step in and say we need to make sense of this so that people can work under a set of rules, and we can get back to business in some of these areas. So—

Mr. OLSON. OK. And, Ms. Ranieri, your comments on Texas? Get 'er done, is that—do you echo those comments?

Ms. RANIERI. I would agree, and I would also like to add that, although we are in the patent context, and Ms. Self raised the issue of it might be difficult for patent owners to be able to comply with a patchwork of laws. To be clear, States have long had different laws when it comes to consumer protection, and companies have had no problems with complying with all those laws. And we don't think that the patent context needs to change—or—that, and companies still can comply with all the laws. We think if some—if a patent owner wants to purposefully avail himself of sending a letter to a State, they can comply with the laws, and look up the laws and make sure that their letter is appropriate.

Mr. OLSON. I am out of time. Thank you.

Yield back.

Mr. BURGESS. Gentleman yields back. Chair thanks the gentleman.

Chair recognizes the gentleman from California, Mr. Cárdenas, for 5 minutes for purposes of questions please.

Mr. CÁRDENAS. Thank you very much, Mr. Chairman. And I appreciate this opportunity to discuss this important issue that really is hampering our economic ability throughout the country. One of the things that the United States has been recognized for, and we should be very proud of, is we are the innovative capital of the world, but when we have people who take opportunity to try to thwart that, that is something that, to me, strikes at the core of our ability to continue to be an economic driver, not only for ourselves as a country but for the world.

Last year, I introduced a bipartisan bill to address patent troll abuse at the International Trade Commission. Patent trolls have

been impacting businesses in every forum, and we should do everything that we can to curb their ability to exploit businesses of every size, small and large. Patent trolls' abuse of the complicated patent system can harm our economy, and hamper innovation by imposing huge litigation costs on productive companies.

I would like to get a sense of the significance of the problem that we—that faces us here today. Ms. Ranieri, in your testimony, you quoted Seventh Circuit Judge Posner's statement, and I am paraphrasing, patent trolls are not trying to protect the market for products they want to produce, but instead, lay traps for producers. How does patent troll activity negatively affect the economy and innovation as far as you are concerned?

Ms. RANIERI. So let me give an example. What we see in the Bay Area is a lot of people who are developing new technologies, and, for example, apps on a smartphone. These innovators, they want to bring a new product to the market, they are very excited. They come out and they bring the—bring it to market and hopefully it becomes successful. What then happens is later, they will receive a demand letter or a filing of a litigation claiming that they infringe on patent rights. These innovators have not seen these patents before. These are not cases of copying others' ideas, this is a case—these are cases of innovators who independently created works and brought them to market, and tried to grow their business, and once they become successful, become targets of patent trolls. And this is the cost to our economy. It is people who are independently creating, independently innovating, that then get targeted by those who have created nothing, and instead, wait for someone else to do the hard work of developing products, testing, marketing, things like that. And not only is the financial cost significant, the settlement demands are extreme, but also it takes away time and energy from actually growing the business. Instead, it directs it towards stress, gathering documents, and although this might be good for the lawyers, it is not good for the companies.

Mr. CÁRDENAS. So, for example, what you just described, I would imagine could, in fact, wreak havoc on a small inventor, a small company, maybe with 5 employees, or 10 or 20 employees, that that particular product is the reason for their existence as a company. Could that kind of activity actually bring such a company like that to bankruptcy or to actually fold? And when I say fold, that means that that 5 or 10 or 20 employees in that scenario now will have to go look for work elsewhere. Do—have you ever seen that happen?

Ms. RANIERI. We have. Actually, there was a case very recently. Someone contacted us and they were being sued by a patent troll, and the patent was on placing photos from sports events online, and allowing someone to search those sports events for their bid number in order to order a picture. And there is actually a patent on that. And it was a small, four-person business, and he was extremely scared that he was going to have to lay off employees in order to fight back. He chose to fight back, but in doing so, he spent a significant amount of resources, and eventually this patent was actually invalidated, but the amount of money and time and stress that that took was significant.

Mr. CÁRDENAS. Upwards of how much did he spend? I mean, was it only \$5,000, \$10,000, \$50,000 perhaps?

Ms. RANIERI. So I can't—I don't know his particular case, but having been in private practice, the amount—what I saw happen in his case, I would estimate anywhere from \$200,000 to \$250,000.

Mr. CÁRDENAS. Exactly. That is a small business. Very few small businesses can part with those kinds of resources and stay in business, and that is at the core of what the problem is. The problem here is, in my opinion, we have individuals and law firms that are just preying on people without even any regard or concern for the cause and the consequence of what happens. And to lose in such a case, or what have you, it appears, in my opinion, that an organization that would bring that upon a small business would probably still flourish and go on, probably have many irons in the fire, such as the one you just described, but you have a small business, one after another, after another, who just disappear because of this practice that should not be allowed.

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

Mr. BURGESS. Gentleman yield back. Chair thanks the gentleman very much for his questions.

Chair recognizes the gentleman from Illinois, Mr. Kinzinger, 5 minutes for your questions please.

Mr. KINZINGER. Thank you, Mr. Chairman. And again, to our witnesses, thank you for being here today and spending some time with us.

Ms. Self, companies like Qualcomm have large patent portfolios because they have invested a large amount of money in new patents and the creation of new products. And presumably, many of Qualcomm's patents can be similar to patents held by other companies. When Qualcomm believes a similar company with a large patent portfolio may be infringing on its patents, how does Qualcomm open communications with that company?

Ms. SELF. Well, let me just say at the outset that, you know, Qualcomm, we are—we have been existence for 30 years. Today, we are a large mature company, as you said, with one of the world's largest wireless communications portfolios, but we—our roots were as a startup, you know, seven engineers, seven academics, who had what they believed was a highly effective solution to what was then viewed as an intractable problem in wireless communications. And solving that problem has allowed this mobile ecosystem to grow, and we would not have an app development community or industry without the hard work that engineers at Qualcomm and other inventive companies undertook.

So today, our—basically, our portfolio is very well known. Most—if you have a smart device, a 3G, 4G device, you use Qualcomm technology, and you—and if you are, you know, a legitimate player, you come to Qualcomm and seek a license, but that dynamic is entirely different for small inventors in this country. And I just wanted to take issue with the characterization of inventors as creating nothing, and all the hard work being done by product manufacturers. Inventors in this country are, I think responsible for the vast majority of economic growth and success that we have seen over the last 200 years, and so characterizing inventors as doing nothing simply because they don't—

Mr. KINZINGER. Right, I—

Ms. SELF [continuing]. Manufacture a product really does disservice.

Mr. KINZINGER. I get that, and I will let you, on somebody else's time, can expand on that, but my question is if you have a company with a large patent portfolio—

Ms. SELF. Um-hum.

Mr. KINZINGER [continuing]. That you believe is impinging potentially on what you guys have, how do you open communications with that company?

Ms. SELF. You know, you—I mean, candidly, I am not part of our licensing team, but I—as a lawyer, I am assuming that you send a letter, you pick up the phone, you send an email communication, you initiate a conversation about the fact that you believe that the other company's products may be infringing or reading upon some aspect of your portfolio. So again—

Mr. KINZINGER. But—

Ms. SELF [continuing]. It is the communication.

Mr. KINZINGER. And, Professor, I am curious as to how private causes of actions have worked in the States. Have they been effective?

Mr. GUGLIUZZA. So, no. As far as I know, there actually is not yet—the statutes are so new, there actually has not yet been a private cause of action actually asserted under any of the statutes. The claims that we have seen so far challenging these mass enforcement campaigns actually come under sort of preexisting general consumer protection and deceptive trade practices laws.

Mr. KINZINGER. OK, all right. Another—are there other theories rooted in tort law that would allow businesses or individuals to reclaim money that they lost to a patent troll?

Mr. GUGLIUZZA. Absolutely. You know, for—even—so as I mentioned the example of general consumer protection deceptive trade practices laws, there are theories of tort law available, tortious interference with business relationships, if a patent troll is targeting your customers, you might be able to assert that claim. You can assert claims of unfair competition under State common law. Under Federal law, for example, when Innovatio sent letters to 8,000 users of wireless internet routers, the manufacturer of those routers, Sysco, Netgear, Motorola, actually sued Innovatio under the Federal RICO Statute—

Mr. KINZINGER. OK.

Mr. GUGLIUZZA. Racketeer—Corrupt Organization—

Mr. KINZINGER. And—

Mr. GUGLIUZZA [continuing]. Statute. Sorry.

Mr. KINZINGER. And I have one more question for you. In your testimony, you mentioned Illinois and a couple of other States have taken a slightly different tactic on dealing with patent trolls; namely, they focus on specific acts or omissions that violate the statute, rather than prohibiting false or bad faith assertion. As I am sure you are aware, the business community in Illinois appears to be more comfortable with this approach. What lessons should Congress learn from this approach as we try to balance going after patent trolls with protecting legitimate communications between businesses?

Mr. GUGLIUZZA. Sure. You know, certainty is important, and I think that sort of purveys a lot of the discussion both in terms of should the Federal Government regulate this or should the State government regulate this, and also the question of what should the standard we are judging this under be. And one that provides certainty is important so that, you know, legitimate assertions of infringement are not punished, but deceptive assertions that intentionally target small businesses, as these mass enforcement campaigns do, are punished.

Mr. KINZINGER. OK. Mr. Chairman, I will yield back. Thank you.

Mr. BURGESS. Chair thanks the gentleman.

Chair recognizes the gentlelady from Indiana, Mrs. Brooks, 5 minutes for your questions please.

Mrs. BROOKS. Thank you, Mr. Chair.

Profession Gugliuzza, I am worried about the widespread practice of sending abusive demand letters. As we have heard, it is a drain on employers and a drain on jobs. And apparently, according to a University of California Hastings College of Law study, 70 percent of venture capitalists had portfolio companies that received patent demand letters. It is a—it does seem suspicious to see so many startups hit with patent claims, and it is troubling to think, and as we have heard, that startups in particular may have a good bit of their funding and money going into fighting patent claims right off the bat.

Do you have any sense, or have you seen anything that talks about how much money and how many jobs are being impacted in our economy to fight off these types of abusive demand letters?

Mr. GUGLIUZZA. So quantifying the effect of these demand letters is incredibly difficult because the persons who are targeted with them or the persons who purchase licenses because of them, are not very willing to identify themselves or disclose what they have done. The reason being that it just makes them a target for the next round of demand letters.

Mrs. BROOKS. And, Mr. Malta, do you have any sense from those you are representing how many job losses there have been among your members?

Mr. MALTA. So the job loss is direct and indirect. Direct when a company is put out of business, OK, and that is more quantifiable, but it is also indirect. We could provide an example such as J.C. Penney who now has a policy of no longer employing or hiring a startup company, in getting them the latest technology, out of fear of being sued because lawyers go where the money is. And so they will go with the startups and then, of course, they will go for the deep pockets in some of the major corporations. So that is affecting small businesses in a great way, when they are not being hired by larger businesses out of fear that they will be sued by patent trolls in relation to their work.

Mrs. BROOKS. Do we have any information as to how many companies have been put out of business? Has there been—and while I recognize that that could be difficult, Ms. Ranieri, anyone know if we have an estimates of how many companies have been put out of business, whether it is startup or larger?

Ms. RANIERI. To be frank, it—we can't figure that out right now. Patent trolls take advantage of the fact that this occurs in the

shadows, and that is why we at EFF think it is really important to have—to implement disclosure requirements so we can understand the true scope of the problem, and the effect that it is having on our economy.

Mrs. BROOKS. Thank you. And finally, Ms. Self, certainly, I am concerned about protection of property rights, ensuring that innovators have the confidence that their patent rights are going to be secure, and you have made a great point in your testimony that IP-intensive industries account for more than $\frac{1}{3}$ of U.S. GDP, and directly or indirectly support over 40 million jobs in this country. If we do move forward, and I appreciate your point on the TROL Act from last Congress, but if we approve the legislation, what is the most important thing, the most important thing you think we need to focus on to get it right in order to protect legitimate patent holders' ability to communicate with potential infringers or licensees?

Ms. SELF. Thank you for that question. I, you know, it hard to point to just one piece of this bill that is, you know, the most important factor. It—the framework of the bill, I think, the four factors that I mentioned in my oral statement, the fact that it is limited to bad faith communications, the fact that it clearly delineates categories of deceptive activity as well as required disclosures, but in a way that is balanced and respectful of the rights of patent owners. The preemption issue, again, I think the combination of preemption with the authority of State attorneys general to enforce the law under the Federal framework. Those components, I think, are really critical. And I think, again, it is that framework that provides the balance and, you know, not just one particular component. So I think all of those components work together to provide an effective solution to what we, I think, all agree is a problem, but without creating unintended problems for patent owners because, you know, the other part of this calculus, if you will, is that if you make it so onerous for patent owners to enforce their rights, then they will become the target of abuse by infringers, by opportunistic lawyers who use State laws to harass them. So that is another important focus to keep in mind as we try to chart forward with the right path.

Mrs. BROOKS. Thank you. Thank you for the thoughtful response, and for all of your work and all of the input all of you are providing us. Thank you.

I yield back.

Mr. BURGESS. Gentlelady yields back.

Chair now recognizes the gentleman from Kentucky, Mr. Guthrie, 5 minutes for questions please.

Mr. GUTHRIE. Thank you, Mr. Chairman. Thank the panel for being here.

Sorry, I was in another hearing of this same committee, in another subcommittee, so I apologize that I may ask questions and you all sort of repeat a little bit of what Mrs. Brooks just asked, but I think a lot of us here are just trying to get our heads around this. I think when you talk about the sports—I can—my son played little league, because I know there are guys in my area go online, you can buy pictures, and I can see where that—I mean, \$250,000, and those stories are out there, they are real. And that is clear, we

need to stop that. Then I have my friend, Thomas Massie here, who represents the northern part of Kentucky, District 4, 3 or—I am 2, so 4 maybe, 4, in Kentucky, he was an inventor. And so when we hear the story like you, Ms. Ranieri, and it is like, well, this is simple, we need to fix this, so that is obviously—obviously needs to be fixed. And then you hear people say, well, if people have patents, if they are not using them, that is a good way—like the manufacturer. Well, then Thomas explains in a long dissertation at breakfast one day about how a lot of people who are legitimate patent holders, who will legitimately invent, hold these patents because they don't have the means or the ability, they are trying to move forward. And so if you do this and this kind of—that kind of reaction to stop patent trolls is going to—could stop the small entrepreneurial inventor, and so you have unintended consequences.

So I am—I guess what I am asking, is there any of this expert panel—where can we delineate between—what—you know, was the old Justice Potter, I know it when I see it. I can't really describe it, but I know it when I see it. And how do you delineate between what is clearly somebody out there patent trolling, versus, you know, somebody like Thomas who works in his garage and comes up with—essentially what you did, come up with several patents that, you know, takes him a while to find the resources to move forward. And so the question is the people just out searching, and then you have trolling, and then you have the people who are legitimate small folks. And that is what we are trying to find with the balance, because we want to fix the problem, but we don't want to have unintended consequences. So I will kind of open it up to the panel.

Mr. MALTA. Thank you. With an issue like this, there is a starting point, and you are here at the starting point, and that is to stop deceptive practices.

Mr. GUTHRIE. Um-hum.

Mr. MALTA. And the way—and we are not stopping innovation. And so you are right, it is that balance, but let us stop deception. And that is why we are suggesting and recommending that these letters have basic information in it. And basically stated earlier, state the claim, who is the part at interest, et cetera.

Mr. GUTHRIE. Um-hum.

Mr. MALTA. And that would be the start to a much greater reform that will probably evolve over time, that will deal with the balancing that needs to be done to preserve innovation.

Mr. GUGLIUZZA. Yes, let me—you know, the enforcement efforts I think this committee should focus on are particularly egregious, right? They, for example, are targeting large numbers of end users of relatively commonplace technology, right? MPHJ sends 16,000 letters out alleging infringement of use of a common office scanner. Innovatio sends out 8,000 letters alleging infringement because of the use of common wireless internet routers. That is—so these are, you know, egregious, they are sending out large numbers of letters focusing on end users, and also the claim—the patents themselves are sort of—you might say they are objectively weak. So an example of this is a troll up in the Pacific Northwest called Savannah IP. It sent letters to home builders throughout the Pacific North-

west alleging infringement of a patent on a “moisture removal system” to dry lumber during construction. So if you were using a fan to dry your lumber during construction, you may be infringing Savannah IP’s patent.

Mr. GUTHRIE. Well——

Mr. GUGLIUZZA. There were real questions about whether that patent is valid, and those sorts of assertions are the ones——

Mr. GUTHRIE. No, I agree with you 100 percent. So you walk out of that and you are going, boy, this is easy to get behind. Let us get onboard, let us move forward, I like the legislation. And then you have the talk with Thomas and say, well, these are some of the consequences that could come from that, and you walk out going—I mean we are really trying to figure out exactly what the right thing to do is, because we all want to solve the problem. I think even people who you are probably hearing oppose the current bill will say I—I have heard Thomas say it, I recognize there is a problem that needs to be solved.

Mr. GUGLIUZZA. Yes.

Mr. GUTHRIE. And so what we are trying to figure out, where is that—I mean what—every situation you just described where somebody is patenting a fan, we all agree needs to be fixed.

Mr. GUGLIUZZA. Yes.

Mr. GUTHRIE. I think most all of us——

Mr. GUGLIUZZA. I would——

Mr. GUTHRIE [continuing]. Would agree.

Mr. GUGLIUZZA. I would just encourage you to trust the courts. They know—they can tell the difference between the good actors and the bad actors. And——

Mr. GUTHRIE. Well, the problem is a lot of people go through court—the problem is the expense of going to court.

Mr. GUGLIUZZA. Yes.

Mr. GUTHRIE. So I mean that is what we are trying to solve. That is one of the problems we are trying to solve is——

Mr. GUGLIUZZA. Well——

Mr. GUTHRIE [continuing]. That people are just paying—they are sending out 8,000 letters, if 1,000 people paid and not go to court, so just using that as a solution, that is actually part of the problem we are trying to solve.

Mr. GUGLIUZZA. So if you have enforcement by State attorneys general or the Federal Government, that can help rectify the sort of resource imbalance that you are talking about, I think.

Mr. GUTHRIE. Yes, but just relying on the courts is what we are trying to solve, the problem, the expense of that.

Ms. SELF. Can I——

Mr. GUTHRIE. I think I am out of time. So I don’t know if the chairman wants to——

Mr. BURGESS. Chair will allow both Ms. Self and Ms. Ranieri to respond.

Ms. SELF. Yes. I just wanted to echo part of the comments that the Professor made. First of all, the bad faith requirement, I think, is an important, you know, dividing line between legitimate communications and communications that are appropriate for FTC enforcement authority. And again, the goal, at least from our perspective, the goal here is not to expand FTC authority, it is to clarify

it. But the pattern or practice component, I think does help, again, further delineate because—I have seen—we have seen at the State level proposals, for example, that any demand—any patent owner that sends 10 demand letters is, you know, automatically subject to enforcement. That is really not an appropriate approach. Pattern or practice denotes widespread communications that meet a standard of deception, and I agree that that standard will evolve through the courts. I think the TROL Act helps—is a starting point because it clearly identifies some areas where, you know, you do have clear objectively, you know, verifiable deception as well as some, you know, some minimal baseline affirmative disclosure requirements. But also the FTC authority has traditionally been limited to consumers, and that means small businesses, nonprofits, as well as individual recipients. I think that is another dividing line that helps with the problem that, I think, you have rightly laid out for us.

If large companies are receiving demand letters, that is a very different dynamic than small mom and pops, and it should be treated differently under the law. So I think all of these various, what I would consider to be safeguards, if you will, that are set forward in the TROL Act, I think, help solve the problem that you have articulated.

Mr. BURGESS. Ms. Ranieri?

Ms. RANIERI. I just wanted to add that EFF is—our constituency are the small innovator and inventors, and unfortunately, as Mr. Malta said, this is a starting point, the deceptive letter practices, but our position is until we get better patents issuing out of the patent office, and until we stop the flow of patents that should never be issued, we cannot solve this problem. And that is why broader reform is needed. Once patents become more—sorry, once patents that issue out of the patent office can actually be looked at and seen as actual inventions, this will make it much easier and clearer to solve all of these problems.

Mr. GUTHRIE. I think that is the argument Thomas Massie made, but he made it in 30 minutes, you have made it in 1, so I appreciate that very much.

Mr. BURGESS. Gentleman's time has expired.

Chair would ask of the ranking member, do you have a follow-up question?

Ms. SCHAKOWSKY. I do not.

Mr. BURGESS. Ranking member has no follow-up question.

The only thing I was going to ask in follow-up, and Professor and Ms. Ranieri, you all talked about flexibility, but then, Ms. Ranieri, you had given us an admonition earlier on't give us loopholes or we will drive a truck through them. So how do we achieve that balance between flexibility and loopholes?

Ms. RANIERI. That is a good question, and I think that is where the courts and the attorneys general, and the FTC and other agencies like the FTC come into play. They can recognize these activities. And as I mentioned, at its base, these laws are meant to target unfair and deceptive trade practices, and these are activities that States have a lot of competency with, in that they see them a lot in different industries, and they can apply the knowledge that they have learned in those industries to this context.

Patents are involved, yes, so that changes it slightly, but at the base, the types of deceptive and unfair practices often span many different industries.

Mr. GUGLIUZZA. Yes, I agree. I think, you know, the—allowing the courts flexibility rather than sort of hamstringing them with a complicated statutory definition of bad faith, or a long list of factors of bad faith, is very important in allowing courts in a case-by-case basis to try to close those loopholes.

Mr. BURGESS. Chair thanks all of our witnesses. And seeing no further Members wishing to ask questions, again, thank the witnesses for their participation.

Before we conclude, I would like to include the following documents to be submitted for the record by unanimous consent: A letter on behalf of the National Association of Federal Credit Unions, a letter on behalf of the Direct Marketing Association, a joint letter on behalf of the American Bankers Association, the American Insurance Association, the Clearinghouse Payments Company, Credit Unions National Association, Financial Services Roundtable, Independent Community Bankers of America, National Association of Federal Credit Unions, and the National Association of Mutual Insurance Companies. Pursuant to committee rules, I remind members that they have 10 business days to submit additional questions for the record. I ask that witnesses submit their responses within 10 business days upon receipt of the questions.

VOICE. We also have a letter from the National Retail Federation.

Mr. BURGESS. My understanding is a late arrival, a letter from the National Retail Federation, which we will make part of the record. And—

Ms. SCHAKOWSKY. Without objection.

Mr. BURGESS. Without objection, so ordered.

[The information appears at the conclusion of the hearing.]

Mr. BURGESS. And then without objection, the subcommittee is adjourned. And I thank the witnesses.

Ms. SCHAKOWSKY. Thank you.

[Whereupon, at 11:56 a.m., the subcommittee was adjourned.]

[Material submitted for inclusion in the record follows:]



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Carrie R. Hunt
Senior Vice President of Government Affairs
and General Counsel

February 24, 2015

The Honorable Michael Burgess
Chairman
Subcommittee on Commerce,
Manufacturing and Trade
House Energy and Commerce Committee
U.S. House of Representatives
Washington, D.C. 20515

The Honorable Jan Schakowsky
Ranking Member
Subcommittee on Commerce,
Manufacturing and Trade
House Energy and Commerce Committee
U.S. House of Representatives
Washington, D.C. 20515

Re: Patent Demand Letter Practices and Solutions

Dear Chairman Burgess and Ranking Member Schakowsky:

On behalf of the National Association of Federal Credit Unions (NAFCU), the only trade association exclusively representing the interests of our nation's credit unions, I write today in advance of this week's subcommittee hearing, "Update: Patent Demand Letter Practices and Solutions." On behalf of NAFCU member credit unions and the 100 million credit union members across the country, we appreciate the subcommittee's continued attention to this matter.

A growing number of credit unions are reporting receipt of demand letters from law firms representing patent assertion entities, claiming patent infringement, with the option to settle or face litigation. These deceptive letters are confusing and misleading as they often allege that the use of everyday technology violates the patent holders' rights. Further, these letters typically state vague or hypothetical theories of infringement, and often overstate or misinterpret the patent in question. Because the cost of litigation is often more expensive than paying a settlement amount, these "patent trolls" use the threat of litigation as leverage to extract payment from the recipient business who settles in lieu of running the risk of a complex and lengthy legal battle.

NAFCU believes a legislative solution is necessary to alter the intimidating business model used by these patent assertion entities and will continue to be supportive of Congressional efforts to curb these practices. As the subcommittee examines this issue further, we would urge you to address the demand letter issue in any action that you take.

Thank you for holding this important hearing. If my staff or I can be of assistance to you, or if you have any questions regarding the impact of patent trolls on credit unions, please feel free to contact myself, or NAFCU's Director of Legislative Affairs, Jillian Pevo, at 703-842-2836.

Sincerely,

Carrie R. Hunt

cc: Members of the Energy and Commerce Subcommittee on Commerce, Manufacturing, and Trade

February 25, 2015

The Honorable Michael C. Burgess
Chairman, Subcommittee on Commerce,
Manufacturing and Trade
U.S. House of Representatives
2336 Rayburn House Office Building
Washington, DC 20515

The Honorable Jan Schakowsky
Ranking Member, Subcommittee on
Commerce, Manufacturing and Trade
U.S. House of Representatives
2367 Rayburn House Office Building
Washington, DC 20515

Statement for the Record for the Energy and Commerce Subcommittee hearing entitled
“Update: Patent Demand Letter Practices and Solutions”

Dear Chairman Burgess and Ranking Member Schakowsky:

On behalf of the thousands of financial institutions of all sizes and charters represented by the undersigned trade associations, we are writing to commend you for your leadership in holding a hearing entitled, “Update: Patent Demand Letter Practices and Solutions.” We respectfully request that this letter be included as part of the record for the hearing.

We fully support your goal of developing legislation to tackle the scourge of bad faith patent demand letters. Financial institutions of every size have been targeted by Patent Assertion Entities (PAEs), often referred to as patent trolls, who in most cases assert patents of dubious quality through vaguely worded demand letters or intentionally vague complaints. Indeed, patent trolls’ recent focus on credit unions, community banks and other financial institutions threatens to pose additional, unwarranted costs on lenders and the communities they serve. In our industry alone, there are hundreds of examples of a patent troll attempting to sell a product – the patent license – to a bank or credit union using tactics resembling fraud or extortion.

Although legislation has not yet been introduced, we strongly believe any legislative solution should include provisions clarifying the Federal Trade Commission’s (FTC) authority to fight against deceptive practices, while not affecting legitimate patent holders’ rights to send demand letters or otherwise assert their patent rights. FTC and state Attorneys General enforcement would help alter the fraudulent business model of trolls by removing some of their financial incentive to send intentionally vague demand letters in the hope of quick settlements. Although outside the scope of your Committee’s jurisdiction, we believe it would also make sense for patent troll legislation to provide that if a demand letter does not contain specific information about the patent, the alleged infringement and who is asserting the patent, any civil action that is later brought by the troll would be dismissed. Compromise language developed by Senators Cornyn and Schumer in the Senate Judiciary Committee in 2014 provides a good model. Indeed, such a provision would complement this Committee’s work because it would help provide the FTC the evidence of unfair and deceptive behavior it needs to bring enforcement actions against the worst actors.

Added transparency would also help businesses make sense of a demand letter upon receipt so they are better equipped to evaluate the claim. We also urge the Committee to limit the number of exceptions provided to patent trolls, such as through affirmative defenses to fraudulent behavior. In addition, we note that states have proven to be effective laboratories for developing and furthering robust policy relating to patent trolls. While most states could see a reduction in unsubstantiated bad faith demand letters if this legislation were to be enacted, the bill should also allow states that have proactively enacted laws to discourage bad faith demand letters to continue to enforce them. **If state law is preempted, it is imperative that strong and enforceable national standards for demand letter transparency be put in place.**

We look forward to continuing to work with the Committee and stakeholders to craft a bipartisan solution that directly addresses the growing abuse of our patent system and these specious claims that are having a negative impact on our industry, our customers, and the American economy. To that end, the following is a more detailed summary of the financial services recommendations for comprehensive legislation dealing with the patent troll problem.

Patent Troll Legislation – Principles Advocated by the Financial Services Industry

The financial services industry, like many other sectors of the economy, has faced deceptive demand letters and frivolous litigation from patent trolls asserting low-quality patents.

We have serious concerns about the current patent litigation environment as well as the quality of patents granted by the Patent and Trademark Office (PTO). In addition, patent trolls continue to assert low-quality patents through vaguely- worded demand letters with the full knowledge that their targets, our members, are more likely to pay unnecessary licensing agreements than engage in lengthy, costly litigation. The deadweight cost of compliance with demand letters and the threat of litigation are ultimately born by our customers.

To that end, the financial services industry has coalesced around a set of key principles needed to address this critical issue. These principles fall into three distinct yet interrelated baskets that, if enacted, would improve the patent system, promote innovation and discourage the assertion of low-quality patents as a legitimate business model.

- 1) Efficiency of the Litigation Process: improvements need to be made to make the cost and burdens of patent litigation equitable and more efficient.
- 2) Enhanced Transparency: abuse of the patent system through the use of vaguely-worded demand letters must be ended by requiring such letters to provide more details about the patent and who claims to assert it.

- 3) Patent quality: improvements are needed in the post-grant review of patents such as making the Covered Business Method (CBM) permanent and more useable for smaller entities.

Collectively, these principles will go a long way in protecting the financial services sector and the millions of customers our members interact with on a daily basis from the harm wrought by patent trolls. As the issue of patent reform unfolds in the 114th Congress, we look forward to working with you to advance these core principles.

The following summarizes a set of principles that the financial services sector is advocating for inclusion in any patent reform legislation during the 114th Congress:

LITIGATION EFFICIENCY

- Contribution Doctrine: Patent trolls target financial services companies as end-users of a product or service, leaving our members vulnerable and liable for products and services outside of their control. Adding a right of contribution to the patent law would enable a more equitable distribution of liability between end users and vendors. Under common law and certain federal statutes, there is right of contribution (e.g., a tortfeasor, or defendant, has a right to seek contribution from other joint tortfeasors where one tortfeasor has paid more than its fair share of damages to the plaintiff). In the patent context, a right of contribution could arise where a patent troll sues the end user of a system, not the upstream supplier of components of the system. Unfortunately, no right of contribution exists under the patent law and state law claims for contribution are preempted.
- End-User Protections: End users should be protected from patent troll lawsuits based on infringements by manufacturers and producers. Trolls should be required to sue the party that is actually responsible for infringement, and end users should be protected by having their cases consistently stayed when the manufacturer is best positioned to fight the patent troll. Definitions should ensure that the stay adequately shields business from all corners of “Main Street” America, including financial services.
- Limitation to Core Discovery Documents: Each party is to pay for the discovery it requests beyond “core” documents. Any discovery requested beyond the “core” documents is at the expense of the party requesting such discovery.

ENHANCED TRANSPARENCY

- Demand Letter Reform: Vaguely-worded demand letters have been used by patent trolls to entice licensing agreements and the payment of royalties even though the facts around infringement may not be compelling. Demand letters should contain greater specificity. This enhanced transparency will help curb abusive lawsuits. Further, demand letters should be filed with regulators and recorded in a public, searchable database. In addition, a demand letter should be sufficient to enable a covered business method review, and State laws that have been enacted to curb abusive demand letters by patent trolls should be viewed as a complement to any federal protections, and not be preempted.
- Enhanced Pleading Standards: Complaints for patent infringement should specifically identify the accused product, the asserted claims and factual basis for infringement.
- Close Marking Loophole: Under current law, a company practicing a patent can only collect past damages if it marks its products, meaning it labels the product as a patented product. Conversely, a patent troll is entitled to past damages because they have nothing to mark. It is unfair that an entity that does not practice a patent is entitled to more damages than a company that actually employs people and contributes to the economy by selling products and services. To fix this loophole and put operating companies and patent trolls on a level playing field, a plaintiff should only be able to collect damages from the date it provided notice of infringement. Marking a product should be considered adequate notice of infringement.
- Recordation of Patent Sales: Establish public record of patent sales, analogous to the sale of real estate. Each sales record should include: (1) Real Parties in Interest – clear identification of purchaser, parent companies of purchaser, as well as identification of companies and individuals that retain a financial interest in the patents; and (2) Purchase Price. P-patent brokers should have licensing and other oversight requirements to ensure that the market is a level playing field and brokers have the requisite expertise and adhere to ethical business practices. As part of the sales process, an objective, third-party valuation should be required. In addition, there should be a transaction fee to cover the costs associated with licensing brokers and maintaining public sales records.

PATENT QUALITY

- Permanent Covered Business Method program and Improvements to other Post-Grant programs: Post-grant review should be available to all practitioners including those who do not generally possess prior art in the form of patents and printed publications. Congress validated this assertion in the American Invents Act when they created the

CBM program. Unfortunately, without intervening action, the CBM program will expire in 2020 once again leaving certain industries exposed to low quality business method patents. The CBM program should be made permanent as it has proven to be a successful low-cost alternative to litigation of covered business method patents. However, additional modifications should be made to inter partes review to ensure that it can be accessed by all practitioners using the very best prior art available. Safeguards should ensure that post-grant proceedings cannot be used to harass patent holders and not so restrictive as to protect low-quality patents from review.

- Language to make CBM Program permanent should include the ability for the PTO to waive or reduce the fee for small entities.
- Lift the prior art bar for inter partes and remove the estoppel bar.

Sincerely,

American Bankers Association
 American Insurance Association
 The Clearing House Payments Co., L.L.C.
 Credit Union National Association
 Financial Services Roundtable
 Independent Community Bankers of America
 National Association of Federal Credit Unions
 National Association of Mutual Insurance Companies



Statement of the
National Retail Federation
National Council of Chain Restaurants
and
Shop.org
submitted to the
U.S. House of Representatives
Committee on Energy and Commerce
Subcommittee on Commerce, Manufacturing and Trade
for its hearing on
"Update: Patent Demand Letter Practices and Solutions"
held on
February 26, 2015

David French
Senior Vice President,
Government Relations

On behalf of:

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Chairman Burgess, Ranking Member Schakowsky and members of the House Energy and Commerce Subcommittee on Commerce, Manufacturing and Trade, on behalf of the National Retail Federation (NRF) and its communities the National Council of Chain Restaurants and Shop.org, I appreciate the opportunity to submit this written statement to the Committee in connection with its hearing entitled "Update: Patent Demand Letter Practices and Solutions" held on February 26, 2015.

NRF is the world's largest retail trade association, representing discount and department stores, home goods and specialty stores, Main Street merchants, grocers, wholesalers, chain restaurants and Internet retailers from the United States and more than 45 countries. Retail is the nation's largest private sector employer, supporting one in four U.S. jobs – 42 million working Americans. Contributing \$2.6 trillion to annual GDP, retail is a daily barometer for the nation's economy. Retailers create opportunities for life-long careers, strengthen communities, and play a critical role in driving innovation.

Retailers are Significantly Impacted by Patent Troll Demand Letters

Members of the National Retail Federation appreciate the attention the Committee is paying to the issue of false and deceptive demand letters and their harmful effect on competitiveness and innovation. Many retailers are using capital resources to settle with or fight patent trolls' infringement claims that they would otherwise use to invest in their businesses, engage in their communities, and create jobs.

Retail, at its core, is a highly competitive industry, and many retailers are using innovative technology creatively to expand and grow their businesses. Patent trolls, who are not investing in technological innovation, providing jobs or giving back to their communities, employ tactics that cut at the heart of this growth and ingenuity.

In recent years, hundreds of retailers have contacted NRF about this issue because they have been, or are currently, the target of patent trolls' abusive behavior. The threat typically comes from firms whose business model is buying obscure patents that are about to expire and then either licensing the patents to retailers through the threat of litigation or filing lawsuits in an effort to force a settlement. Often retailers will choose to pay the licensing fee because patent litigation is prohibitively expensive.

Patent trolls sued more non-tech Main Street companies than tech companies in 2012.¹ Regretfully there is no concrete data on demand letters because, unlike lawsuits, they are not officially filed. Patent trolls employ a strategy that focuses on businesses such as retailers and restaurants because businesses that "use" technology, but don't manufacture it, are more numerous. One manufacturer or vendor may supply a product or service to thousands of retail end-users. Thus, there are many more entities from which to demand a royalty. End-user retailers are also easy prey because they lack the legal resources and in-house expertise to fight complex patent infringement claims. Compared to high tech companies, retailers typically operate on thin profit margins. Patent trolls, knowing that retailers lack technical expertise, retail

¹ Colleen Chien, "Patent Trolls by the Numbers," Patently-O, March 14, 2013.
<http://www.patentlyo.com/patent/2013/03/chien-patent-trolls.html>

stores operate on thin margins, and patent litigation is exorbitantly expensive, will often price a settlement demand (which may still be in the millions) below the cost of litigating, effectively blackmailing a retailer into settlement. This is an abuse of the system.

Patent trolls assert infringement claims often by sending reams of vague, misleading, or deceptive letters to businesses. The trolls demand that those businesses immediately purchase expensive licenses of uncertain value or face the threat of protracted and costly patent litigation. These claims are often based on broad concepts and general business methods (such as operating a retail business “online”), covering the use of technology in all areas of e-commerce and mobile retailing, in addition to specific software innovations. This approach is especially damaging to retailers, who rely on new technology to better serve their customers.

Trolls’ claims not only affect e-commerce and mobile retailing but also the operations of traditional “brick and mortar” retail stores. Some examples of the latter are claims that purport to cover the printing of receipts at cash registers, the sale of gift cards, and the connection of any device (such as a computer or printer) to an Ethernet network. Recently, patent trolls have sent demand letters to dozens of retailers and other Main Street businesses on technology directed to arrival and status messaging systems and methods for transportation, transportation logistics, cargo shipment, package delivery, package tracking and related industries. This is a primary function of a retail business dealing with supply chain logistics.

These cases rarely go to trial because the patent troll has no intention of ever taking the retailer or Main Street business to court. They know that their damages claims are so exorbitant, and the prospect of relief through litigation so time-consuming, that retailers will make a sound business decision and settle, rather than litigate. It has been reported that trolls lose 92 percent of cases that proceed to merits judgments; but, as noted, it is infrequent that a defendant has the fortitude to litigate.² Smaller retailers, in particular, may find themselves ill-equipped legally or financially to defend themselves from abusive claims, and dealing with these claims certainly inhibits their ability to innovate and grow.

The exorbitant costs associated with seeing a court case through to final adjudication are startling for retailers, especially small businesses. We have heard from our members that they spend as much as one million dollars or more annually on patent troll-related expenses and settlement agreements. These expenditures and the employee hours diverted to fighting patent trolls are precious capital resources that retailers would rather reinvest in their businesses. It is important to note, however, that many retailers do not have these types of resources to redirect to fight patent trolls. Therefore, those retailers often will settle the claim when they receive their first demand letter to make the problem go away.

NRF Support for Patent Legislation

NRF is engaged in discussions with Members of the Committee and Congress to address patent trolls’ tactics, including vague and deceptive demand letters and the abusive litigation practices patent trolls utilize.

² John R. Allison, Mark A. Lemley, and Joshua Walker, *Patent Quality and Settlement Among Repeat Patent Litigants*, 99 GEO. L.J. 677, 694 (2011).

Demand letters and new cases pile up while the court cases proceed. Retailers need certainty and clarity that only multi-pronged legislation, targeted at the asymmetry in the system that patent trolls exploit, will provide. Legislation, which should require that patent trolls include correct information and communicate fairly, should give Main Street businesses that certainty and clarity by making patent trolls explain their claims, protect innocent customers, make patent litigation more efficient, stop discovery abuses, make abusive trolls pay and allow for less expensive alternatives to litigation.

Conclusion

By papering Main Street businesses, including retailers, with broad and vague demand letters and filing an endless series of lawsuits against retail end-users alleging the same patent infringement claims alleged against manufacturers and service providers of a particular device or technology, patent trolls are able to cast a very wide net that hauls in a lucrative catch. They have proven that many of the companies they target will settle given the extraordinarily high demands they make and the costs those companies know it will take to fight even the most frivolous of alleged claims.

Addressing this abusive and growing patent litigation problem with common sense reform will help release retailers from the controlling grip on their industry that patent trolls currently enjoy. Because the retail industry contributes \$2.6 trillion to our nation's annual GDP, removing or even loosening this grip on retailers will allow innovation and growth to flourish, and undoubtedly benefit the overall U.S. economy.

Multi-faceted patent litigation reform, which includes requiring transparency and fairness in demand letters, is about stopping the lucrative business model used by patent trolls of asserting meritless patents and getting shakedown settlements. Only Congress can pass reform needed to put them out of business for good.

We appreciate your leadership and the Subcommittee's work on strengthening enforcement and dramatically reducing the number of bad faith demand letters that our businesses receive. With the possible exception of the patent-holding community, few businesses have either the expertise or the wherewithal to take multiple, million dollar patent claims to court. Trolls target Main Street businesses for just this reason, and thus are able to extract exorbitant settlements from each. NRF looks forward to working with you to address this growing and costly problem.