

ONE HUNDRED FOURTEENTH CONGRESS
Congress of the United States
House of Representatives
COMMITTEE ON ENERGY AND COMMERCE
2125 RAYBURN HOUSE OFFICE BUILDING
WASHINGTON, DC 20515-6115

Majority (202) 225-2927
Minority (202) 225-3641

MEMORANDUM

February 24, 2014

To: Subcommittee on Commerce, Manufacturing, and Trade Democratic Members and Staff

Fr: Committee on Energy and Commerce Democratic Staff

Re: Hearing on “Update: Patent Demand Letter Practices and Solutions”

On Thursday, February 26, 2015, at 10:15 a.m. in room 2322 of the Rayburn House Office Building, the Subcommittee on Commerce, Manufacturing, and Trade will hold a hearing titled “Update: Patent Demand Letter Practices and Solutions.”

I. BACKGROUND

A patent is an intellectual property right granted to an inventor that allows the patent holder to exclude others from “making, using, offering for sale, or selling” claimed inventions, generally for a period of 20 years.¹ Patents are granted by the U.S. Patent and Trademark Office (USPTO) if the proposed patent meets statutory requirements.² The explicit purpose of the patent system is to promote innovation on the theory that disclosure of the invention will incentivize research and development and allow for others to build upon the invention.³

¹ U.S. Patent and Trademark Office, *General Information Concerning Patents* (Oct. 2014) (online at www.uspto.gov/patents-getting-started/general-information-concerning-patents#heading-28).

² Brian T. Yeh, *An Overview of the “Patent Trolls” Debate*, Congressional Research Service (Apr. 16, 2013) (R42668).

³ U.S. Const. art. I, § 8, cl. 8 (“Congress shall have the power ... [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.”); Trolling Effects, *Frequently Asked Questions*, Electronic Frontier Foundation (online at trollingeffects.org/faq#t57n252) (accessed Feb. 20, 2014).

A patent holder may authorize another person or entity to make, use, or sell the patented invention through an assignment or license, usually in exchange for a license fee or other compensation.⁴ Patent holders may bring suit in federal court against a person or entity that uses, sells, makes, or imports their patents without authorization.⁵ In an infringement suit, the patent holder is given the benefit of a rebuttable presumption that the patent is valid. However, an alleged infringer may introduce evidence of invalidity or unenforceability of the patent as a defense.⁶

Patent litigation is often complex and extremely expensive. According to the American Intellectual Property Law Association, the average patent suit for which \$1 million to \$25 million is at stake costs both sides a combined \$1.7 million through the end of discovery (production and review of written materials) and \$2.8 million through the end of trial.⁷ Patent litigation is split into two distinct phases.⁸ First, in what is known as claim construction, the terms of the patent are defined as a matter of law.⁹ In the second phase, validity of the patent and infringement are determined.¹⁰

II. PATENT ASSERTION ENTITIES

There has been growing concern over the past few years about abusive practices by certain patent assertion entities (PAEs). These entities, sometimes called ‘patent trolls,’ generally do not invent or produce any products or services.¹¹ Instead, their business models are based primarily on acquiring patents and then enforcing them, often by sending demand letters to numerous companies asserting infringement and threatening to sue, with the intention of

⁴ General Patent Corporation, *Patent Licensing* (online at www.generalpatent.com/services/patent-licensing) (accessed on Feb. 20, 2015).

⁵ U.S. Patent and Trademark Office, *General Information Concerning Patents* (Oct. 2014) (online at www.uspto.gov/patents-getting-started/general-information-concerning-patents#heading-28).

⁶ Brian T. Yeh, *An Overview of the “Patent Trolls” Debate*, Congressional Research Service (Apr. 16, 2013) (R42668).

⁷ American Intellectual Property Law Association, *2013 Report of the Economic Survey* (2013).

⁸ Trolling Effects, *Patent Law Primer: Patent Infringement*, Electronic Frontier Foundation (online at trollingeffects.org/patent-law-primer) (accessed Feb. 20, 2015).

⁹ *Id.*

¹⁰ *Id.*

¹¹ Federal Trade Commission, *The Evolving IP Marketplace: Aligning Patent Notice and Remedies with Competition*, at 51 (Mar. 2011); Executive Office of the President, *Patent Assertion and U.S. Innovation* (June 2013) (online at www.whitehouse.gov/sites/default/files/docs/patent_report.pdf). Some patent intermediaries play a useful role, by specializing in matching patent holders and manufacturers, or through technology transfer.

extracting license fees or settlement payments.¹² The demand letters often lack basic information regarding the patent, the specific claims that are allegedly being infringed, or what product is allegedly infringing the patent.¹³ PAEs are rarely successful in cases decided on the merits (8% success rate versus 40% for other entities),¹⁴ but because of the complexity and expense of litigation, many defendants choose to pay the license fee or settle to avoid going to court.¹⁵

III. EXISTING FEDERAL TRADE COMMISSION AUTHORITY

The Federal Trade Commission (FTC) has authority under Section 5 of the FTC Act to investigate and take legal action against individuals or entities that engage in unfair or deceptive acts or practices, including senders of unfair or deceptive patent demand letters.¹⁶ According to the FTC's policy statement regarding deception, "the Commission will find deception if there is a representation, omission or practice that is likely to mislead the consumer acting reasonably in the circumstances, to the consumer's detriment."¹⁷ The FTC's primary remedy under Section 5 is an injunction; the FTC lacks authority, however, to directly levy civil penalties under the FTC Act.

In September 2013, pursuant to Section 6(b) of the FTC Act, the Commission announced it would seek public comment on a proposed study to examine PAEs and their impact on innovation and competition.¹⁸ After two comment periods, the study will include two main parts: a general descriptive examination of the PAE business model; and a second, narrower case study of PAE activity in the wireless communications sector.¹⁹ The study is expected to be released at the end of this calendar year.²⁰

¹² Trolling Effects, *Frequently Asked Questions*, Electronic Frontier Foundation (online at trollingeffects.org/faq) (accessed Feb. 20, 2015).

¹³ *Id.*

¹⁴ Brian T. Yeh, *An Overview of the "Patent Trolls" Debate*, Congressional Research Service (Apr. 16, 2013) (R42668). The failure rate at judgment of PAEs is more likely attributable to their failure to show actual infringement, rather than the relative weakness or invalidity of their patents.

¹⁵ Trolling Effects, *Frequently Asked Questions*, Electronic Frontier Foundation (online at trollingeffects.org/faq#t57n252) (accessed Feb. 20, 2015).

¹⁶ 15 U.S.C. § 45.

¹⁷ Federal Trade Commission, *FTC Policy Statement on Deception* (Oct. 14, 1983) (online at www.ftc.gov/bcp/policystmt/ad-decept.htm).

¹⁸ Federal Trade Commission, *FTC Seeks to Examine Patent Assertion Entities and Their Impact on Innovation, Competition* (Sept. 27, 2013) (online at www.ftc.gov/opa/2013/09/paestudy.shtm).

¹⁹ *Id.*

²⁰ *FTC Commissioner Looks Back, And Ahead, On Patent Litigation Reform Efforts*, Forbes (Dec. 18, 2014) (online at www.forbes.com/sites/wlf/2014/12/18/ftc-commissioner-looks-back-and-ahead-on-patent-litigation-reform-efforts/).

IV. LITIGATION AND LEGISLATIVE ACTIVITY AT THE STATE AND FEDERAL LEVELS

Numerous court challenges have emerged in an effort to curb certain PAE activities. For example, the FTC filed a complaint alleging MPHJ Technology Investments, a well-known PAE, engaged in deceptive practices in its communications asserting its patent rights. That suit, which was settled in late 2014, requires MPHJ to refrain from making certain deceptive representations, such as false or unsubstantiated representations that a patent has been licensed in substantial numbers or has been licensed at particular prices, in its patent assertion communications.²¹ At the state level, the attorneys general of Vermont, Minnesota, Nebraska, and New York have attempted to bring legal action against MPHJ under the states' general consumer protection laws.²² The results of these state actions have been mixed, and Vermont's legal action is still ongoing. Furthermore, a private civil action brought by hardware manufacturers against Innovatio IP Ventures, another well-known PAE, was dismissed for failing to demonstrate that Innovatio's misrepresentations went to the substance of the infringement claim.²³

A. State-Level Legislative Activity

In May 2013, Vermont Governor Peter Shumlin signed a law requiring patent demand letters "to be specific about the claim being violated, to be particular about how the target is violating the patent, and to give targets a reasonable estimate of the damage costs coupled with a reasonable time to respond."²⁴ Since then, 17 other states have enacted legislation explicitly regulating patent demand letters.²⁵ Nine other states are currently considering legislation.²⁶ Although legislation varies by state, many states have passed legislation containing language similar to the Vermont statute.²⁷

B. Judiciary Committee

²¹ Federal Trade Commission, *FTC Settlement Bars Patent Assertion Entity From Using Deceptive Tactics* (Nov. 6, 2014) (online at www.ftc.gov/news-events/press-releases/2014/11/ftc-settlement-bars-patent-assertion-entity-using-deceptive).

²² See, e.g., *Nebraska's Attorney General Has Declared War on Patent Trolls*, Washington Post (Sept. 12, 2013).

²³ *In re Innovatio IP Ventures, LLC Patent Litig.*, 921 F. Supp. 2d 903 (N.D. Ill. 2013).

²⁴ 9 V.S.A. § 4195 et seq.

²⁵ Patent Progress, *Patent Progress's Guide to State Patent Legislation* (Feb. 19, 2015) (online at www.patentprogress.org/patent-progress-legislation-guides/patent-progresss-guide-state-patent-legislation/).

²⁶ *Id.*

²⁷ See e.g., O.C.G.A §§ 10-1-770 et seq. (Georgia), I.C. §§ 48-1701 et seq. (Idaho), and 14 MRS c. 757 (Maine).

Last Congress, a number of bills aimed at patent reform were introduced in the House of Representatives, many of which were focused on patent litigation. One of those bills was H.R. 3309, the Innovation Act, a package of broad patent litigation reforms, which passed the House on December 5, 2013, by a vote of 325-91.

On February 5, 2015, Rep. Goodlatte again introduced the Innovation Act, H.R. 9. H.R. 9 is the same as the bill that passed the House last Congress. H.R. 9, would require plaintiffs in a patent infringement suit to list specific information about their claims in their initial court pleadings. The bill expresses the sense of Congress that purposely evasive demand letters, and any actions or litigation stemming from such demand letters, should be considered a fraudulent or deceptive practice. Also, the bill would prohibit a party seeking to establish willful infringement from relying on pre-suit notification unless the notification identifies the asserted patent, identifies the product or process alleged to be infringing, and explains to the extent possible, following a reasonable investigation or inquiry, how the product or process infringes the claims of the patent. In addition, the bill would require the USPTO to conduct studies and report to Congress on various aspects of the patent system, including the prevalence of patent demand letters sent in bad faith and the extent to which that practice may, through fraudulent and deceptive practices, impose a negative impact on the marketplace. H.R. 9, however, does not give any explicit enforcement authority to the FTC with regard to demand letters.

C. Energy and Commerce

The Subcommittee on Commerce, Manufacturing and Trade held two hearings and one markup last Congress on the topic of abusive practices by certain PAEs.²⁸ Markup was held on H.R. __, the Targeting Rogue and Opaque Letters (TROL) Act.

The TROL Act provided that certain communications in connection with the assertion of a United States patent, made in bad faith, are unfair or deceptive acts or practices. The bill enumerated several representations, requests for compensation, and omissions that are violations of the FTC Act if committed in connection with patent assertion and done in bad faith. The bill preempted all state laws, rules, regulations, or other provisions relating to the transmission or contents of communications in connection with the assertion of patent rights. It also required the FTC or state attorneys general attempting to enforce violations of the bill to establish that the sender of false or misleading communications did so knowingly, with reckless indifference to the false or misleading nature of such statements, or with awareness of the high probability of the

²⁸ Subcommittee on Commerce, Manufacturing, and Trade, *Hearing on Trolling for a Solution: Ending Abusive Patent Demand Letters*, 113th Cong. (Apr. 8, 2014); Subcommittee on Commerce, Manufacturing, and Trade, *Hearing on H.R. __, a Bill to Enhance Federal and State Enforcement of Fraudulent Patent Demand Letters*, 113th Cong. (May 22, 2014); Subcommittee on Commerce, Manufacturing, and Trade, Markup of H.R. __, the Targeting Rogue and Opaque Letters (TROL) Act of 2014, 113th Cong. (July 10, 2014). The Subcommittee on Oversight and Investigations also held a hearing. Subcommittee on Oversight and Investigations, *Hearing on The Impact of Patent Assertion Entities on Innovation and the Economy*, 113th Cong. (Nov. 14, 2013).

representations or omissions to deceive and with the intention of avoiding the truth. The bill was not considered by the full Committee.

IV. WITNESSES

The following witnesses have been invited to testify:

Laurie Self

Vice President and Counsel, Government Affairs
Qualcomm
On behalf of the Innovation Alliance

Professor Paul Gugliuzza

Associate Professor
Boston University School of Law

Vince Malta

2015 Liaison for Law & Policy
National Association of REALTORS
On behalf of United for Patent Reform

Vera Ranieri

Staff Attorney
Electronic Frontier Foundation