



THE COMMITTEE ON ENERGY AND COMMERCE

MEMORANDUM

NOVEMBER 12, 2013

TO: Members, Subcommittee on Oversight and Investigations

FROM: Committee Majority Staff

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

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

I. WITNESSES

One panel of witnesses will testify:

Mr. Justin Bragiel
General Counsel
Texas Hotel & Lodging Association

Mr. Lee Cheng
Chief Legal Officer
Newegg, Inc.

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

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

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

Mr. Daniel Seigle
Director of Business Operations
FindTheBest.com

II. BACKGROUND

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

The first step that a PAE usually will take is to send a “demand letter” to a company or an individual stating that a product or technology they are selling or using is infringing upon a patent or series of patents owned by the PAE. Oftentimes, these letters provide little detail about the patents or claims being infringed, yet threaten to initiate litigation unless a licensing fee is agreed upon within a short timeframe. Many of these cases do not reach the court room since, according to the recipients of these demand letters, the licensing fees or settlement amounts are often well below the cost of hiring lawyers, commencing costly discovery, and taking them to trial. These decisions are particularly difficult for small businesses or startup companies because of the significant costs. It has been estimated that the average patent trial can take longer than a year and costs from one to six million dollars.² In fact, according to one recent study, PAE activity cost defendants and licensees \$29 billion in 2011—a 400% increase since 2005.³

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

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

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

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

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

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

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

III. ISSUES

The following issues may be examined at the hearing:

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

IV. STAFF CONTACTS

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

⁵ See FED. TRADE COMM’N, THE EVOLVING IP MARKETPLACE: ALIGNING PATENT NOTICE AND REMEDIES WITH COMPETITION 50-51 (2011). See also James Bessen et al., *The Private and Social Costs of Patent Trolls*, REGULATION 26 (2006).

⁶ See Eric Savitz, *Cuban Says Vringo Stake Hedges Patent Risk in Other Investments*, FORBES, Apr. 17, 2012.

⁷ Fed. Trade Comm’n., *FTC Seeks to Examine Patent Assertion Entities and Their Impact on Innovation, Competition*, Sept. 27, 2013.