THE COMMITTEE ON ENERGY AND COMMERCE

MEMORANDUM

May 20, 2014

To: Members of the Subcommittee on Commerce, Manufacturing, and Trade

From: Majority Committee Staff

Re: Hearing on H.R. __, a bill to enhance federal and state enforcement of fraudulent patent demand letters.

On Thursday, May 22, 2014, the Subcommittee on Commerce, Manufacturing, and Trade will convene a hearing at 9:15 a.m. in 2123 Rayburn House Office Building on H.R. __, a bill to enhance federal and state enforcement of fraudulent patent demand letters. Witnesses are by invitation only.

I. Witnesses

Rob Davis, Counsel, Venable, *on behalf of* the Stop Patent Abuse Now Coalition;

Lois Greisman, Associate Director, Bureau of Consumer Protection, Federal Trade Commission;

Adam Mossoff, Professor of Law, George Mason University;

Jon Potter, President & Co-Founder, Application Developers Alliance;

Alex Rogers, Senior Vice President, Legal Counsel, Qualcomm; and,

Wendy Morgan, Chief of the Public Protection Division, Office of the Attorney General of Vermont.

II. Purpose

The hearing will examine the draft legislation and provide stakeholders the opportunity to discuss whether and how the draft bill can be improved further to balance the need to prevent the bad actors from abusing the patent demand letter process while preserving the legitimate purposes of communicating intellectual property rights.

III. Summary

The draft bill addresses the growing problem of so-called patent "trolls" sending false or deceptive written communications seeking compensation for alleged infringement of a patent. The draft prohibits an enumerated list of false and misleading statements in such communications. The draft requires the communications to provide, to the extent reasonable under the circumstances, enumerated disclosures in order to help recipients respond appropriately. The draft would replace various State laws with a single Federal regime enforced by the Federal Trade Commission and subject to civil penalties. Additionally, State Attorneys General would be authorized to enjoin violations and seek compensatory damages on behalf of

the recipients who suffered actual damages as a result of a violation. A detailed section-by-section description of the relevant provisions is provided later in this memorandum.

IV. Background

In recent years, many small businesses have been targeted with financial threats through demand letters alleging infringement of a patent. Communications often instruct the recipient to either pay for a license for the product or process alleged to be infringing within a short period of time, or face litigation for infringing on the sender's vaguely defined and often specious intellectual property rights. While these bad actors dominate the headlines, many entities with significant patent holdings also communicate to engage other companies in lawful and productive discussions around their businesses.

Policymakers have focused increasing attention on patent assertion entities (PAEs), also known as "patent trolls," in the last several months due to the outcry from small businesses who are on the receiving end of their demand letters. PAEs are non-practicing entities[1] (NPEs) that purchase patents from inventors or other rights-holders on the open market and then prosecute that patent against alleged infringers. While there are some PAEs that hold such rights and assert legitimate claims of patent infringement, PAEs have garnered negative attention for deceptive practices aimed at small businesses.[2]

These bad actors behave largely the same way: send hundreds or thousands of letters to small businesses, including coffee shops, restaurateurs, grocers, community banks, hoteliers, and realtors, containing vague claims of patent infringement and demanding payment of a relatively small amount of money within a short timeframe for a "license" to continue using the technology or the asserting entity will file suit.[3] The claims often involve widely-used technology, and the infringing activity generally involves the use of another person's product, such as scanning-to-email function on a copier or printer, or using a commercially available router for wireless internet connectivity. Often, these letters allege the assertion of patents that are expired or were invalidated. In fact, the Subcommittee received testimony from a witness at the Subcommittee's April 8 hearing that the letter he received listed 13 patent numbers without further explanation or information. Because patent litigation can cost millions of dollars, even for a small business, the PAEs rely on the fact that their targets will decide that settling – or paying for a "license" – is more cost effective than hiring a patent attorney to verify or litigate the claim.

In addition to the attention received from Capitol Hill, patent trolls have prompted action at the Federal Trade Commission (FTC) and in a number of States. In October 2013, the FTC announced it would initiate a study under its §6(b) authority to compel information from PAEs regarding their patent acquisition, rights assertion, licensing, and litigation practices, and

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[1] All PAEs are NPEs because they do not practice the patent they hold, but not all NPEs are PAEs, however. For instance, a university often develops and patents their innovations, but they do not monetize – or "practice" – the technology, process, or invention that is the subject of the patent. In addition, the university's patents are, most frequently, developed in-house rather than purchased on the open market. *See generally*, Federal Trade Commission, *The Evolving IP Marketplace* at 8 (March 2011), available at http://www.ftc.gov/sites/default/files/documents/reports/evolving-ip-marketplace-aligning-patent-notice-and-remedies-competition-report-federal-trade/110307patentreport.pdf.

[2] One estimate places the number of threatening demand letters sent in 2012 at over 100,000. *See* Executive Office of the President, *Patent Assertion and U.S. Innovation* at 6 (June 2013), available at http://www.whitehouse.gov/sites/default/files/docs/patent_report.pdf .

[3] For examples of actual demand letters sent by a PAE, visit https://trollingeffects.org/search/node/.

compare those to the practices of other patent owners.[4] The purpose of the study is to examine the competition and consumer protection implications of PAE practices and eventually, will result in a report on the Commission's findings. At the State level, at least four Attorneys General have pursued litigation against PAEs who have engaged in unfair or deceptive patent assertion practices.[5] Additionally, as of May 1, nine States have adopted legislation specifically pertaining to demand letters (Georgia, Idaho, Maine, Maryland, Oregon, South Dakota, Tennessee, Vermont, Wisconsin, and Utah),[6] and legislation of varying approaches is pending before the legislatures of at least 19 other States.[7]

Description of H.R. __,

Sec. 2. Unfair or Deceptive Acts or Practices in Connection With the Assertion of A United States Patent

Subsection 2(a) accomplishes two purposes: it (prohibits/identifies) certain fraudulent statements; and it requires certain disclosures to provide greater transparency to the recipient of the letter.

It establishes that it is an unfair or deceptive act or practice under the FTC Act to engage in a pattern or practice of sending demand letters to consumers, end users, or system integrators if the communications include any of the twelve elements contained in paragraphs (1) through (3), or fails to include any of the elements in paragraph (4) (to the extent reasonable under the circumstances for subparagraphs C and D).

The elements in paragraphs (2) or (3) must be made by the sender in "bad faith" (as defined in Section 5 as representations the sender made with actual knowledge, or knowledge fairly implied on the basis of objective circumstances that such representations were false) to be an unfair or deceptive act or practice.

Subsection 2(b) provides a rebuttable presumption for senders with respect only to subsection (a)(4) that the communications are not an unfair or deceptive act or practice under the FTC Act if: 1) a good faith effort is made to include the information specified in subparagraphs (A) through (E); and 2) there is no violation of paragraphs (1) through (3).

Sec. 3. Enforcement By Federal Trade Commission.

Section 3 provides the FTC the ability to seek civil penalties for a violation (as opposed to injunctive relief) by establishing that a violation of Section 2 shall be treated as a violation of a rule defining an unfair or deceptive act or practices prescribed under section 18(a)(1)(B) of the FTC Act. Section 3 also makes clear that the FTC's existing powers and enforcement authority are preserved, meaning anything not specifically prohibited by the draft legislation remains

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[4] Federal Trade Commission, *FTC Seeks to Examine Patent Assertion Entities and Their Impact on Innovation, Competition* (September 27, 2013), available at http://www.ftc.gov/news-events/press-releases/2013/09/ftc-seeks-examine-patent-assertion-entities-their-impact.

[5] Minnesota, Nebraska, New York, and Vermont.

[6] Ferguson, Kirby. "*Ten states pass anti- patent troll laws, with more to come"(*May 15, 2014) available at http://arstechnica.com/tech-policy/2014/05/fight-against-patent-trolls-flags-in-the-senate-but-states-push-ahead/

[7] Connecticut, Illinois, Kansas, Kentucky, Louisiana, Maine, Maryland, Mississippi, Missouri, Nebraska, New Hampshire, New Jersey, Oklahoma, Pennsylvania, Rhode Island, South Carolina, Tennessee, Virginia, and Wisconsin.

subject to general FTC enforcement as an unfair or deceptive act or practice under Section 5 of the FTC Act and subject to an injunction.

Sec. 4. Preemption of State Laws on Patent Demand Letters And Enforcement by State Attorneys General

Subsection (a)(1) preempts any law, rule, regulation, standard or other provision having the effect of law of any State law or political subdivision expressly relating to the transmission or contents of patent demand letters.

Subsection (a)(2) provides that other State laws (such as laws of general applicability or state's mini-FTC statutes) are not affected.

Subsection (b)(1) provides for enforcement of the Act by the State Attorneys General and empowers them to enjoin violations or seek compensatory damages.

Subsection (b)(2) requires the attorney general of a State to provide the FTC with prior written notice of any action taken under paragraph (1) and also provides the FTC authority to intervene in the action. It further provides no state action may be brought if the FTC has a civil action pending against any named defendant.

Sec. 5. Definitions

Section 5 provides certain terms used throughout the draft legislation.

Of note, paragraph (1) defines "bad faith" as it pertains to representations made in Section 2 (a) paragraphs (2) and (3) as previously described above.

Paragraph (7) defines "systems integrator" and is intended to describe persons who develop or contract for development of a website or mobile application that incorporates commercially available software or services intended for direct sale or license to consumers or end users. The purpose of the definition is to extend the protections of section 2(a) in demand letters sent to app developers and others similarly situated.

IV. Committee Legislative History

On April 8, 2014, the Commerce Manufacturing and Trade Subcommittee held an oversight hearing on the problem and the responses to date. The Subcommittee received testimony from victims of patent "troll" letters, companies with large portfolios of intellectual property, a non-practicing entity, an academic, and a State Attorney General. Previously, the Committee's Oversight and Investigations Subcommittee held a hearing titled, "The Impact of Patent Assertion Entities on Innovation and the Economy" on November 14, 2013.[8] Members received testimony from an association of franchisees, an internet company, a mobile device applications developer, a consumer group, and an academic regarding the growing problem of demand letters from PAEs.

[8] Hearing notice, background memo, and archived video of the hearing is available at http://energycommerce.house.gov/hearing/impact-patent-assertion-entities-innovation-and-economy.

V. Questions for Consideration

- Does the draft legislation appropriately exclude the legitimate patent assertion communications of companies that regularly engage in protecting their IP through the thresholds and definitions set forth in the draft?
- Is the scope of enumerated entities receiving the protections of the draft legislation appropriately defined (i.e., consumer, end user, and systems integrator)? If not, are the definitions too inclusive or too exclusive?
- Is the condition of sending such letters in a "pattern or Practice" sufficient to capture the troll behavior? If not, is it too inclusive or too exclusive?
- Are there any First Amendment implications of requiring the inclusion or exclusion of any language or disclosures in patent demand letters?
- Does the "bad faith" requirement appropriately protect legitimate or accidental patent activities from strict liability while facilitating the levying of penalties against bad actors? What would be the impact of a different standard or no standard?

Please contact Paul Nagle, Brian McCullough or Shannon Taylor of the Committee staff at (202) 225-2927 with questions.