

**PREPARED STATEMENT OF
THE FEDERAL TRADE COMMISSION**

on

Discussion Draft of Patent Demand Letter Legislation

Before the

SUBCOMMITTEE ON COMMERCE, MANUFACTURING, AND TRADE

of the

COMMITTEE ON ENERGY AND COMMERCE

UNITED STATES HOUSE OF REPRESENTATIVES

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I. Introduction

Chairman Terry, Ranking Member Schakowsky, and members of the Subcommittee, I am Lois Greisman, Associate Director of the Division of Marketing Practices at the Federal Trade Commission (“FTC” or “Commission”).¹ I appreciate the opportunity to present the Commission’s testimony on consumer protection issues involving patent demand letters, patent assertion entities (“PAEs”),² and the draft bill.

The activities of PAEs and the related issue of patent demand letters have been topics of increasing interest and concern. Last June, the Executive Office of the President reported that “suits brought by PAEs have tripled in just the last two years, rising from 29 percent of all infringement suits to 62 percent of all infringement suits,” and that this activity may have “a negative impact on innovation and economic growth.”³

The Commission is examining PAEs and patent demand letters from both a policy and an enforcement perspective. This testimony will focus on the latter, and how the draft bill might affect our enforcement efforts.

It is important to note that information about PAEs, how they operate, and their overall impact is limited, and that PAE activity may include a number of different business models.⁴

PAEs could act as efficient middlemen who increase return on investment, particularly for small and individual inventors. PAEs may also have incentives to exploit flaws in the patent system,

¹ This written statement presents the views of the Federal Trade Commission. My oral statements and responses to questions are my own and do not necessarily reflect the views of the Commission or of any Commissioner.

² By patent assertion entities, or PAEs, the Commission refers to firms with a business model based primarily on the purchase and assertion of patents, *i.e.*, firms that seek to generate revenue by licensing, or litigating against, persons who are already using the patented technology.

³ Exec. Office of the President, Patent Assertion and U.S. Innovation at 1-2 (2013), *available at* http://www.whitehouse.gov/sites/default/files/docs/patent_report.pdf.

⁴ GAO, Intellectual Property: Assessing Factors That Affect Patent Litigation Could Help Improve Patent Quality (Aug. 22, 2013), *available at* <http://www.gao.gov/assets/660/657103.pdf>.

generating a harmful tax on innovation. In September 2013, following a joint workshop with the Antitrust Division of the Department of Justice to explore the claimed harms and efficiencies of PAE activity, the FTC announced it would conduct a study to shed light on the practices of PAEs beyond litigation activity and help assess the competitive impact of PAE activity. The FTC is proceeding with this study.⁵

II. FTC Enforcement Authority and Patent Demand Letters

Concerns with patent demand letters, the subject of the draft bill, have emerged with the growth in PAE litigation activity. Although the assertion of a patent claim in itself is of course not deceptive and serves the important purpose of protecting patent rights, the Commission has followed the hearings in this Committee and others that have discussed concerns relating to certain patent demand letters. For example, letters may be sent very broadly and without prior investigation, may assert vague claims of infringement, and may be designed to obtain payments that are based more on the costs of defending litigation than on the merit of the patent claims. Commission staff have heard from businesses and their representatives that believe they have been inappropriately targeted by demand letters. And our staff have actively solicited samples of these letters to determine whether the Commission's authority over unfair or deceptive acts or practices in or affecting commerce, pursuant to Section 5 of the FTC Act, can be used to address them.

We believe that the Commission's Section 5 authority can and should be brought to bear with respect to demand letters where appropriate, as I will discuss more fully below. However, even if its authority is enhanced, the FTC will not be in a position to address the broader and complex issues that underlie many businesses' grievances regarding patent demands. These

⁵ Fed. Trade Comm'n, Notice and Request for Public Comment on PAE Activity, 79 Fed. Reg. 28,715 (May 19, 2013), *available at* <http://www.gpo.gov/fdsys/pkg/FR-2014-05-19/pdf/2014-11484.pdf>.

issues include the broad scope of many patents, the ease with which patent infringement claims can be asserted, and the cost of defending against such claims, which some businesses report as prohibitive. The Commission understands that Congress is seeking to address broader reforms to the patent system and litigation abuses in separate bills.

Although there are limits to the FTC's ability to address concerns with demand letters, the Commission can take action against unfair or deceptive conduct.⁶ Section 5(a) of the FTC Act, the Commission's main operative statute, prohibits unfair or deceptive acts or practices in or affecting commerce.⁷ A company acts deceptively if it makes materially misleading statements or omissions. A company engages in unfair acts or practices if its conduct causes or is likely to cause substantial injury to consumers that is neither reasonably avoidable by consumers nor outweighed by countervailing benefits to consumers or to competition. The Commission can obtain permanent injunctive relief and equitable monetary relief, among other remedies, in appropriate Section 5(a) cases, but cannot obtain civil penalties for violations of Section 5(a) itself.⁸

Depending on the facts, a PAE may violate Section 5 if it asserts a patent claim in circumstances where the PAE has no ownership interest in or standing to assert the patent; where the patent or the relevant statute of limitations has expired; where the patent claim would be covered by an existing license; or where the patent on its face relates to a topic obviously unrelated to the claim of infringement. A PAE also may violate Section 5 where it makes false or deceptive claims that are unrelated to the merit of its patent claims, such as false threats of

⁶ While this testimony focuses on the FTC's consumer protection authority, the Commission is also prepared to exercise its competition authority where warranted.

⁷ 15 U.S.C. § 45(a). The Commission also enforces numerous specific statutes.

⁸ The Commission can seek penalties for some other types of violations, including violations of Commission rules respecting unfair or deceptive acts or practices.

litigation.

The Commission has substantial experience in dealing with potentially deceptive representations made in connection with attempts to collect a debt, which is similar to the patent demand context in that, in both circumstances, individuals or businesses are seeking payments to which they may be legally entitled. Although some FTC defendants have argued that, if their claim for payment is legitimate, they cannot have violated the FTC Act, both the Commission and the federal courts have rejected the argument that a company may lawfully deceive a business or individual who owes, or may owe, compensation to that company.⁹

For more than fifty years, the Commission has pursued deceptive representations made in connection with an attempt to collect an allegedly owed payment. The Commission's enforcement actions have taken place both in the context of debt collection¹⁰ and in a variety of sales contexts.¹¹ These actions have included a number of cases involving false threats of legal action. Decisions in these actions have held that a false threat that legal action will be taken,¹² or that legal action will be taken imminently,¹³ may violate Section 5.

In 1977, Congress enacted the Fair Debt Collection Practices Act ("FDCPA"), which also prohibits false threats of legal action in connection with the collection of a debt. 15 U.S.C. § 1692e(5). Thus, in addition to the decisions under the FTC Act, there is a robust body of FDCPA federal case law addressing false threats of litigation and false threats of imminent

⁹ *In re Trans World Accounts, Inc.*, 90 F.T.C. 350, 399 n.7 (1977), *aff'd in relevant part*, 594 F.2d 212 (9th Cir. 1979); *Floersheim v. FTC*, 411 F.2d 874, 878 (9th Cir. 1969).

¹⁰ *E.g.*, *In re Capax*, 91 F.T.C. 1048 (1978) (debt collector); *Trans World Accounts*, 90 F.T.C. 350 (debt collector); *In re Dean S. Slough*, 70 F.T.C. 1318, 1365 (1966) (seller of debt collection letters), *aff'd*, 396 F.2d 870 (5th Cir. 1968).

¹¹ *E.g.*, *FTC v. Magazine Solutions, LLC*, No. 07-692 (W.D. Pa. Dec. 1, 2008) (magazines); *In re Sunshine Art Studios, Inc.*, 81 F.T.C. 836 (1972) (greeting cards); *In re Wilson Chem. Co.*, 64 F.T.C. 168 (1964) (salve); *In re Wm. H. Wise Co.*, 53 F.T.C. 408 (1956) (books).

¹² *E.g.*, *In re Wilson Chem. Co., Inc.*, 64 F.T.C. at 185; *In re Capax, Inc.*, 91 F.T.C. at 1104 & n.27.

¹³ *E.g.*, *In re Trans World Accounts, Inc.*, 90 F.T.C. at 397-98.

litigation.¹⁴

This enforcement experience and jurisprudence inform the way the FTC approaches potential violations of Section 5 concerning patent demands. As this Subcommittee is aware, FTC investigations are generally non-public, and the Commission does not disclose information such as the identities or alleged practices of individuals or entities under investigation. On January 13, 2014, however, MPHJ Technology Investments, LLC, a company under investigation, sued the Commission, challenging the FTC's authority to take enforcement action against it and seeking an injunction against any law enforcement efforts the agency might pursue.¹⁵ As a result, the Commission can address certain facts that MPHJ has made public through its lawsuit.

MPHJ filed, along with its complaint against the Commission, a draft of a proposed complaint that FTC staff sent to MPHJ's counsel for purposes of settlement discussions. FTC staff's draft complaint alleges that MPHJ had sent letters to thousands of small businesses located in all fifty states representing that the recipient is likely infringing certain patents by using ordinary office equipment. According to the draft complaint, these letters state that the recipients likely need to obtain a license for use of the patents at a price of either \$1,000 or \$1,200 per employee. The draft complaint further alleges that MPHJ's letters represented that substantial numbers of businesses had purchased patent licenses from MPHJ when that was not in fact the case, and that MPHJ's letters also falsely threatened imminent litigation. The Commission has moved to dismiss MPHJ's lawsuit contesting the FTC's authority in this area.

¹⁴ *E.g.*, *United States v. Nat'l Fin. Servs.*, 98 F.3d 131, 138 (4th Cir. 1996); *Crossley v. Lieberman*, 868 F.2d 566, 571 (3d Cir. 1989); *Jeter v. Credit Bureau*, 760 F.2d 1168, 1175–77 (11th Cir. 1985).

¹⁵ *MPHJ Tech. Investments, LLC v. FTC*, No. 14-11 (W.D. Tex.).

III. The Committee's Draft Bill

The Commission shares this Subcommittee's goal of stopping deceptive patent demand letters while respecting the right of patent holders to assert legitimate claims, and recognizes that achieving this goal is not easy. Although the Commission has had only limited time to consider the Committee's draft bill, there are a few observations we can share.

Despite limits on the FTC's ability to address some of the broader issues underlying the issue of patent demand letters, the Commission believes that civil penalty authority in this area is of potential benefit and may deter some bad actors.¹⁶ We appreciate that the draft bill seeks to give the FTC this authority. We note that the new scienter requirement to establish "bad faith" that the Commission would need to meet in order to obtain the civil penalties is consistent with that which already is required to obtain civil penalties under Section 5(m) of the FTC Act.¹⁷ As such, the new scienter requirement is unlikely to create new obstacles for Commission action in the context of civil penalty cases. However, because the FTC Act generally imposes no scienter requirement in non-civil penalty cases (for example, where the Commission seeks injunctive and other equitable relief), this requirement in the draft bill may present hurdles that do not exist under the FTC Act for these matters. Given these potential challenges, among other reasons, the Commission is pleased that the draft contains a "savings clause" that preserves the Commission's existing authority to seek relief other than civil penalties under its existing Section 5 authority.

¹⁶ As noted *supra* footnote 8, the Commission can currently seek civil penalties for violations of Commission rules, such as the Telemarketing Sales Rule and the Franchise Rule, and for violations of certain statutes, such as the Fair Debt Collection Practices Act.

¹⁷ 15 U.S.C. § 45(m)(1)(A).

IV. Conclusion

Thank you for this opportunity to share the Commission's views. We look forward to working with you on this important issue.