STATEMENT OF

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BEFORE THE

**COMMITTEE ON ENERGY AND COMMERCE**
Subcommittee on Commerce, Manufacturing, and Trade

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"H.R. __, a Bill to Enhance Federal and State Enforcement of Fraudulent Patent Demand Letters"

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## INTRODUCTION

Chairman Terry, Ranking Member Schakowsky, and Members of the Subcommittee:

Thank you for this opportunity to speak with you today about the draft bill prohibiting false statements and mandating disclosures in demand letters sent to alleged patent infringers.

The draft bill is directed at bad actors who engage in "bad faith communications" in asserting a patent against an alleged infringer. These communications are identified as "demand letters," and they are a long-established norm in the innovation industries as a common first step to entering into a license agreement, filing a patent infringement lawsuit, or sometimes both. Importantly, there is no single, clear definition of what constitutes a "demand letter" (a similar situation to the equally ill-defined term, "patent troll," that dominates the broader patent policy debates).[1] A classic example, though, is correspondence asserting that the recipient is infringing a patent and demanding payment of damages, a royalty for ongoing use, or both.

This bill has laudable provisions aimed at preventing bad actors from strategically exploiting demand letter practices solely to obtain nuisance settlements. Such bad actors have no real

[1] *See* Hearing on Demand Letters and Consumer Protection: Examining Deceptive Practices by Patent Assertion Entities, Senate Committee on Commerce, Science, and Transportation, Subcommittee on Consumer Protection, Product Safety, and Insurance (Nov. 7, 2013) (Prepared Testimony of Adam Mossoff), at 3-5 (discussing the various usages of this term and how it encompasses both legitimate and illegitimate behaviors by patent owners), available at http://www.commerce.senate.gov/public/?a=Files.Serve&File_id=c5cc328a-af61-4f12-bea7-e2ae6fb42ce3; Adam Mossoff, *Thomas Edison was a "Patent Troll"* SLATE (May 19, 2014), *at* http://www.slate.com/articles/technology/history_of_innovation/2014/05/thomas_edison_charles_goodyear_and_elias_howe_jr_were_patent_trolls.single.html.

interest or legal basis for going to court to obtain legitimate compensation for patent infringement, and the prohibitions in Section 2 on false or deceptive statements in demand letters thus reflect sound industry practices in the legitimate licensing and assertion of patent rights.[2] Moreover, false or deceptive statements in this context are rightly excluded from well-established First Amendment protections for the right to free speech.[3]

Yet I am concerned that overbroad legislation could sweep within its prohibitive effects legitimate licensing or assertion activities by equally legitimate patent owners. Other provisions of this bill mandating specific disclosures in demand letters and authorizing the Federal Trade Commission (FTC) to sanction violations of these disclosure requirements are troubling.[4] In particular, they likely run afoul of constitutional protections long accorded to these communications under the First Amendment.

My testimony will focus on two First Amendment concerns with the provisions of the draft bill that mandate specific disclosures in demand letters. First, these provisions likely violate the First Amendment's longstanding guarantee of the right to free speech in communicating freely and truthfully in the marketplace. Second, by burdening the legal process of taking the first steps in enforcing legitimate property rights, these mandated disclosures likely violate the right to petition secured under the First Amendment. Although bad actors should be excised from the patent system, Congress should tread carefully in considering a bill that threatens to sweep within its prohibitions and sanctions the reasonable licensing and assertion activities of legitimate patent owners.

## DEMAND LETTERS ARE PROTECTED SPEECH UNDER THE FIRST AMENDMENT

Some people assume that since demand letters could result in financial remuneration for patent owners, they are a type of commercial speech that may be heavily regulated pursuant to the First Amendment doctrines formulated by the Supreme Court.[5] This assumption is deeply mistaken. In its "compelled speech" jurisprudence under the First Amendment, the Supreme Court has historically distinguished the strength of the constitutional protection afforded to speech on the basis of whether it is noncommercial or commercial speech.[6] There is some question as to

[2] Although the bill defines as an "unfair or deceptive" trade practice within the jurisdiction of the Federal Trade Commission to sanction only statements made in "bad faith," § 2(a)(2)-(3), it expressly defines "bad faith" in terms of actual or constructive knowledge that "such representations were false." §5(1).

[3] *See* Central Hudson Gas & Elec. Corp. v. Pub. Serv. Comm'n of New York, 447 U.S. 557, 593 (1980) ("The Court similarly has recognized that false and misleading commercial speech is not entitled to any First Amendment protection.").

[4] *See* § 2(a)(4).

[5] *See* Zauderer v. Office of Disciplinary Counsel of Supreme Court of Ohio, 471 U.S. 626, 651 (1985) ("[W]e hold that an advertiser's rights are adequately protected as long as disclosure requirements are reasonably related to the State's interest in preventing deception of consumers.").

[6] *Compare* West Virginia State Bd. of Ed. v. Barnette, 319 U.S. 624 (1943) (applying a type of strict scrutiny in reviewing a state law compelling noncommercial speech) *with* Central Hudson Gas & Elec. Corp. v. Pub. Serv. Comm'n of New York, 447 U.S. 557 (1980) (applying intermediate scrutiny and developing multi-factor test for commercial speech) *and* Zauderer v. Office of Disciplinary Counsel of Supreme Court of Ohio, 471 U.S. 626 (1985) (applying rational basis standard of review for purely commercial speech).

whether this distinction is still viable today, as the Supreme Court has become more solicitous of providing strong protections for commercial speech in recent cases.[7] But even if the distinction between commercial and noncommercial speech in the Supreme Court's historical precedents were applied to the draft bill, it would still be scrutinized under a stricter constitutional standard of review and it would likely be found wanting.

A demand letter is not commercial speech because its primary function is to inform its recipient that it is infringing a property right secured under federal law. While such a communication has commercial implications, a *legal notice* is not the same thing as an *advertisement* in the marketplace. A demand letter, even if requesting payment of a royalty under a license agreement, is a critical first step to enforcing a *property right*. Without the threat of a potential lawsuit, infringers would "hold out" and continue infringing, and thus patent owners would no longer have a *right* to the patented innovation as secured to them under federal law and pursuant to the Framers' authorization to Congress in the Constitution.[8]

Also, characterizing demand letters as commercial speech conflicts with the essential nature of the American patent system. Patent rights are not commercial monopolies; to the contrary, the longstanding and unique American approach to promoting technological innovation has been to define and secure property rights in innovation.[9] As such, the claim in a demand letter asserting patent infringement is at heart a legal claim, not a commercial claim. While protecting property, especially patented innovation licensed or sold in the marketplace, has commercial implications, this does not mean that the legal act of securing this property right constitutes an act of commercial speech. In fact, the Supreme Court has repeatedly stated that an *economic motivation* for sending a communication does not by itself define it as a form of commercial speech.[10]

For this reason, demand letters do not fit the Supreme Court's definition of commercial speech. The Supreme Court has defined commercial speech as "speech which does 'no more than propose a commercial transaction.'"[11] This clearly covers the commercial speech example of an advertisement in the marketplace, but unlike an advertisement a demand letter identifies a violation of a *property right* and proposes either a legal process initiated in a federal court or a

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It should be noted that, despite these technical differences in how the speech is reviewed by the Court, in all three of these cases (*Barnette*, *Central Hudson*, and *Zauderer*), the state law was invalidated as an unconstitutional violation of the First Amendment right to free speech.

[7] *See* Sorrell v. IMS Health Inc., 131 S. Ct. 2653 (2011) (invaliding Vermont law restricting sale, disclosure, and use of records that revealed the prescribing practices of doctors as unconstitutional compelled speech under the First Amendment); *cf.* Citizens United v. Federal Elections Comm'n, 558 U.S. 310 (2010) (holding that the corporate status of a speaker does not justify suppression of political speech).

[8] *See* U.S. CONST. art. I, § 8, cl. 8.

[9] For a discussion of the constitutional and statutory protection of the property rights in innovation in the American patent system, *see* Adam Mossoff, *Patents as Constitutional Private Property: The Historical Protection of Patents under the Takings Clause*, 87 B.U. L. REV. 689 (2007); Adam Mossoff, *Who Cares What Thomas Jefferson Thought About Patents? Reevaluating the Patent "Privilege" in Historical Context*, 92 CORNELL L. REV. 953 (2007).

[10] *See* Bolger v. Youngs Drug Products Corp., 463 U.S. 60, 67 (1983) ("[T]he fact that Youngs has an economic motivation for mailing the pamphlets would clearly be insufficient by itself to turn the materials into commercial speech."); *see also* Riley v. National Federation of the Blind of North Carolina, 487 U.S. 781, 795 (1988) ("It is not clear that a professional's speech is necessarily commercial whenever it relates to that person's financial motivation for speaking.").

[11] Virginia State Bd. of Pharmacy v. Virginia Citizens Consumer Council, Inc., 425 U.S. 748, 762 (1976).

settlement of this legal claim. Accordingly, mandated disclosures in demand letters would be strictly scrutinized under the First Amendment's guarantee of the right to free speech, and like other cases involving compelled speech, they would likely be found to be constitutionally suspect.

Even if demand letters are deemed to have a mixture of both noncommercial (legal) and commercial elements, the result would be the same because the Supreme Court has held that mixed speech cases are accorded the more stringent free speech protection given the close constitutional question. As the Court explained in *Riley v. National Federation of the Blind of North Carolina*,[12] when noncommercial and commercial speech are "inextricably intertwined" in a single communication, the communication should be treated for First Amendment purposes as if it is entirely noncommercial speech.[13] This is the situation with demand letters par excellence. If a demand letter is not deemed to be a pure legal (noncommercial) expression, then a claim to legal protection of a property right against infringement with a concomitant demand for past damages or a future license is still speech that has both non-commercial and commercial elements that are "inextricably intertwined."

The Supreme Court has confirmed the significance of this fundamental insight by consistently and repeatedly invalidating laws compelling speech in a commercial context as a violation of the First Amendment.[14] In such situations, the Court has refused to apply by rote its traditional "rational basis" test for commercial regulations, and it has knowingly departed from this lax constitutional standard even when the speech expressly refers to a product sold in the marketplace.[15] This explains why, despite the ostensibly lax constitutional protection for commercial speech, the Court has trended toward a de facto rule of strict protection for free speech for all types of communications and speakers, both commercial and noncommercial.[16]

As applied to demand letters, the Court's compelled speech jurisprudence raises First Amendment concerns about the draft bill's mandatory disclosure requirements. These concerns are rooted in strong constitutional case law in which the Supreme Court has held that "the First Amendment guarantees 'freedom of speech,' a term necessarily comprising the decision of both what to say and what *not* to say."[17] Although constitutional law sometimes can be murky, the application of the "compelled speech" jurisprudence to demand letters is a case in which the Constitution speaks clearly about the protection it affords to patent owners.

[12] 487 U.S. 781 (1988).

[13] *Id.* at 796 ("[W]here, as here, the component parts of a single speech are inextricably intertwined, we cannot parcel out the speech, applying one test to one phrase and another test to another phrase. Such an endeavor would be both artificial and impractical. Therefore, we apply our test for fully protected expression.").

[14] *See* Sorrell v. IMS Health Inc., 131 S. Ct. 2653 (2011) (invaliding Vermont law restricting sale, disclosure, and use of medical records as unconstitutional compelled speech under the First Amendment); Riley v. National Federation of the Blind of North Carolina, 487 U.S. 781 (1988) (invaliding law compelling speech of professional charity organizers); Bolger v. Youngs Drug Products Corp., 463 U.S. 60, 67 (1983) (holding that an economic motivation for sending a communication does not by itself define it as a form of commercial speech); Virginia State Bd. of Pharmacy v. Virginia Citizens Consumer Council, Inc., 425 U.S. 748 (1976) (holding that a state may not suppress commercial speech regarding lawful activity and concededly true information even when it merely proposes a transaction).

[15] Bolger v. Youngs Drug Products Corp., 463 U.S. 60, 67 (1983).

[16] *See supra* note 7 and accompanying text.

[17] *Riley*, 487 U.S. at 796-97**.**

**DEMAND LETTERS ARE NECESSARILY INCIDENTAL TO THE FIRST AMENDMENT RIGHT TO PETITION**

The recognition of the essential legal nature of demand letters as protected free speech raises another equally important First Amendment issue for legislation mandating disclosures in demand letters: "the right of the people . . . to petition the Government for a redress of grievances."[18] In what is now known as the *Noerr-Pennington* doctrine, the Supreme Court has held that antitrust law cannot be used as a cudgel by which persons are precluded from exercising their constitutionally guaranteed right to seek protection of their legal rights in the courts.[19] Since the draft bill defines any violation of its provisions as an "unfair or deceptive act"[20] and expressly grants authority to the FTC to enforce its provisions,[21] it directly implicates this important constitutional doctrine at the intersection of antitrust law and the First Amendment.

As a preliminary matter, it is important to recognize that courts do not narrowly apply the *Noerr-Pennington* doctrine to cover only specific court filings, such as complaints, motions to dismiss, motions for summary judgment, etc. Instead, the *Noerr-Pennington* doctrine has been extended to protect "conduct incidental to the prosecution of the suit," such as a "decision to accept or reject an offer of settlement."[22] This makes sense, because limiting the *Noerr-Pennington* doctrine to only the specific legal documents filed in federal court would permit strategic behavior by private and public antitrust plaintiffs seeking to sanction pre-litigation conduct, thereby achieving a *de facto* suppression of a core constitutional right.[23] Thus, as one federal court recognized, "prelitigation activities . . . are protected by the *Noerr-Pennington* doctrine, . . . [which] protects a party's entitlement to act in furtherance of the First Amendment right to petition governmental authorities for redress."[24]

Unlike with the first issue of whether the mandated disclosures in the draft bill fall within the scope of protections for the right to free speech, assessing whether the *Noerr-Pennington* doctrine applies to demand letters does not require making an inference from prior case law. As a judicial doctrine, there is some variance among the courts in how far they have been willing to extend the *Noerr-Pennington* doctrine, but, in recent years, some federal courts have repeatedly held that sanctioning demand letters under the antitrust laws runs afoul of the *Noerr-Pennington* doctrine.

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[18] U.S. Const. amend. I.

[19] *See* Eastern Railroads Presidents Conference v. Noerr Motor Freight, Inc., 365 U.S. 127 (1961); United Mine Workers v. Pennington, 381 U.S. 657 (1965).

[20] § 2(a)

[21] *See* § 3.

[22] Columbia Pictures Industries, Inc. v. Professional Real Estate Investors, Inc., 944 F.2d 1525, 1528 (9th Cir. 1991); *cf. Noerr,* 365 U.S. at 143-44.

[23] This corresponds to the exact concerns and impetus for the draft bill currently under consideration by this committee; to wit, limiting the *Noerr-Pennington* doctrine to only court pleadings raises similar concerns about permitting unacceptable strategic behavior given that other bills revising patent litigation practices, such as H.R. 3309, apply only to conduct undertaken after a formal complaint has been filed in court.

[24] DirecTV, Inc. v. Lewis, 2005 WL 1006030, at *5-6 (W.D.N.Y. Apr. 29, 2005) (citing cases).

In one case involving an antitrust challenge to a patent owner sending over 100,000 demand letters to consumers, the court recognized that "restrictions on presuit demand letters may therefore raise substantial Petition Clause issues if, on examination, such restrictions could impair the right of access to the courts protected by the First Amendment."[25] The court concluded that applying the antitrust laws against the patent owner in this case violated the *Noerr-Pennington* doctrine given "the intimate relationship between presuit settlement demands and the actual litigation process."[26] Moreover, the court further held that "demand letters . . . are not 'the type of commercial activity that has traditionally had its validity determined by' the generally applicable competition or regulatory laws. To the contrary, they are the type of activity that typically arises only in the context of contemplated petitioning activity."[27] Several other federal courts have reached similar conclusions.[28]

The consistent application of the *Noerr-Pennington* doctrine in shielding legitimate demand letters from antitrust scrutiny is directly relevant to understanding the constitutional concerns about the mandated disclosure provisions in the draft bill. Since the mandated disclosure provisions are separate from the prohibition on false and misleading claims, the mandated disclosure requirements bring within the scope of federal antitrust scrutiny *all* demand letters sent by *all* patent owners. This is important for two reasons. First, the mandated disclosure requirements do not fall within the "sham litigation" exception to the *Noerr-Pennington* doctrine,[29] because the mandated disclosures necessarily apply to legitimate demand letters sent by patent owners seeking to enforce their legitimate patent rights. Second, as a logical corollary of this first point, the draft bill likely imposes an unconstitutional burden on the right to petition secured to all persons (corporate or natural) under the First Amendment.

**THE FUNCTION OF PROPERTY RIGHTS IN INNOVATION**

In addition to these fundamental constitutional concerns with the draft bill, there are important policy concerns that counsel against adopting disclosure requirements that necessarily affect all legitimate licensing or asserting of patented innovation. The significance of freely alienable and

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[25] Sosa v. DirecTV, Inc., 437 F.3d 923, 936 (9th Cir. 2006).

[26] *Id.*

[27] *Id.* (quoting Allied Tube & Conduit Co. v. Indian Head, Co., 486 U.S. 492, 505 (1988)).

[28] *See, e.g.*, Globetrotter Software, Inc. v. Elan Computer Grp., Inc., 362 F.3d 1367 (Fed. Cir. 2004) (holding that *Noerr-Pennington* shields pre-lawsuit communications such as demand letters from both state and federal competition laws); In re Innovatio IP Ventures, LLC Patent Litig., 921 F. Supp. 2d 903 (N.D. Ill. 2013) (same); DirecTV, Inc. v. Lewis, 2005 WL 1006030 (W.D.N.Y. Apr. 29, 2005) (holding that *Noerr-Pennington* shields pre-lawsuit communications such as demand letters from federal antitrust law).

Similar conclusions have been reached by courts outside of patent litigation. *See, e.g.*, McGuire Oil Co. v. Mapco, Inc., 958 F.2d 1552 (11th Cir. 1992) (holding that *Noerr-Pennington* protects threats of litigation under Alabama law); Columbia Pictures Indus., Inc. v. Professional Real Estate Investors, Inc., 944 F.2d 1525 (9th Cir. 1991) (applying *Noerr-Pennington* to settlement offer in copyright infringement case), *aff'd,* 508 U.S. 49 (1993); Barq's Inc. v. Barq's Beverages, Inc., 677 F.Supp. 449 (E.D. La. 1987) (applying *Noerr-Pennington* protection to presuit threat of trademark infringement); Coastal States Mktg., Inc. v. Hunt, 694 F.2d 1358 (5th Cir. 1983) (applying *Noerr-Pennington* to threat of litigation for conversion under state law).

[29] *See* Professional Real Estate Investors, Inc. v. Columbia Pictures Indus., Inc., 508 U.S. 49, 60 (1993). In *Sosa*, the court expressly held that the "sham litigation" exception to the *Noerr-Pennington* doctrine applies if the patent owner engages in misrepresentations or other fraudulent conduct. *See Sosa,* 437 F.3d at 939.

enforceable patent rights, whether in historical context or in today's innovation economy,[30] is that this is an essential legal mechanism to bring innovation, such as smartphones, tablets, and personalized medicine, from the lab or garage to the marketplace—and into people's everyday lives. This is what has been achieved by the federal laws and court decisions that comprise the American patent system. It is also indirectly secured by the First Amendment protections implicated by the mandated disclosure requirements in the draft bill.

[30] *See* B. Zorina Khan, *Trolls and Other Patent Inventions: Economic History and the Patent Controversies in the Twenty-First Century*, 21 GEORGE MASON LAW REVIEW 825 (2014), *available at* http://www.georgemasonlawreview.org/doc/Khan-Website-Version.pdf.; B. ZORINA KHAN, THE DEMOCRATIZATION OF INVENTION: PATENTS AND COPYRIGHTS IN AMERICAN ECONOMIC DEVELOPMENT, 1790-1920, at 67 (2005) ("Patent laws ensured the security of private property rights in invention and facilitated the development of extensive and deep markets in such rights.").