



Protecting Small and Main Street Business From Patent Trolls' Favorite Bullying Tactic

Summary of Testimony Jon Potter, President, Application Developers Alliance

Deceptive and fraudulent patent demand letters are harming America's small and Main Street businesses, our tech industry entrepreneurs, and the credibility of our world's-best patent system. Smash-and-grab patent trolls have adopted a business model of sending deceptive demand letters to bully businesses into paying licensing fees or settlements that are often tens of thousands of dollars, and more.

App developers and our Main Street business colleagues urge the Committee to legislate good-faith dealing by all patent owners when they demand licenses and communicate infringement assertions. Legitimate innovators already behave fairly, but trolls do not and so standards must be legislated. The Discussion Draft bill is a strong step in the right direction, but we urge these amendments:

- Demand letters should identify which specific patent claims are allegedly infringed (in addition to identifying the patent).
- Demand letters should document the basis of an infringement assertion, including the result of substantial investigation by the patent owner.
- The bill should not limit protections to only those who use off-the-shelf technology, which excludes creators of custom websites, apps, networks.
- The bill should not limit Federal Trade Commission authority to enforce against deceptive demand letters.

These steps will protect America's innovative startups and our Main Street businesses and restore public trust in our patent system.



Protecting Small and Main Street Business From Patent Trolls' Favorite Bullying Tactic

Testimony of Jon Potter President, Application Developers Alliance

U.S. House of Representatives Committee on Energy and Commerce
Subcommittee on Commerce, Manufacturing and Trade Hearing on:
A Bill to Enhance Federal and State Enforcement of Fraudulent Patent Demand Letters

May 22, 2014

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

Thank you for holding this hearing, and for recognizing that deceptive and fraudulent patent demand letters are harming America's small and Main Street businesses, our tech industry entrepreneurs, and the credibility of our world's-best patent system.

In support of our 30,000 individual members, our 175 corporate members, and thousands of businesses represented by our colleagues in the Main Street Patent Coalition, the Application Developers Alliance urges you to swiftly enact legislation to prohibit a favored weapon of America's patent troll bullies – fraudulent demand letters that are intentionally vague, deceptive, and baseless. The Committee's Discussion Draft bill goes a fair distance toward this goal by including modest, common sense standards that require patent assertion letters to simply identify the patent infringed, and how a product or service infringes the patent. And it does so in a manner that promotes the patent system and respects our Constitution.

Substantial research documents nearly \$30 billion dollars of annual economic loss due to patent trolls, and recent studies document incontrovertibly that abusive patent troll litigation is growing. In 2013, the House of Representatives approved legislation to reduce abusive patent litigation – which we hope the Senate will also do very soon. But today the Committee focuses on work left undone in the House bill – eliminating the extraordinary economic damage that happens before litigation, when startups and Main Street businesses are targeted by fraudulent patent troll demand letters. Today's hearing is about legislation that simply will stop fraud: fraud on small business, fraud on the American public, and fraud on the patent system.

Please understand the challenge before the Subcommittee. We are asking you to legislate honesty and good faith dealing by a class of patent owners that thrive and profit on deception, extortion and bad faith – and that rely on our expensive litigation system as their ally and ultimate hammer. These smash-and-grab trolls have adopted a business model of providing minimal information in demand letters, and then refusing to provide additional written or verbal supporting information unless the victimized business spends hundreds of thousands of dollars on lawyers and litigation.

This is not hyperbole. One patent troll sent an Alliance member a 5-page demand letter that included only three sentences describing the patents and the alleged infringement. The remaining 4+ pages threatened “full-scale litigation,” “protracted discovery” and escalating settlement demands if the letter recipient did not quickly agree to a license.

When the company dared to call the troll's lawyer to request more information about the patent, the lawyer refused to respond. He literally answered “no comment” to every question, then asked whether the business was ready to negotiate a

settlement payment, and kindly made a “one-day settlement offer” of only \$50,000. The company was left with only two choices – pay the troll or pay for lawyers. As patent litigation costs average well more than \$1 million, it is foolish for a small business to fight instead of paying the extortion tax.

Neither the App Developers Alliance nor our partners are challenging the patent licensing or enforcement practices of great American innovators like Qualcomm or DuPont. Great American innovators do not license in the manner I have described. Rather, they undertake many hours of research before asserting a patent and demanding a license. They inform the licensee of the basis of their patent demands and provide documentation, including detailed claim charts. They negotiate in good faith and seek win-win solutions and business partnerships. Great American innovators do not say “no comment” and “see you in court” when a potential licensee calls for the first time to ask about the patent and potential infringement.

Demand letters that abuse our patent system are a relatively new phenomenon, but, they are no longer unusual. A survey published by University of California Hastings Law School Professor Robin Feldman in October 2013 documented that fully one-third of startups responding to the survey had received patent demand letters. Sixty percent of those letters came from entities whose primary business is asserting and litigating patents. And when the assertions are deceptive and abusive, and when companies confident that the claim is specious are paying settlements instead of fighting, it is easy to appreciate why demand letter abuse is a growing and successful business model, why more than 40 states' attorneys general are urging federal demand-letter reform and why ten states have new laws prohibiting abusive demand letters.

I urge the Committee to appreciate the extraordinary significance when the government issues patents – in essence awarding valuable monopolies on behalf of all Americans. Patents confer extraordinary power, but should also confer important responsibilities – including honesty and good faith. Patents are similar to government grants, tax exemptions, and contracts. They are all earned and deserved by their recipients, but all come with good faith obligations imposed by Congress.

To ensure that patent owners act in good faith, and have at least a modest basis for asserting that a royalty is due, the Alliance suggests the following amendments to the Discussion Draft:

1. Demand letters should identify which specific patent claims are allegedly infringed, and not only the patent that is infringed. Claims describe each step in the patented technology or methodology and are the core components of a patent. In order to prove infringement the patent owner must prove infringement of specific claims, so it is fair to ask that the patent owner identify in the demand letter which claims have been infringed. This requirement will effectively stop the type of troll that recently sent an Alliance member a four sentence letter asserting that three patents were infringed, but not detailing which of the 58 claims the company had violated.
2. It is not enough that the bill requires a description of the infringing activity “to the extent reasonable under the circumstances.” This is an exception that will swallow the rule as every troll with a mediocre lawyer will exploit it. A demand letter that imposes extraordinary costs and hardships on the recipient should not cavalierly assert infringement without substantial investigation, and the letter should include the results of that investigation.

3. It is critical that the bill protects all victims of demand letter abuse, but the Discussion Draft oddly limits protection to only those who use off-the-shelf technology. Thus, creative agencies that build websites, apps or customized networks are excluded from the bill's protection, and only their clients are protected.
4. Ensure that the bill does not limit Federal Trade Commission authority to enforce against deceptive and unfair practices in any way whatsoever. This bill should clarify and sharpen FTC authority, but should not expand or contract its authority.

Small businesses across all industries – on Main Street, in tech, and in every state and city – face great patent abuse challenges well before litigation when they first receive a fraudulent demand letter. This is because the smallest companies cannot even afford to litigate in federal court, and the mere threat of expensive patent litigation scares off potential customers and investors.

The hardest challenge for the Subcommittee may be to require good faith and fair dealing by extortionist patent trolls without upsetting legitimate enforcement practices of great American innovators. The Discussion Draft makes progress toward threading that needle, but it does not yet effectively protect startups and Main Street businesses from the trolls I have described. Fortunately, the Discussion Draft does not harm legitimate enforcement practices; and it can be improved to strengthen protection against trolls without undermining legitimate patent owners' interests.

On behalf of the millions of small businesses of all kinds represented by the Main Street Patent Coalition, the Application Developers Alliance urges Congress to swiftly enact meaningful requirements for the form and content of demand letters, including a

requirement of honesty and fair dealing, and to pair these requirements with potent penalties for failure to satisfy them. These steps will protect America's innovative startups and our Main Street businesses, and restore public trust in our patent system.

Thank you for your consideration of our views.