



February 24, 2015

TO: Members, Subcommittee on Commerce, Manufacturing, and Trade

FROM: Committee Majority Staff

RE: Hearing entitled “Update: Patent Demand Letter Practices and Solutions”

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## I. INTRODUCTION

On Thursday, February 26, 2015, at 10:15 a.m. in 2322 Rayburn House Office Building, the Subcommittee on Commerce, Manufacturing, and Trade will hold a hearing entitled “Update: Patent Demand Letter Practices and Solutions.”

## II. WITNESSES

- Vince Malta, Liaison for Law & Policy, National Association of REALTORS;
- Paul Gugliuzza, Associate Professor, Boston University School of Law;
- Laurie Self, Vice President and Counsel, Government Affairs, Qualcomm; and,
- Vera Ranieri, Staff Attorney, Electronic Frontier Foundation

## III. BACKGROUND

### A. *CMT Subcommittee Activity*

The Subcommittee took up the issue of patent demand letters in the 113th Congress. On April 8, 2014, the Subcommittee held a hearing entitled “Trolling for a Solution: Ending Abusive Patent Demand Letters.” Witnesses included representatives of the American Bankers Association, Cisco Systems Incorporated, UNeMed Corporation, New York University School of Law, Coalition for 21st Century Patent Reform, and the State of Vermont.

On May 22, 2014, the Subcommittee held a legislative hearing to consider draft legislation entitled “H.R. \_\_\_\_, a Bill to Enhance Federal and State Enforcement of Fraudulent Patent Demand Letters.” Witnesses included Rep. Tom Marino and Rep. Jared Polis, as well as representatives from Stop Patent Abuse Now Coalition, the Federal Trade Commission, the State of Vermont, George Mason University School of Law, Application Developers Alliance, and Qualcomm.

On July 9, 2014, the Subcommittee held a markup including draft legislation authorizing the Federal Trade Commission (FTC) and State attorneys general to bring enforcement actions against patent owners engaging in a pattern of sending patent demand letters making false

statements or omissions in bad faith. The draft legislation was forwarded to the full Committee, as amended, by a vote of 13 – 6.

B. *Abusive Demand Letters*

Much like other schemes to defraud, abusive behavior by patent trolls often appears authentic. Indeed, patent trolls' success is dependent largely on the perceived legitimacy of claims made in communications to unsuspecting businesses and individuals. These communications can be difficult to differentiate from legitimate communications—demand letters—that inform others of an entity's patent rights or are meant to open cordial cross-licensing discussions. This hearing focuses particularly on the practice of sending demand letters on a large scale that contain lies, misrepresentations, or omissions in order to extract unjustified payments from businesses and individuals.

The relative lack of expertise many businesses have in patent matters gives patent trolls an advantage. This “expertise asymmetry” has helped create an opportunity for a pernicious business model, whereby a patent holder sends hundreds or thousands of demand letters at once in order to scare letter recipients into paying the patent holder.<sup>1</sup> Such activity has imposed serious costs, although attempts to quantify the impact have not been separated from analyses of broader patent enforcement activity.<sup>2</sup> By asking letter recipients for amounts well below the costs of litigation and slightly below the cost of hiring a patent attorney, patent trolls are able to induce businesses to pay “license fees” in return for the troll ceasing its harassment. These bad actors typically target small businesses, including coffee shops, realtors, restaurateurs, grocers, community banks, and hoteliers—many of which have no reason to employ patent counsel on a full-time basis. Abusive demand letters often make vague claims of patent infringement and demand payment of a relatively small amount within a short timeframe for a “license” to continue using the technology at issue, or else the patent holder will sue.<sup>3</sup>

The most well-known instance of abusive demand letters is a campaign by MPHJ, which sent over 16,000 initial demand letters to businesses in all fifty States from 71 different subsidiaries.<sup>4</sup> The case illustrates the kind of scheme that has generated the majority of complaints to the subcommittee. The MPHJ letters alleged that one or more patents in the MPHJ Portfolio covered claims “directed to a system having a digital copier/scanner/multifunction

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<sup>1</sup> Mark A. Lemley and Douglas Melamed, *Missing the Forest for the Trolls*, 113 COLUM. L.REV. 2117, 2126 (2013) (“a growing number of trolls are interested in quick, low-value settlements for a variety of patents . . . We call this group “bottom-feeder” trolls.”).

<sup>2</sup> See, e.g. Michael J. Meurer and James E. Bessen, *The Direct Costs from NPE Disputes*, 99 Cornell L. Rev. 387 (2014), available at <http://cornelllawreview.org/files/2014/01/99CLR387.pdf>; Lauren Cohen, Umit Gurun, and Scott Duke Kominers, *Patent Trolls: Evidence from Targeted Firms* (Aug. 2014) (finding that in cases where defendants have lost to non-practicing entities in court, those defendants subsequently spent an average of \$211 million less on research and development).

<sup>3</sup> For examples of such demand letters, see MPHJ's letter campaign, attached to its settlement with the New York Attorney General, Exhibit A at <http://www.ag.ny.gov/pdfs/FINALAODMPHJ.pdf>.

<sup>4</sup> See MPHJ Technology Investments, LLC, Fed. Trade Comm'n, Proposed Consent Agreement (adopted Nov. 6, 2014), available at <http://www.ftc.gov/system/files/documents/cases/141106mphjagree.pdf>.

device with an interface to office equipment . . . .”<sup>5</sup> Many of the letters claimed MPHJ had licensed certain patents to “many companies,” but at the time of the representations, only one or no licenses had been sold.<sup>6</sup> MPHJ sent over 10,000 follow-up letters and 5,000 third-round letters, including implied or express representations that MPHJ would sue if no response was received. The third-round letters included a copy of an infringement complaint.<sup>7</sup>

It can be difficult, however, to differentiate between the bad behavior of patent trolls and legitimate communications. Some entities with significant patent holdings worry about the impact of any legislation on normal business correspondence or efforts to market or license patents. In addition, there are firms that seek to help small inventors and universities ensure that their rights are enforced.<sup>8</sup>

### C. Legal Issues

There are two legal issues that are raised frequently in discussions about how to address the problems caused by abusive demand letters. Some argue that the First Amendment may have serious implications for attempts to regulate patent owners’ speech in demand letters. Federal courts’ interpretation of the First Amendment right to petition the government is embodied in a line of cases referred to as *Noerr-Pennington*, after two of the most notable and oldest cases developing the doctrine.<sup>9</sup> Petitioning the government has been further interpreted to include communications notifying others of a person’s patent rights, because these communications precede litigation of those rights in a court setting.<sup>10</sup> As a result, some argue that patent demand letters are constitutionally protected.

Parallel to the *Noerr-Pennington* cases, the Federal Circuit—which has exclusive appellate jurisdiction over patent cases—has developed doctrine holding that the Federal Patent Act preempts State enforcement actions against patent assertion activities unless those activities are “objectively baseless” and done in bad faith.<sup>11</sup> The Federal Circuit’s preemption test is similar to—and in part derived from—the *Noerr-Pennington* requirements,<sup>12</sup> which protect patent assertions from any form of liability unless they constitute “sham” litigation.<sup>13</sup> The

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<sup>5</sup> See Investigation by Eric T. Schneiderman, Attorney General of the State of New York, of MPHJ Technology Investments, LLC, Exhibit A, [Attachment A-1], at <http://www.ag.ny.gov/pdfs/FINALAODMPHJ.pdf>.

<sup>6</sup> See Federal Trade Commission, Draft Complaint, MPHJ Technology Investments, LLC, at paras. 32, 33, available at <http://www.ftc.gov/system/files/documents/cases/141106mphjcmpt.pdf>.

<sup>7</sup> *Id.* at paras. 18 – 24.

<sup>8</sup> Universities often develop and patent their innovations, but do not monetize – or “practice” – the technology, process, or invention that is the subject of the patent. University of Nebraska, for example, develops patentable inventions and then sells the rights to its inventions through a non-practicing entity called UNeMed: <http://www.unemed.com/about-us>.

<sup>9</sup> *Eastern Railroad Presidents Conf. v. Noerr Motor Freight, Inc.* 365 U.S. 127 (1961); *United Mine Workers v. Pennington*, 381 U.S. 657 (1965).

<sup>10</sup> *Sosa v. DirecTV, Inc.*, 437 F.3d 923 (9th Cir. 2006); *McGuire Oil Co. v. Mapco., Inc.*, 958 F.2d 1552 (11th Cir. 1992).

<sup>11</sup> *Globetrotter Software, Inc. v. Elan Computer Grp., Inc.*, 362 F.3d 1367, 1377 (Fed. Cir. 2004), available at <http://openjurist.org/362/f3d/1367/globetrotter-software-inc-v-elan-computer-group-inc>.

<sup>12</sup> *Id.* at 1337 (para. 47).

<sup>13</sup> *Sosa v. DirecTV, Inc.*, 437 F.3d at 932.

resulting legal landscape creates uncertainty as to what kinds of State—or Federal—regulatory activity around patent demand letters is constitutionally permissible.

*D. Federal Activity*

The Federal Trade Commission conducted an extensive investigation of MPHJ’s activity and eventually adopted a proposed consent order on November 6, 2014. The order bars MPHJ from further false or unsubstantiated representations about the licenses it has sold, and prohibits representations that MPHJ will initiate a lawsuit unless they “have decided to take such action and possess competent and reliable evidence sufficient to substantiate that they are prepared and able to do so.”<sup>14</sup> Under current law, the FTC’s enforcement authority is limited to injunctions, along with the authority to obtain civil penalties for violations of injunctions or consent orders.

Aside from its MPHJ consent decree, the FTC also began a study of Patent Assertion Entity (PAE) activity to determine where abuse is occurring in the market in October 2013. Under its §6(b) authority, the FTC is compelling information from PAEs regarding patent acquisition, rights assertion, licensing, and litigation practices, along with a comparison of those activities with those of other patent owners.<sup>15</sup> The study eventually will result in a report on the FTC’s findings.

*E. State Activity*

In addition to the Federal activity around patent trolls, eighteen States have enacted different laws seeking to protect consumers and businesses from abusive patent demand letters.<sup>16</sup> Several State attorneys general have also brought enforcement actions against patent holders for abusive demand letters.<sup>17</sup> The Vermont Attorney General’s case is proceeding in State court,<sup>18</sup> but the Nebraska Attorney General’s case was removed to Federal court and dismissed on several grounds, including the First Amendment.<sup>19</sup>

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<sup>14</sup> MPHJ Technology Investments, LLC, Fed. Trade Comm’n, Proposed Consent Agreement, at 5 (adopted Nov. 6, 2014), available at <http://www.ftc.gov/system/files/documents/cases/141106mphjagree.pdf>.

<sup>15</sup> 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>.

<sup>16</sup> Alabama, Georgia, Idaho, Illinois, Louisiana, Maine, Maryland, Missouri, New Hampshire, North Carolina, Oklahoma, Oregon, South Dakota, Tennessee, Utah, Vermont, Virginia, and Wisconsin.

<sup>17</sup> For example, Nebraska, Vermont, and Minnesota have each brought suits under consumer protection laws against abusive demand letter activity.

<sup>18</sup> See VTD Staff, “Federal Judge Rules for Vermont Again in Patent Troll Venue Case” (Jan. 14, 2015), available at <http://vtdigger.org/2015/01/14/federal-judge-rules-vermont-patent-troll-venue-case/>.

<sup>19</sup> Order on Preliminary Injunction, MPHJ Technology Investments LLC v. Pinnacle Bancorp, Inc., and Jon Bruning, Attorney General of Nebraska (Jan. 14, 2014), available at <http://www.essentialpatentblog.com/wp-content/uploads/sites/234/2014/01/2014.01.14-111-Order-on-PI.pdf>.

#### **IV. ISSUES**

The following issues may be examined at the hearing:

- *The scope of the problem.* The witnesses will help delineate what kinds of activities have been harmful and which types of activities are commonly thought of as good faith patent assertion.
- *Suppressing bad behavior and preserving efficient behavior.* The witnesses will help Subcommittee members understand how policy responses have impacted and could impact legitimate, as well as abusive behavior.
- *State of the law.* The witnesses will provide thoughts on the impacts of Federal courts' interpretation of the First Amendment and preemption on State efforts thus far, as well as the implications of these legal developments for our Subcommittee in drafting legislation.

#### **V. STAFF CONTACTS**

If you have any questions regarding this hearing, please contact Paul Nagle or Graham Dufault of the Committee staff at (202) 225-2927.