



April 14, 2015

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

FROM: Committee Majority Staff

RE: Hearing entitled “H.R. ____, Targeting Rogue and Opaque Letters (TROL) Act”

I. INTRODUCTION

On Thursday, April 16, 2015, at 11:00 a.m. in 2123 Rayburn House Office Building, the Subcommittee on Commerce, Manufacturing, and Trade will hold a hearing entitled “H.R. ____, Targeting Rogue and Opaque Letters (TROL) Act.” The hearing will examine the discussion draft and provide stakeholders the opportunity to provide input on how the discussion draft can be improved further to protect recipients of abusive patent demand letters and maintain the property rights of legitimate patent holders.

II. WITNESSES

- David W. Long, Partner, Kelley Drye, *on behalf of* Innovation Alliance;
- Gregory Dolin, Associate Professor of Law, Baltimore University School of Law;
- Diane Lettelleir, Senior Managing Counsel, Litigation, J.C. Penney Corporation, Inc., *on behalf of* United for Patent Reform; and,
- Charles Duan, Director, Patent Reform Project, Public Knowledge.

III. BACKGROUND

A. Abusive Demand Letters

Abusive behavior by patent trolls often appears authentic. 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 cross-licensing discussions. The Targeting Rogue and Opaque Letters (TROL) Act focuses particularly on the practice of sending demand letters on a large scale that contain lies, misrepresentations, or purposeful 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.¹ Such activity has imposed serious costs, although attempts to quantify the impact have not been separated from analyses of broader patent enforcement activity.²

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 whom 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.³

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 seventy one different subsidiaries.⁴ The case illustrates the kind of scheme that has generated the majority of complaints to the subcommittee. 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.⁵

B. Legal Issues

Two legal issues 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

¹ 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.”).

² 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).

³ 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>.

⁴ 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>.

⁵ 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>.

the doctrine.⁶ Petitioning the government has been interpreted further to include communications notifying others of a person's patent rights, because these communications precede litigation of those rights in a court setting.⁷ 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 cases⁸—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.⁹ The Federal Circuit's preemption test is similar to—and in part derived from—the *Noerr-Pennington* requirements,¹⁰ which protect patent assertions from any form of liability unless they constitute “sham” litigation.¹¹ The resulting legal landscape creates uncertainty as to what kinds of State—or Federal—regulatory or enforcement activity around patent demand letters is constitutionally permissible.

C. Federal Activity

The Federal Trade Commission (FTC) 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 it has “decided to take such action and possess competent and reliable evidence sufficient to substantiate that they are prepared and able to do so.”¹² 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.¹³ The study eventually will result in a report on the

⁶ *Eastern Railroad Presidents Conf. v. Noerr Motor Freight, Inc.*, 365 U.S. 127 (1961); *United Mine Workers v. Pennington*, 381 U.S. 657 (1965).

⁷ *Sosa v. DirecTV, Inc.*, 437 F.3d 923 (9th Cir. 2006); *McGuire Oil Co. v. Mapco., Inc.*, 958 F.2d 1552 (11th Cir. 1992).

⁸ 28 U.S.C. 1295(a) (“The United States Court of Appeals for the Federal Circuit shall have exclusive jurisdiction . . . of an appeal from a final decision of a district court of the United States . . . in any civil action arising under, or in any civil action in which a party has asserted a compulsory counterclaim arising under, any Act of Congress relating to patents . . .”).

⁹ *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>.

¹⁰ *Id.* at 1337 (para. 47).

¹¹ *Sosa v. DirecTV, Inc.*, 437 F.3d at 932.

¹² 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>.

¹³ 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>.

FTC's findings.

D. 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.¹⁴ Several State attorneys general also have brought enforcement actions against patent holders for abusive demand letters.¹⁵ The Vermont Attorney General's case is proceeding in State court,¹⁶ but the Nebraska Attorney General's case was removed to Federal court and dismissed on several grounds, including the First Amendment.¹⁷

IV. SECTION-BY-SECTION

Section 1. Short Title.

This Act may be cited as the "Targeting Rogue and Opaque Letters (TROL) Act."

Section 2. Unfair or Deceptive Acts or Practices in Connection with the Assertion of a United States Patent.

This section 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 if the communications, in bad faith, include any of the twelve prohibited elements enumerated in paragraphs (1) or (2), or fail to include any of the five elements enumerated in paragraph (3). Section 2 also sets forth an affirmative defense that statements, representations, or omissions were not made in bad faith if the sender can demonstrate that such statements, representations, or omissions were mistakes, including by evidence that the sender does not send letters in violation of this Act in the usual course of business.

Section 3. Enforcement by Federal Trade Commission.

Section 3 establishes that a violation of section 2 shall be treated as a violation of a rule defining an unfair or deceptive act or practice prescribed under the FTC Act. This enables the FTC to seek civil penalties for violations; whereas, under its current authority, it could only seek an injunction against a sender of an unfair or deceptive demand letter. Essentially, the bill gives the FTC a "fast track" to obtain civil penalties in demand letter cases. Section 3 also clarifies that the FTC's existing powers and enforcement authority are preserved.

¹⁴ Alabama, Georgia, Idaho, Illinois, Louisiana, Maine, Maryland, Missouri, New Hampshire, North Carolina, Oklahoma, Oregon, South Dakota, Tennessee, Utah, Vermont, Virginia, and Wisconsin.

¹⁵ For example, Nebraska, Vermont, and Minnesota each have brought suits under consumer protection laws against abusive demand letter activity.

¹⁶ 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/>.

¹⁷ See 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://docs.justia.com/cases/federal/district-courts/nebraska/nedce/8:2013cv00215/63465/111>.

Section 4. Preemption of State Laws on Patent Demand Letters and Enforcement by State Attorneys General.

Section 4 preempts State laws, rules, regulations, standards, and other provisions having the effect of law expressly relating to the transmission or contents of patent demand letters, while preserving other State laws of general applicability, such as the State consumer protection laws of general applicability. Section 4 also permits State Attorneys General to enforce the Act and to seek civil penalties for violations. Section 4 requires the attorney general of a State to provide the FTC with prior written notice of any action taken to enforce the law and also provides the FTC authority to intervene in the action. It further provides that no State action may be brought if the FTC has a civil action pending against any named defendant.

Section 5. Definitions.

Section 5 defines certain terms used throughout the draft legislation, including “bad faith” as it pertains to the representations or omissions enumerated in section 2.

V. ISSUES

The following issues may be examined at the hearing:

- How can the draft legislation be amended to ease the FTC’s enforcement burden in cases where a sender of a demand letter has omitted key information enumerated in the draft legislation?
- How can the affirmative defense be altered to ease the FTC’s enforcement burden?
- What are the most desired changes to the draft legislation?
- What are the most important provisions to remain in the draft legislation?

VI. 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.