Testimony of Charles Duan
Director, Patent Reform Project
Public Knowledge

Before the
U.S. House of Representatives
Committee on Energy and Commerce
Subcommittee on Oversight and Investigations

Hearing on
The Impact of Patent Assertion Entities
on Innovation and the Economy

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Chairman Murphy, Ranking Member DeGette, and members of the Subcommittee: thank you for holding this hearing and inviting me to testify today on this important issue. My name is Charles Duan, and I am the Director of the Patent Reform Project at Public Knowledge.

Public Knowledge is a nonprofit public interest organization whose primary mission is to promote technological innovation, protect the rights of all users of technology, and ensure that emerging issues of technology law, including patent law, serve the public interest.

By way of background, prior to taking on my current position at Public Knowledge, I was a practicing patent attorney, where I prosecuted over a hundred patent applications before the U.S. Patent and Trademark Office, and litigated dozens of patent cases. Many of my clients were small businesses who had received demand letters or threats of litigation of the sort we will be discussing in this hearing today. Prior to this, I was a software developer at a Silicon Valley startup, where we built a system for facilitating collaboration among science researchers. As a result of these and other activities, I have had experience both with the intricacies of patent law and with the practicalities of running a small technology business.

I. Patents Should Serve the Public Interest, But They Are Often Abused in Ways that Disserve the Public Interest

As members of the Committee are certainly aware, patent assertion entities, especially in their use of demand letters, affect small business in particular and the
innovation economy in general. To begin, it is worth starting at the beginning, with the fundamental basis for patents.

The patent system exists for a utilitarian purpose: to encourage invention and the creation of new technologies, and to ensure that those inventions and those technologies are available to all. This principle is enshrined in our very Constitution, which grants Congress the power to award patents, not for any reason, but specifically to “promote the Progress of Science and the useful Arts.”¹ Numerous commentators have observed that the grant of a patent is a bargain: in exchange for receiving the temporary monopoly on an invention that a patent affords, the inventor must reveal the inner workings of that invention, so that the public may learn from it and recreate it themselves.² Our patent system, ultimately, must serve the public interest.

A patent system that worked this way, spurring information and disseminating knowledge while protecting small inventors, would be admirable and worthy of commendation. And in many areas our patent system does indeed work in this way. But far too often, scheming speculators and clever lawyers find ways to abuse patents, to profit off of the system while detracting from the social good.

The most egregious among these abusers are often what are called “patent assertion entities,” or more colloquially, “patent trolls,” because their business models focus on purchasing and asserting patents, rather than producing products or offer services.³ Patent assertion entities argue that their patents are a property right with which they may do as they please regardless of the public interest, but their argument ignores the fundamental fact that patents must serve the public interest. It is the task of this Committee, of this government, and this society to

¹ U.S. Const. art. 1, § 8, cl. 8.
² See, e.g., Mark A. Lemley, The Economics of Improvement in Intellectual Property, 75 Tex. L. Rev. 989, 993 (“Intellectual property is fundamentally about incentives to invent and create.”).
discover, expose, and eliminate abuses of the patent system that only enrich the few
to the detriment of the many.

II. Patent Demand Letters Are an Easily and Often Abused Aspect of the
Patent System

The patent demand letter, where a patent assertion entity springs a possible
patent infringement lawsuit on an unsuspecting business or individual and
demands a settlement, is one such area ripe for, and rife with, abuse. Throughout
the halls of Congress we have heard the sustained laments of small, innovative
businesses that have fallen victim to this extortative practice.\(^4\) A survey of
technology entrepreneurs from Silicon Valley found that companies who had
received such letters were forced to lay off employees, throw away products, or even
close up shop in the face of these threats.\(^5\)

It is simply inconceivable that the value of the patents being asserted
outweighs the destruction of small businesses, widely recognized to be the engine of
our economy. And this is borne out by the facts: when these sorts of patents are
actually taken to court, almost 90% of them are losers.\(^6\)

Demand letter abusers succeed because they take advantage of two

\(^4\) E.g., Kate Tummarello, Trade Groups Ask Congress to Tackle Patent Demand
groups-ask-congress-to-tackle-patent-demand-letters.

\(^5\) Colleen V. Chien, New Am. Found., Patent Assertion and Startup Innovation 16-17
& fig. 3 (2013), http://newamerica.net/sites/newamerica.net/files/policydocs/Patent
%20Assertion%20and%20Startup%20Innovation.pdf (“[A] significant portion of
respondents...reported at least one significant operational impact from the
assertions: a delay in hiring or other milestone, change in product, business pivot,
exit, or loss of customers or revenue.”).

\(^6\) See John R. Allison et al., Patent Quality and Settlement Among Repeat Patent
A. Demand Letters Can Be Vague, Misleading, and Deceptive

First, because there is no requirement as to the content of a demand letter, they can be written to be threateningly intimidating and yet wholly uninformative. Oftentimes they list patent numbers and describe the patents in detail, but fail to explain what aspect of the patents are allegedly infringed. In some cases, the demand letter fails to even identify what products infringe the patent, leaving the targeted business in the Kafkaesque position of being accused of a wrong without knowing what wrong has been alleged.

Numerous examples of such vague, uninformative demand letters can be found. For example, the patent assertion entity MPHJ Technologies, who claims to hold patents on basic scanning technology, has sent out numerous demand letters to businesses. Those letters do not identify what products of these businesses infringe MPHJ’s patents. Those letters do not even allege that the businesses infringe MPHJ’s patents at all. Instead, they provide a checklist of possibly infringing technologies. Indeed, the letters evince no knowledge about the targeted company at all; the basis for the threat is that “a substantial majority of companies like yours utilize systems” that MPHJ claims infringe.

Worse yet, there is no requirement that the content of a demand letter be even truthful. Some demand letters contain plain falsehoods and deceptions, intended only to stoke fear where there is no legitimate claim. An example from my time as a patent attorney comes to mind. We represented a client who ran a small e-commerce website, and who had received a demand letter claiming that his website infringed a patent. The client ordinarily would not have been able to afford to pay our law firm to analyze the letter and the patents at issue, but we did so as a favor. When we looked into prior litigation over the patent, we discovered to our surprise

8 Id. at 3.
that the patent had been invalidated in court. The sender of the letter, apparently, was betting that his targets would pay the settlements and never find out that the patents being asserted were actually worthless.

Thus, by sending demand letters with vague, misleading, or outright false statements, abusers of the patent system are able to threaten small businesses and erode our innovation economy, with no benefit other than to their own personal pocketbooks.

B. Small Businesses Often Lack the Resources to Defend Themselves Against Even Illegitimate Demand Letters

The second technique that allows demand letter abusers to succeed is sending letters to small, unprepared businesses. When a business receives a demand letter, it must weigh the demanded settlement amount, on the one hand, against the costs of fighting a lawsuit and the risk of loss, on the other.

For a large technology company, this is an ordinary calculation in the course of doing business. The company likely has a law firm on retainer, dedicated in-house counsel, and experience in previous patent cases. It can afford to analyze the patent, assess its validity and the claims of infringement, determine the risks of litigation, and make an informed decision on how to proceed.

A small business cannot afford to do any of these. The cost to hire attorneys simply to review the patents at issue can far outstrip the finances of a small technology startup. At the startup that I worked at, we ran our entire operation off of a few hundred thousand dollars of angel investments. As a patent attorney, it was not unreasonable to charge a hundred thousand for a detailed analysis of several patents. Attorney fees for full-blown litigation can cost in the millions.\textsuperscript{9} These are simply not amounts that a small company, focusing its energy and

resources on building a competitive, innovative product, can drop every time it receives a threatening letter.

Furthermore, demand letters are being sent to those outside the technology sector. Retailers, restaurants, advertising agencies, real estate brokers, and all sorts of industries have started seeing patent demand letters in their mailboxes. These parties lack the experience necessary to make informed decisions about how to respond to such demand letters, and the abusers of the system take advantage of this naïveté to extract undue settlements.

C. Because Demand Letters Are Privately Sent, There Is a Dearth of Information About Their Use and Abuse

It is at this point that I would ordinarily recite statistics on the number of demand letters sent per year, the industries receiving them, the average settlement demands, and so on. Unfortunately this is not possible, because those statistics do not exist.

Demand letters are sent in private. The senders of the letters often have no desire to make their campaigns known, perhaps for fear of being exposed for their actions, perhaps to aid in their deception of victims. Some letter senders even build up facades of shell companies, thus further concealing their identities from scrutiny.

Of course, we know of the big examples of patent assertion entities, companies like Intellectual Ventures and Acacia, demand letter senders like Innovatio and MPHJ, the repeat players and public faces of this industry. We certainly can investigate them, and indeed the FTC has already announced its intention to investigate them using a § 6(b) study. But for every one of those big names, there are potentially dozens or hundreds of smaller ones, owners of a handful of patents on a specific technology who use those patents to threaten unknown numbers of companies. These patent assertion entities can be large enough to stifle valuable industries, yet small enough to fly under the radar of government oversight.

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Consider the case of a company called Activision TV, a corporation in Florida that owns patents that purport to cover all sorts of digital signage, who has been sending out demand letters since at least August 2012. Activision’s demand letter activities fit perfectly in the framework I have laid out so far. They target small businesses that are mere consumers of technology, such as grocery stores, banks, movie theaters, and jewelry stores. The demand letters they send are some of the least informative, failing to identify any particular devices accused of infringement but rather generalizing that “Activision has learned that your organization uses remote control digital signage technology and/or related products.” Activision thus exemplifies the abuses of patent demand letters that we are discussing today.

Activision gained notoriety in the last few months, when it sued the Attorney General of Nebraska, Jon Bruning, to prevent him from intervening in Activision’s demand letter campaign. But prior to Mr. Bruning’s intervention, Activision was essentially unknown to the media, to policymakers, and even to Mr. Bruning himself, who apparently had intended to intervene in a different patent assertor’s case. Stories like Activision’s often go unnoticed, and companies like Activision can pursue their demand letter strategies unchecked and unregulated.

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11 Activision TV is not related to the video game company named Activision.
The letter recipients also are not likely to reveal the threats against them. For one thing, those that are forced to accept settlements are often also forced to accept nondisclosure agreements. Also, victims of patent demand letters have a legitimate fear of being revictimized by other patent holders, and so naturally are reluctant to publicize their involvement in receiving the demand letter.

As a result, all we have to work with right now are intuitions and anecdotes. We must commend those efforts, like the Electronic Frontier Foundation’s Trolling Effects site, the actions of state attorneys general in Nebraska, Minnesota, Vermont, and Massachusetts, the tireless research of journalists and academics, and the bravery of the few companies who have come forward with their stories and taken their stands. These efforts have given us valuable information on the scope of demand letter abuses and what they have caused.

But we should not be satisfied with these few stories. As a body that constructs policy based on evidence, Congress should be unsatisfied with this situation, where all the evidence points to substantial harm to the public interest occurring but where hard data is lacking. The first step to addressing demand letter abuses must be to investigate and discover those demand letter abuses in a comprehensive, systematic fashion.

III. The Public Has an Interest in Knowing About and Combatting Abusive Demand Letters

What is needed, to investigate and discover those demand letter abuses, is comprehensive information about demand letters themselves. This information comes in two forms, which translate to two legislative proposals. First, information about demand letter campaigns should be publicly disclosed, to guarantee transparency about the demand letter economy and inform the public about those who send such letters. Second, demand letters should themselves contain truthful disclosures, to prevent deception and provide fair notice to recipients of such letters.

Google News for “Activision TV” reveals no relevant articles other than those mentioning the lawsuit with Mr. Bruning.
Addressing these proposals should be the domain of Congress and relevant agencies. The Federal Trade Commission (FTC) has expertise in developing consumer protection rules, and the U.S. Patent and Trademark Office (USPTO) has expertise in administering the details of patent law, so it is appropriate for both to be involved in solving demand letter abuses. But as explained previously, those abuses are too wide-ranging to be solved by those agencies alone; Congress must establish the framework for such solutions. I offer two proposals that Public Knowledge supports to accomplish these needed protections of the public interest.

A. Proposal: Transparency Would Reveal Information About the Demand Letter Economy that Would Be Useful to Letter Recipients, Businesses, and the Public

First, we propose a transparency requirement, namely that Congress should mandate that, upon meeting certain threshold requirements, senders of demand letters must publicly reveal certain information about themselves and about their demand letter campaigns. At a minimum, they should identify:

- *The patents being asserted and proof of ownership of the patents.* This avoids situations where the sender of the demand letter asserts a patent that it does not even own.
- *The true entity asserting those patents.* This ensures that demand letter senders cannot use shell corporations and other such tactics to hide their identities from public scrutiny or mask the size of their campaigns.
- *Any litigation or proceedings involving the patents.* Among other things, this would deter situations like the one I related above where a patent owner was sending demand letters on an invalidated patent.
- *The number of demand letters being sent.* This would inform the public as to the size of various demand letter campaigns.

Furthermore, the USPTO should establish a searchable database of this and other collected information, so that letter recipients, related businesses, researchers, and the public can have transparent access to the disclosed information.
This transparency information about both patent assertion entities and the demand letters they send would be helpful for everyone, including individual consumers, small businesses, policymakers, and the public. Individuals and small businesses would benefit by being able to understand much more fully what they actually face when presented with a demand letter. Negotiation would occur on a much more level playing field. Those not targeted by demand letters would also better understand how to identify and work around patents and, thus, potentially avoid unnecessary and costly lawsuits. Finally, if patent assertion entities must publicly disclose information like the number of demand letters they send, ultimately they may even send fewer abusive demand letters to the economically vulnerable on the weakest of claims. Patent assertion entities that are currently taking a shotgun approach of demand first, investigate later, might select their cases more judiciously, thus reducing the prevalence of abusive demand letters.

Those interested in patent, competition, and consumer protection policy would likewise find the information useful. At a workshop exploring the impact of patent assertion entity activity on innovation and competition, the FTC recently noted that panelists and commenters identified potential harms but lacked empirical data that could enrich the debate regarding PAE activities. Quality empirical data provided by demand letter transparency would thus empower various parts of the government, including the FTC, USPTO, the International Trade Commission, and the Executive Office of the President, to formulate sounder policies to preserve competition and protect consumers. Groups outside of government, too, would be more able to pinpoint accurately the problems with demand letter campaigns and suggest solutions tailored to protecting consumers while preserving a competitive and vibrant innovation economy.

Accordingly, demand letter transparency would have wide-ranging benefits, and we urge Congress to consider legislative proposals for such transparency.

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B. Proposal: Truth in Demand Letters Would Give Fair Notice to Letter Recipients and Deter Many Abuses

In addition to requiring transparency of demand letter campaigns to create a database of demand letter information, Congress should mandate, or authorize the FTC to mandate, that demand letters include certain minimum disclosures within the text of the letters themselves. Currently, demand letters can contain a great deal of bluster and intimidation, without any useful substance. A small company receiving such a letter often cannot afford to hire a lawyer to evaluate the letter’s merits, and the weight of the threats may force that small company to pay an unjustified settlement fee. Abusers of the patent system are free to issue demand letters that conceal information, misrepresent the facts, and even outright deceive.

Congress would be justified in taking such actions in the same way that it has repeatedly been justified in taking actions against deceptive advertising and marketing practices in the past. Indeed, upon consideration one must realize that a demand letter, in essence, is simply an advertisement for a sort of product, namely a patent license. Just as Congress has demanded truth in advertising and truth in lending, Congress should demand truth in patent demand letters.

The purpose of such a mandate would be to provide fair notice to recipients of demand letters, particularly those unfamiliar with the intricacies of patent law, so that those recipients can adequately evaluate their options and make informed decisions. Such information should include:

- A link or reference to the USPTO’s website on how to respond to demand letters\textsuperscript{17}
- The specific patents, and specific claims of those patents, that are being asserted (and not a laundry list of possibly relevant patents or claims)

\textsuperscript{17} This website was ordered to be built by a Presidential Executive Action. See Press Release, \textit{Fact Sheet: White House Task Force on High-Tech Patent Issues} (June 4, 2013), \textit{available at} http://www.whitehouse.gov/the-press-office/2013/06/04/fact-sheet-white-house-task-force-high-tech-patent-issues.
• The particular products, services, and activities believed to infringe those patents, and the reasons why those products, services, and activities are believed to infringe
• Whether the patent has been licensed to any manufacturer or other entity, such that the letter recipient may have a patent exhaustion defense
• All the information required for the transparency disclosures above

By requiring demand letters to include this information, demand letter recipients are better served by having critical information before them at the time of receiving the letter, and the public is better served knowing that patents are being used for their merits rather than for their intimidation value.

IV. Conclusion

In closing, I would like to return to my initial thought, that patents are intended to serve the public interest. A properly granted patent should be an engine for innovation. Instead, though, abusers of patent demand letters have turned their patents into brakes on innovation, holding valuable small businesses back from their full potential, so that those abusers may extract pecuniary gain. The members of this Committee and this Congress should be champions of innovation, defenders of small businesses, and challengers of these abusers of the public good, and we call for swift action to implement reforms that will return our patent system to one that promotes the progress of science and the useful arts.

Thank you again for inviting me to testify, and I look forward to your questions.