TD Ameritrade

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"Assessing the Effectiveness of the Transitional Program for Covered Business Method Patents"

House Judiciary Subcommittee on Courts, Intellectual Property, and the Internet

March 20, 2018

Chairman Issa, Vice Chairman Collins, Ranking Member Johnson, and Members of the Committee, my name is David Hale and I am Chief Privacy Officer and Deputy General Counsel of TD Ameritrade, where my team and I are responsible for information protection legal issues, including both intellectual property and privacy. I have been with TD Ameritrade over 15 years as both in-house and outside counsel.

TD Ameritrade provides investing services and education to more than 11 million client accounts with more than $1 trillion in assets, and custodial services to more than 6,000 independent registered investment advisors. TD Ameritrade clients place an average of 700,000- plus trades each day using an array of technology, from automated phone-based systems (which TD Ameritrade pioneered in the 1980s) to trading over the web (which TD Ameritrade pioneered in the 1990s) to mobile trading technologies (which we have led for 20 years), along with an extensive network of local branches throughout the United States.

My testimony today focuses on the success of the Covered Business Method Review (CBM) program and the clear need to make the program permanent. The CBM program plays a critical role in mitigating the harmful effects that the assertion of low quality business method patents has on innovation. But we should not confuse temporary deterrence with elimination of the underlying threat, for the reasons discussed below. The CBM program provides protection against these low quality patents, but tens of thousands of such patents are being issued each year. As noted in the Government Accountability Office's recent report the on the CBM program, the threat of these patents does not disappear in 2020 – owners of patents vulnerable to being found invalid under CBM may simply bide their time until 2020.[1] That is why this critical program should be made permanent. There are two ways to accomplish this: The *inter partes* review (IPR) program could be amended to incorporate the core elements of CBM and thus cover all subject matter patented in the United States. But if amending IPR is not a viable alternative, making the CBM program permanent would provide the certainty and stability that fosters innovation in the financial sector, and the vast number of other sectors that rely on the program.

After decades of ruinous patent litigation, the passage of the America Invents Act (AIA) – of which CBM is a part – marked an inflection point for the startup and small business community, as well as financial institutions like TD Ameritrade.[2] The

[1] United States Gov't Accountability Office, *U.S. Patent and Trademark Office: Assessment of the Covered Business Method Patent Review Program*, GAO-18-320, at 19, 35 n. 65 (March 2018), https://www.gao.gov/products/GAO-18-320.
[2] Testimony of Julie P. Samuels, *The Impact of Bad Patents on American Businesses: Hearing Before the Subcomm. on Courts, Intellectual Property, and the Internet of the*

effect of AIA on financial technology (fintech) was perhaps even more pronounced. For example, a recent report by McKinsey showed that the number of fintech startups working on capital markets has grown by hundreds in the years following the passage of the AIA.[3] The growth in fintech startups is indicative of the AIA's role in fostering innovation across the entire sector.

TD Ameritrade's extensive use of technology to provide services to our clients inevitably results in disputes over intellectual property. To the surprise of many, however, most disputes are not related to cutting-edge technologies, but rather standard, ubiquitous technologies long found throughout the financial services industry. And the trend was accelerating, until suddenly reined in by the America Invents Act and – in particular – the availability of the CBM process.

Through 2008, patent litigation in the financial services industry was rare. But beginning in 2009, the number of patent suits and demand letters sharply increased. TD Ameritrade was no exception to this trend. Thankfully, the America Invents Act appears to have turned the tide. Upon the implementation of the CBM process, TD Ameritrade has actively used the process to combat several of the low quality patents brought against it, bringing a total of eight CBM petitions.

Before I address those topics, I will describe why financial services companies, such as TD Ameritrade, have a unique stake in these issues.

I. THE FINANCIAL SERVICES INDUSTRY DEPENDS ON STRONG PATENT PROTECTION FOR INNOVATION, BUT ALSO BEARS THE BRUNT OF THE HARM FROM LOW QUALITY PATENT ASSERTIONS

Like other sectors, the financial services industry has a strong interest in ensuring that the U.S. patent system provides robust protection for meaningful innovations while also ensuring that low quality patents, particularly those relating to business methods, are not used in abusive litigation. Financial institutions, including broker-dealers like TD Ameritrade, serve a multifaceted role in the U.S. economy, because they are both innovators themselves and financiers of innovation.

The Financial services industry provides frictionless movement of capital in every sort of financial transaction, from purchasing securities, to credit card purchases, ATM withdrawals, online and mobile banking, and digital wallet payments – all of which are fundamental to the modern financial system and the facilitation of e-commerce. Today, financial institutions are investing heavily in developing technologies related to fraud detection, blockchain and distributed ledger technologies, advanced authentication and security, and faster and simpler

H. Comm. on the Judiciary, at 2, 7-9 (July 13, 2017) ("the good news is that Congress, by the America Invents Act … have started to right the ship.").

[3] Siobhan Cleary et al., McKinsey & Co., *Fintech decoded: The Capital Markets Infrastructure Opportunity*, at 7 (Feb. 2018).

payments, to name a few. Financial institutions have increasingly sought to protect such innovation through the patent system in recent years. In 2016, a sample of ten major financial institutions obtained more than ten times the number of patents that those same companies obtained in 2010.[4]

Additionally, the financial services industry is a primary source of capital for fintech start-ups, and other small businesses of every kind. Based on the most recent data from the Small Business Administration, as of June 2015 there were $599 billion in small business loans outstanding.[5] Traditional banks also help fund millions of businesses every year, and have a strong interest in seeing those entities achieve returns on their innovations, supported by a strong, sensible patent system.

Due to the ubiquity of financial services platforms, however, our industry is uniquely vulnerable to the assertion of low quality patents by non-practicing entities (NPEs). And because interoperability is fundamental to the financial industry, if an NPE has a low-quality business method patent that it asserts against one broker-dealer, credit union, bank, merchant, or other financial institution, it likely means that the patent will be asserted against every other entity operating in that same space. Given the high and asymmetric cost of patent litigation, financial institutions are heavily incentivized to settle and license rather than litigate, regardless of the merits of the patent in question. And every dollar spent on meritless litigation is one less dollar that can be deployed on research and development of new technologies or in our nation's communities.

II. THE COVERED BUSINESS METHOD REVIEW PROGRAM STRENGTHENS THE PATENT SYSTEM, FOSTERS INNOVATION, AND AMELIORATES THE HARMFUL IMPACTS OF LOW QUALITY BUSINESS METHOD PATENTS ON THE U.S. ECONOMY

The CBM program is a landmark effort by Congress to create "a relatively cheap alternative to civil litigation for challenging [low quality patents], and will reduce the burden on the courts of dealing with the backwash of invalid business-method patents," as confirmed by the GAO report.[6] Thus far, it has operated precisely as Congress intended: CBM is a narrowly tailored, carefully constructed program that preserves and enhances incentives for innovation by protecting legitimate patents while providing an efficient, cost-effective alternative to litigation for the review of questionable business method patents.

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[4] The sample of financial services companies consists of Visa, MasterCard, American Express, State Farm, Allstate, AIG, Bank of America, Capital One, JPMorgan Chase, and USAA.

[5] Office of Advocacy, U.S. Small Business Administration, *Small Business Lending in the United States*, at 15 (June 2017), https://www.sba.gov/sites/default/files/Banking_study_Full_Report_508_FINAL.pdf.

[6] 157 Cong. Rec. S1367 (Mar. 8, 2011) (statement of Sen. Kyl).

The recent GAO report on the program is further evidence of its importance. The report's findings demonstrate that the CBM program has enabled the PTO to get a second look at CBM-eligible patents against the most relevant grounds of invalidity, and roughly one third of those patents have been invalidated.[7] Perhaps just as importantly, the GAO also observed a marked decline in the assertion of low quality business method patents in litigation and demand letters, even though business method patents make up an increasing share of the new patents granted.[8] Stakeholders reported to GAO that the CBM program has been an effective deterrent.[9] Troublingly, stakeholders also reported that patent holders may be waiting for the CBM program to expire to assert their patents.[10] The experience of the financial services sector is fully consistent with the GAO's report; it is certainly consistent with what we experienced at TD Ameritrade. The invalidation rate supports the effectiveness of the gate-keeping provisions, while the decrease in litigation in which a non-practicing entity asserts low-quality business method patents is a testament to the program's overall effectiveness.

At present, there is no viable alternative to CBM, particularly for sectors such as financial services against which low quality business method patents tend to be asserted most frequently in litigation.

- As it currently exists, *inter partes* review (IPR) is not an alternative to CBM, because IPR does not permit the Patent Office to review patents to determine whether they claim patent-eligible subject matter or comply with the requirements that patents be clearly drafted. These invalidity challenges are vital to address low quality business method patents. IPR also has a more limited range of allowable prior art and employs a broader estoppel provision.[11] Likewise, although both programs allow for a stay of litigation pending resolution by the Patent Office, the stay provision in the CBM process provides litigants with more certainty that the case will be stayed. The IPR program could be amended to incorporate the core elements of CBM, but the program is not a viable alternative absent Congressional action.

- While some may suggest that post-grant review (PGR) is a viable alternative to CBM, PGRs can only be filed to challenge very new patents – those that have priority dates no earlier than March 16, 2013, and must be filed within nine months of patent issuance. PGR does nothing to address the tens of thousands of low-quality business method patents that issued from applications first filed prior to 2013. Further, even when considering patents first applied for after March 2013, tens of thousands of business method

[7] GAO-18-320 at 17.
[8] *Id.* at 8, 17.
[9] *Id.* at 35.
[10] *Id.* at 19.
[11] Testimony of Julie Samuels, *supra* note 2, at 8.

patents continue to issue each year. It would be impossible for a company to either monitor that number of patents, or to challenge them through PGR on a regular or comprehensive basis. Moreover, the vast majority of patents are never asserted, so it would be wasteful to force firms to initiate PGRs against every patent that could possibly be asserted against them.

- Finally, the availability of defenses and counterclaims in a district court action is not a viable substitute for CBM because the cost, time, and uncertainty pushes defendants to settle unmeritorious claims. First, plaintiffs asserting low-quality business method patents frequently choose to file in judicial districts known for rarely granting defendants' motions to dismiss based on invalidity. Second, unlike in CBM, an invalidity challenge raised in district court can drag on for years. If a court denies defendants' motion to dismiss or early motion for summary judgment (e.g., because it finds there are factual issues), then the defendant will be subject to millions of dollars of litigation expenses before it has a meaningful opportunity to obtain a judgment of no infringement or invalidity. In some instances, courts allow discovery to proceed even while a motion to dismiss is pending, and can take over a year to rule on the motion. Third, because district court judges have widely varying levels of comfort with patent law and with software technology, whether a motion to dismiss or for summary judgment is granted or denied can sometimes depend more on the judge to whom the case is assigned than on the merits of the patent. Moreover, according to the American Intellectual Property Law Association, the median cost of litigating even the pre-trial portion of a patent case ranges from $950,000 for relatively small cases to millions of dollars for the kinds of cases more commonly found in the financial services sector.[12] These numbers align with TD Ameritrade's own experience: estimates we receive to defend filed or threated suits through trial regularly average several million dollars, with some particularly complex cases in unfavorable jurisdictions costing much more – not including the costs for and impact on TD Ameritrade internal resource.

The absence of a viable alternative makes continuing the availability of CBM critical. If the CBM program sunsets without a viable replacement, NPEs will be free to assert low-quality business method patents in litigation, and defendants that do not prevail on a motion to dismiss will be left with little choice but to incur the enormous cost of litigation, or to simply settle and license. Without CBM, companies sued on low quality business method patents in this space are denied a viable alternative to costly litigation. This is exactly the imbalance that CBM was designed to correct. Unless the program is made permanent or its core elements are incorporated into IPR, the progress Congress made when it passed the America

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[12] American Intellectual Property Law Assoc., *2017 Report of the Economic Survey*, at I-222.

Invents Act will be undone.

CBM Is Needed and Is Achieving Its Intended Goals.

There are more than 85,000 business method patents that have already been issued, and that number continues to grow by tens of thousands each year.[13] While the PTO has made progress at improving patent quality, the issuance of low quality business method patents continues to be a problem.[14] According to a recent study by scholars at Harvard University and Stanford University, even a relatively small decrease in the number of words changed by a patent examiner – just one standard deviation below the average – makes a patent 40.5% more likely to be asserted in litigation by a patent assertion entity.[15] Similarly, a patent examination that is just one standard deviation more lenient than the average is far more likely be both the subject of litigation and to be invalid.[16]

During consideration of the AIA, opponents of CBM raised several concerns regarding how the program would operate in practice. As such, Congress opted to establish the CBM program as a "transitional" program to determine its effectiveness. Six years into the program, the performance data reinforces the wisdom of Congress in establishing the program as an efficient means for addressing the problem of litigation initiated by NPEs based on low-quality business method patents. This data supports continuing he CBM program.

To access the CBM program the petitioner must demonstrate that the challenged patent is "more likely than not invalid." This is a significant barrier, and a substantial number of petitions do not reach the trial phase; the GAO reports that only 38% of petitions actually reach a final written decision.[17] As a result, for those CBM Reviews that are instituted, there is a high rate of invalidation. According to the GAO, through September 2017, 95 percent of patents challenged in CBM proceedings that reached a final written decision have had at least one claim held invalid.[18] Because challenges to a patent's subject matter and clarity (under sections 101 and 112, respectively) are not available in IPR, a significant percentage of the invalidity findings could not have been made if the CBM program did not exist.

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[13] GAO-18-320 at 8.

[14] *See* Michael D. Frakes & Melissa F. Wasserman, *Is the Time Allocated to Review Pattent Applications Inducing Examiners to Grant Invalid Patents? Evidence from Micro-Level Application Data*, The Review of Economics and Statistics (2017).

[15] Josh Feng & Xavier Jaravel, *Crafting Intellectual Property Rights: Implication for Patent Assertion Entities, Litigation, and Innovation*, 26 (Dec. 29, 2017), https://scholar.harvard.edu/files/jfeng/files/crafting_ip.pdf.

[16] *Id.* at 1.

[17] GAO-18-320 at 25.

[18] *Id.*

In light of its effectiveness, the CBM program has had a powerful impact on addressing low quality business method patents. Through July 11, 2017, 358 patents were the subject of CBM review.[19] These 358 patents had been asserted in a total of 1,662 patent infringement lawsuits. On average, each CBM review impacts 17.7 defendants – compared to 7.1 per IPR. Thus, CBM review has had a significant ripple effect in terms of collateral beneficiaries of the program. And, as I mentioned earlier, this ripple effect extends far beyond the number of patents asserted or suits filed. Perhaps the most important evidence of CBM's effectiveness is the decline in the number of CBM challenges brought at the PTAB. This decline as a sign that many low quality patents are *not* being asserted by NPEs, because an efficient, effective remedy – CBM – is now available. Simply put, CBM is a credible threat to the assertion of bad patents in litigation.

CBM Includes Safeguards to Prevent Abuse.

Unlike IPR or PGR, CBM includes strong gatekeeping provisions and procedural safeguards to prevent the harassment of patent holders and ensure that only those patents that claim dubious business methods and are more likely than not invalid are ever subjected to review.

- The first safeguard is that, unlike IPR and PGR, a patent only becomes eligible for CBM when the patent holder threatens or elects to pursue litigation on that patent. And only parties that have a direct interest in addressing the charge of infringement of that patent can petition for review under CBM.

- CBM also sets a high bar for institution. Petitioners are required to establish that the patent is "more likely than not" invalid in order to obtain review. As of September 2017, the PTAB found that the CBM petition did not meet this standard in roughly 36% of institution decisions.[20]

- Further unlike IPR and PGR, only a specific subject matter of patents is subject to CBM.

- CBM also contains a strong stay provision that prevents the waste of litigation proceeding simultaneously in district court and before the Patent Board.

- Finally, filing a CBM is a high stakes risk for the company that files the petition challenging the patent. Because the challenger must have

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[19] According to the GAO, this number rose to 359 by September 2017. *See* GAO-18-320, at 17.
[20] *Id.* at 25.

> been charged with infringement in order to qualify for CBM review, should the challenger fail to prove invalidity, it is at increased risk in that existing litigation. And, the challenger will be estopped from raising in court the same arguments raised during CBM proceedings. These are significant deterrents against filing a meritless petition.

The GAO Report acknowledges that abuses of the CBM processes are possible, but notes such abuses appear to be rare. Any process can be abused, and the handful of potential (but not clear cut) abuses identified by the GAO pales in comparison with the historically extensive abuses of district court procedures by holders of low quality patents, which the CBM program was created to combat in the first place.

III. CONCLUSION

Today, there are no existing viable alternatives to the CBM program to rid the system of weak business method patents.

Letting the CBM program expire would harm the innovation that keeps our industry, start-ups, small businesses, and our customers, competitive in a rapidly changing economy. The benefits of CBM are now clearly established, and those benefits accrue to the economy as a whole. In contrast, the only people who benefit from sunsetting CBM are holders of low quality patents with an appetite for baseless litigation.

In short, as Congress continues efforts to address the challenge of non-practicing entities asserting low quality patents, CBM should remain in place or its core elements should be incorporated into the IPR program. Moreover, while the PTO is actively engaged in improving patent quality, low quality patents are still issued today, which only supports the need for CBM moving forward.

Thank you for this opportunity to testify on this extremely important issue for our industry, for innovators, for consumers, and for the country. We look forward to working with Congress and the stakeholder community to address these issues moving forward.