

**DEMAND LETTERS AND CONSUMER PROTECTION:
EXAMINING DECEPTIVE PRACTICES BY PATENT
ASSERTION ENTITIES**

HEARING

BEFORE THE

SUBCOMMITTEE ON CONSUMER PROTECTION,
PRODUCT SAFETY, AND INSURANCE

OF THE

COMMITTEE ON COMMERCE,
SCIENCE, AND TRANSPORTATION
UNITED STATES SENATE

ONE HUNDRED THIRTEENTH CONGRESS

FIRST SESSION

NOVEMBER 7, 2013

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ONE HUNDRED THIRTEENTH CONGRESS

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**DEMAND LETTERS AND CONSUMER
PROTECTION: EXAMINING DECEPTIVE
PRACTICES BY PATENT ASSERTION ENTITIES**

THURSDAY, NOVEMBER 7, 2013

U.S. SENATE,
SUBCOMMITTEE ON CONSUMER PROTECTION, PRODUCT
SAFETY, AND INSURANCE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
Washington, DC.

The Subcommittee met, pursuant to notice, at 10:04 a.m. in room SR-253, Russell Senate Office Building, Hon. Claire McCaskill, Chairman of the Subcommittee, presiding.

**OPENING STATEMENT OF HON. CLAIRE McCASKILL,
U.S. SENATOR FROM MISSOURI**

Senator McCaskill. This hearing will come to order.

We thank our witnesses for being here. And I thank Senator Heller for being a great working partner with me on this subcommittee.

This morning we are examining a growing consumer protection concern within our patent system. In recent years, the growth of patent assertion entities—also known as PAEs or referred to by many as patent trolls—has led to an increase in patent litigation and spawned greater use of the so-called demand letters. Too often, this appears to be an unfair and deceptive practice that is harming everyday businesses, consumers, and startups.

Patent trolls send out hundreds and, in some cases, thousands of demand letters to unsuspecting entities alleging patent infringement. These letters demand payment and threaten to sue if payment isn't made. The demand letters we are talking about often don't even contain the most basic information that would allow recipients to know which patents they have allegedly infringed or how. Many times, recipients can't even tell who is sending the letter in question, because patent trolls use multiple shell companies to hide their identities. Sometimes the patents in question aren't even valid or already covered by an existing license. But, of course, none of this is disclosed in these "demand letters."

The result is that the recipients are left in the dark, unable to know whether they should settle or fight the claim. Even if the allegations are outrageous and untrue, companies often choose to cough up the money anyway because they worry that going to court would simply be too costly. Never mind that, despite their threats

to the contrary, many patent trolls have no intention of bringing suit or no basis on which to do so.

It's hard to distinguish the deceptive nature of this conduct from the many other scams that prey on Americans who do not have the resources or expertise to go on the offensive.

By many accounts, deceptive demand letters seem to be a growing problem. By some estimates, patent trolls are sending well over a hundred thousand demand letters a year, impacting a wide swath of innovative startups and other small businesses. Making matters worse, patent trolls are increasingly seeing dollar signs in targeting small businesses that have nothing to do with the patent system, such as coffee shops and brick-and-mortar retailers. These small businesses aren't in the patent business, and they don't have the expertise or resources to evaluate the claims in a demand letter, much less hire an army of lawyers for what could be protracted litigation.

Sometimes the alleged patent infringement is a technology patent that they have purchased for their business like scanners or Wi-Fi routers, or that is already covered by a license from the manufacturer. As we will hear today from Cisco, one patent troll sent 13,000 demand letters to Cisco's customers for using one of its products.

This is not just an issue facing technology companies. I have heard from businesses in Missouri and across the country, large and small, that are facing similar challenges. Most are reluctant to share their stories because of ongoing litigation, terms of settlement agreements, or fear of becoming a target for other patent trolls. But for many retailers, banks, credit unions, app developers, hotels, restaurants, cable companies, and broadcasters, dealing with demand letters has become an additional cost of doing business.

The issue here is not about the right to assert one's patent. Let me repeat that. The issue here is not about the right to assert one's patent. It's not really even about the patent system. It's about the deceptive and unfair practice of threatening businesses and consumers based on often—unfounded claims for the sole purpose of bilking them. It's about scam artists preying on the vulnerable.

I'm pleased that the Federal Trade Commission recently launched an in-depth investigation into the patent troll industry. And I would like to applaud the various State Attorneys General, including Attorney General Bruning, who is here today, for taking steps to protect their constituents against harmful demand letter tactics.

At the same time, perhaps there is something Congress can do, too. It seems to me that demand letters should, at a very minimum—well, nothing like missing electronics.

[Laughter.]

Senator MCCASKILL. Apple, do you hear me?

[Laughter.]

Senator MCCASKILL. At the same time, perhaps there is something Congress can do. It seems to me that demand letters should, at a very minimum, include basic common sense disclosures: who, what, when, where, and why. In addition to learning more about the impact of demand letters, I hope to hear from our witnesses

today whether these demand letters could use some transparency to better protect American consumers and businesses.

Senator HELLER.

**STATEMENT OF HON. DEAN HELLER,
U.S. SENATOR FROM NEVADA**

Senator HELLER. Well, I have my opening statement here on my BlackBerry.

Senator MCCASKILL. Good luck.

Senator HELLER. I think I better switch to the——

Senator MCCASKILL. I got to the last paragraph.

Senator HELLER. Yes.

Chairwoman, thank you for having this hearing. I want to take just a minute to thank her for her work that she's done recently with the FAA. I noticed the gentleman sitting next to me, as we were landing, was playing Angry Birds. So, for your help and work in keeping those apps open——

Senator MCCASKILL. Did you send him Claire's love that he gets to keep playing Angry Birds as he lands?

Senator HELLER. While he lands, correct.

I also want to thank our witnesses. I don't think that table was built for six witnesses, but you're squeezed in well. So, thank you very much for being here.

Today we're taking a hard look at patent litigation. Specifically, we're looking at the practice of some entities that engage in aggressive pre-litigation practices based on alleged patent infringements.

We all agree that patent holders should be protected under the law. They should be able to assert patent protection methods. Patents are incredibly important in our economy and we all agree that patent holders should receive compensation for their innovation. Unfortunately, there are some bad actors in this sphere who are aggressively asserting that a patent they own has been infringed on in a manner that some believe is, in fact, deceptive.

Examples brought to our attention include a business that accumulates patents often by purchasing them from the PhoneGap companies or directly from individual investors. The companies then make use of patents that are ambiguous or broadly written in order to maximize the number of companies which they can assert the patent.

These companies generally do not make or sell anything related to these patents. Instead they identify companies using a technology that it can allege as an infringement of the patent. Then, they write a letter to the alleged infringer stating that infringement has occurred and litigation will commence unless the licensing agreement is entered into. Either pay us or we will sue you for patent infringement.

This practice seems to have initially started with technology companies. However, other industries including retailers, hospitals, banks, restaurants and the gaming industry have become targets as well. This practice concerns me as I am sure it concerns many Senators.

If frivolous lawsuits are being filed across my state of Nevada because a coffee shop allows their customer to use Wi-Fi in Reno, or a Las Vegas Casino receives a demand letter on a game they offer,

it can have a negative impact on the economy because it could hinder innovation and, of course, economic growth.

So, I do not believe that there is any question that this practice is taking place. It is. What I hope this hearing today sheds light on is the scope of the problem, most appropriate method to stem this behavior.

It is my understanding that the Federal Trade Commission has authority to act under the existing Section 5 authority to enforce against unfair and deceptive acts and practices. I also understand—I understand that they are waiting for the results of their own six-week study to be completed before moving forward.

I think it's important to see that study or at least the very least have a strong understanding of the scope of the issues before us, especially before moving on to any proposal that they be used that may be under the Committee's jurisdiction regarding the FTC. I also know that patent reform is an issue that the Judiciary Committee has looked at and will continue to look at.

Many of the issues that will be discussed here will also be solved by passing rulemaking authority instructing the Patent and Trademark Office to enforce standards on these demand letters.

I hope that we can aid in solving this problem by using this hearing today to shed light on this issue, but this committee is somewhat limited due to the narrow scope and lien of jurisdiction that we have. Nevertheless, this is an important issue and I thank the Chairwoman for holding this hearing today and even by holding this hearing we're drawing attention to it and rightfully so.

So again, thanks, Madam Chairwoman, for holding this hearing to discuss ways in which we can work to ensure patent holders can protect their faith that patents, frivolous patent lawsuits, are mitigated.

Thank you.

Senator McCASKILL. Thank you, Senator.

Let me introduce the witnesses. First, we have the Honorable Jon Bruning, who is the Attorney General from the State of Nebraska. Thank you for traveling here from Lincoln. Now that we're in different conferences, I can show you a lot more love.

[Laughter.]

Senator McCASKILL. Mr. Jon Potter, who is President of the Application Developers Alliance from here in Washington, D.C.; Mr. Mark Chandler, who is Senior Vice President, General Counsel and Chief Compliance Officer of Cisco Systems from San Jose, California; Ms. Julie Samuels, who is Senior Staff Attorney, Electronic Frontier Foundation, also out of San Francisco, California; Mr. Lary Sinewitz, who is the Executive Vice President of BrandsMart USA, who is from Florida; and finally, Mr. Adam Mossoff, who is a Professor of Law nearby here in George Mason University School of Law.

We will begin with your testimony, Mr. Bruning. Thank you very much.

**STATEMENT OF HON. JON BRUNING, ATTORNEY GENERAL,
STATE OF NEBRASKA**

Mr. BRUNING. Chairwoman McCaskill, Ranking Member Heller, thank you very much for holding this hearing. And Madam Chair,

it's funny you say that about our conferences. I have in my office a Missouri tiger tail that was a gift from Robin Carnahan. I sent her a corn head from Nebraska; she sent me a tiger tail. I keep it proudly even though, of course, I cheer for the Huskers.

[Laughter.]

Mr. BRUNING. Patent trolls abuse the open nature of our intellectual property system and they represent a destructive threat to small businesses, even out in nonprofit organizations and consumers. They offer little or no innovative value to our economy; they undertake their scheme in the shadows, often beyond the view of regulators.

So the time is ripe for Federal and State authorities to work in concert to address this issue and stem the tide of patent trolling nationwide, but still protect the ability of legitimate patent holders to enforce their rights.

I thought both your statements were right on and very well thought out. We want to protect the ability of legitimate patent holders but this is not about that. This is about a nationwide scheme that's happening because of a few.

These patent trolls seek to only extract costly licensing fees from these alleged infringers. They lack any intention to develop the underlying technology, improve upon it, or bring it to market. They send scattershot demand letters, which include a vague description of the patent and a demand that the target pay up. Unfortunately, these targets are often small businesses and nonprofits. Recently, we've had several examples of this in my state.

MPHJ Technologies has been an active and notorious patent troll in Nebraska and across the country. MPHJ claims it owns the patent for using a basic scan-to-e-mail technology. According to MPHJ and its lawyers, any person who has scanned a paper document to an e-mail attachment has infringed MPHJ's patent. That's about everybody in this country, seemingly.

MPHJ demands a thousand dollars per employee from hundreds of organizations around the country. So for small businesses and nonprofits, this can be a death threat.

MPHJ's scheme functions through dozens of shell companies that it and its lawyers have created. These shells go by names like AccNum, GosNel, FolNer and build themselves as licensing agents for MPHJ.

One example of MPHJ's targets in Nebraska was Eldon Steinbrink. Mr. Steinbrink is perhaps the perfect example of not only the absurdity of MPHJ's campaign, but how little research that MPHJ does before they send out these letters scattershot across the country. MPHJ, through its shell company FosNel, somehow decided that Mr. Steinbrink was infringing on its scan-to-e-mail patent through his work for Phelps County Emergency Management and sent him a demand letter. And these are the—we have the letters right here, Exhibits A, B and C and we included them in our filing.

Mr. Steinbrink never worked for Phelps County Emergency Management. He is an elderly gentleman; he lives in a nursing home in Holdrege, Nebraska. He once served on the Phelps County Board many years ago. He now has Alzheimer's.

Other examples in Nebraska have included nonprofits, such as Voices of Omaha, which is a community choir group; they have a few hundred dollars in their checking account, small businesses ranging from plumbers to accountants. Very few of MPHJ's Nebraska targets would have had the resources to mount a full defense had MPHJ followed through on its threats, which they never do. They have never sued anyone.

These letters are designed to frighten consumers and small organizations who lack the resources to mount an expensive legal fight. The average cost for such a defense is estimated in the hundreds of thousands of dollars, at a minimum. So accordingly, many of these people pay to make the patent troll go away. It's a silent extortion is what it is.

My office and other state attorneys general have declared a bipartisan, multistate war on these patent trolls. In Nebraska and Vermont, my colleague, Bill Sorrell in particular, we've taken aggressive and innovative steps to use our state consumer protection laws to address these demand letters. My understanding is yesterday, Attorney General Martha Coakley who is a good friend of mine in Massachusetts, she's becoming involved. And attorney general after attorney general is now realizing we have to band together to fight these patent trolls.

We're planning to introduce a bill in our legislature in Nebraska, which will further focus on patent abuse. But really, what we need is Congress to lead. The Senate has to lead here.

This Committee, in particular, has an important role in conducting a national consumer protection investigation. You can bring national attention to some of America's worst patent trolls and their use of demand letters as weapons of extortion.

We encourage Congress to use your subpoena powers to bring the most egregious patent trolls and their lawyers who enable them to account. Call MPHJ to this subcommittee. Have them explain why they sent a demand letter to Eldon Steinbrink in Holdrege, Nebraska, with no knowledge that he had violated their patent. Compel other patent trolls to come here and do the same. Explain themselves.

This has to be a multipronged effort. It's not just the Attorney Generals, it's not just Congress reforming the patent system. States and the FTC have to be empowered to address these demand letter abuses using our consumer protection laws and we're going to go about doing that.

This issue has to be given prolonged and meaningful attention. Through these efforts, we can stop the problem of patent trolling in America; we can protect our consumers, our small businesses, and our nonprofits who have been victimized.

Again, I want to thank the Subcommittee for inviting my testimony. I look forward to your questions.

Thank you.

[The prepared statement of Mr. Bruning follows:]

PREPARED STATEMENT OF HON. JON BRUNING, ATTORNEY GENERAL,
STATE OF NEBRASKA

Good morning, Chairman McCaskill, Ranking Member Heller, and members of the Subcommittee. I am the Attorney General of the State of Nebraska and have

served in that capacity since 2003. I appreciate the Subcommittee's interest in addressing the growing problem of patent trolls and am pleased to have the opportunity to share the state enforcement perspective on this issue.

Patent trolls abuse the open nature of our intellectual property system and represent a destructive threat to small businesses, nonprofit organizations, and consumers. They offer little or no innovative value to our economy and undertake their schemes in the shadows, often beyond the view of regulators. The time is ripe for Federal and state authorities to work in concert to address this issue and stem the tide of patent trolling nationwide, while protecting the ability of legitimate patent holders to enforce their rights. I am pleased to participate in that effort.

I am charged with the obligation to enforce Nebraska's Consumer Protection and Uniform Deceptive Trade Practices statutes and view this role as one of my top priorities. My office includes a division of attorneys and staff devoted exclusively to combating fraud, unfair, and dishonest trade practices. We pursue these efforts using a broad spectrum of tools, including consumer mediation, multi-state investigations, and full-scale litigation. Because we understand that financial predators are often sophisticated, technically savvy, and adept at creating an air of legitimacy, we take our role as guardian of the public interest in this area very seriously.

Over the past year, we have grown increasingly aware of the threat posed to Nebraska small businesses, nonprofits, and consumers by patent assertion entities, commonly known as "patent trolls." Generally, patent trolls acquire patents solely for the purpose of using them to coerce license fees from legitimate charities or businesses they claim have infringed on the patent. Patent trolls typically lack any intention to develop the underlying technology, improve upon it, or bring it to market. Rather, they seek only to extract costly licensing fees and/or pretrial settlements from alleged "infringers."

Our investigations and research have developed insight into the modus operandi of the prototypical patent troll. First, the patent troll acquires one or a handful of patents relating to a particular technology. The patent troll will then gather a list of targets against which it believes it can assert "infringement." Very little research is likely performed at this stage. The troll simply assembles a list of a substantial number of targets it believes might be utilizing the patented technology.

Our investigations have revealed little rhyme or reason to the type or size of entity a patent troll will include in its target list. We identified victims ranging from small businesses and nonprofits for whom patent trolls can represent an existential threat to global technology producers and nationwide telecommunications firms for whom patent trolls represent a drain on resources and constant annoyance. The former are often caught off-guard by the notion that they are "infringing" on a patented technology totally unrelated to their organization's actual work.

The scope of a patent trolling effort can be extraordinary in breadth and scope. A 2013 White House report noted that one patent troll sent eight thousand demand letters to coffee chains, hotels, and retailers seeking compensation for use of Wi-Fi equipment made by several manufacturers that the patent troll alleged to infringe on its patents. One constant has emerged, however: in virtually every case, we found the process began with a "demand letter."

A patent troll's demand letter usually includes several components. It typically identifies the patent or patents owned by the troll, usually by number accompanied by a vague or generalized description of the nature of the patent(s), with a conclusory statement that the targeted company is infringing upon the specified patent. The demand letter will often indicate it is necessary for the targeted entity to engage in some type of negotiation to pay the patent troll a license fee and will explain, in very broad terms, why a license is needed. Though the demand letter may indicate the possibility that the targeted entity is, in fact, *not* infringing, this caveat is often at the end, coming well after a series of conclusory and ominous statements that the targeted entity's use of a particular technology—usually completely unrelated to the entity's actual business—has infringed on the patent or patents in question.

If the initial demand letter carries the *implicit* threat of litigation, as described above, then subsequent correspondence from the patent troll will often include the *explicit* threat of litigation. Should a targeted entity not respond to the initial demand for license fee negotiations or should such negotiations stall or prove insufficiently profitable for the patent troll, additional letters may include a draft copy of a Federal court complaint, complete with the targeted entity's name in the caption and numbered allegations. Though the inclusion of such a document may appear to some to be the ultimate leverage as the final step toward litigation against the targeted entity, chosen by the patent troll solely toward the aim of winning a significant patent infringement award specifically from the target, it is often simply a template scare tactic. In reality, the same complaint with virtually the same language

may well have been submitted to a number of other targeted entities as a result of their own alleged “infringement.”

One patent troll active in Nebraska is “MPHJ Technologies.” Nationwide, MPHJ has become notorious. MPHJ has asserted it owns the patent for using a basic office scanner to scan a document to e-mail. According to MPHJ and its lawyers, anytime any person has scanned a document to e-mail, that person has infringed on MPHJ’s patent. The potential financial consequences to MPHJ’s targeted victims are significant. MPHJ has demanded a thousand dollars *per employee* from hundreds of organizations around the country. In many instances, such a claim can mean a death threat to a small business or nonprofit incapable of defending itself without incurring substantial legal expenses.

MPHJ’s scheme functions through dozens of shell companies it and its lawyers have created. MPHJ itself owns the patents—ostensibly for scan-to-e-mail technology—but the initial assertion of infringement comes from a veritable alphabet soup of LLCs such as “AccNum,” “GosNel,” or “FolNer.” These shell companies bill themselves as “licensing agents” for the patents owned by MPHJ and are the entities from which demand letters are sent to hundreds of alleged infringers.

One example of MPHJ’s targets in Nebraska was Eldon Steinbrink. Mr. Steinbrink is perhaps the perfect example not only of the absurdity of MPHJ’s campaign but also of how little research MPHJ and its lawyers perform before sending threatening letters scattershot across the country. MPHJ, through its shell company FosNel, somehow decided that Mr. Steinbrink was “infringing” on its scan-to-e-mail patent through his work for Phelps County Emergency Management and sent him a demand letter. *See* Exhibit A (on information and belief, a demand letter virtually identical to the one sent to Mr. Steinbrink), Exhibit B (the second demand letter sent to Mr. Steinbrink), and Exhibit C (the third demand letter sent to Mr. Steinbrink which included a draft lawsuit complaint).

The problem with this scheme was that Mr. Steinbrink *never* worked for Phelps County Emergency Management. He is an elderly gentleman living in a nursing home in Holdrege, Nebraska, and who once served on the Phelps County Board many years ago. It is obvious MPHJ and its lawyers performed little or absolutely no research prior to threatening Mr. Steinbrink.

Mr. Steinbrink’s story is but one of many. Others in Nebraska have included nonprofits, such as Voices of Omaha, a community choir, to small businesses ranging from plumbers to accountants. Very few of MPHJ’s Nebraska targets would have had the resources to mount a full defense had MPHJ followed through on its threats and most were forced to find alternative means to resolve the issue. In sum, MPHJ represents patent enforcement abuse at its very worst.

Patent troll demand letters, usually marked by a steady increase in pressure and aggression, are typically designed to ultimately achieve a single aim: the extraction of as big a payment as possible from the targeted entity. Indeed, it is our understanding that most patent trolls do not ordinarily desire their enforcement actions be fully adjudicated—or even subjected to a *preliminary* evaluation—by a Federal court. For if such adjudication occurs and the patent or patents are invalidated, efforts against other targeted entities based on the same patents are rendered useless and unprofitable.

Instead, patent trolls generally seek to “price” their license or settlement demands such that the sum obtained will be high enough to make the effort worthwhile but low enough that it can actually be afforded (using the term loosely) by the targeted entity. In other words, it is worth it to simply pay the troll to go away (for a price which reflects not any true market value for the patented technology, but its litigation-induced value) instead of engaging in protracted and costly litigation.

The latter point appears to be one of the main reasons patent trolls have been so successful and, thus, so destructive. To put it simply, most targeted entities have neither the time, resources, nor inclination to engage in a pitched legal battle to defend a patent. This is particularly so when the patent in question is collateral to the entity’s actual line of business. The average cost of a full-scale patent defense ranges from \$350,000 to \$3 *million*. Regardless of the exact price, defending a patent can be fairly described as one of the most expensive forms of litigation in existence.

A large entity, such as a software or technology firm (frequent targets of patent trolls), may have the resources to fight those efforts which are facially illegitimate, but it also has the resources to simply make a troll go away through settlement. Indeed, large corporations may employ an intellectual property specialist on staff to manage the large number of challenges it receives, in addition to one or more outside firms to handle disputes if they are ultimately litigated.

Smaller entities, including nonprofits and firms who cannot afford to hire attorneys well-versed in the intricacies of patent litigation (which, candidly, applies to

most attorneys, including seasoned litigators) are often even more eager to limit significant litigation risk and will pay the patent troll a sum to dispose of the case. Indeed, even if a targeted entity *can* hire an experienced patent litigator, prudent risk management strategy still often results in a settlement with the patent troll. This is so because a hired patent attorney will usually foresee the resources and expense which are the hallmarks of successfully defending almost *any* patent infringement enforcement effort and recommend the prompt resolution of the matter. In any event, a smaller entity will have little choice but to so hire a specialized patent attorney because few small organizations have the capacity to employ a patent lawyer on a full-time basis.

The damaging effects of patent trolls are clear. Patent trolls succeed through the issuance of egregious threats which serve to advance no valid legal purpose or the legitimate protection of productive intellectual property but, rather, seek only to extract quick settlements from those otherwise committed to building their businesses and providing positive value to society. The question for policymakers charged with building a legal framework of robust consumer protection is how to stem the destructive tide of patent trolls and give targeted entities some support in what has, thus far, been a rather one-sided fight.

As a preliminary matter, I proceed from the premise that America's intellectual property enforcement system, though in need of significant reform, should remain one which readily enables holders of valid, productive patents to enforce such patents without undue hurdles or unfair obstacles. I firmly believe in the principle that intellectual property is precisely that—*property*—and that legitimate enforcement of the rights which flow from such property should be protected. Patent trolls, however, have abused America's relatively open system that expressly provides for a presumption of validity of patents. To protect the integrity of that system while simultaneously protecting consumers and businesses from patent trolls, therefore, increased consumer protection tools are necessary at both the Federal and state level to address this issue.

Several states, including Nebraska, have explored using our existing Consumer Protection and Unfair and Deceptive Trade Practices statutes to combat patent trolls. The theory behind this strategy is simple: if a patent troll sends a demand letter demanding licensing fees from an alleged "infringer" but in fact lacks a good faith belief in the validity in the underlying patent or its application to the target's technology, or if the troll threatens litigation categorically lacking any intention of ever filing suit, that may violate *existing* consumer protection laws.

Though we are confident this approach using existing statutes can be highly effective, we are also exploring ways in which we can strengthen existing laws and further tailor their applicability to patent trolls. Such state legislation—which must be done in a manner that does not stray into the clearly pre-empted Federal sphere of patent regulation—may include stricter demand letter content requirements, the requirement of a bond posting by the asserting entity, or the inclusion of a sworn affidavit by the asserting entity that the assertion is legitimate and made in good faith. I look forward to continuing my work with my fellow state Attorneys General to develop what could ultimately be termed "model legislation" for this purpose.

Congress must also act to align Federal consumer protection activities with state efforts. Though reform of the patent system itself must originate with your colleagues on the Judiciary Committee, the Commerce Committee possesses the jurisdiction to empower Federal enforcement authorities to take a hard line against unfair and deceptive demand letter practices. I encourage you to do so.

I am pleased that the Federal government has already shown a willingness to address this problem. The FTC has proposed a patent troll information gathering project which is currently in the public comment phase. Vermont Attorney General William Sorrell and I have partnered to co-sponsor a multi-state letter of support for that project. I encourage the Subcommittee to champion that project and use its results as the basis for additional hearings on the workings and methods of patent trolls nationwide.

In the meantime, however, I call upon Congress to utilize its subpoena power to bring the investigation of some of the worst known patent trolls to the national level. I encourage you to bring the most notorious patent trolls—and the lawyers who facilitate their schemes—to account for their alleged abuses of the patent enforcement system and explain how they do business. For too long patent trolls have operated in the shadows with virtual impunity. It is now time for Federal and state authorities to bring them into the open.

In conclusion, addressing the problem of patent trolls is achievable and necessary if we are to truly fulfill our consumer protection roles. Frankly, it is one of those rare issues which commands truly broad consensus on the need for reforms. Entities of all types and sizes—from the very large to the very small—view patent trolls as

a threat to their productivity and, sometimes, their existence. Scholars and practitioners from across the intellectual property legal spectrum have voiced the problems posed by these financial predators. Democrats and Republicans alike view patent trolls as a direct threat not only to our constituents but to innovation, overall. In short, few other consumer protection concerns are more deserving of our immediate attention.

Again, I appreciate the Subcommittee's attention to this issue and for the opportunity to share my views. I look forward to working in partnership with Congress to bring about changes which will enhance our consumer protection tools and put an end to the problem of patent trolls.

Senator McCASKILL. Thank you, Attorney General.
Mr. Potter.

**STATEMENT OF JON POTTER, PRESIDENT,
APPLICATION DEVELOPERS ALLIANCE**

Mr. POTTER. Thank you, Chairman McCaskill and Ranking Member Heller.

The App Developers Alliance and our more than 30,000 members urge swift enactment of legislation to eliminate patent trolls' favorite weapon: vague, deceptive, baseless and threatening demand letters that inhibit investment and startups; cause app developers to stop hiring engineers; and bully companies into extortionist settlements because the settlements are cheaper than litigation.

I invite you to join me this morning in your local version of startup land. At Lab1500 in St. Louis, Work In Progress, Las Vegas, and work share spaces nationwide, passionate, energetic app developers are creating new products and services to improve our lives. They dream about IPOs, but in reality money is tight, risk is the norm and threatening letters from patent trolls are devastating.

Legitimate companies assert their patents by offering voluminous documentation after researching the letter recipients' business or technology. In contrast, smash and grab patent trolls buy cheap patents and use them to extract shakedown licenses from small companies and startup land. Letters threaten protracted litigation. They demand fixed-fee licenses regardless of how valuable the patented technology is for the recipient's businesses. They offer limited time, six figure settlement specials, and they threaten to increase royalties if a business hires a lawyer or requests more information about the patent.

Please remember, patent trolls make no products and produce no services. They are the patent equivalent of the penny stock boiler room that sells worthless stock to our grandmothers and exterminators who help rid you of termites that they just flung into your garage.

The patent troll racket has reached epidemic levels that require a legislative response. A study released this week documented that one third of VC funded startups have received patent demand letters and 60 percent of the letters were from trolls. Defending against patent demands cost at least \$100,000 and quickly rises into the millions. And every dollar wasted against a troll is another marketing person not hired, another engineer without a job, and a sales person who can't get work.

Our website shows an interview of a moderately successful startup CEO lamenting that he now pays six lawyers but only five employees. He hasn't paid himself for a year and he names the three

employees that he hasn't hired. Beyond the costs to fight, patent demand letters scare away potential business partners and customers and are a major deterrent to investment. For all these reasons, app developers are vulnerable.

As several attorneys general and trade associations have documented, the trolls are taxing business, investment, growth and opportunity. Last week, visiting St. Louis, I learned of three local companies recently attacked by patent trolls. One company's service was built on a digital platform but the troll had an analogue technology patent. It didn't matter. The company had to hire a lawyer. The company ultimately settled because it couldn't afford the fight. Nationwide there are stories like this.

Earlier, I was in Los Angeles with a four-employee startup that once held a highly ranked app in the iTunes store. A troll demanded an unjustified license in royalties, but the company couldn't even afford a lawyer. Instead of fighting, it gutted its own app. It took away all the features that were compelling and it created sales for it. So in one sense they think they have won because they haven't paid the troll, but they have lost because their app is no longer successful, the company is floundering, and they are no longer hiring.

All across America app developers and main street businesses are frustrated by trolls and their demand letters. And they wonder how the government, which manages the patent system, has allowed this to happen. Skeptics suggest that trolls and demand letters and demand letter problems have been enabled by poor quality patents that our underfunded Patent and Trademark Office should not have allowed. The alliance agrees and we urge Congress to remedy this by legislating expanded opportunities for the Patent and Trademark Office to administratively review and cancel poor quality, previously issued patents through its covered business method program.

Other skeptics suggest that Congress needs more demand letter data before we're legislating to stop the abusive startups, grocery stores, coffee shops and retailers. But app developers are being driven out of business today. Main street businesses are being sued or being attacked today and Americans are paying higher prices in food and lost innovation and lost jobs today.

To be clear, I'm not asking this committee to amend the Patent Act. Rather, I'm urging the Committee to legislate very precise standards to prevent a new and growing strain of garden variety fraud—the transmittal of deceptive, unfair and abusive demand letters that just happen to be bolted onto our patent system.

On behalf of our thousands of innovators and entrepreneurial members, I urge you to prohibit demand letters that knowingly overstate the breadth of a patent's coverage, that do not disclose the patent or claim being infringed, that accuse businesses of infringement without the sender having any knowledge of whether infringement has actually occurred, or that menacingly threaten litigation when there's no intention of following through.

Please promote the patent system, promote app innovation and promote economic growth by ending demand letter abuse.

Thank you.

[The prepared statement of Mr. Potter follows:]

PREPARED STATEMENT OF JON POTTER, PRESIDENT,
APPLICATION DEVELOPERS ALLIANCE

Chairman McCaskill, Ranking Member Heller and Members of the Subcommittee:

On behalf of the Application Developers Alliance, our more than 30,000 individual members and 145 corporate members, I urge you to swiftly act to eliminate a favored weapon of America's patent troll bullies—vague, deceptive, baseless and fraudulent demand letters.

In the last few years, a new business model has emerged. Patent trolls send demand letters that knowingly overstate the breadth of a patent's coverage, or alternatively do not disclose the patent or claim being infringed. The letters accuse businesses of infringement without the sender having any knowledge of whether infringement has actually occurred, and they menacingly threaten litigation when they have no intention of following through.

These demand letters unnerve startups, cause better capitalized companies to needlessly hire lawyers, and force even large companies to pay extortionist settlements just to avoid the even higher costs of litigation discovery. But when the defending company fights back, the often thinly capitalized trolls retreat without punishment or regret, and simply move on to threaten another company or dozens of companies, knowing that several will sign unnecessary licenses and pay unjustified royalties because it is cheaper—much cheaper—than fighting.

Demand letters that abuse our patent system are a relatively new phenomenon but no longer unusual. This is a business model; it is growing; and it must be stopped. On behalf of the mobile app industry and our thousands of innovative, entrepreneurial members, I urge you to:

- (i) Prohibit patent infringement assertions that do not identify: (a) the patent being asserted; (b) the claim that is allegedly infringed; (c) the specific means by which the patent is allegedly infringed; and (d) the parties that are financially interested in the license and royalty demanded.
- (ii) Require patent infringement assertions to be supported by honest, good faith appraisals of the patent's validity, and by reasonable efforts to determine whether and how the business might actually be infringing the patent.
- (iii) Punish those who knowingly in demand letters inflate the breadth of a patent's coverage or its value, and thereby attempt to bully defendants into quick settlements that are either entirely undeserved or obligate unjustifiably high payments.

At the outset, it is important to clarify that my testimony is *not* about patent reform legislation. The Alliance supports legislation to reduce abusive patent litigation and to divert from expensive Federal courts wasteful infringement litigation based on low-quality patents. But today's hearing is about stopping fraud on small business, fraud on the American public, and fraud on the patent system.

Ending demand letter fraud requires decisive action like that of General Bruning and other Attorneys General. But Federal agencies, including the Federal Trade Commission, must also have a critical role in preventing intentionally deceptive business practices that undermine public trust in the patent system, stifle innovation and hurt consumers.

In the online world, a smash-and-grab patent troll's demand letter is the equivalent of the popup ad that says your computer has a virus, and for \$49 the advertiser will remove it. The advertiser "helpfully" informs you about the high costs of not paying the fee, but it really has no idea if your computer has a virus. In the offline world, the troll is an exterminator who cheerfully offers to fix your termite problem for only \$125. And though he has no knowledge of whether your house is infested, he is happy to give you a certificate after you pay him.

Individually and in combination, many patent trolls' demand letter practices are unfair, deceptive, fraudulent and are the equivalent of legalized extortion. Patents are a grant of public trust, with the value of coveted, beachfront property. They are granted by the Federal government for a specific purpose, and enforced by Federal judges who act with extraordinary deference to the PTO regarding a patent's validity and scope. Just like land grants, research grants, tax-exemptions and government contracts, rules regarding patents' assertion and exploitation can be—and should be—imposed or authorized by Congress in an effort to reduce abuse.

Earlier this year the App Developers Alliance began surveying our members about abusive patent litigation and related legislative proposals. We quickly heard strong support for proposals to reduce litigation discovery costs, to increase the likelihood of abusive plaintiffs being sanctioned, and to divert litigation from courts to the Pat-

ent and Trademark Office so that questionable business method patents can be closely scrutinized before courts enforce them.

But we also heard that the greatest challenge for the smallest companies happens well before litigation—when they first receive a patent assertion and demand letter. This is because the smallest companies cannot even afford to litigate in Federal court. This explains why patent litigation fee-shifting proposals are important to many companies and to a healthy patent system, but not as directly important to startups. For small companies the mere threat of expensive patent litigation can kill a young company’s fundraising efforts and scare off potential customers.

How prevalent are patent assertion and demand letters? Earlier this week a study was released documenting that fully one-third of startups responding to the survey have received patent assertions. Sixty percent of those assertions came from entities whose primary business is asserting and litigating patents. And just for startups, the cost of preparing for and defending patent demands generally exceeds \$100,000—and can easily reach millions of dollars in the very rare challenge that proceeds to trial. It is easy to understand why settlement is cheaper than fighting, even when the company is confident that the claim is specious.

Last week I was in St. Louis with a serial entrepreneur who shared stories of three local companies attacked by audacious trolls. One innovator had built an entire company based on digital technology, but was being threatened by a troll whose patent was based on analog technology.

All three companies had similar experiences after receiving abusive demand letters: they spoke to the troll’s lawyer who offered a simple choice— sign a license, or hire litigation counsel and prepare for a lengthy, expensive battle. The first company retained counsel, but made a business decision to sign an unnecessary and unjustified license. This is a classic “tax on innovation” that our patent system was not intended to support and our startup economy cannot afford. The second two companies are still exploring options, undoubtedly while paying lawyers to help them appreciate the cost-benefit analysis of their choice—fight righteously and expensively, or settle quickly and feel extorted.

An Alliance member in Los Angeles responded differently when he received an abusive demand letter. He called several lawyers and quickly realized that he could not afford to fight, though he was almost certain to win. He did not want, however, to reward the troll by signing a license, so instead he removed his app’s community features, its interactive features, and its most successful upgrade path. His app quickly dropped from the App Store’s Top 10 list and his business is suffering. In one regard, he feels victorious because he has avoided the troll’s wrath and has not been extorted directly. But, his business is harmed; his three employees are questioning their futures; and his spirit has flagged.

Legitimate companies asserting high-quality patents that they seek to license for a fair royalty do not hide behind vague and threatening letters. They disclose the patents; explain the breadth of the claims in detail; and justify financially the basis of their royalty requests. They are seeking to engage in a legitimate business relationship and they behave accordingly.

Trolls, in contrast, rely on vague and overbroad patents, and bullying threats of costly litigation and years of executive distraction. Settlement becomes very attractive, even when it is unjustified.

To be clear, as General Bruning knows, the worst trolls have absolutely no interest in litigation regardless of how strenuously they threaten lawsuits. This is because a defendant’s first affirmative defense will be that the patent or the claims being asserted are invalid, and the troll’s worst nightmare is that a court will address their validity on the merits.

But only the bullying troll knows where its particular limit is. Will it back off when a business hires competent counsel, or prove willing to spend money on discovery, or only when discovery concludes and the case gets close to trial? Along the way the bloviating troll’s goal is to increase defendants’ legal fees, increase executive distraction, and continue to increase settlement costs—all in an effort to persuade the business to settle, sign a license, pay a royalty, and end the costly, painful litigation. And it all begins with a baseless, threatening, and fraudulent demand letter.

One troll went so far as to demand a meeting at its office in California within ten days of contacting our New York-based member company, and then increased its settlement “offer” every time that our member contacted him again to learn more about the patent or to negotiate. In an ironically different but also abusive contrast, another troll thoughtfully offers a \$300,000 flat-fee license without any pretense of knowing if that amount bears any relation to the letter recipient’s alleged use of the invention in question, and then enthusiastically offers an early settlement discount for the low, never to be beaten, rate of \$100,000. In this regard the troll re-

sembles the stereotypical used car salesman—asking how much will you pay me if I agree to stop threatening you without justification today?

Congressional Action is Necessary, and Timely

Often Congress is reluctant to tackle a problem unless and until it is absolutely clear that existing laws are insufficient. In this regard, some might believe that the important and worthy actions of General Bruning and his counterparts in Minnesota and Vermont demonstrate that Congressional action is premature. They might also look at the law enacted by the Vermont legislature this summer and conclude the same. The Alliance, however, believes that state and Federal action are complementary and that both are necessary right now.

The efforts of General Bruning and his counterparts in other states, and of the Vermont legislature, only help the citizens of those states. The Alliance believes that Congress and Federal agencies also play an important role, by ensuring that citizens nationwide are protected against abusive patent troll demand letters.

Courts—for example those handling patent infringement cases—do not have jurisdiction over pre-litigation demand letters except to the extent they are evidence of intentional infringement, which affects damages calculations.

Also, the Federal Trade Commission's current authority over unfair and deceptive trade practices has not been exercised to address the problem of abusive demand letters. We believe the FTC could do more, but that its enforcement actions necessarily will be against only a few of the abusive trolls that send bullying, fraudulent demand letters.

The Alliance proposes three complementary solutions that will reduce fraud and abuse, help demand letter recipients analyze demands less expensively, and restore public trust in the patent system.

First, the FTC should set minimum standards on the transmittal of patent assertion communications, and to define that communications lacking indicia of good faith and fair dealing are per se “unfair and deceptive” under the Federal Trade Commission Act. Including this basic information will not conclusively define that the patent is valid or that the troll is acting in good faith, but they will increase the likelihood that the troll appreciates the gravity of its actions and will minimize the risk of demand letter abuse. The required information should include:

1. The patent number that is the subject of the assertion communication;
2. The specific claims that are being asserted as being infringed;
3. The specific reasons why the asserting party believes that the recipient of the communication is infringing the patent and/or the claims, including a description of the specific functionality or attribute of the receiving party's technology or activity that is infringing;
4. The names of all parties with financial interests in the patent, or in the settlement of the infringement, or in the licensing fees or royalties that the asserting party is requesting to be paid by the recipient of the assertion communication; and,
5. The names of all parties to whom the asserting party, or others with financial interests in the patent, have sent assertion communications with regard to the same patent.

Second, the Alliance urges Congress to codify that patents are a public trust granted by the people's government, and that patent assertion communications must include a sworn statement of good faith and fair dealing regarding the breadth of the patent, that the assertion is based on thorough research and fair analysis including about the letter recipient's technology and business, and that the requested royalty amount is reasonably related to the benefit derived by the recipient by its use of the patented invention.

Third, the Alliance urges Congress to impose on patent owners through the Patent Act the same terms and conditions delineated above, and to empower courts to revoke or reduce patent ownership rights and enforcement rights patents parties that deliberately or consistently fail to comply with these requirements.

Irrespective of the agency or agencies empowered to act, the Application Developers Alliance urges Congress to swiftly enact meaningful minimum 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 the Alliance's views.

Senator MCCASKILL. Thank you, Mr. Potter.

**STATEMENT OF MARK CHANDLER, SENIOR VICE PRESIDENT,
GENERAL COUNSEL, AND CHIEF COMPLIANCE OFFICER,
CISCO SYSTEMS, INC.**

Mr. CHANDLER. Thank you, Chairman McCaskill, Ranking Member Heller, Senator Klobuchar.

My name is Mark Chandler. I'm Senior Vice President and General Counsel of Cisco. Today I'll describe our experience with a new kind of scam that is based on a formula that's as old as the hills, but dressed up with the language of patent infringement and innovation.

The perpetrators send out thousands of threat letters to small businesses and consumers and file lawsuits in the hopes of a big payday, not based on any merits of the case, but on the fears of victims who just want to make a problem go away. These victims, mom and pop stores, hospitals, pharmacies, car dealers, aren't manufacturers of products. They're simply users like you and me.

I'm involved as General Counsel of Cisco because I want to defend my customers, but we need your help in bringing a little sunshine to a dark corner of the patent system.

Cisco was founded 30 years ago to build equipment so that disparate computer systems could communicate with each other. Today, we're the world's largest manufacturer of devices that make up the backbone of the Internet and we also build Wi-Fi, telephone and video systems. We employ 36,000 people in the United States and create jobs for hundreds of thousands of more. Our products are used directly or indirectly by billions of people around the globe and are in tens of millions of American homes and businesses. We, ourselves, hold over ten thousand individual U.S. patents and we appreciate that your colleagues in the Judiciary Committee are tackling issues related to the patent system. But their efforts to make patent litigation more fair won't affect what I'm describing today.

And let me tell you a story that unfortunately is not unique, as has been well documented by others on this panel including EFF which has collected many examples. Our story begins when a lawyer named Noel Whitley bought patents related to Wi-Fi from a great American chip company, Broadcom, and created a company that he cynically named Innovatio.

Broadcom, for its part, didn't want the patents anymore since their intrinsic economic value, related to innovation, was coming to an end. They were near or past expiration, had been broadly cross licensed to other chip companies and were subject to binding contracts requiring licensing on fair terms.

But Whitley was not deterred. Whitley and his lawyers at the Niro firm in Chicago, which specializes in this game, sent almost 14,000 threat letters to small businesses, cafes, bakeries, inns, hotels, a children's health clinic—basically, anyone that might use Wi-Fi in their place of business. Did they tell them what products might infringe? Nope. Instead, his lawyers just wrote, "I represent an individual who has suffered injuries as a result of your company's business," in claiming that the Innovatio portfolio covers all Wi-Fi usage.

Did his lawyers disclose that a huge proportion of Wi-Fi devices were already licensed through the chip companies and no more

could legally be collected? No. Instead, they told them that thousands of companies had already paid Innovatio and referred to almost a billion dollars in royalties, without letting on they were talking almost exclusively about Broadcom cross licenses that have little or nothing to do with these particular patents.

Did they tell them that the patents related to industry standards and had to be licensed on fair terms? No. Instead they told them, and again I quote, “We wish to license your company at a very affordable rate; far less than the cost of patent litigation. I can quote you a rate of less than \$3,000,” this for patents that a court determined were worth pennies per chip.

And did they tell them that manufacturers like Cisco were eager to defend them? No. Instead, they wrote that the equipment manufacturers, and I quote, “have not stepped in to defend any of their users. This means we can still sue your client and they cannot expect equipment manufacturers to aid in their defense.”

Finally, for those who had the temerity to resist, they enumerated thousands of pages of documents to be reviewed by counsel, meaning a mountain of legal fees. Sadly, this isn’t an isolated incident as Attorney General Bruning has told you, as others in the panel will, and as I’ve described also in my written statement. This is a dangerous trend.

Let me close by suggesting four simple steps that would make it much harder to carry out these schemes. First, require anyone who is sending more than ten patent demand letters to someone who is not a manufacturer or reseller of the accused product to file the letters in an online registry at the FTC. Second, require them to include a list of model numbers which are believed to possibly infringe, the fact that manufacturers, like Cisco, may be required to defend, and contact information for the manufacturers. Third, require any such letter include the names of the real entities or individuals who own the patents. And fourth, require the letters to include a list of all previous licenses and whether the patents are subject to special licensing rules that apply to standards.

We aren’t asking you to change substantive patent law, but these simple steps will provide basic transparency to protect the innocent end users. The paycheck I get every other week says Cisco on it, but every cent comes from my customers. That’s why I’m passionate about making sure they don’t get ripped off by charlatans dressed up as innovators when they trust us to supply them with products. And if the predators are forced to come to me, once they have disclosed what they are after, I can guarantee they will get a fair fight.

Thank you.

[The prepared statement of Mr. Chandler follows:]

PREPARED STATEMENT OF MARK CHANDLER, SENIOR VICE PRESIDENT, GENERAL COUNSEL, AND CHIEF COMPLIANCE OFFICER, CISCO SYSTEMS, INC.

Chairwoman McCaskill, Ranking Member Heller, members of the Subcommittee, I am grateful for the opportunity to appear before you today and describe our experience with a new kind of consumer scam that we are seeing with increasing frequency.

This is deceptive behavior of the kind that has long existed but now comes clothed in language like “patent infringement” and “innovation.” The goal is the same as in many old-fashioned consumer rip-off schemes that the government has long taken

action against—trying to scare or convince people to pay something they don't owe or buy something they don't need. The direct victims are not large companies like Cisco Systems, but small businesses, non-profit organizations and individuals.

I am involved because I need to defend my customers. But we need your help. We need a little sunshine to disinfect this dark corner of the patent world—because once the practices used by these scam artists are exposed, and the harm to their victims better understood, these rip-off artists will be forced to change their ways.

Introduction

I am Senior Vice President and General Counsel of Cisco Systems. We are a 30-year old company, founded by two Stanford graduate students, who developed the key technology to allow different computer systems to communicate with each other.

Our products are used every day by billions of people around the world, and we sell everything from the core switches and routers that make up the backbone of the Internet, to Wi-Fi systems people use in their homes and businesses, to telephone and video conference systems used by tens of millions of businesses and consumers.

Our annual revenue is approximately \$50 billion, and we directly employ 36,510 people in the United States and indirectly provide jobs to hundreds of thousands more.

We hold over 10,000 U.S. patents and file many hundreds of new patent applications every year. Our patents portfolio is regularly rated among the strongest in the telecommunications industry. Most importantly, our products are used in tens of millions, and perhaps over 100 million, American homes and businesses.

Earlier this year I testified in front of your colleagues on the Judiciary Committee about the scourge of abusive patent litigation practices.¹

I am pleased to report that your Judiciary Committee colleagues and their counterparts in the House of Representatives are working to make patent litigation fairer and more efficient.

We are also hopeful that your Finance Committee colleagues and their counterparts on the House Ways and Means Committee will soon work to assure that International Trade Commission procedures can no longer be used for shakedowns by non-practicing entities that do not truly want an exclusion order. Exclusion orders are the only remedy available from the I.T.C., but often non-practicing entities only want to leverage the threat of such an order to obtain money to which they are not entitled.

These reforms, which focus on litigation abuses, however, don't address the kind of rip-off I'm describing today—a rip-off that targets small businesses and consumers with threat letters, deception, and intimidation tactics.

Examples: Innovatio

Our first story begins with a lawyer named Noel Whitley, who bought patents related to Wi-Fi from his former employer—a great American chip company, Broadcom—and then worked with a team of Chicago lawyers, the Niro firm, which specializes in representing patent assertion entities, to target legitimate businesses.

He created a company which he cynically called “Innovatio,” since innovation is the last thing that the company does. Broadcom sold the patents because they were near their expiration date, heavily licensed to Broadcom's competitors and subject to binding commitments to license on fair and reasonable terms.

So Mr. Whitley and the Niro firm came up with a scheme. He sent over 14,000 letters to small businesses, cafes, bakeries, inns and hotels, a children's health clinic—anyone who he thought might be using Wi-Fi.

Mr. Whitley's team of lawyers and licensing “consultants” told these non-profits and small businesses: “I represent an individual who has suffered injuries as a result of your company's business.” They went on to say, “We are highly confident that the Innovatio portfolio covers effectively ALL currently implemented embodiments of Wi-Fi technology in use today.”

They didn't tell them that a huge proportion of Wi-Fi devices were already licensed, because of Broadcom's cross licenses and the license Broadcom kept for itself, and that therefore they might not even need any further permission or licenses from Innovatio. Instead, they claimed that almost a billion dollars had been collected in royalties already; referring mostly to amounts paid to Broadcom by its

¹*Abusive Patent Litigation: The Impact on American Innovation & Jobs, and Potential Solutions; Hearing before the House Judiciary Committee (Mar. 14, 2013) (statement of Mark Chandler)*, available at http://judiciary.house.gov/hearings/113th/03142013__2/chandler%2003142013.pdf (last visited Nov. 4, 2013)

arch-competitor Qualcomm to resolve numerous U.S. and foreign legal claims that had almost nothing to do with these patents.

They also claimed that thousands of companies had already paid Innovatio as well. They didn't tell their targets that the patents related to industry standards and therefore had to be licensed on fair and non-discriminatory terms—something that all three of the former owners including Broadcom had irrevocably promised to do. Instead they told them, that “[W]e wish to license your company at a very affordable rate—far less than the cost of patent litigation. I can quote you a rate of less than \$3000 per location”—this for patents that a Federal court recently determined were worth pennies per chip.²

And he didn't tell them that the manufacturers of the products, including Cisco, were suing Innovatio to defend their customers. Instead he misrepresented to them that the equipment manufacturers, “have not stepped in to defend any of their users. This means we can still sue your client and they cannot expect equipment manufacturers to aid in their defense.”

Finally, for those businesses who had the temerity to resist, Innovatio enumerated thousands of pages of documents that would have to be reviewed by counsel to even begin to defend against Innovatio's allegations, meaning thousands of dollars in legal fees. Unfortunately, thousands of businesses may have fallen for this scam.

So, although Innovatio cloaks its business in the patina of patents and patent infringement, the reality is that Innovatio is just a modern take on an old scam.

Innovatio conducts its racket by sending letters containing mistruths and omissions to thousands of consumers in an attempt to obtain money from these targets to which Innovatio is not entitled.

And, unfortunately, Innovatio is only one example of this emerging type of consumer fraud.

Project Paperless/MPHJ

There have been numerous news articles about a similar scam by an entity that originally was called Project Paperless and which ultimately became known as MPHJ. Project Paperless engaged in a letter-writing campaign demanding \$1,000 per employee from their targets.³ An online project⁴ discovered that some of the partners in Project Paperless's law firm likely had an ownership interest in the patents. Soon after the revelation of this inconvenient truth, Project Paperless dropped its lawsuits and sold the patents to another shell company called MPHJ Holdings, after which threatening letters started coming from a full alphabet soup of strangely named shell companies including AccNum, AllLed, AdzPro, CalNeb, ChaPac, FanPar, FasLan, FulNer, GosNel, and HunLos.

State attorneys general in Minnesota, Nebraska, and Vermont have taken various actions against MPHJ to protect business and consumers in their respective states from MPHJ's deceptive practices. For example the Vermont attorney general's action against MPHJ lists MPHJ's lies and abusive practices in gory detail including:⁵

1. MPHJ entities sent threatening letters without doing any actual investigation of whether their patents were being infringed.
2. MPHJ forced its targets to do the work of analyzing infringement
3. MPHJ deliberately targeted small businesses without ready access to sophisticated representation
4. MPHJ told its targets that it had a successful established licensing program when in fact it had signed very few licenses with an average licensing fee of \$900.
5. MPHJ's letters indicate that litigation would be imminent if a license deal was not signed almost immediately yet MPHJ had never actually filed suit.

Minnesota reached a settlement with MPHJ forcing them to cease and desist from targeting Minnesota businesses.

²*In re Innovatio IP Ventures, LLC Patent Litig.*, MDL No. 2303, 2013 WL 5593609 (N.D. Ill. Oct. 3, 2013).

³See Joe Mullin, *Meet the nice-guy lawyers who want \$1,000 per worker for using scanners*, arstechnica (Apr. 7, 2013), available at <http://arstechnica.com/tech-policy/2013/04/meet-the-nice-guy-lawyers-who-want-1000-per-worker-for-using-scanners/> (last visited Nov. 4, 2013).

⁴See Stop Project Paperless website—<http://stop-project-paperless.com/the-patents/> (last visited Nov. 4, 2013).

⁵Consumer Protection Complaint in *Vermont v. MPHJ Technology Investments, LLC*, No. 282-S-13WNCV (Vt. Super. Ct.) (filed May 8, 2013), available at <http://www.atg.state.vt.us/assets/files/Vermont%20v%20MPHJ%20Technologies%20Complaint.pdf> (last visited Nov. 4, 2013).

Helferich

Cisco also is aware of another such entity, Helferich Patent Licensing, LLC (“Helferich”). Helferich was founded in 2007 “for the purpose of commercializing, licensing, and enforcing” patents relating to delivery of content to a cell phone. Although Helferich had already licensed its patents to cell phone manufacturers, it sought to double dip by demanding payment from hundreds of companies who sent text messages to those very same licensed cells phones.

Helferich’s letters told its end user targets that companies that paid up immediately would get a discounted rate but threatened that this rate would go up if the target didn’t pay up within 60 days.

Numerous companies entered into licenses, but the New York Times and others decided to fight back. In the New York Times case, the District Court found that the original license to the cell phone manufacturers meant that no further license to the users was needed.

We can only hope that Helferich was exaggerating when it claimed that over 100 companies already had signed licenses that it turned out none of the companies needed.

USEI

Another example is an entity called United States Ethernet Innovations, LLC (“USEI”). USEI purchased a group of patents that were about to expire from 3Com prior to 3Com’s acquisition by Hewlett-Packard.

In addition to filing numerous lawsuits, USEI has sent licensing threat letters to hundreds (or possibly thousands) of end user businesses. USEI’s letters assert that Ethernet technology is covered by their patents and their technology “is utilized in many day-to-day business activities within corporations, including Internet connections, data transmission, retail transactions, corporate transactions, networked security system cameras, point of sale information, and inventory management systems.”

The letters further warn that USEI has hired “the largest and most successful plaintiff’s law firm in the world” and has recently filed infringement lawsuits, but that it was willing to offer a license to a “select group” of entities such as the letter target in order to avoid “protracted litigation.”

We understand that USEI has refused to provide its targets with information that would help them determine whether they actually need a license. For example, we understand that USEI has refused to disclose to its targets what entities already are licensed, a disclosure that would allow the target to determine whether the products it was using already were licensed and thus for which the target user did not have to pay. Targets of USEI’s licensing campaign have included department stores, markets and other end user businesses both large and small.

Cisco’s customers have received licensing demands from many of these shake down campaigns. In each case, the campaigns are inherently deceptive. The patents are often invalid or irrelevant to their targets or already licensed. The target end-users do not get a real picture of the licensing history and the real likelihood of suit. The massive deceptive letter writing campaigns are just a way for the scam artists to get far more money than their patents are worth (if they are worth anything at all) just like in any other scam.

Recommendations

Much of what we have said here is based on Cisco’s own experiences and what Cisco’s own customers have told us about their experiences.

But we do not know the scope and extent of the deceptive practices in which these entities are engaging. Our customers, the end user consumers that these entities are targeting and which we are seeking to protect, know even less. That is why your help is needed.

There are four simple steps that would make it much harder for these scam artists to use deceptive letter writing schemes to extract money to which they are not entitled from end user/consumer targets:⁶

First, require anyone sending patent demand letters to more than ten entities who are NOT the manufacturers of the accused products to file the letters in an on-line registry to be maintained by the FTC. The public, the targets of the campaigns and the FTC need to know the full picture.

⁶My proposal is very consistent with the White House’s recommendations for reforming the patent system. See *Fact Sheet: White House Task Force on High-Tech Patent Issues (June 4, 2013)*, available at <http://www.whitehouse.gov/the-press-office/2013/06/04/fact-sheet-white-house-task-force-high-tech-patent-issues> (last visited Nov. 4, 2013).

Second, require anyone in that category to include in the letter a list of products which are deemed to infringe, including the manufacturer and model number, and informing them that they may have the right to have the manufacturer defend the case, and providing contact information for the manufacturer.

Third, require any such letter to include the names of the entities which own the patents or benefit from their enforcement and any related entities.

And fourth, require the letters to include a list of all previous licenses granted for those patents, with a notice that if the recipient of the letter is using the products or services of a licensed entity, the recipient may require no further rights or permission from the patent holder. Also, the letter should say if there is a relevant licensing commitment to a standards organization.

By adding a basic level of transparency and accountability, these simple steps will help protect innocent end users.

The paycheck I get every other week says "Cisco" on it, but every cent comes from my customers. That is why I am passionate about making sure my customers who trust us to supply them with products don't get ripped off by these predators.

And when these predators are forced to come to me, I can guarantee they will get a fair fight.

Thank you. Please let me know if you have any questions.

Senator McCASKILL. Thank you, Mr. Chandler.
Ms. Samuels.

**STATEMENT OF JULIE P. SAMUELS, SENIOR STAFF ATTORNEY,
MARK CUBAN CHAIR TO ELIMINATE STUPID PATENTS,
ELECTRONIC FRONTIER FOUNDATION**

Ms. SAMUELS. Chairman McCaskill, Ranking Member Heller, Senator Klobuchar, I am Julie Samuels from the Electronic Frontier Foundation, and it is an absolute honor to be here today.

EFF is a nonprofit civil liberties organization that has worked for more than 20 years to protect consumer interests, innovation, and free expression in the digital world. Today we're here to talk about patent assertion entities and their practice sending demand letters.

I'm going to tell you the problem we saw and we continue to see, what we've done to fix it and why we still need your help. The so-called patent troll problem is not a new one, but in the past 18 months something shifted. We started hearing, sometimes daily, from people who had received demand letters, often vague, written in dense legalese, threatening litigation if the recipient didn't pay up.

We heard from app developers, small business owners, startup founders, people who ran their companies out of their living rooms and garages. These victims didn't know what to do or how to respond. They couldn't afford patent lawyers and, frankly, they were scared.

Even worse, the vast majority of these people were being accused of infringing a patent based on everyday technology: online shopping carts; Wi-Fi routers; document scanners and the like. I personally wanted to help everyone who called, but we couldn't. I wanted to give them more information on who was sending the letters but we didn't have it. I wanted to tell them about patent law, what the letter meant, and reinforce that they in fact had no legal obligation to respond to the letter. But that alone would have filled up all of our time. We couldn't represent everyone who needed our help.

Something we quickly learned is that these letters really had nothing to do with patent law. They merely used the guise of patent law as leverage to conduct, frankly, run-of-the-mill extortion.

Two main problems we saw were lack of information and under-reporting. First, without simple facts about the threat it faces, such as who is really behind the demands and if the troll will ever actually sue, a recipient is unable to assess its risk. It is left with a host of undesirable options: to hire a lawyer; to pay the troll to go away; or to do nothing and simply hope the troll disappears.

Second, because the vast majority of the deals entered into between trolls and their targets are not public, the exact scope and contours of the activity we're talking about are frankly hard to understand. So we came up with a solution.

We've developed a website called Trolling Effects; a simple database that allows people to post the demand they received online, find letters received by others, and research who is really behind the threats. Finally, and most importantly, all of the information is freely available to anyone, period.

Our experience so far with Trolling Effects has taught us, however, that many victims are often not willing or inclined to publicly share their letters. This has to do in large part with the public nature of the database and the fact that even with redactions, it is virtually impossible to safely anonymize all letter recipients.

Larger, more established companies fear that making these demands public paints a target on their back while smaller companies and individuals are often even more afraid to attract attention from the trolls. That's why we're here today. To really solve this problem, we need Congressional help.

Despite our best efforts, trolls continue to benefit from the asymmetry of information in the marketplace. Certain targeted legislative fixes could curb these abusive letter-sending practices. Congress could create registries, similar to what we are trying to do with Trolling Effects and what Mr. Chandler also brought up. Legislation could require patent owners to report on details of their demands at the Patent Office, for instance. The Patent Office already has many kinds of reporting requirements for patent holders, so this would be nothing new. Making this information public would fundamentally change the landscape. Armed with more facts, everyday consumers will be better able to assess their options.

The FTC could also maintain a registry of those who send demands and the scope of those demands. Registries, at either the Patent Office or the FTC, would create additional incentives for letter recipients to turn over information. At the Patent Office, a certain amount of complaints regarding a particular patent could lead to a *sua sponte* review of that patent. And at the FTC, a certain number of complaints could trigger a Section 5 investigation. Both options create a value proposition for letter recipients; the hope that, in exchange for information, something might be done.

Legislation could also define certain practices such as making false demands and failing to include certain basic details in those demands as presumptively unfair or deceptive. This would not only trigger existing Section 5 authority, but also many state consumer protection statutes already on the books. At least three states, including Nebraska, as Attorney General Bruning testified, have already targeted this type of behavior and we know that even more are interested.

The importance of today's hearing cannot be understated, particularly because these trolls conduct the vast majority of their business behind a veil of secrecy. But a business model based on secrecy is antithetical to the entire patent system and it's destructive to consumers and our innovation economy.

I thank you for your time and look forward to answering your questions.

[The prepared statement of Ms. Samuels follows:]

PREPARED STATEMENT OF JULIE P. SAMUELS, SENIOR STAFF ATTORNEY, MARK CUBAN CHAIR TO ELIMINATE STUPID PATENTS, ELECTRONIC FRONTIER FOUNDATION

Chairman McCaskill, Ranking Member Heller, and members of the Subcommittee, thank you for holding this hearing and inviting me to testify today about deceptive practices by Patent Assertion Entities. We are greatly encouraged by your interest in this important issue and its impact on consumers.

I am a Senior Staff Attorney at the Electronic Frontier Foundation, where I also hold the Mark Cuban Chair to Eliminate Stupid Patents. EFF is a non-profit civil liberties organization that has worked for more than 20 years to protect consumer interests, innovation, and free expression in the digital world. Founded in 1990, EFF represents more than 24,000 active members. Many of those members are small innovators and tinkerers who often find themselves facing patent litigation or demands. Through litigation, the legislative process, and administrative advocacy, EFF seeks to represent those members' interests and promote a patent system that facilitates, and does not impede, what the Constitution defines as "the Progress of Science and useful Arts."

PAEs use the threat of patent litigation to extort settlements in the form of what they might call "licensing deals." These "licensing deals," however, are not the kind of responsible technology transfer that benefits consumers. These companies, also known as non-practicing entities (NPEs) or, colloquially, as patent trolls, usually neither make nor sell anything but use patents to sue, and threaten lawsuits upon, unsuspecting businesses. As Judge Posner of the Seventh Circuit Court of Appeals explains, patent trolls "are companies that acquire patents not to protect their market for a product they want to produce—patent trolls are not producers—but to lay traps for producers, for a patentee can sue for infringement even if it doesn't make the product that it holds a patent on."¹

Patent trolls are causing enormous harm to innovators and consumers, not to mention job creators. Companies that actually create products, services, and jobs find themselves under siege by trolls who purchase vague and overbroad patents to launch or threaten lawsuits. As you know, the conduct surrounding those lawsuits, and solutions to curb further abuse, are being considered in both chambers of Congress.² The harm to consumers, however, does not only arise out of actual lawsuits; instead, it also comes from dangerous and irresponsible demand letter-writing campaigns. Indeed, as the White House found: "The PAE business model is based on the presumption that in many cases, targeted firms will settle out of court rather than take the risky, time-consuming course of allowing a court to decide if infringement has occurred."³

These demand letters are often vague, lacking basic detail of what the recipient does to allegedly infringe the patent at issue. The letters frequently list patent numbers without detailing which parts of the patent—which typically comprises many pages of dense technical content and legalese—are at issue. While the recipient of the letter, most often an entrepreneur focused on building her business, has no legal obligation to reply, she might not know that, and the senders often include "draft complaints" and other enclosures in an attempt to threaten real litigation, even though the patent holders may have no intention of actually bringing a suit in court. And this is no wonder, as the letters' targets are ever more frequently individuals and small companies whose entire annual revenue would not cover the cost of a lawyer's time to obtain the information necessary to respond to the letter.

¹Richard A. Posner, *Why There Are Too Many Patents in America*, The Atlantic (July 12, 2012), <http://www.theatlantic.com/business/archive/2012/07/why-there-are-too-many-patents-in-america/259725/>.

²See, e.g., The Innovation Act of 2103 (H.R. 3309); The Patent Quality Improvement Act (S. 866); and the Patent Abuse Reduction Act (S. 1013).

³Executive Office of the President, *Patent Assertion and U.S. Innovation*, at 12, http://www.whitehouse.gov/sites/default/files/docs/patent_report.pdf.

To understand the threat to consumers that irresponsible demand letter practices pose, one first must understand the harms that flow from current patent litigation trends. Since 2002, litigation at the hands of patent trolls has grown from just five percent of total patent litigation to a majority of all patent cases.⁴ Moreover, patent trolls are targeting smaller companies, such as startups, that lack the resources to defend against a patent suit (which can cost well over \$1 million per side) and thus have no choice but to pay extortionate settlement demands.⁵

This explosion of patent troll litigation has been very costly. The research shows that “NPE lawsuits are associated with half a trillion dollars of lost wealth to defendants from 1990 through 2010. [And] during the last four years the lost wealth has averaged over \$80 billion per year.”⁶ The burden of patent troll litigation falls particularly hard on small companies. Professor Colleen Chien recently found that at least 55 percent of unique defendants in patent troll suits have revenues under \$10 million per year.⁷

Of particular note, the patent troll problem is quite often a software patent problem. Software patents serve as an attractive tool for patent trolls because they are notoriously difficult to interpret—giving unscrupulous patent owners the ability to claim that their patent covers a wide range of technology.⁸ Thus, litigation involving software patents has increased dramatically—from fewer than 200 per year prior in 1997 to the current rate of over 1000 per year.⁹ Many of these suits are brought by patent trolls. In fact, more than 80 percent of troll-filed suits assert high-tech patents, and more than 65 percent have software-related claims.¹⁰ For the same reasons that software patents and their “fuzzy boundaries” result in an increase in litigation, they too provide patent holders a dangerous tool to send menacing demand letters.

Another dangerous demand-letter trend, too, has its roots in litigation, but directly results in extraordinary harm to consumers outside of the courtroom. PAEs now make a regular practice of targeting those who use generally available technology. In fact, six of the top ten largest patent litigation campaigns targeted end users and not the manufacturers or suppliers of the supposedly infringing product or technology.¹¹ And the research shows that:

The burden for these suits falls disproportionately on small companies, and too often results in nuisance settlements based on the high cost of defending a patent case, not the merits of the claim.¹²

Even worse, many of these letter recipients are not what we commonly think of as “technology companies.” Instead, they merely use technology, as we all do. In fact, retail is “among the most highly pursued industries” by PAEs.¹³

Because the use of technology is widespread, so is the harm from these types of patent demands. “Indeed, many businesses have stopped adopting technology altogether to avoid patent infringement claims—for example, scanning to a USB stick

⁴James Bessen, Jennifer Ford and Michael Meurer, *The Private and Social Costs of Patent Trolls*, (“Bessen 2011”) at 7, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1930272; Colleen V. Chien, *Patent Assertion Entities*, presentation to the December 10, 2012 DOJ/FTC Hearing on PAEs, (“Chien Slides”), at slides 23–24, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2187314.

⁵Colleen V. Chien, *Startups and Patent Trolls* (Santa Clara Univ. Sch. of Law Legal Studies Research Paper Series, Accepted Paper No. 90–12, 2012), (“Chien 2012”), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2146251.

⁶Bessen 2011 at 2.

⁷Chien 2012 at 1–2.

⁸In other words, “software patents have ‘fuzzy boundaries’: they have unpredictable claim interpretation and unclear scope. . . and the huge number of software patents granted makes thorough search to clear rights infeasible, especially when the patent applicants hide claims for many years by filing continuations. This gives rise to many situations where technology firms inadvertently infringe.” Bessen 2011 at 23.

⁹James Bessen, *A Generation of Software Patents*, 18 B.U. J. Sci. & Tech. L. 241, 259 (2012) (Figure 3).

¹⁰See Brian J. Love, *An Empirical Study of Patent Litigation Timing: Could a Patent Term Reduction Decimate Trolls Without Harming Innovators?* (August 30, 2011), at 39, <http://ssrn.com/abstract=1917709> (forthcoming in University of Pennsylvania Law Review).

¹¹Colleen V. Chien and Edward Reines, *Why Technology Customers are Being Sued En Masse for Patent Infringement & What Can Be Done*, Santa Clara University School of Law Working Paper No. 20–13 (August 2013) (“Chien & Reines”) at 2, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2318666.

¹²*Id.* at 4.

¹³*Id.* at 8.

to avoid infringing a PDF machine patent, not offering Wi-Fi to customers to avoid Wi-Fi patents, or, in some cases exiting the business or business line.”¹⁴

Even though a demand letter is not a legal complaint, and even if it makes specious claims, the mere threat of litigation brings with it serious costs. As one study found:

Patent demands can be costly to resolve, and particularly so for small companies. The overwhelming majority of companies said that resolving the demand required founder time (73 percent) and distracted from the core business (89 percent); most experienced a financial impact as well (63 percent). However, responses and the costs of these responses ran the gamut; for example, 22 percent of those surveyed said they “did nothing” to resolve the demand.¹⁵

Mere threats can cause this harm because the costs of patent litigation are, simply, outrageous. If taken to verdict, defending a lawsuit can easily cost nearly \$3 million.¹⁶ Even if the case is dismissed early, legal costs will often run into the six and seven figures.¹⁷ Thus, when facing a vaguely worded demand letter that threatens immediate suit and the expensive and unpredictable world of litigation, it is no wonder that so many recipients will merely pay the troll, *even when the PAE may have no intention of ever bringing a lawsuit.*

These harms are not abstract. They affect real people everyday. Like Mark Egerman, founder of Cover. Cover is a smartphone application (“app”) that allows customers to easily split and pay their bills at restaurants. According to Mr. Egerman,

When we launched in October, we were thrilled by the support we got from restaurants and users. Unfortunately, the press attention brought with it something else—our first patent troll. Within days of launching we received a threatening letter asking us to license a patent or else lawyers would get involved. The patent doesn’t address our product and yet we find ourselves in the same unenviable position of hundreds of other startups. Pay off the troll or face an unnecessary lawsuit.

Another app developer, Gedeon P. Maheux, found himself in a similar situation:

[We] and several other companies were threatened by a well-known patent troll for a patent we (and thousands of other software developers) supposedly violated dealing with in-app purchases in iPhone apps. . . . At first we decided to use legal means to fight the troll. We hired a lawyer who informed us of our options. . . . The troll demanded payment by a given date and unless we were prepared to go to court, we had to comply. We’re a small business and quickly found our mounting legal fees becoming unreasonable. In the face of [the slow legal system] and increasing costs dealing with the troll, we decided as a group to take the license and pay the troll his toll.

En masse, these threats wreak havoc on consumers. Take Innovatio, a company that, “using a portfolio of 31 patents directed at the 802.11 wireless communication standard (most of which are expired or lapsed). . . has made demands of over 13,000 small and large end-users of wi-fi technology using devices sold by Cisco, Netgear, Apple, and others.”¹⁸ In less technical terms, this means that coffee shops, hotels, and other small retailers who have bought a \$40 router off-the-shelf at their local retailer find themselves facing letters with ominous warnings threatening expensive litigation.

Or, MPHJ, a PAE that has sent letters to thousands of small businesses around the country demanding steep license fees for the use of standard office scanners.¹⁹ MPHJ’s practices are particularly egregious—it has created a series of shell corporations with nonsensical names like AdzPro, GosNel, and FasLan, making them nearly impossible to track. MPHJ demands approximately \$1,000 per employee who uses simple scanning technology—a claim that surely implicates office workers across the country

MPHJ sends demand letters (including letters with draft complaints attached) without any apparent intent of ever suing; indeed, there is no record that a single suit has been filed. MPHJ’s practices have drawn the attention of at least three

¹⁴ *Id.* at 12.

¹⁵ Chien 2012 at 10.

¹⁶ See http://news.cnet.com/8301-32973_3-57409792-296/how-much-is-that-patent-lawsuit-going-to-cost-you.

¹⁷ Chien & Reines at 3.

¹⁸ *Id.* at 19.

¹⁹ *Id.* at 10.

states' Attorneys General. In Vermont, the Attorney General sued MPHJ, claiming that its actions demonstrate unfair trade practices in commerce and deceptive trade practices in commerce.²⁰ That suit is ongoing. Minnesota's Attorney General reached a consent decree with MPHJ prohibiting the PAE from sending correspondence to anyone in the state that seeks fees or payments or threatens litigation in connection with intellectual property infringement, unless MPHJ gives 60 days' written notice to the Attorney General or obtains consent.²¹ And, finally, Nebraska's Attorney General issued a civil investigative demand and cease and desist letter to Farney Daniels, one of MPHJ's law firms, who also represents another notorious PAE, Activision, in Nebraska.²² Farney Daniels has sued over the propriety of the cease and desist order and that litigation is ongoing.

Massive PAE demand-letter campaigns like these lead to additional problems surrounding the sharing of and reporting on information. Because the demands by definition exist pre-complaint, they create no public record. And once a license or settlement is signed, it most likely will include a non-disclosure provision leaving the recipient unable to share its experience. This causes two problems: asymmetry of information and underreporting.

The asymmetry of information problem is simple: the PAE holds all of the information surrounding its threat while the recipient is left with almost none. Without simple facts about the alleged threat it faces, such as who is really behind the demand and if the PAE's history makes it likely to further pursue its threats, a demand recipient is unable to assess its risk. It is left with a host of undesirable options: to hire a lawyer, to pay the PAE to go away, or to do nothing and simply hope the PAE disappears. In most instances, the PAE risk was not one that the recipient bargained for when it bought the product at issue or started its business, yet it finds itself with no choice but to face it.

The second problem is underreporting. Because the vast majority of the deals entered into between PAEs and their targets are not public, the exact scope and contours of PAE activity is difficult for policymakers and others to properly understand.

To combat these concerns, EFF, along with a broad coalition, launched Trolling Effects, a database to collect demand letters.²³ The site was officially launched on July 31, 2013. The site allows demand letter recipients to post the documents online, find letters received by others, and research who is really behind the threats. The site also features comprehensive guides to the patent and additional relevant information. Finally—and most importantly—all of the information is freely available, not only to those who receive PAE demands, but to academics, policy makers, and the general public.

Our experience thus far with Trolling Effects has taught us that many demand recipients are often not willing or inclined to publicly share their letters. This has to do in large part with the public nature of the database and the fact that, even with redactions, it is virtually impossible to safely anonymize letter recipients. Demand recipients, both large and small, often chose to keep their identity hidden.²⁴ Larger, more established companies fear that making these demands public “paints a target on their back.” Smaller companies and individuals are often even more afraid. It appears that ensuring more thorough transparency will require action from Congress.

Statutory Intervention is Necessary to Protect Consumers

While questions of patent law usually find themselves before the Judiciary Committee, this Committee should consider and correct the negative impact that demand letter-sending practices have on consumers. Those practices can be regulated without disrupting the underlying patent laws and without negative impact on responsible technology transfer. Below, we set forth some potential targeted legislative solutions.

²⁰ See <http://www.atg.state.vt.us/news/vermont-attorney-general-sues-patent-troll-in-ground-breaking-lawsuit.php>.

²¹ See <http://www.ag.state.mn.us/Consumer/PressRelease/130820StopPatentTrolling.asp>.

²² See http://www.ago.ne.gov/resources/dyn/files/1069520z2e735d6e/_fn/071813+Bruning+Patent+Troll+Release+.pdf.

²³ See <https://www.trollingeffects.org>

²⁴ Professor Robin Feldman came to a similar conclusion: “for a number of years, companies have been reluctant to speak to reporters or researchers, partly out of fear of retaliation by large players with large patent portfolios.” Robin Feldman, *Patent Demands & Startup Companies: The View from the Venture Capital Community* (Oct. 29, 2013) (“Feldman”) at 29, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2346338.

A. Defining Relevant Practices that Violate Consumer Protection Statutes

Section 5 of the FTC Act declares unlawful “unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce.” 15 U.S.C.A. § 45(a)(1). Abusive demand letters are both an unfair method of competition and a deceptive practice. A law defining those practices as such would trigger not just Section 5, but many similar state law provisions already on the books.

There can be no doubt that PAE actions cause significant economic harm. According to a congressional study, PAE activity cost defendants and licensees \$29 billion in 2011, a 400 percent increase over \$7 billion in 2005, and the losses are mostly deadweight, with less than 25 percent flowing to innovation and at least that much going towards legal fees.²⁵ Moreover, a recent survey found that 74 percent of venture investors “reported that patent demands had either a highly significant or a moderately significant impact on the companies that received them, including distracting management, expending resources, or altering business plans.”²⁶ The demand activity in these reports is not limited to letters, of course. But the demand letters do extract their toll, and make up a significant portion of those costs. For instance, Professor Colleen Chien has reported that there are at least 100 demand threats for each filed lawsuit.²⁷

The FTC Act was enacted to protect consumers from the type of demand-letter practices many PAEs have lately practiced. By statutorily defining certain of those practices as “unfair methods of competition” or “unfair or deceptive acts or practices,” Congress could trigger existing Section 5 protections.²⁸ For instance, the following type of demand-sending behavior might be addressed:

- Demands falsely threatening litigation;²⁹
- Demands sent without specifically listing the patents and claims that are allegedly infringed;
- Demands sent without listing the products and services that allegedly infringe those patents;
- Demands sent without any clear indication of who owns the patent at issue;
- Demands sent following a failure to perform any pre-demand investigation into the recipient; and
- Demands sent to businesses with the direct knowledge that those businesses can neither afford to take a license or defend themselves in Federal court.

PAEs routinely send demands that do all of these things. They leave recipients without any meaningful information on how to mitigate and manage their risk, and leave them oftentimes with little choice but to take an unearned license. This is precisely the kind of behavior that may and should be regulated by consumer protection statutes. As the Commission itself has stated, it can target “[c]onduct that results in harm to competition, and in turn, in harm to consumer welfare, [which] typically does so through increased prices, reduced output, diminished quality, or weakened incentives to innovate.”³⁰

Defining the types of practices that PAEs like MPHJ rely on as unfair or deceptive practices would allow the FTC and various states with statutes similar to Vermont’s to take advantage of existing statutory frameworks and end the dangerous PAE demand-sending campaigns. Moreover, it would present no risk to companies who engage in responsible licensing practices and technology transfer, who could easily obtain the information necessary to conduct proper business.

²⁵ Brian T. Yeh, Cong. Research Serv., R42668, *An Overview of the “Patent Trolls” Debate*, (2012) (“Yeh”) at Summary and 2, https://www.eff.org/sites/default/files/R42668_0.pdf (citing James Bessen & Michael Meurer, *The Direct Costs from NPE Disputes* 2, 18–19, (Boston Univ. School of Law, Law and Economics Research Paper No. 12–34, 2012) (“Bessen 2012”), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2091210

²⁶ Feldman at 39–40.

²⁷ Chien Slides at slide 25.

²⁸ FTC Chairwoman Edith Ramirez said in a recent speech she believed Section 5 authority could reach certain PAE activities, such as those “that target small businesses with false claims made to induce the payment of illegitimate licensing fees.” Opening Remarks of Chairwoman Edith Ramirez, Competition Law & Patent Assertion Entities: What Antitrust Enforces Can Do (June 20, 2013) at 9 <http://ftc.gov/speeches/ramirez/130620paespeech.pdf>.

²⁹ See, e.g., The Federal Fair Debt Collections Practices Act, 15 USC § 1692(e), limiting the scope of threats that can be made in a debt collection letter.

³⁰ Statement of Commissioner Joshua D. Wright, Proposed Policy Statement Regarding Unfair Methods of Competition Under Section 5 of the Federal Trade Commission Act (June 19, 2013) at 7, <http://www.ftc.gov/speeches/wright/130619umcpolicystatement.pdf>.

B. Creating Public Registries of Relevant PAE Information

Because a patent is a government-granted monopoly, the government may impose conditions on that grant. Indeed, it does that all the time by requiring that certain conditions be met before a patent is granted and that patent holders keep their records up-to-date by, for instance, reporting on changes in ownership. Likewise, a patent holder should be required to provide certain information to the Patent Office when it asserts infringement of that patent in a letter.

Patent owners could be required to report information such as how many demand letters have been sent regarding a specific patent; identification of all parties who stand to benefit financially from any resulting license; identification of any obligation to license the patents at issue on fair or reasonable terms; and how many times the holder has filed suit based on the patent at issue.

There are various reasonable triggers that could require such reporting, such as a certain number of letters sent in a set period of time or notification to the Patent Office of a threshold number of letter recipients.

At a minimum, reporting this information to the Patent Office would make it public (assuming the Patent Office provided it in a publicly-accessible database, which it should be required to do). This information would fundamentally change the unfair information asymmetry facing demand recipients—armed with more facts, they will be better able to assess their options.

Collecting the information might also assist the Patent Office in initiating *sua sponte* review of certain patents. If the Office has information regarding which patents are most often used as weapons by PAEs, it might prioritize those for such review. Indeed, in a world with literally millions of existing patents, it makes sense to focus challenges on those that pose the greatest threat to consumers.³¹ It is not until those patents are asserted in demands that we can ascertain just which patents will cause harm. Requiring reporting to the Patent Office will give the Office necessary knowledge to know which patents make the most sense to target for additional review.³² (The potential for Patent Office review of existing patents may likewise serve as an incentive for demand-letter recipients to provide information as well.)

It is not just the Patent Office who may decide to subject existing patents to additional review (indeed, this is a very rare practice, though there is no reason it could not happen more). It also gives third parties—including public interest groups like EFF—knowledge surrounding which patents they might choose to challenge. EFF alone has made more than 15 third-party patent challenges to patents and patent applications, one as recent as October of 2013. These challenges require significant resources, both financial and otherwise, and it is of great benefit to know which patents pose the greatest threat to consumers, end-users, and those who may not be in a position to put forth such a challenge themselves.

In the alternative, the FTC could also house a similar registry of patent demands. It already does this in various other contexts, such as the Do Not Call Registry. When a certain threshold number of demands are sent involving a particular patent, or from a particular sending party, the FTC might initiate an investigation. Similar to a registry at the Patent Office, one at the FTC might be made up of patent holders self-reporting or consumers submitting information on the demands they receive. Given the FTC's expertise in consumer-facing issues, it would be particularly equipped to house the latter type of registry; given the Patent Office's expertise in dealing with patent owners, it might focus on the former.

C. Increasing Public-Private Partnerships

In virtually every area of the law there has been a long history of productive public-private partnerships. Patent law is no exception. The Peer To Patent project³³ serves as a telling example. Peer To Patent provided the first “governmental ‘social networking’ Website designed to solicit public participation in the patent examination process.”³⁴ After its first two years, Peer To Patent attracted more than 74,000 visitors; of those visitors, more than 2,600 went on to become peer reviewers.³⁵ Also in its first two years, the project contributed relevant prior art in more than 25 percent of the applications it handled.

EFF envisions a similar partnership with our Trolling Effects site. Trolling Effects may serve as a public-facing database for information collected by the Patent Office

³¹ Dan L. Burk & Mark Lemley, *Policy Levers in Patent Law*, 89 Va. L. Rev. 1575 (2003).

³² See Chien & Reines at 6.

³³ <http://www.peertopatent.org>.

³⁴ Peer To Patent Second Anniversary Report at 4, http://dotank.nyls.edu/communitypatent/CPI_P2P_YearTwo_lo.pdf

³⁵ *Id.* at 5

or otherwise work with the government to increase the reach and scope of that information. In combination with statutory provisions providing for submission of information, Trolling Effects or a project like it will serve as a powerful tool to curb the current demand letter abuses.

Conclusion

In conclusion, EFF has grave concerns about the impact that PAE activities are having on consumers. The importance of today's hearing on those activities cannot be understated, particularly because PAEs conduct the vast majority of their business behind a veil of secrecy. Individual consumers, small start-ups, and ordinary Americans find themselves facing patent troll threats everyday, yet even the most basic information on those threats is often unattainable. Even just having us here today to talk about this problem is a crucial step toward solving it. We encourage you to continue this important conversation and consider legislative proposals that would limit the harm to consumers from PAE activity, particularly the direct harm that comes from demand letters.

STATEMENT OF LARY SINEWITZ, EXECUTIVE VICE PRESIDENT, BRANDSMART USA ON BEHALF OF THE NATIONAL RETAIL FEDERATION

Mr. SINEWITZ. Sorry.

My name is Lary Sinewitz, and I am the Executive Vice President of BrandsMart USA. BrandsMart USA is a consumer electronics and appliance retailer in the Southeast. We have ten retail stores and one clearance center in South Florida and Georgia and a growing ecommerce presence at *BrandsMartUSA.com*. We employ 2,000 people; that actually represent 2,000 families throughout our business.

I'm here today on behalf of, not only BrandsMart, but also the National Retail Federation and the Stop Patent Abuse Now Coalition. NRF represents retailers of all types and sizes including chain restaurants, industry partners from the United States and more than 45 countries abroad. Retailers operate more than 3.6 million U.S. establishments that literally support one in every four U.S. jobs.

The SPAN Coalition represents the interests of retailers, advertisers, advertising agencies and direct marketers, increasingly targets of patent trolls' unfair and deceptive patent infringement demand letters. Members of the NRF and the SPAN Coalition appreciate the attention that the subcommittee is paying attention to the issue of demand letter transparency and the harmful effect patent trolls have on competitiveness and innovation.

I'm just one retailer, but I really believe that my experience receiving these patent troll demand letters is fairly typical, not only of retailers but of also businesses and not-for-profits of all types who are the end users of technology.

Over the course of the last several years, my company alone has received six patent troll demand letters. The scary thing, though, is that BrandsMart's experience is not unique. For example, in 2008, I received this short, two-paragraph letter, from a law firm, which you have a copy of up there, stating that it had come to their attention that my retail facilities were using credit, debit and gift cards that were activated in a manner that may raise issues with their client's patent.

To be clear, the technology at issue in the demand letter is one that enables credit, debit and gift cards to read and process information via the magnetic stripe on the back of the card. Virtually,

every retailer uses this type of technology. So imagine my shock when some law firm sends me a vague letter accusing me of patent infringement and trying to get me to pay them some unknown sum of money for a license.

So I ask you to put yourself in my shoes, and the shoes of retailers and other businesses across the country. You receive a vague patent troll demand letter about some process you are using to enable credit cards to be used in your stores. What do you do? Do you consult a patent lawyer? Well, BrandsMart doesn't have an in-house patent lawyer. They don't even have a patent lawyer on retainer. So one can imagine, just to pick up the phone to consult a patent lawyer, to determine the validity of the infringement claim and evaluate the license demand, costs tens of thousands of dollars.

Patent troll demand letters like this one puts the fear in you that a costly lawsuit could be forthcoming. So what do you do? You stop accepting credit, debit and gift cards? No way. That would be the death of your business. So, a business like mine either ignores the letter at their own peril, hopes the harassment goes away, or we begrudgingly try to settle for as little money as possible. And in every case, we've had to choose the latter approach and pay.

Incidentally, we still incur the expense of consulting a patent lawyer about this letter. And when BrandsMart informed the PAE that we use a different technology to read cards, they still demanded a settlement, but reduced the amounts. We ended up paying this particular PAE five figures to settle, and our legal fees were five figures as well. In all, BrandsMart has spent a half a million dollars to settle patent infringement claims and attorneys' fees.

We're a retailer trying to serve our customers and settling with patent trolls takes away from our resources. We would rather use those resources investing in our communities, our stores, our employees and for newer innovation.

Patent trolls are increasingly harassing businesses and not-for-profits of every size across a wide swath of industries with demand letters. Retailers appear to be an easy prey because they often do not have the technical expertise, operate on thin profit margins, and lack the legal resources and expertise to fight complex patent infringement claims. Ninety-one percent of the retail companies operate with fewer than 20 employees and 95 percent of the retail companies operate just one location. Most retailers do not have the time or the money to engage in lengthy battles with patent trolls. Something must be done to help the retailers and other businesses get out from under the patent trolls' control.

NRF and SPAN Coalition members support legislative proposals to have the Federal Trade Commission look into these unfair or deceptive demand letters which are so effective because they lack detail. And using their current consumer protection enforcement powers, rein in bad actors that target main street businesses.

Patent trolls should not have free rein to assert expired patents, make repeated and false threats of litigation to extort fees, and materially mislead the recipients of these demands. At the very least, patent trolls should be required to provide more details in their letters. It's imperative that Congress act to give retailers and other businesses relief from this escalating problem.

If I could just sum it up in one sentence or in a nutshell, it's all about fairness. That's all that we're asking for. We appreciate your attention to this issue. I thank you personally and I look forward to any of your questions.

[The prepared statement of Mr. Sinewitz follows:]

PREPARED STATEMENT OF LARY SINEWITZ, EXECUTIVE VICE PRESIDENT,
BRANDSMART USA, ON BEHALF OF THE NATIONAL RETAIL FEDERATION

Introduction and Background

Chairman McCaskill, Ranking Member Heller, and members of the Subcommittee, I thank you for the opportunity to appear before you today. My name is Lary Sinewitz, and I am Executive Vice President of BrandsMart USA. Founded in 1979, BrandsMart USA is a consumer electronics and appliance retailer in the Southeast. With 11 retail stores in South Florida and the Atlanta area and a growing ecommerce presence at BrandsMart-USA.com, BrandsMart USA is the 8th largest appliance retailer in the country. We employ 2,000 people.

I am here today on behalf of the National Retail Federation ("NRF") and the Stop Patent Abuse Now ("SPAN") Coalition to testify about the impact of demand letters sent by patent assertion entities ("PAEs") or "patent trolls" on small businesses and consumers. Members of the NRF and the SPAN Coalition appreciate the attention the Subcommittee is paying to this particular issue.

As the world's largest retail trade association and the voice of retail worldwide, NRF represents retailers of all types and sizes, including chain restaurants and industry partners, from the United States and more than 45 countries abroad. Retailers operate more than 3.6 million U.S. establishments that support one in four U.S. jobs—42 million working Americans. Founded in 1996, Shop.org's 600 members include the 10 largest online retailers in the U.S. and more than 60 percent of the *Internet Retailer* Top 100 E-Retailers. The National Council of Chain Restaurants, a division of the National Retail Federation, has worked to advance sound public policy that serves restaurant businesses and the millions of people they employ for over 40 years. NCCR members include the country's most respected quick-service and table-service chain restaurants. Contributing \$2.5 trillion to annual GDP, retail is a daily barometer for the Nation's economy. Retailers create opportunities for life-long careers, strengthen communities at home and abroad, and play a leading role in driving innovation.

The SPAN Coalition represents the interests of retailers, advertisers, advertising agencies, and direct marketers who increasingly are being targeted by patent trolls with unfair and deceptive patent infringement demand letters.

BrandsMart's Experience with Patent Troll Demand Letters

You have invited me to testify about my company's experience with unfair or deceptive demand letters. I am just one retailer, but I believe my experience receiving patent troll demand letters is fairly typical, not only of retailers, but also of businesses and not-for-profits of all types who are the end-users of technology.

Over the course of the last several years, my company alone has received six patent troll demand letters. For example, in 2008, I received a short, two paragraph letter from a law firm stating that it had come to their attention that my retail facilities were using debit and gift cards that were activated in a manner that may raise issues with their client's patent.

To be clear, the technology at issue in the demand letter is a ubiquitous technology that enables debit cards and gift cards to read and process information via the magnetic strip on the back of the card. Virtually every retailer uses this type of technology. So imagine my shock when some law firm sent me a vague letter accusing me of patent infringement and trying to get me to pay them some unknown sum of money for a license.

I do not believe this law firm did any due diligence truly to ascertain whether BrandsMart was infringing its client's patent. Rather, I believe, based on my conversations with other retailers in my region, that the firm simply picked the 150 biggest retailers in the Atlanta metropolitan area and sent the same vague demand letter to each of them.

So, I ask you to put yourselves in my shoes—and the shoes of retailers and similarly situated small businesses across the country. You receive a vague patent troll demand letter about some process you are using to enable credit cards to be used in your stores. What do you do? Consult a patent lawyer? BrandsMart does not have in-house patent lawyers, and we did not even have a patent lawyer on retainer. As

one can imagine, just to pick up the phone to consult a patent lawyer to determine the validity of the infringement claim and evaluate the license demand could cost tens of thousands of dollars. Moreover, the cost of litigating the claim in court or going to the Patent Trademark Office to challenge the patent could be prohibitive or imprudent to a business such as mine.

Patent troll demand letters like this one put the fear in you that a costly lawsuit could be forthcoming. So what can you do? Stop accepting credit cards and gift cards? No way; that would be the death of your business. So, a business like mine either ignores the letter at our own peril (and hope the harassment goes away) or we begrudgingly try to settle for as little money as possible. In every case, we have chosen the later approach and paid.

Incidentally, we did incur the expense of consulting a patent lawyer about this letter, and when BrandsMart informed the PAE that we used a different technology to read cards, they still demanded a settlement, but reduced the amount. We ended up paying this particular PAE for five figures, and our legal fees were five figures as well. I have submitted the redacted letter with my testimony today.

Regrettably, in the past ten years, BrandsMart has spent approximately \$500,000 consulting with attorneys on infringement claims and settling with patent trolls.

BrandsMart's Experience with Patent Troll Demand Letters is not Unique

What NRF and the SPAN Coalition have learned is that BrandsMart's experience with patent troll demand letters is not unique. Patent trolls are increasingly harassing businesses and not-for-profits of every size, across a wide swath of industries, with demand letters. These letters come out of nowhere, and often allege that the mere use of everyday technology violates the patent holders' rights. Further, these questionable letters typically state vague or hypothetical theories of infringement, often overstate or grossly reinterpret the patent in question, and, in some cases, make allegations of infringement of expired or previously licensed patents.

At their core, demand letters use the threat of litigation as leverage to extract a "licensing fee" from the recipient business. Businesses like BrandsMart often simply settle these nuisance claims rather than run the risk of protracted litigation in Federal court. Put simply, it is often much more expensive to hire a lawyer to review or defend against a suspect claim than it is to pay the requested "fee." This is the trolls' business model.

No one knows just how many thousands of patent-related demand letters are sent out by trolls each year; statistics only track actual patent infringement litigation in Federal courts. The troll has to actually file a case in court before a judge is even made aware of the infringement claim, therefore it is impossible to get an accurate understanding of the full breadth of this problem.

End-user businesses such as retailers also appear to be easy prey because they often lack the legal resources and expertise to fight complex patent infringement claims. Many retailers do not even employ legal counsel in-house, let alone a highly specialized patent attorney. Ninety-one percent of retail companies operate with fewer than 20 employees and 95 percent of retail companies operate just one location.¹ Further, most retailers also do not have the time or money to engage in a lengthy battle with patent trolls. The average cost of fighting a patent troll is around \$2 million and takes about 18 months.² Patent trolls knowingly exploit their targets' tactical disadvantages, often pricing a settlement demand (which may still be in the millions) just below the cost of litigation, effectively blackmailing a retailer into settlement. This is an abuse of the system.

Trolls' claims not only affect e-commerce applications and the everyday use of technology, but also affect the storefront operations of traditional "brick and mortar" retailers, like BrandsMart. Some real world examples of the latter are claims that purport to cover point of sale and inventory control equipment, including; scanning barcodes, printing receipts, the sale of gift cards, and the connection of any product, such as a computer or printer, to an Ethernet network.

Today, too many businesses like BrandsMart are diverting precious capital resources to settle with or fight patent trolls. This is capital that they could otherwise use to invest in their businesses and in their communities, including; creating jobs, fostering innovation, and maintaining their stores. Because the retail industry contributes \$2.5 trillion to our Nation's annual GDP, loosening the grip of patent trolls on retailers and others will allow innovation and growth to flourish, and undoubtedly benefit the overall U.S. economy.

¹2007 Economic Census, *thisisretail.org*.

²Mark Gibbs, "A Patent Troll Wants to Charge You for E-mailing Your Scans," *Forbes.com*, January 5, 2013.

NRF and SPAN Coalition members support legislative proposals to have the Federal Trade Commission (“FTC”) look into these unfair or deceptive demand letters and, using their current consumer protection enforcement powers, rein in bad actors that target main street businesses. Patent trolls should not have free reign to assert expired patents, make repeated and false threats of litigation to extort fees, and materially mislead the recipients of these demands. At the very least, patent trolls should be required to provide more details in their letters. Currently, the letters are so effective because they lack specificity. Requiring greater and truthful disclosure will provide greater certainty to businesses, saving them time and money as they investigate the person or entity asserting the patent and determine the overall merits of the infringement claim.

Combating the rise of patent trolls is a top priority for retailers and the SPAN Coalition as a whole. We look forward to discussing meaningful legislative solutions and demand letter relief as patent litigation reform legislation moves forward this year. We appreciate the Subcommittee’s attention to this issue, and look forward to continuing our work together.

CHICAGO
ILLINOIS
60604-3606
U.S.A.

EMAIL:
TELEPHONE:
TOLLFREE:
FAX:

OF COUNSEL

22 February 2008

**VIA CERTIFIED MAIL/
RETURN RECEIPT REQUESTED**

BrandsMart USA
Attn: Legal Department
3200 SW 42nd St.
Hollywood, FL 33312

In Re. U.S. Patent No.

To Whom It May Concern:

Please be advised that this law firm represents the owner of United States Patent No. [redacted] entitled ("Patent"). A copy of the Patent is enclosed for your review.

It has come to our attention that your retail facilities are using debit and gift cards that are activated in a manner that may raise issues with the Patent. Please review the Patent and advise the undersigned if you would be interested in taking a license under the Patent. If you do not believe that your system has any conflict with the Patent, please advise the basis of your position so that we can analyze the situation and make an appropriate decision on how to proceed. Thank you for your attention to this matter.

Very truly yours,



Enclosures

Senator McCASKILL. Yes, Mr. Mossoff.

**STATEMENT OF ADAM MOSSOFF, PROFESSOR OF LAW,
GEORGE MASON UNIVERSITY SCHOOL OF LAW AND
SENIOR SCHOLAR, CENTER FOR THE PROTECTION OF
INTELLECTUAL PROPERTY**

Mr. MOSSOFF. Chairman McCaskill, Ranking Member Heller, and members of the Subcommittee, thank you for this opportunity to speak to you today.

There certainly are bad actors, deceptive demand letters and frivolous litigation in the patent system. The important question though is whether there is a systemic problem requiring further systemic revisions to the patent system. There is no answer to this question and that is the case for three reasons.

First, the calls to rush to enact systemic revisions to the patent system are being made without scientifically established evidence that there is in fact systemic harm to innovation, let alone any harm to the consumers that Section 5 authorizes the FTC to protect. As the Government Accountability Office found in its August 2013 report on patent litigation, the frequently cited studies claiming harms are actually “nonrandom” and “non-generalizable,” which means that they are unscientific and unreliable. These anecdotal reports and unreliable studies do not prove that there is a systemic problem requiring a systemic revision to the patent licensing process.

Of even greater concern, is that the many changes to the patent system Congress is considering, including extending the FTC’s authority over demand letters, would impose serious costs on real innovators and thus do actual harm to America’s innovation economy and job growth. From Charles Goodyear and Thomas Edison in the 19th century, to IBM and Microsoft today, patent licensing has been essential to bringing patented innovation to the marketplace, creating economic growth and a flourishing society. But expanding FTC authority to regulate requests for licensing royalties under vague evidentiary and legal standards only weakens patents and creates costly uncertainty. This will hamper America’s innovation economy, causing reduced economic growth, lost jobs, and reduced standards of living for everyone, including the consumers the FTC is charged to protect.

Second, the Patent and Trademark Office and courts have long had the legal tools to weed out bad patents and punish bad actors. And these tools were just massively expanded 2 years ago with the enactment of the America Invents Act. This is important because the real concern with demand letters is that the underlying patents are invalid. No one denies that owners of valid patents have the right to license their property or to sue infringers, or that patent owners can even make patent licensing their sole business model as did Charles Goodyear and Elias Howe in the mid-19th century.

Now, there are too many of these legal tools to discuss in my brief remarks, but to name just a few: recipients of demand letters can sue patent owners in courts through declaratory judgment actions and invalidate bad patents, and the PTO now has four separate programs dedicated solely to weeding out bad patents.

For those who lack the knowledge or resources to access these legal tools, there are now numerous legal clinics, law firms and policy organizations that actively offer assistance, often times for free. Again, further systemic changes to the patent system are unwarranted because there are existing legal tools with established legal standards to address bad actors and their bad patents.

Last, Congress is being driven to revise the patent system on the basis on rhetoric and anecdote, instead of objective evidence and reasoned explanation. Now there are certainly bad actors in the patent system as we have heard, but terms like patent assertion entity or patent troll constantly shift in meaning and there is no settled definition for them. These terms have been used to cover anyone who licenses patents, including universities, startups, companies that engage in R&D, and many others.

Classic American innovators in the 19th century like Thomas Edison, Charles Goodyear and Elias Howe would be called patent assertion entities or patent trolls today. In fact, they and many other patent owners, some of them secondary owners who just license their patents, made royalty demands against thousands of farmers, dentists and other end users in the 19th century.

Congress should exercise restraint when it is being asked to enact systemic legislation or regulatory changes on the basis of pejorative labels that lead us to condemn or discriminate against classic innovators like Thomas Edison who have contributed immensely to America's innovation economy.

In conclusion, the benefits or costs of patent licensing to the innovation economy is an important empirical and policy question, but systemic changes to the patent system should not be based on rhetoric, anecdotes, invalid studies and incorrect claims about the historical and economic significance of patent licensing.

As former PTO Director, David Kappos stated just last week in his testimony before the House Judiciary Committee, "we are reworking the greatest innovation engine the world has ever seen almost instantly after it has just been significantly overhauled. If there was ever a case where caution is called for, this is it."

Thank you.

[The prepared statement of Mr. Mossoff follows:]

PREPARED STATEMENT OF ADAM MOSSOFF, PROFESSOR OF LAW, GEORGE MASON UNIVERSITY SCHOOL OF LAW AND SENIOR SCHOLAR, CENTER FOR THE PROTECTION OF INTELLECTUAL PROPERTY

Chairman McCaskill, Ranking Member Heller, and members of the Subcommittee:

Thank you for this opportunity to speak with you today about patented innovation and the impact that licensing and threatened litigation have on our innovation-driven economy.

Today, two propositions define the American patent system and yet they stand in stark contrast to each other. On the one hand, patented innovation plays a central role in the United States in creating a prosperous economy. It drove the Industrial Revolution in the nineteenth century with the cotton gin, sewing machine, railroads, steam engines, and many other inventions, and it is driving the Digital and Biotech Revolutions today with engineered drugs, wireless communication, tablets, smart phones, and more inventions still. As former U.S. Patent & Trademark Office (PTO) Director David Kappos recently remarked, the U.S. patent system is "the greatest

innovation engine the world has ever known.”¹ On the other hand, the “smart phone wars” and related patent litigation issues, as well as the commercial and legal activities of patent licensing companies, have lead many to believe that the “patent system is broken,” a mantra one reads almost daily on the Internet, in newspaper reports, and in op-eds.²

It is without a doubt that the patent licensing business model and patent litigation have become a flashpoint of controversy. One area of concern, the topic of today’s hearing, is the impact of demand letters sent by patent licensing companies, which are widely referred to as “patent assertion entities” (PAE), “non-practicing entities” (NPE) or by the more fashionable and inflammatory term, “patent trolls.”³ For reasons that I will discuss shortly, I prefer instead to refer to these companies by their actual business model: patent licensing. Unless one works at a law firm, litigation (or threats of litigation) is not a business model; rather, the business model is licensing, in the course of which it can be necessary to threaten to sue or sue recalcitrant licensees. Since the early nineteenth century, many inventors and companies have licensed or sold their patents, rather than manufacture the technology. This has achieved tremendous efficiencies through the division of labor, and thus has been essential to America’s flourishing innovation economy.

Nonetheless, terms like “patent troll” have easily captured the public’s imagination. This has happened in part because it is undeniable that there are some rent-seeking patent owners who strategically exploit poor quality patents and the high costs of American civil litigation. Such bad actors exist in every legal system, and in fact have always existed—in the nineteenth century, the popular rhetorical epithet for these patent owners was “patent shark.”⁴ But whether such bad actors exist in large enough numbers today to cause a breakdown in the patent system requiring a systemic intervention via legislation or regulation is an entirely different question—and it is a question that remains largely unanswered.

Unfortunately, in addition to the mistaken empirical claims about patent litigation based on what the Government Accountability Office (GAO) has recognized as “nonrandom and nongeneralizable” studies,⁵ mistaken claims abound about patent licensing and its longstanding historical role in making patented innovation a commercial reality. Scholars and commentators claim that the patent licensing business model arises from a “patent marketplace [that] is a relatively new secondary market.”⁶ The inference is clear: this new commercial and legal activity requires new legislation and new regulations to address allegedly new problems.⁷ Rote repetition in scholarship, blogs, op-eds and newspaper articles, has solidified these claims into conventional wisdom among policy and legal elites. This conventional wisdom in turn is driving numerous legislative and regulatory proposals to address the allegedly systemic problems caused by the allegedly new patent licensing business model.

This conventional wisdom (like much conventional wisdom) is profoundly mistaken. We are racing to revise the patent system, a mere two years after the largest revision to the patent system since 1836,⁸ on the basis of rhetoric and anecdote in-

¹*Innovation Act of 2013: Hearing on H.R. 3309 Before the Comm. on the Judiciary*, 113th Cong. — (Oct. 29, 2013) (statement of David J. Kappos, Partner, Cravath, Swaine & Moore LLP), p. 2, available at <http://judiciary.house.gov/hearings/113th/10292013/Kappos%20Testimony.pdf>.

²See Adam Mossoff, *The Trespass Fallacy in Patent Law*, Florida L. Rev. (forthcoming 2013), p. 1 n. 1–2, available at <http://ssrn.com/abstract=2126595> (reviewing examples).

³As will be explained later, this term lacks an agreed-upon, objective definition and thus it should not be used by lawyers, commentators or scholars who care about precision and accuracy in discussions of patent law and policy. See Adam Mossoff, *The SHIELD Act: When Bad Economic Studies Make Bad Laws*, CPIP Blog (March 15, 2013), <http://cpip.gmu.edu/2013/03/15/the-shield-act-when-bad-economic-studies-make-bad-laws/>.

⁴See Earl W. Hayter, *The Patent System and Agrarian Discontent, 1875–1888*, 34 MISS. VALLEY HIST. REV. 59 (June 1947); Earl W. Hayter, *The Western Farmers and the Drivewell Patent Controversy*, 16 AGRICULTURAL HIST. 16 (Jan. 1942). See also Dan Mitchell, *When Patent Trolls Were Simply Sharks*, FORTUNE (June 7, 2013), <http://tech.fortune.cnn.com/2013/06/07/when-patent-trolls-were-simply-sharks/>.

⁵GOVERNMENT ACCOUNTABILITY OFFICE, INTELLECTUAL PROPERTY: ASSESSING FACTORS THAT AFFECT PATENT INFRINGEMENT LITIGATION COULD HELP IMPROVE PATENT QUALITY 26 (Aug. 2013), <http://www.gao.gov/assets/660/657103.pdf>.

⁶Anne Kelley, *Practicing in the Patent Marketplace*, 78 U. CHI. L. REV. 115, 117 (2011).

⁷Judge Richard A. Posner, for instance, has called for the adoption of a new legal rule “that barred enforcement of a patent that was not reduced to practice within a specified time after the patent was granted.” Richard Posner, *Patent-Trolls—Posner*, THE BECKER-POSNER BLOG (July 31, 2013), <http://www.becker-posner-blog.com/2013/07/patent-trollsposner.html>.

⁸See Richard Maulsby, *President Obama Signs the America Invents Act*, INVENTORS EYE, vol. 2, issue 5 (Oct. 2011), http://www.uspto.gov/inventors/independent/eye/201110/america_inventsact.jsp (referring to the America Invents Act of 2011 as “the most significant reform of the U.S. patent system since 1836”).

stead of objective evidence and reasoned explanations. Even worse, the proposed legislative or regulatory interventions will not fix the unproven systemic problems they purport to address, but instead will cause actual damage to the dynamic innovation that the patent system promotes and secures. In the rush to enact legislation to revise the patent system, there is too little regard for the harm to innovation that will result from the weakening of patent rights and the increased legal hurdles that make it harder to license patents and enforce these patents against infringers. As David Kappos stated in his testimony before the House Judiciary Committee last week: “we are reworking the greatest innovation engine the world has ever known, almost instantly after it has just been significantly overhauled. If there were ever a case where caution is called for, this is it.”⁹

In this testimony, I will provide a brief overview on two important issues regarding the patent licensing business model and the assertion of these licensed patents that have gone largely unrecognized by those calling for legislative or regulatory changes. First, the patent licensing business model, and even the litigation of patents owned by these companies, has long been an essential feature of the American patent system, reaching back to the early nineteenth century and playing a key role in the commercial distribution of patented innovation. Second, aside from anecdotes and deeply flawed studies, there is no evidence yet of systemic harm to innovation caused by patent licensing companies requiring legislative or regulatory intervention. Even more important, such intervention carries serious risk of overreach that could harm the dynamic innovation that the patent system promotes and secures.

What is a Patent Assertion Entity or “Patent Troll”?

As a preliminary matter, it is necessary to address a fundamental problem in the patent policy debates today—the terminology used in these debates is deeply confused and has produced misleading claims and arguments that have proliferated widely among scholars and laypersons alike. This hearing concerns the assertion of patents via demand letters by PAEs or patent trolls. The FTC has defined PAEs as “firms whose business model primarily focuses on purchasing and asserting patents,”¹⁰ but this is not the accepted definition among all commentators or necessarily even among the witnesses testifying today. In fact, there is no settled, agreed-upon definition of a PAE or patent troll that is universally adopted by scholars and commentators alike.

Many commentators equate a PAE or patent troll with an NPE, another term that even the critics of these commercial entities recognize has yet to be objectively defined.¹¹ Aside from the strange locution of identifying the active commercialization of a property right in the marketplace as “non practicing”—it is tantamount to saying that landlords are “non-practicing” owners of their property rights because they do not live on their real estate parcels—this term is applied in inconsistent ways. For example, one of the first widely condemned NPEs in the high-tech industry was NTP, which successfully sued RIM (the maker of the Blackberry) after RIM refused to license NTP’s patents on wireless e-mail communication.¹² Prominent scholars, such as Mark Lemley and Carl Shapiro, among many others, have called NTP a “patent troll.”¹³ But NTP was a holding company formed by the inventor, Thomas Campana, Jr., and who did so only after numerous failed attempts at producing the technology.¹⁴ It seems strange that knowledgeable scholars and commentators are condemning *inventors* as “patent trolls,” when almost everyone regards inventors as rightly excluded from such pejorative labels (and especially when Campana’s pat-

⁹Kappos, *supra* note 1, at 2.

¹⁰FED. TRADE COMM’N, THE EVOLVING IP MARKETPLACE: ALIGNING PATENT NOTICE AND REMEDIES WITH COMPETITION 8 n.5 (Mar. 2011), available at <http://www.ftc.gov/os/2011/03/110307patentreport.pdf>.

¹¹See, e.g., James Bessen & Michael J. Meurer, *The Direct Costs from NPE Disputes*, p. 11, available at <http://ssrn.com/abstract=2091210> (“There is no consensus among researchers on the proper definition of NPE.”).

¹²See *NTP, Inc. v. Research in Motion, Ltd.*, 418 F.3d 1282 (Fed. Cir. 2005).

¹³Lemley & Shapiro, *Patent Holdup and Royalty Stacking*, 85 TEX. L. REV. 2008–09 (2007) (discussing NTP as an example of how “patent trolls [can] hold up defendants by threatening to enjoin products that are predominantly noninfringing”); Gerard N. Magliocca, *Blackberries and Barnyards: Patent Trolls and the Perils of Innovation*, 82 NOTRE DAME L. REV. 1809, 1809–10 (2007) (observing that the BlackBerry litigation “was brought by a ‘patent troll,’ which is a derogatory term for firms that use their patents to extract settlements rather than license or manufacture technology”); Bruce Sewell, *Troll Call*, WALL ST. J., Mar. 6, 2006, at A14 (criticizing NTP as a patent troll).

¹⁴See Barrie McKenna *et al.*, *Patently Absurd*, GLOBE AND MAIL, Jan. 28, 2006, at B4 (discussing how Campana attempted to manufacture his patented invention but was unsuccessful, and thus NTP was formed in 1992 only after his earlier firm, Telefind, went bankrupt in 1991).

ents were upheld as valid through repeated reviews both in court and under re-examination at the PTO).

The PAE, NPE and patent troll terms thus have many different definitions such that they sometimes cover and sometimes exclude universities,¹⁵ startups, firms that both manufacture and license, firms that engage in research and development and then license this patented innovation, and even individual inventors—including classic American inventors like Thomas Edison, Elias Howe (the inventor of the lockstitch in the 1840s), and Charles Goodyear (the inventor of vulcanized rubber in the late 1830s).¹⁶ One oft-cited study that has played a significant role in the patent policy debates concluded that NPEs/patent trolls imposed \$29 billion in costs on defendants in 2011.¹⁷ This study has been rightly criticized by scholars and by the GAO for many methodological and substantive failings,¹⁸ and one of these problems is its extremely broad definition of an NPE/patent troll. The authors defined an NPE/patent troll as covering almost every person, corporation, or university that sues someone for infringing a patent that it is not currently being used to manufacture a product at that moment, including even manufacturing companies that sue on patents deemed to be “well outside the area in which they make products.”¹⁹ The scope of this definition is breathtaking. What patent owner *isn't* currently or potentially an NPE under this definition, especially given that the innovation industries are extremely heterogeneous and constantly evolving, with companies like IBM and Nokia shifting their business models, product lines and commercial activities?

Even the more restrictive definition of a PAE that limits it to companies who “purchase and assert” patents is still not applied as evenly as it may first appear. Again, “assertion” in patent law means filing a lawsuit, but the actual business model of the majority of companies who purchase patents is licensing, not litigation. Moreover, the real-world firms to which this term has been applied are more complex and heterogeneous than is often acknowledged. For instance, one company that is widely alleged to be a PAE, Intellectual Ventures, employs hundreds of inventors who engage in research and development, and the company licenses this homegrown patented innovation along with the other patents it purchases from third-party inventors and companies. In a recent presentation on Capitol Hill, Nathan Myhrvold, the founder of Intellectual Ventures, stated that his firm is a top-ten filer for new patents in the U.S., and that he personally has received about 1200 patents.²⁰ Again, inventors and companies that produce patented innovation are being swept up in the terminology of PAE, NPE, and patent troll.

Given the variance and lack of clarity in these basic terms in the patent policy debates about patent licensing and patent litigation, I prefer instead to refer to these individuals and companies by their actual business model: patent licensing. This avoids the misleading shading of meaning that comes from loose rhetoric about mythical beasts or unverified litigation practices, and instead focuses the discussion on what these companies actually do in terms of their business model. By focusing on the business model of patent licensing, it also brings into sharper focus the historical pedigree of patent licensing, which inventors and companies have long employed to bring new patented innovation to market.

¹⁵The University of Wisconsin has been called a “patent troll.” See Erin Fuchs, *Tech’s 8 Most Fearsome “Patent Trolls,”* Business Insider (Nov. 25, 2012 2:01PM), <http://www.businessinsider.com/biggest-patent-holding-companies-2012-11?op=1>.

¹⁶Cf. Joshua D. Wright, *What Role Should Antitrust Play in Regulating the Activities of Patent Assertion Entities* (Apr. 17, 2013), p. 3, available at <http://www.ftc.gov/speeches/wright/130417paespeech.pdf> (“The entities qualifying as NPEs are wide-ranging and heterogeneous: they include all universities, which certainly do not manufacture or sell patented inventions, but also start-up companies, semiconductor design houses, and even some large, established commercial firms, like IBM. Thomas Edison would have been called an NPE, if that term existed 100 years ago . . .”).

¹⁷See Bessen & Meurer, *supra* note 11.

¹⁸See GOVERNMENT ACCOUNTABILITY OFFICE, *supra* note 5; David L. Schwartz & Jay Kesan, *Analyzing the Role of Non-Practicing Entities in the Patent System*, 99 Cornell L. Rev. (forthcoming 2013), <http://ssrn.com/abstract=2117421> (identifying serious methodological and substantive flaws in patent litigation study by Bessen and Meurer). Cf. Christopher A. Cotropia, Jay P. Kesan & David L. Schwartz, *Patent Assertion Entities Under the Microscope: An Empirical Investigation of Patent Holders as Litigants* (Oct. 28, 2013), available at <http://ssrn.com/abstract=2346381> (finding from publicly available data substantially less litigation rates than those found by Bessen and Meurer in a study using secret, proprietary data from RPX).

¹⁹Bessen & Meurer, *supra* note 11, at 10.

²⁰See “The Future of Invention—What’s at Risk?,” available at http://youtu.be/4IINBhu7a_E.

Patent Licensing as a Longstanding and Essential Feature of the American Patent System

Contrary to many claims today about PAEs or patent trolls, however they are defined, the patent licensing business model is not a new phenomenon in the commercialization of patented innovation in the marketplace. As award-winning economist Zorina Khan has explained, licensing has long been an essential feature of America's unique patent system, which secured property rights in innovation to both inventors and to the marketplace actors who commercialized this innovation.²¹ I have also explained in my scholarship how early American legislators and judges defined patents as property rights—specifically as civil rights securing fundamental property rights²²—and that this had profound implications in securing the free alienation of patents in the nineteenth-century marketplace.²³ Here, I can only briefly summarize some of this research and highlight its relevance to the concerns about patent licensing entities and their litigation practices.

In more recent scholarship, Professor Khan and other economists have shown that there was an active commercial market in both selling patents and licensing patent rights in the nineteenth century.²⁴ Many early American inventors (and third parties) embraced this market to sell, purchase, and license patented innovation.²⁵ For instance, Edison certainly meets the definition of an “NPE,” as he sold and licensed his patents, especially in his early invention-intensive career.²⁶ He also assigned outright some of his later patents, such as transferring his patented innovation in incandescent light bulbs to the General Electric Company.²⁷ Even earlier in the nineteenth century, inventors sold and licensed their patent rights. Charles Goodyear, the inventor of vulcanized rubber in 1839,²⁸ never manufactured or sold rubber products, and instead made all of his money by selling the rights to manufacture, license, sell, and use his patented innovation.²⁹ As the archetypical obsessive inventor, Goodyear was not interested at all in manufacturing or retail sales of his patented innovation.

Even more relevant to today's policy debates, Goodyear and his assignees and exclusive licensees filed many, many lawsuits against individual end users, commercial firms, and manufacturers.³⁰ End-user lawsuits in particular were a prominent tool in their litigation strategy. Moreover, these end-user lawsuits were commonplace. As legal historian Professor Christopher Beachamp has discovered in his research, over a thousand patent infringement lawsuits were filed just in the Southern District of New York in 1883 and almost all of these were against farmers for

²¹See B. ZORINA KHAN, *THE DEMOCRATIZATION OF INVENTION: PATENTS AND COPYRIGHTS IN AMERICAN ECONOMIC DEVELOPMENT, 1790–1920*, at 9–10 (2005) (“The analysis [in this book] emphasizes the role that patents and copyrights played in the securitization of ideas through the creation of tradeable assets: intellectual property rights facilitated market exchange, a process that assigned value, helped to mobilize capital, and improved the allocation of resources. . . . Extensive markets in patent rights allowed inventors to extract returns from their activities through licensing and assigning or selling their rights.”).

²²See Adam Mossoff, *Who Cares What Thomas Jefferson Thought About Patents? Reevaluating the Patent “Privilege” in Historical Context*, 92 CORNELL L. REV. 953 (2007).

²³See Adam Mossoff, *Exclusion and Exclusive Use in Patent Law*, 22 HARV. J. L. & TECH. 321, 349–60 (2009); Adam Mossoff, *A Simple Conveyance Rule for Complex Innovation*, 44 TULSA L. REV. 707, 711–20 (2009).

²⁴See, e.g., B. Zorina Khan, *Trolls and Other Patent Inventions: Economic History and the Patent Controversy in the Twenty-First Century*, __ GEORGE MASON UNIV. L. REV. __ (forthcoming 2014) (draft available at <http://cpip.gmu.edu/wp-content/uploads/2013/09/Khan-Zorina-Patent-Controversy-in-the-21st-Century.pdf>); Naomi R. Lamoreaux, Kenneth L. Sokoloff, and Dhanoos Sutthiphisal, *Patent Alchemy: The Market for Technology in U.S. History*, 87 BUSINESS HIST. REV. 3 (Spring 2013).

²⁵See Lamoreaux, Sokoloff & Sutthiphisal, *supra* note 24, at 20. Classified ads in nineteenth-century issues of *Scientific American* establish that patents and patent rights were actively offered for sale and purchased. See, e.g., *Scientific American* 383 (Aug. 12, 1854); *Scientific American* 143 (Aug. 28, 1869) [PDFs on file with author].

²⁶See Lamoreaux, Sokoloff & Sutthiphisal, *supra* note 24, at 6 (explaining how Edison sold 20 of his early patents to third parties in order to fund his ongoing research and development).

²⁷RANDALL E. STROSS, *THE WIZARD OF MENLO PARK: HOW THOMAS ALVA EDISON INVENTED THE MODERN WORLD* 165 (2008).

²⁸U.S. Patent No. 3,633 (issued June 15, 1844).

²⁹See CHARLES SLACK, *NOBLE OBSESSION: CHARLES GOODYEAR, THOMAS HANCOCK, AND THE RACE TO UNLOCK THE GREATEST INDUSTRIAL SECRET OF THE NINETEENTH CENTURY* (2002); HAROLD EVANS, *THEY MADE AMERICA: FROM THE STEAM ENGINE TO THE SEARCH ENGINE: TWO CENTURIES OF INNOVATORS* 92–100 (2004).

³⁰For a few examples of the extensive litigation surrounding Goodyear's patent, see Adam Mossoff, *Who Cares What Thomas Jefferson Thought About Patents? Reevaluating the Patent “Privilege” in Historical Context*, 92 CORNELL L. REV. 953 (2007) (cases cited in footnotes 174, 183, 188, and 192–194); Adam Mossoff, *A Simple Conveyance Rule for Complex Innovation*, 44 TULSA L. REV. 707, 711–20 (2009) (cases cited in footnotes 50 and 55).

infringing a single patent on well drilling technology.³¹ These end-user lawsuits were brought by a company that Professor Beachamp recognizes as falling within the definition today of a NPE—a firm engaged solely in patent licensing.³² In fact, given its extensive litigation practice, this firm would likely be classified as a PAE as well. Professor Beachamp found similar litigation practices against end users of sewing machines, cheese frames, barbed wire, and other patented innovation reaching back to the 1840s.³³

The inventor of the lockstitch in the 1840s,³⁴ Elias Howe, Jr., also licensed his patented innovation for most of his life. In fact, Howe engaged in ex post licensing: making royalty demands and suing retailers and manufacturers after discovering that they were infringing his patent rights. He also used ads to threaten liability for all purchasers of unlicensed sewing machines.³⁵ One historian identified Howe’s “main occupation” in the early 1850s as consisting entirely of “suing the infringers of his patent for royalties.”³⁶ His demands caused much ire. In fact, Howe’s assertion of his patents against noncompliant infringers refusing his licensing offers precipitated the very first “patent war”—called, at the time, the Sewing Machine War.³⁷

Even more important for understanding the practices of patent licensing and patent litigation, Howe’s litigation practices were similar to many practices today. For instance, Howe was destitute and found investors to provide third-party financing for his patent infringement lawsuits.³⁸ Ultimately, after being a principal legal pugilist in the Sewing Machine War, Howe joined the Sewing Machine Combination of 1856. This was the first patent pool in American history, which ended the Sewing Machine War and successfully licensed the patents in the sewing machine.³⁹ Moreover, similar to the end-user lawsuits by Goodyear’s assignees and other patent owners, when Howe first sued Singer and many other retailers and manufacturers,⁴⁰ these companies were the equivalent of today’s “mom and pop stores” or “start up” companies.

This brief survey establishes that the patent licensing business model has not only existed from the early nineteenth century, it has long served a significant function in the commercialization of patented innovation in the United States. Other famous early nineteenth-century inventors also extensively assigned and licensed rights in their patented innovation, including William Woodworth (planing machine), Thomas Blanchard (lathe), and Obed Hussey and Cyrus McCormick (mechanical reaper),⁴¹ and many others. Such commercial practices continued into the twentieth century and up through today, with such innovative firms as Bell Labs,⁴²

³¹ Professor Beachamp discusses his ongoing research into this issue in the panel, “End-User Lawsuits in Patent Litigation: A Bug or a Feature of Patent Law” (Aug. 29, 2013), available at <http://cpip.gmu.edu/events/teleforum-panel-end-user-lawsuits-in-patent-litigation-a-bug-or-a-feature-of-patent-law/>.

³² *Id.*

³³ *Id.*

³⁴ U.S. Patent No. 4750 (issued Sept. 10, 1846).

³⁵ See Mossoff, *The Rise and Fall of the First American Patent Thicket: The Sewing Machine War of the 1850s*, 53 ARIZ. L. REV. 165, 185 (2011) (quoting one of Howe’s advertisements that “You that want sewing machines, be cautious how you purchase them of others than [Howe] or those licensed under [Howe], else the law will compel you to pay twice over.”).

³⁶ RUTH BRANDON, *A CAPITALIST ROMANCE* 71–72 (1977).

³⁷ See generally Mossoff, *supra* note 35.

³⁸ See *id.* at 183.

³⁹ See *id.* at 194–202.

⁴⁰ See, e.g., *id.* at 189 (noting how “Howe quickly filed lawsuits in Boston against firms selling Singer Sewing Machines, and, as before, he sought preliminary injunctions”).

⁴¹ See Lamoreaux, Sokoloff & Sutthiphisal, *supra* note 24, at 8.

⁴² See JON GERTNER, *THE IDEA FACTORY: BELL LABS AND THE GREAT AGE OF AMERICAN INNOVATION* chpt. 6 (reprint ed. 2013) (discussing how Bell Labs licensed the transistor to any individual or firm willing to pay the \$25,000 licensing rate).

IBM,⁴³ Apple,⁴⁴ Microsoft,⁴⁵ Research in Motion (Blackberry),⁴⁶ and Nokia,⁴⁷ among others, using this long-established, successful method of patent licensing to commercialize patented innovation in the marketplace.

Moreover, the litigation practices of these patent owners, including suing numerous defendants, suing end users, and receiving third-party financing for lawsuits, among others, have been common features of the patent litigation landscape since the early nineteenth century. It is simply untrue that these commercial and legal strategies are novel developments in recent years that require novel legislative or regulatory changes. While there are certainly some bad actors, Congress must be cautious in making systemic revisions to the longstanding legal rules governing how patented innovation is commercialized and litigated. This is especially the case when such revisions are based more on rhetoric about particular types of patent owners than evidence of systemic problems that are clearly harming innovation.

The PTO and Courts Have the Tools to Address Bad Actors in the Patent System

It is significant that the commercial and legal practices about which commentators and scholars today express extensive concern have in fact been longstanding features of both the American patent system and the Federal courts. The commercialization of patented innovation and resulting economic growth has occurred throughout every historical “patent war” and periods of extensive litigation against manufacturers, retailers, and end users. The creation of patented innovation and the resulting economic growth continue today because the PTO and courts already have the tools to separate the bad actors from the legitimate patent licensing companies. Even more important, the America Invents Act of 2011 (AIA), a product of a six-year policy debate and rightly recognized as “the most significant reform of the U.S. patent system since 1836,”⁴⁸ vastly expanded these tools as well.

The concern about patent licensing companies demanding royalties from or even suing alleged infringers is that many people believe that the patents are invalid. In other words, the policy concern that needs to be addressed is the validity of the underlying property right, as an owner of a *valid* patent has every right to demand licenses from unauthorized users and to seek relief in court against recalcitrant infringers. There have long existed many legal tools, and even more exist today, for challenging and weeding out such bad patents.

Consider two historical examples (among the many that exist). First, potential defendants have long had the right to bring declaratory judgment actions in Federal court to invalidate patents that might be asserted against them in a future lawsuit, and the Supreme Court recently liberalized the rules even further for when someone can bring a declaratory judgment action in its 2007 decision in *MedImmune v. Genentech*.⁴⁹ Second, defendants or potential defendants have long had access to the PTO to challenge improperly issued patents. Singer instigated a lengthy proceeding at the Patent Office in 1850 in attempting to invalidate Howe’s patent, for instance, and defendants in all of Howe’s lawsuits repeatedly argued (and reargued) in Federal court that Howe’s patent was invalid as well.⁵⁰ Like any newly created asset or valuable resource, all commercially significant and valuable patents are always heavily disputed as to their validity, both in courts and at the PTO. This explains

⁴³ See David Kilpatrick, *The Future of IBM. Lou Gerstner seems to have pulled off a miracle. Sam Palmisano will have to be at least as good*, FORTUNE (Feb. 18, 2002), http://money.cnn.com/magazines/fortune/fortune_archive/2002/02/18/318158/index.htm (“Throughout the Gerstner years IBM has been the world leader in new patents; it earns well over \$1 billion a year licensing those patents.”).

⁴⁴ See Tom Haubert, *The Troubled Life of Patent No. 6,456,881: Tracing the Tortured Legal Trail of a Simple Smartphone Patent*, IEEE SPECTRUM (Apr. 23, 2013), <http://spectrum.ieee.org/at-work/innovation/the-troubled-life-of-patent-no-6456841> (describing patent purchased from Mitsubishi by Apple, and then Apple sold the patent to a “patent acquisition and licensing company” that brought patent infringement lawsuits against many high-tech companies (but not against Apple)).

⁴⁵ See Rakesh Sharma, *Six Answers About Rockstar’s Suit Against Google*, FORBES (Nov. 1, 2013 6:21PM), at <http://www.forbes.com/sites/rakeshsharma/2013/11/01/six-answers-about-rockstars-suit-against-google/> (discussing the patent licensing entity, Rockstar Consortium, which is backed by Apple, Microsoft, Sony, Ericsson, and Research in Motion).

⁴⁶ *Id.*
⁴⁷ See Dan Levine, *Why Nokia Didn’t Sell Its Patents to Microsoft*, REUTERS (Sep. 3, 2013 7:05PM EDT), <http://www.reuters.com/article/2013/09/03/us-nokia-microsoft-patents-idUSBRE9820ZZ20130903>.

⁴⁸ Maulsby, *supra* note 8.

⁴⁹ *MedImmune, Inc. v. Genentech, Inc.*, 127 S. Ct. 764 (2007).

⁵⁰ See Mossoff, *supra* note 35, at 187–89.

the historical prevalence of the patent wars that have occurred with every major technological leap forward.⁵¹

Today, such legal mechanisms continue to exist in the PTO and in the courts, which serve as a check on both bad actors and bad patents. In the courts, the Judicial Conference's Committee on Rules of Practice and Procedure has officially published proposed revisions to the pleading requirements in patent lawsuits, one of the sources of the much maligned minimal notice requirements in patent infringement complaints.⁵² Additionally, the Supreme Court recently granted cert in two cases that will likely result in liberalizing the rules on the issuance of sanctions in patent cases.⁵³ Such legal changes will necessarily change the calculus of individual patent owners who are bluffing in demand letters, because those bluffs may now be called and courts will both make it harder to bring the actual lawsuits and will punish bad-faith assertions.

Even more important, at the PTO, the many new, AIA-created review proceedings are just beginning to be implemented and to produce results.⁵⁴ And there are more reforms that can and should be adopted, such as securing full funding of the PTO to ensure complete and timely examination of patent applications. Full funding of the PTO will also ensure proper implementation of the many new administrative review programs created by the AIA to weed out invalid and vague patents that clog the innovation economy.

And for those who lack the knowledge or wherewithal to navigate these processes, there are many law firms and policy organizations, such as Public Patent Foundation, Electronic Frontier Foundation (EFF), the Berkman Center for Internet and Society, and others who are offering assistance.⁵⁵ For instance, the App Developers Alliance has created the "Law School Patent Troll Defense Network," which involves law school clinics providing legal services to individuals or small businesses receiving demand letters or complaints.⁵⁶ Moreover, two weeks ago, EFF joined with the Berkman Center to file an inter partes review of the widely known and notorious "podcasting patent," which has been the subject of thousands of demands letters being sent to individuals, small companies, and large companies.⁵⁷ In a world in which Internet searches easily and effortlessly produce such information, it is becoming harder to maintain that recipients of demand letters lack the resources and capabilities to respond effectively.

The Harm to Dynamic Innovation from Legislative or Regulatory Overreach

It is against this backdrop that Congress must assess any proposal to intervene via commercial regulation in patent licensing and patent litigation practices. First, there is too much rhetoric and too many "nonrandom and nongeneralizable" studies in the policy debates,⁵⁸ and too little actual evidence definitively establishing that more revisions to the patent system are needed. Second, while there are certainly bad actors, there are a number of existing legal mechanisms at the PTO and in the courts to address them, especially after the enactment of the AIA just two years ago.

⁵¹See Adam Mossoff, *Patented Innovation and Patent Wars: Some Historical Perspective*, A SMARTER PLANET BLOG (Jan. 11, 2013 8:00AM), available at <http://smarterplanet.com/blog/2013/01/patented-innovation-and-patent-wars-some-historical-perspective.html>.

⁵²See Committee on the Rules of Practice and Procedure of the Judicial Conference of the United States, *Preliminary Draft of Proposed Amendments to the Federal Rules of Bankruptcy and Civil Procedure* (Aug. 2013), available at <http://www.uscourts.gov/uscourts/rules/preliminary-draft-proposed-amendments.pdf>; see also Honorable Katherine O'Malley, *Key Note Speech at Intellectual Property Owners Association Annual Meeting* (Sep. 17, 2013), p. 9, available at <http://www.ipo.org/wp-content/uploads/2013/02/IPO-Annual-Meeting-Keynote-Speech-09-17-13.pdf> (discussing this process).

⁵³See *Octane Fitness, LLC v. Icon Health & Fitness, Inc.*, No. 12-1184, 2013 WL 1283843 (U.S. Oct. 01, 2013); *Highmark Inc. v. Allcare Health Mgmt. Sys.*, No. 12-1163, 2013 WL 1217353 (U.S. Oct. 01, 2013).

⁵⁴See generally Kappos, *supra* note 1.

⁵⁵On behalf of individual women lacking the funds to pay for expensive DNA testing (and thus lacking the funds to bring a lawsuit), the Public Patent Foundation brought the challenge to the patents on the BRAC1 and BRAC2 genes, which correlated with breast cancer. The Public Patent Foundation ultimately won before the Supreme Court. See *AMP v. Myriad Genetics*, 133 S. Ct. 1747 (2013).

⁵⁶See *Law Schools Join App Developers Alliance to Fight Patent Trolls* (Oct. 10, 2013), available at <http://www.ipwatchdog.com/2013/10/15/law-schools-join-app-developers-alliance-to-fight-patent-trolls/>.

⁵⁷See *EFF Files Challenge With Patent Office Against Troll's Podcasting Patent: Massive Crowdsourcing Effort Leads to Strong Petition Before the USPTO* (Oct. 16, 2013), available at <https://www.eff.org/press/releases/eff-files-challenge-patent-office-against-trolls-podcasting-patent>.

⁵⁸GOVERNMENT ACCOUNTABILITY OFFICE, *supra* note 5, at 26.

Third, and certainly not least, there is too little regard for the serious costs that regulatory overreach imposes on the individuals and businesses who create the real-world innovative products and services that have become basic commodities of modern life.

While many pay lip service to the importance of promoting innovation, there has been too little regard given to the benefits of strong and certain patent rights and the costs of lost innovation when these rights become uncertain. In contrast to the many studies done on the alleged “costs” imposed by patent licensing companies on defendants and manufacturers, there has not been a single statistical study done on either (1) the costs imposed on patent owners in either licensing or enforcing their legal rights, or (2) the costs, especially the error costs, that further legislative or regulatory changes to patent licensing and litigation practices will impose on legitimate owners of valid patents—the modern-day Edison, Howe, and Goodyear.

This is striking and reinforces the concern that proposed legislation and regulation is being driven today more by rhetoric than by a dispassionate, reasoned consideration of all sides of the policy equation. If there is objective harm established by the knowing abuse of invalid patents via demand letters—such as, for example, cognizable harms in lost production and lost business opportunities via in terrorem threats—then such harm must first be proven via established empirical methodologies and assessed according to known legal standards.⁵⁹ If Congress intends to direct a regulatory agency to punish the licensing and litigation activities of certain types of patent owners, then such a radical alteration to the patent system should at least be supported by definitive evidence justifying such systemic changes. Otherwise, the in terrorem effect runs the other way, sweeping legitimate inventors and companies into an arbitrary regulatory environment that makes the licensing and enforcement of their patented innovation prohibitively costly.⁶⁰ As a recent letter submitted by several Senators and Representatives to Chairwoman Edith Ramirez stated:

The absence of clear parameters for the FTC’s Section 5 authority based on empirical and economic justifications engenders uncertainty in the business community. This uncertainty acts as a deterrent to innovation and creativity, which are critical drivers of the American economy and vitally important in today’s challenging economic environment.⁶¹

Such concerns are endemic in any legal intervention into patented innovation.⁶² As Commissioner Joshua Wright has similarly observed in his previous academic scholarship, after a careful review of the economic literature to date:

Our economic knowledge regarding innovation itself, conduct affecting innovation, and how to assess competitive outcomes involving tradeoffs between product market competition and innovation are far less impressive than our knowledge in a purely static setting. The costs of false positives leading to a chilling of pro-competitive innovation are significant.⁶³

This is not to diminish the existence of individual bad actors and the particular harms they might be imposing via improper demand letters. But anecdotes alone do not justify legislative or regulatory action. Given the lack of an established and proven connection between these individually harmful acts and systemic harm to innovation, the lack of cognizable legal standards for acting in this area, the pre-existing tools at the PTO and in courts to address the problems, and the ever-

⁵⁹ See Commissioner Joshua D. Wright, *Proposed Policy Statement Regarding Unfair Methods of Competition Under Section 5 of the Federal Trade Commission Act* (June 19, 2013), available at <http://ftc.gov/speeches/wright/130619umcpolicystatement.pdf>.

⁶⁰ See Donald Rosenberg, *First Rule of Patent Reform: Do No Harm*, WALL ST. J. (Sep. 10, 2013 6:54PM), (“How will the proposed changes that make it harder and more expensive to enforce these patents affect small inventors, universities and companies that legitimately seek to protect their intellectual property rights? New legislation must take care not to sacrifice their rights or those of other inventors.”).

⁶¹ Letter from Chairman Bob Goodlatte, House Comm. on the Judiciary, Ranking Member Charles Grassley, Senate Comm. on the Judiciary, Chairman Spencer Bachus, House Comm. on the Judiciary Subcomm. on Regulatory Reform, Commercial, and Antitrust Law, and Ranking Member Mike Lee, Senate Comm. on the Judiciary Subcomm. on Antitrust, Competition Policy, and Consumer Rights, to Chairwoman Edith Ramirez, Fed. Trade Comm’n (Oct. 23, 2013).

⁶² See Mossoff, *A Simple Conveyance Rule for Complex Innovation*, *supra* note 23, at 120–30 (identifying inherent difficulties in assessing or predicting commercial innovation and the high error costs this portends for commercial regulation).

⁶³ Joshua D. Wright, *Antitrust, Multi-Dimensional Competition, and Innovation: Do We Have an Antitrust-Relevant Theory of Competition Now?*, in REGULATING INNOVATION: COMPETITION POLICY AND PATENT LAW UNDER UNCERTAINTY 230 (Geoffrey A. Manne & Joshua D. Wright eds., 2010).

present threat of causing even greater harm to the innovation economy through legislative or regulatory overreach, this is an issue on which Congress should exercise restraint.

Conclusion

Contrary to popular myth today, the patent licensing business model has long played an essential role in distributing patented innovation through the marketplace. These commercial activities reflect the basic economic principle of the division of labor that Adam Smith famously recognized as essential to a successful free market and flourishing economy—in this context, it is the division of labor between inventors and businesspersons.⁶⁴ This fundamental economic principle is just as applicable to patented innovation as it is to any other economic activity; as Henry Ford famously said of his friend and business partner, Edison was “the world’s greatest inventor and the world’s worst businessman.”⁶⁵ Thus, it is significant, as Commissioner Wright has observed, that “[t]he PAE is a specialist in licensing and enforcing patent rights.”⁶⁶

Of course, the twenty-first century innovation economy is incredibly different from that of the nineteenth century. The exogenous market and technological variables at work in this economy are different as well. But it is still wrong to claim that the patent licensing business model and secondary markets are novel practices today. It is equally wrong to call for legislative or regulatory action based on the admittedly potent mix of mistaken historical claims, undefined and inflammatory rhetoric, the disregard of existing legal mechanisms addressing the concerns, and with little regard for symmetry of costs and benefits.⁶⁷ Whether there are benefits or harms from specific commercial and legal practices in the innovation economy is an important empirical and policy question, but such benefits or harms should no more be based on rhetoric, anecdotes, and incorrect claims about historical practices than they should be based on “nonrandom and nongeneralizable” studies.⁶⁸ Congress should exercise restraint, avoid “[a]ttempting to label and then discriminate based on identity,” and be cautious in accidentally killing “the goose laying our golden egg.”⁶⁹

Senator McCASKILL. Thank you, Mr. Mossoff.

You know, I don’t think anybody, at this hearing anyway—this is not the Judiciary Committee. We’re not talking about systemic changes to the patent law system. We’re talking about bottom feeders. We’re talking about scam artists and my question to you, Mr. Mossoff, is how would we ever know anything other than anecdotal if these guys are completely free? And if you go on Ms. Samuels’ website, which I took a moment to do while she was testifying, I think you can clearly see that. I know you’re a smart guy, and you know this area of the law very well. You’re not going to sit there and tell me you don’t think these letters are scams.

Mr. MOSSOFF. Well, thank you, Senator.

I mean, it’s an excellent question about to what degree patent owners and even secondary owners of patents are deceptively asserting demand letters and are deceptively asserting invalid patents. The problem is that we don’t have any established statistical evidence in comparison to the entire patent system that tells us that this is actually a systemic problem. The types of regulations that would be adopted at the FTC or the type of legislation that would be adopted would effect a systemic change that all patent

⁶⁴ See ADAM SMITH, *THE WEALTH OF NATIONS* Book I Chpt.1 (1776).

⁶⁵ STROSS, *supra* note 27, at 165. Ford knew of which he spoke, because he provided Edison a total \$1.2 million in business loans, and some of which he was forced to forgive. *Id.* at 253.

⁶⁶ Wright, *supra* note 16, at 5.

⁶⁷ See Lamoreaux, Sokoloff & Sutthiphisal, *supra* note 24, at 4 (“To many critics, there is something new and unethical about profiting from intellectual property by marketing the rights rather than using it in production.”).

⁶⁸ GOVERNMENT ACCOUNTABILITY OFFICE, *supra* note 5, at 26.

⁶⁹ Kappos, *supra* note 1.

owners who license their patents and send royalty requests would be affected by.

Senator MCCASKILL. Well, how about if we just, to get beyond anecdotal, if we just—I don't think Edison would have been offended if he would have been asked just to file the letter that he was sending that clearly states what patent he's asserting and his bases for doing it.

I mean, isn't the registry a way we would get past anecdotal? How in the world would we get past anecdotal if we let these scam artists, these bottom feeders, operate in the shadows without—I mean, how do we ever do anything other than you saying we have anecdotal?

How do we get at the problem?

Mr. MOSSOFF. Again, Senator, these are excellent questions and you're right. Anecdotes are a type of evidence, but when you're talking about adopting a legal regime that will be applied to all patent owners, that's a systemic change. And then we have to determine whether there is actually a systemic problem that justifies a great systemic change because costs are always symmetrical.

And, yes, while we need to be concerned about the costs of inappropriately sent demand letters to retailers and other end users, we need to be aware of and sensitive to the cost that additional regulations or legislation impose upon companies working within the innovation industries.

Senator MCCASKILL. Well, I got a good idea. We have somebody on the panel that owns a bunch of patents.

Mr. CHANDLER, how many patents do you own?

Mr. CHANDLER. We have about 10,000 issued U.S. patents.

Senator MCCASKILL. Does anybody else own patents on the panel?

All right, let's talk to the expert.

You own 10,000 patents. If you were going to send a letter asserting your patents, would you find it something that would really negatively impact your business if you had to file them on a registry with no other requirement other than you had to file them?

Mr. CHANDLER. I'm conscious in being called an expert, that I'm always mindful of the fact there are people on my staff who have the word intellectual in their title and I don't.

Senator MCCASKILL. Right.

Mr. CHANDLER. You know, we have no issue; we generally don't assert our patents. Our position on standards bodies, for instance, is that not only do we license freely but we license for free because we believe in disseminating standards and encouraging the adoption of technology; that happens to be our personal policy.

I propose a registry, whenever anyone is sending a letter to more than ten end users, and I'd have no problem complying with that myself were I going to be in that business.

Senator MCCASKILL. The other part of your testimony, Mr. Mossoff, that I found interesting was that there are plenty of legal clinics out here for these small businesses. I don't know how in touch you are with the legal community right now. They have suffered through this recession like all other communities. And one of the reasons probably a lot of these bottom feeder firms have popped up is that everyone is scrambling for legal business.

Now I don't know what legal aid is like in your state, Senator Heller, but ours is on life-support. They are overwhelmed with desperately poor people trying to assert even basic rights.

I'm not aware of any entities that are funded well in my state that any small business—that a local coffee shop that wasn't a franchise—could call and say, hey, "I got a letter today that they're threatening to sue me if I don't pay them \$3,000. What should I do?" I know no where that small businesses in Missouri can call.

Are you aware of some burgeoning legal clinic, free pro bono services, that I don't know, or should we just give them your phone number?

Mr. MOSSOFF. That would be excellent, and thank you, Senator—

Senator MCCASKILL. Don't say that would be excellent, because you don't know me.

[Laughter.]

Senator MCCASKILL. I'll give them your phone number.

Mr. MOSSOFF. Well, you should give them my phone number because it gives me the opportunity to expand upon this point and I know exactly where to send to them. The App Developers Association has announced that it is now working with law schools and they have created six law school clinics and the announcement indicated that more are coming at law schools throughout the country that are specifically dedicated to assisting individuals. And I assume that the individuals that they would be most directing their services to are end users and small businesses who receive letters or become defendants in lawsuits.

Thus, there appear to be private organizations that are working with law schools and providing them the funds to better assist in the provision of defense for the actual deceptive practices that you've heard about. As well, there are some organizations and law firms that actually are filing actions in the new administrative review procedures at the patent office. Thus, I am certain that Julie Samuels can tell us about the work that EFF has done in recently filing a challenge in the Inter Partes Review Program at the Patent Office to address the notorious podcasting patent.

Senator MCCASKILL. I'll save, for my next round, some of my questions about civil claims against the trolls and criminal behavior and for you, General Bruning, about your activity. And now, I will turn it over to Mr. Heller for questioning.

Senator HELLER. Thank you, Mr. Chairman. And I certainly do appreciate everybody being here, spending time and sharing your stories with us. I think the message is loud and clear, what's going on out there, and for that, I can't thank you enough.

We've heard all the words; this practice is deceptive, it's wrong, it's harassment, there's fear. I think unfair is a clear, descriptive word of how this practice has impacted small businesses and the economy.

But, Jon, out in Nebraska, I just want to ask you: When you deal with this, is anything that's going on there, this practice, is it actually illegal?

Mr. BRUNING. We believe it's illegal on two fronts. Our consumer protection statutes, which I enforce as Attorney General, because these patent trolls, number one, don't have any intent to sue and

number two, don't have any evidence that the recipient of the extortion letter has actually violated their patent, we believe it's a violation of our consumer protection statutes to send the letter. So before you send that extortion letter, you have to have knowledge that there has been some violation of the patent. They don't have any knowledge. They don't know anything about Eldon Steinbrink; they just got his name off a list somewhere. And they don't actually have any intent to sue. MPHJ has never sued anybody, other than us. We alleged that in court and they said, well, we have sued somebody—we sued you, Mr. Attorney General. And they did sue us. But they never actually sued an alleged infringer. So, we think it's a violation for that reason. We're actually looking into the criminal statutes as well. We have a RICO statute in Nebraska we've modeled after the Federal RICO statute and we're considering whether or not that's applicable as well.

So, we're looking at this from all fronts. We consider this very similar to just garden variety extortion, where the mafia walks in, says, it's nice that your front window hasn't been broken out. For \$50 a month, I can make sure it never gets broken. That's essentially what this is, in our opinion.

Senator HELLER. How much of your time do you deal on this issue?

Mr. BRUNING. Well, we've been spending a lot lately, and I've got my chief deputy and one of my top lawyers with me. We have four or five of our top people. But we're trying to get a national coalition group formed. Met with Mr. Chandler earlier and we're very interested in having some of the top legal minds in the business community aid our coalition. We think we're on the side of the angels on this one, and I'm very grateful that you Senators have called this hearing, because this is very, very important. As I think was mentioned by Ms. Samuels earlier, in the last 18 months, this has exploded. These letters now are going to individuals and non-profit organizations. That choir in Omaha? I mean, they must have \$300 in their checking account for robes. They get a letter? I mean, how on earth can they be alleged to have violated someone's patent? They were simply culled off a list that these fraudsters have gathered from somewhere.

Senator HELLER. Why do you think this has exploded in the last 18 months? Is it economically driven?

Mr. BRUNING. I think there's no question. What has happened is, they have—these patent trolls have kind of run to the end of the line with Mr. Chandler in Cisco that actually has in-house patent lawyers. They've realized that Mr. Chandler's going to fight. He's willing to spend tens of millions of dollars. He's gotten to the point where he says, I'm not going to put up with it anymore. Because what America's larger businesses have realized is as soon as you pay out and you pay out again, they'll come back for more. It's a typical extortion scheme. If you pay the first time, they're going to come back again and again. So they've run to the end of their rope with the big boys and now they're going after the little guy who can't fight back because they don't have a patent lawyer, they've never had one, and when they call one, it's \$20,000 up front and \$500 an hour to get that person in gear.

Senator HELLER. Ms. Samuels—your Trolling Effects website; what kind of activity do you get on that?

Ms. SAMUELS. Thanks for the question, Senator Heller. We get less than we would like and that we would have hoped. I think we've had somewhere in the neighborhood of only 30 submissions. And we launched a couple months ago and it made a lot of news, so it's not for lack of people knowing.

We've held meetings with people from large companies, in-house attorneys from large companies and we've talked to a lot of smaller individuals. And pretty much across the board, everyone we've talked to says, we'd like to submit our letters, but we're afraid to. We're afraid to make it public. And we think that our website only has value if it's public because we're really worried about the small individuals that get these letters and have no idea what to do when they get them. I mean, no clue whatsoever.

So we want to create a space where they can go and Google the name of who sent it, Google the patent number, end up at our site, say, oh, well you know, this person sent out thousands of letters and they only sued twice; maybe I'll just ignore it. Or say, wow, this person sues all the time; maybe I do need to find a way to hire a lawyer. Understand what their options are; I mean, have the most basic facts. But, you know, the problem is, again, that people are afraid, which is why I think we need some Congressional help to give those companies some cover so that they're more willing to share the data.

Senator HELLER. Very good. Thank you.

Senator MCCASKILL. Thank you. Senator Klobuchar.

**STATEMENT OF HON. AMY KLOBUCHAR,
U.S. SENATOR FROM MINNESOTA**

Senator KLOBUCHAR. Well, thank you very much, Chairman McCaskill and Senator Heller, for holding this important hearing.

I'm on the Judiciary Committee and chair the antitrust subcommittee. Many of you remember we had a hearing related to this—Senator Lee and I did. And I also wrote to the FTC asking them to examine the abusive assertion tactics and to bring enforcement actions if they violate the FTC prohibition on false and deceptive practices. I've heard a lot about this in my state. I actually got interested in this because what was happening to many of our companies who—we're home to many innovative companies and are proud of that. We brought the world everything from the pace-maker to the Post-it note in Minnesota, so we care a lot about patents.

And I know, Mr. Chandler, that this subcommittee, under Chairman McCaskill's great leadership, is focused on protecting consumers from not only deceptive practices but also market inefficiencies. And using your case as an example, how did the demand letters drive up cost or negatively impact consumers?

Mr. CHANDLER. Well, I think it's clear that that's what the goal ultimately is. Interestingly, just last week, one of the leading lawyers in Texas who represents patent assertion entities spoke at a conference in Austin and actually referred to the Innovatio case specifically and the fact that the judge, when he looked at it, found that all of the technology related to these patents was embodied in

chips that were sold to companies that built routers and that as a result, the chips were worth \$5 a piece and this particular technology had a value of about \$.10 a chip. And he bemoaned that result and described driving from Dallas to Austin and seeing signs for free Wi-Fi. And he said the reason Wi-Fi is free at all of these places is because the judiciary isn't putting enough value on patents and allowing people, like in Innovatio, to collect the money they want to collect.

So I think it's—I viewed that statement last week as a gift in preparation for this hearing.

Senator KLOBUCHAR. I imagine you did.

Mr. CHANDLER. But what has gone on—and the answer to the question that was asked a moment ago is, we have a very vibrant and liquid market for patents in the country. And I think that ultimately is a good thing in general for a patent system; when it is leveraging litigation games, though, as opposed to underlying intrinsic economic value of patents, it runs amok. And, because of this liquid market, big companies often will have patents that no longer have economic value in their businesses like these Broadcom patents. But people who can exploit the litigation system can buy them up and rely on cost asymmetry to send letters to thousands of people and know that some of them will pay, either because they don't know better or because it's cheaper than hiring a lawyer, as the Innovatio people pointed out.

And that's really what has driven it over the last 18 months is big companies selling patents to people who will go do this, then, and take advantage of people.

Senator KLOBUCHAR. Thank you.

Attorney General Bruning, if I could. I have limited time, and then maybe at the end we'll come back if the Chairman will allow me.

Attorney General Bruning, I'd first like to note: I wondered if you watched the Nebraska-Minnesota game where the Gophers—

[Laughter.]

Senator KLOBUCHAR. I know that the Chairwoman already brought up football, but I just wanted to make sure.

[Laughter.]

Mr. BRUNING. I was there, yes, thank you.

Senator KLOBUCHAR. You were there? I was there, too.

Mr. BRUNING. Yes.

Senator KLOBUCHAR. I had a lot of fun.

[Laughter.]

Senator KLOBUCHAR. Really great. And I had a bet the last time with Senator Nelson, and so I had to call him afterwards to say that I bet the wrong year. But this was the time, so anyway.

Mr. BRUNING. Congratulations.

Senator KLOBUCHAR. Thank you very much.

[Laughter.]

Senator KLOBUCHAR. But now to some more serious questions.

We've heard compelling testimony about abusive use of demand letters. But as we consider the issue, we need to also be mindful of the importance of intellectual property rights and the correspondence that takes place each and every day among patent owners and innovators to assert their patent rights in good faith.

How do we ensure that any potential solutions to the problems of abusive demand letters do not adversely impact generally accepted licensing practices, which could include demand letters or other similar types of correspondence?

Mr. BRUNING. Senator, I thank you for the question.

And I think, generally, the answer to that is, more disclosure, whether it's a registry for a minimum number of letters, whether it's a registry for each individual letter, whether it's disclosure of the owner of the patents. Remember at MPHJ, that I talked about in my testimony in particular, they have a whole series of alphabet soup shell companies that they use that are registered in Delaware. We can't even get to who owns this thing, who's asserting the patent. It's MPHJ through Accuver, whoever that is; we don't even know. So this seems to be, by all accounts, a simple scheme. And so disclosure—if somebody stands up and says, I'm John Smith, I own the patent, even if they bought it on the open market, that's OK, but explain who they are. That's the first thing. The second thing is, explain how the person receiving the letter or the organization receiving it violated the patent. Right now, they don't even have to assert that. They simply say in these letters, you have to prove that you didn't violate our patent; that you didn't infringe on our patent, which is a very topsy-turvy way to go about it.

So Eldon Steinbrink, the 80-year-old gentleman in Phelps County, Nebraska, he gets this 20-page letter and it says, Mr. Steinbrink, we think you violated our patent. We have no evidence to prove that, but you have to prove to us that you didn't. And that's a very perverse result, where it's simply extortion dressed up using the patent system.

Your attorney general—if I may, Senator? Your attorney general in Minnesota, Attorney General Swanson, effectuated a settlement with MPHJ where MPHJ agreed not come into Minnesota. I haven't talked to her yet, but I'm very interested in the terms of that, how she got that done.

I want to protect all Americans, but, of course, I want to protect Nebraskans. How did she figure out to keep these people out of Minnesota? I don't know.

Senator KLOBUCHAR. Maybe it's the cold weather.

[Laughter.]

Mr. BRUNING. She's very smart. Good for her.

Senator KLOBUCHAR. OK. Could I just follow up? I know, Mr. Mossoff—

Senator McCASKILL. Sure.

Senator KLOBUCHAR.—you wanted to, if that's all right. You wanted to respond.

Mr. MOSSOFF. Well, thank you, Senator, because I just wanted to have the opportunity to expand a bit upon Mr. Chandler's comments because I worry that what patent lawyers call the secondary market, the buying and the selling of patent rights from inventors to other commercial entities, is being perceived in some sort of pejorative sense. That large companies are unloading patents to small companies that then exploit these for deceptive or inappropriate purposes.

In fact, a vibrant market in the sale of patents and of patent rights has existed from the very early 19th century. People then

bought and sold patents in classified ads. The end of *Scientific American* issues were littered with offers to buy and sell patents and patent rights. And this was important for the efficiencies achieved by the American patent system from the very beginning because it permitted the division of labor to be embraced; for inventors to focus on inventing, for business persons to focus upon business; for manufacturers and retailers and others, etc. And it was a key to why the American patent system ultimately gave birth to an explosive growth in the economy in the 19th century. We were surpassing other countries—England and other countries—by the mid-19th century. And they were marveling at us and recognizing that it was our patent system that was bringing this innovation economy.

Fundamental to this innovation economy was the secondary market in patents. And so, it wasn't just Thomas Edison and Charles Goodyear, the inventors; there were also people who were buying and selling patents and were embracing what I call the patent licensing model, which involved sending royalty letters and making demands upon infringers. One historian found in 1883 that a thousand cases were filed in the Southern District of New York just that year, and almost all of them were involving a single patent—a well-drilling technology—and almost all of those lawsuits were filed against farmers. Well, the farmers were infringing, and this entity was going to these farmers and saying, we think you're infringing, please pay us a royalty. And they did not, so they were required to enforce their patent rights in order to legitimately recoup the investment that they had in their property.

Senator KLOBUCHAR. Thank you.

Senator McCASKILL. Thank you.

Let me take a moment on the record to say how much we would welcome whistleblowers that work in any of these factories that are churning out these letters.

Speaking of algorithms that are well-known to people in the tech world, clearly there's a financial algorithm that has being used. You're going to get an average of "x" dollars for every letter you send; let's cast a wide net; you know, the chances of there being any negative consequences to casting a wide net are very low; the chances of driving up what you receive per letter are very high. Someone is working in one of these "law firms"—I put "law firm" in quotes because I don't consider this legal work—and we would welcome a whistle-blower that is inside one of these entities. And we are very used to, in my office, protecting whistleblowers because we've done so much work in the contracting area, where we have done great oversight work with contracting. So I wanted to put that on the record, that your identity and where you work will be protected if you can give us a dirty inside glance as to how this actually—how they're figuring out what lousy patents to buy, how they're figuring out who to send the letters to, where they're getting the list, how much they're receiving. Maybe that would get us beyond anecdotal if we could pull back the curtains and see what's actually going on behind the scenes.

Let me ask you this: Are any of you aware of anyone who has turned the tables and brought a civil cause of action for damages against these entities? It seems to me, there's a great—I think it

would be really fun for somebody to get a really good class action going against one of these law firms. And, you know, I'm not a class action lawyer, but it seems to me that there's a class here.

Yes.

Mr. CHANDLER. We brought a RICO claim against these individuals at Innovatio based on the deceptive letters that they were sending, their fraudulent purpose in doing so, and the conspiracy among the individuals to do it. And that approach failed in a ruling by Judge Holderman, the Chief Judge in the Northern District of Illinois. And the reason it failed was that our Constitution protects the right of citizens to petition the government for redress of grievances and litigation is considered a form of petitioning with an exception where the litigation is deemed a sham. And since they sent 13,000 letters and we felt that since they knew that a huge proportion, if not a majority of devices were already licensed, that that was a sufficient sham to take action under RICO. And the judge said, no, that's not a sufficient sham to shut off their ability to litigate or to hold their actions in litigating to be actionable under RICO.

And I understand the ruling. I felt differently, which is why I brought the case. On the other hand, it brings me to this hearing and to the fact that I think some action to shed some light on this to create a registry to get the data to force them to tell end users who the manufacturers are will go a long way toward resolving the most abusive problems that are out there.

So yes, we did take an action. It happened to fail, but I think that brings it back to all of you.

Senator MCCASKILL. Mr. Potter.

Mr. POTTER. On two counts. One is, there's a company called Find the Best in California which is a member of ours. We brought them to D.C. last week and, in fact, I think they're coming back next week. They have sued the plaintiff on a RICO action. They have counterclaimed, essentially against the so-called inventor and their so-called law firm and their eight or ten or twelve shell corporations that they pass it through so that this guy and this woman in Connecticut won't be found out and uncloaked as, essentially, people who pushed through patents at the patent office and then go around and sue people.

I want to reiterate. I want to respond to two other points, if I might, Madam Chairman.

Senator MCCASKILL. Sure.

Mr. POTTER. Number one, the Application Developers Alliance has launched the Patent Troll Defense Network with six law schools around the country. We're pleased, we're proud, and we're doing the darn best we can. We now have 12 or 13 law students, while they're not in class and while they're not always studying for the bar and while they're not trying to get some sleep, to—

Senator MCCASKILL. That's a lawyer I want.

[Laughter.]

Senator MCCASKILL. No, just being a little sarcastic.

[Laughter.]

Mr. POTTER. They have made one or two students available to us for a certain number of hours per week at these law firms and we're figuring it out. To say that they're ready, willing and able to

fight arm-in-arm with highly trained, aggressive litigators who are around the country—is a sham. And it’s just pathetic.

Number two, let me reinforce what Julie said about the fear. We brought, I think, 15 companies to D.C. two or three weeks ago, maybe 6 weeks ago, to meet with members and staff and talk about their experiences. And some of them I talk about in my testimony. If you go to our website and you look at that CEO on our website who the video’s on, his face is pixelated and his voice is changed. And it’s done that way because he’s afraid. He’s been funded by substantial brand-name venture capitalists who don’t want him to go public. The idea that anecdotal evidence isn’t good enough is preposterous.

Senator MCCASKILL. Yes.

Ms. SAMUELS. Thank you for the question.

And while Jon and Mark have talked about going into court to go after these bad actors, I think EFF is probably one of the organizations in the country that has the most experience trying to challenge bad patents. You know, knock off one-by-one, protect consumers. And I briefly just want to tell you that that’s incredibly hard work. It is incredibly resource-intensive. We do it on a one-by-one basis and we recently, as Mr. Mossoff just said earlier, have challenged a patent that is being asserted against podcasters, and it took help from students at Harvard, pro bono help from a giant law firm, and we had to still pay more than \$30,000 in fees.

This is not an easy thing to do. And that’s why we need more help.

Senator MCCASKILL. Transparency is what sounds like we need.

Senator HELLER.

Senator HELLER. Thank you.

Mr. Mossoff, listening to you, I’m trying to get a description of your testimony that you discuss the need for objective evidence—reasoning explanation before legislative steps are taken. I’d assume that’s a fair description of what you said.

Mr. MOSSOFF. Yes.

Senator HELLER. And also that your concern is that legislation enacted could weaken patent rights or increase legal hurdles.

Mr. MOSSOFF. Yes.

Senator HELLER. That could be a burden on innovation.

Is that also a fair description?

Mr. MOSSOFF. Yes.

Senator HELLER. OK.

Have you seen any specific proposals out there? Any specific proposals that address these demand letters that would weaken patent right?

Mr. MOSSOFF. Well, the concern is over the proposal that we’re discussing here before this committee about authorizing the FTC to regulate and punish the sending of demand letters because under Section 5 the authorization is to protect consumer welfare. The inferential leaps that one has to go from receipt of demand letter to, ultimately, the impact upon consumer welfare is significant. I’m not saying that it may not necessarily be proven, but it would have to be shown. And it would have to be established through evidence that there is actually existing harm to consumer welfare that would then establish the basis for having definitive legal standards

that would not increase uncertainty for legitimate companies and owner of legitimate patents. Because I think the concern here is we have to get clear on what the underlying problem is, and that's why we need more evidence. Because I don't deny, and one can't deny, that there are bad actors. But there are over 3,000 lawsuits filed every year in this country in Article 3 courts. And if the majority of the demand letters that are being sent are being sent by 10 or 12 bad actors, then that's not a significant impact within the patent system relative to the people who are filing legitimate patent lawsuits and will have increased burdens imposed upon them because costs are always symmetrical.

And so, the increased ability to punish under vague legal standards the sending of demand letters in one context can be exploited by a real infringer of a legitimate patent in another context. And that's something that we have to be aware of, understand and investigate as well.

Senator HELLER. Mr. Sinewitz, do you want to respond?

Mr. SINEWITZ. You know, I'm listening to organizations and I'm listening to all the other testimony. At the end of the day, maybe I come from a little bit of a different angle because we're just a small company. And the answer, very simply, is when I call a patent attorney and he tells me I can settle something for \$50,000 or \$60,000 and probably \$50,000 in his fees, or I can take this to court and it's going the cost me \$2 million, it's just not happening. And even though I'm a small company compared to somebody who has a coffee shop, or somebody who only owns one little location, I mean, I'm huge compared to them.

We had a call—or actually, a letter, just a week ago from a company called Red Star. Red Star owns the patent to DVD players and the ability to read the DVD players. And in it was a very detailed, very explicit letter explaining to us that we had a machine on our floor that came from China that had not paid the North American Philips patent. Within 15 minutes, I pulled every one of those machines off the shelf, contacted the manufacturer, or the person who imports them, and told them that I wanted a return authorization to send these back. Because they did identify the product, because they did make it very clear, and they were very specific as to where they felt this thing was being infringed, we were able to react to that.

I will also probably tell you that at the end of the day, they will now pay that fee. They'll pay for the royalties of that fee. And that's what we're really here for. You know, I said in my testimony that really the bottom line here is fairness, OK? We can get involved in all the websites you want, we can get involved in all the legal things that happened in the 1800s and 1900s; that's really great. Today, technology is moving so quickly and there are so many more new things that are coming out and things are so much more broad and so much different than worrying about drilling rights and farmers. Today, every single day, some new technology is showing up. You know, as the Senator saw when her Apple wasn't able to read and she had to go back to paper—the world changes every 24 hours for us in the electronics world. And the bottom line's going to be is that if the consumer wants to continue to

participate in this kind of technology and everything else, then yes, we have to protect the people who are inventing things.

Senator HELLER. Thank you.

Mr. SINEWITZ. I don't think anybody wants to argue that.

Senator HELLER. Ms. Samuels, do you want to comment?

Ms. SAMUELS. I have two brief points to make.

First, just to be clear, we're not talking about regulating all demand letters, ever. We're talking about regulating certain bad behavior. And it can be limited. And I think that's really important because there is a place for responsible technology transfer in this country and I don't know anyone who would disagree with that statement.

Senator HELLER. Do you believe the FTC has the authority to act?

Ms. SAMUELS. I actually believe the FTC already has the authority to act. My understanding is the FTC also believes it already has the authority to act but, you know, a little nudge maybe wouldn't be the worst thing in the world.

And the second point I'd like to make, and I'll try and be brief here, on this whole, you know, anecdotal versus real, let me just quickly tell you some things we do know. And this is in my written testimony.

We do know that troll lawsuits are associated with half a trillion dollars of lost wealth to defendants from 1990 through 2010. Academics and economists average that patent trolls in 2011 imposed a direct cost of \$29 billion to companies. And while, you know, we're talking, of course, about mainly litigation costs because that's the data we have, Innovatio's a great example.

Eighteen thousand letters, did you say?

Mr. CHANDLER. Thirteen.

Ms. SAMUELS. Thirteen thousand letters and about 30 lawsuits.

Another professor, Colleen Chien, has said that she estimates there are about 100 demands per a single lawsuit. So to the extent the data we have surrounds lawsuits, when you extrapolate it, then that's something.

And finally, I would just say one business that goes out of business because of a patent troll is one business too many.

Thank you.

Mr. MOSSOFF. Senator, may I just quickly note, if I may, that the studies and figures that she's citing are exactly the studies and figures that were identified by the Government Accountability Office as being "non-random and non-generalizable." They were taken from proprietary, secret data owned by companies and firms with a real policy interest and financial interest in these issues. No one has any access to the data to test whether these claims are legitimate or not. And follow-on studies from publicly available data have actually shown that these figures are actually heavily inflated, including a study that was just placed up on the Internet this week by professors Jay Kesan, David Schwartz, and Chris Cotropia.

Thank you.

Senator MCCASKILL. Just as a note, it sounds like to me that, honestly, the more you testify, Mr. Mossoff, the more I believe we

need the registry, because then we will no longer have to worry about whether or not we've got real data.

Senator KLOBUCHAR.

Senator KLOBUCHAR. Thank you very much.

Mr. Sinewitz, Minnesota is also—I mentioned some of our innovative companies. We're also a big place for retailers. As you know, the retail industry contributes \$2.5 trillion to our Nation's annual GDP. We're the home of companies in Minnesota like Target and Best Buy as well as being the home to the Mall of America—the biggest retail space in the country, which I suggest everyone visit during the holidays.

[Laughter.]

Senator KLOBUCHAR. Mr. Sinewitz, how much do retailers end up paying out because of demand letters, either in settlement or in litigation?

Mr. SINEWITZ. I'm not sure I can answer for either Best Buy's or Target which are two of the, obviously, large firms that are based in Minneapolis. But I can tell you that we've spent a half a million dollars already either in settlements and legal fees. And a half a million dollars for a small company our size is outrageous.

Senator KLOBUCHAR. And do you see this—has it been exponential in terms of the increase? What were you seeing, you know—

Mr. SINEWITZ. It has been—

Senator KLOBUCHAR.—ten years ago?

Mr. SINEWITZ. reasonably steady, it's, like, one a year that we're getting. I will tell you that I sit with both of those companies on the Florida Retail Federation and on the Georgia Retail Association, where I have stores. Both of those companies are every bit as concerned about this as I am. And to be perfectly honest, one of the suits that we got hit with, they just took every major retailer in Atlanta and they nailed us. And they were both nailed in that same process because both of them have stores in Atlanta.

So the reality of it is, is that if they win—and, you know, to answer the other question of a second ago about wanting to come out, I have real problems bringing you guys letters because when I settle these things, I have to settle non-disclosures. And it opens me right back up to getting sued again.

Senator KLOBUCHAR. By someone else.

Mr. SINEWITZ. By the same people.

Senator KLOBUCHAR. The same?

Mr. SINEWITZ. I mean, the same people that I gave them \$50,000—

Senator KLOBUCHAR. Oh, because they'll sue you because of your violation of the non-disclosure agreement.

Mr. SINEWITZ. Because they gave me non-disclosures as part of settlement. Because they surely don't want me to go out there and tell people what I've done.

Senator KLOBUCHAR. Were you in this business 20 years ago? Or is it—

Mr. SINEWITZ. Oh, I've been with my company for 32 years.

Senator KLOBUCHAR. So you've seen it change over time?

Mr. SINEWITZ. For us, this is in the last six, seven years that we have seen this kind of a problem.

Senator KLOBUCHAR. But you have numbers because you know your bottom line.

Mr. SINEWITZ. Yes, I do have that. I mean, I can tell you I've given the Committee the eight letters—heavily redacted, unfortunately—but I did give the Committee all eight letters that we had to settle on. I will tell you that that isn't the only letters that we've gotten. And I will tell you again that when we see one and it's legitimate, I don't think there's anybody that wouldn't want to honor that.

Senator KLOBUCHAR. And speaking of these trends, since there have been some issues raised—you know, I kind of believe my constituents when they tell me this stuff and then when I hear it about 15 times, I know it's real. But there were some issues raised by Mr. Mossoff about whether this is truly a problem.

And Ms. Samuels, when did the trend switch from primarily legitimate use of demand letters—from your perspective, largely to manufacturers—to more deceptive letters that go to all end users?

Ms. SAMUELS. Thank you for the question, Senator Klobuchar.

I will tell you my personal experience. It was about 18 months ago that it really was noticeable, and it started with a troll called LODSYS, L-O-D-S-Y-S, who started targeting app developers for using technology that's provided to them by Apple and Google. You know, when they put their apps in the smartphone marketplaces. And, you know, I literally got to work one morning and my phone was ringing and I had a bazillion e-mails from these app developers who'd gotten these scary letters. There was one who is somewhere in Western Europe and the little FedEx package he had gotten, you know, the receipt showed how much it cost to send it. And it cost more to send a package to him than he'd ever made on his app.

You know, these people did not know what to do. And that was kind of—from my perspective that was the tipping point. But since then it has really just been a torrent.

Senator KLOBUCHAR. Mr. Chandler, just one last question here. As I mentioned before, I urged the FTC to approve a 6(b) study—and Chairwoman Ramirez testified at our hearings—and the Commission has taken the first steps now to begin this study.

Do you think this study is enough, or should the FTC take additional action? Should it put out an interim report, for instance, to highlight the findings so far so the market sees what they're looking at? And should it bring enforcement actions against the senders of the demand letters? It's really a two-part question. Should they do some kind of interim report and then should they do something with enforcement?

Mr. CHANDLER. Senator, thank you for your leadership on this issue, not just here but also in your other life on the Judiciary Committee.

Senator KLOBUCHAR. That is another life.

[Laughter.]

Mr. CHANDLER. The FTC study is a very broad one that looks at the entire universe of non-practicing entities including large patent aggregators who license portfolios to operating companies such as Cisco, all the way down to individual non-practicing entities that pursue this type of activity.

So it's a very broad study. I think it will take a long time to bring forward. I think an interim report would be a very good step, so I would urge the FTC to consider issuing an interim report and ask you to use your good offices with them to encourage that step as well.

I do think more is needed sooner, given the trend that we're seeing. And I don't think the FTC today has been very—and historically—has not used its very unique rulemaking capability to pursue issues like this very effectively. They do enforcement. On some occasions, the Congress has asked them, such as in the Child Online Privacy Act, to adopt specific rulemaking to pursue particular problems. And I think that's a step that this committee could begin, to ask the FTC to create a registry like this and to collect information and to allow manufacturers like me to then step in and help our customers deal with these. Because for the customers, when they're told do you want to pay \$2,000 to avoid spending \$10,000 to solve a problem, they will pay the \$2,000 even if the thing they're paying for is worth \$.10. If the manufacturers can get involved, we can aggregate it and deal with it.

I spent \$13 million dealing with Innovatio, but I'm proud of every cent, and I'm a guy who packs my lunch every day.

[Laughter.]

Senator KLOBUCHAR. Very good.

Well, I think that I saw a lot of nodding heads and I know we have a new colleague here, so I'll ask the questions later on the record to get your ideas. Because I think how we move forward is just as important as identifying the problem.

So thank you, everyone.

Senator McCASKILL. Senator Ayotte.

**STATEMENT OF HON. KELLY AYOTTE,
U.S. SENATOR FROM NEW HAMPSHIRE**

Senator AYOTTE. Thank you very much, Madam Chairwoman.

I wanted to first of all say to my former colleague, Attorney General Bruning, it's great to have you here today. And let me just ask you based on your testimony, you said the time is ripe for Federal and state authorities to work in concert to address this issue and stem the tide of patent trolling nationwide.

What do you view the role of state attorneys general, state authorities, on this issue versus cooperation with Federal authorities on how to address these problems? Often people think that Washington is the answer to everything, but the state AGs and state authorities are much closer on the ground level.

What role do you think they can play and how can we help consumers on this issue?

Mr. BRUNING. Well, thank you for the questions, Senators.

Very nice to see you as well. I always look forward to seeing you when I'm in Washington. I'm glad to be before the Committee today.

I would say it's a two-pronged effort. One, the attorneys general, as you recall, would gather, you know, in concert. Tobacco is an example that's very well-known, in 1999, where the attorneys general pursued Big Tobacco. I would say this is a case where the collective action of the attorneys general is warranted. We can use our con-

sumer protection statutes. These are fraudulent actions; they have no intention of suing, they have no knowledge of any of these individuals actually violating their patents. So I think it violates Nebraska's consumer protection statutes. I think it probably violates most states' consumer protection statutes.

For those of us that also have concurrent criminal authority—which is, you know, 35 or so attorneys generals, to my recollection—we have to analyze that because this is fraud; is it a criminal fraud? And certainly, our office is analyzing that. That's a higher bar to get over, but we're analyzing whether or not we should use our criminal statutes as well.

And at the Federal level, I certainly think the power of the FTC and the national scope of the FTC and the subpoena power of the U.S. Senate to lift the curtain on these folks, we can't even figure out who's behind MPHJ. Who are these people? Who is this? There's some guy right now at his country club in Austin, Texas or Atlanta, Georgia and everybody thinks he's a great, successful business guy, and what he is is a fraudster. And I want to see the U.S. Senate lift the curtain on it and say, here you are. And I want to see Steve Kroft at *60 Minutes* standing on the guy's driveway with a microphone—

[Laughter.]

Mr. BRUNING.—saying, why is it you held hostage these voices for—you know, this choir in Omaha that got this letter? Or this 80-year-old man with Alzheimer's in Holdrege, Nebraska that got this letter? I want to see those national news people standing on the driveway of this guy that everybody thinks is a preeminent business man; I want to see him exposed. And you can do that with your subpoena powers.

And I think a small tweak in the statutes or in the rules at the FTC to require registration of these letters, I think there seems to be some agreement that that may be useful.

Senator, I think you've said it extremely well. I mean, as we listen to Mr. Mossoff, perhaps registration is one way to lift the veil. We just need to have openness in this process. Legitimate patent holders, none of us have any problem with them enforcing their rights using the court system, but this isn't about patents; this is about fraud. This is about extortion. This is about fear with little companies that Mr. Potter represents, little app developers that it's their life or death. Some guy that has invested his last \$100,000, this letter will take him down.

Senator AYOTTE. Right.

Mr. BRUNING. And so, I think that's how—I know I went far afield there, Senator, but I think there is a role for each of us to play.

Senator AYOTTE. Great. I appreciate it. Thank you.

And this is something that I'm concerned about. We're blessed, in this country, to have incredibly great innovators. Many of them start out of their garages. So in New Hampshire, we have a great one—Dean Kamen. So when I was preparing for this hearing, we reached out to him and he rightly raised the issue that I want to hear from you on, which is—and I think Mr. Chandler, you can help me with this. You think about Cisco's revenue, so much of it comes from small businesses. And how do we make sure that by

trying to address the patent trolls, we aren't harming or decreasing the value of legitimate small innovators? These people who start out of their garage and have such great ideas—and that is what America is all about.

So when we address this problem, we've got to get that right to make sure that we are not hurting these wonderfully brilliant individuals who just have a great idea in America.

So can you comment on this, Mr. Chandler? And can you also comment on it, Mr. Mossoff?

Mr. CHANDLER. You know, I think that's a very, very important concern and I've testified on a panel together on patent reform with Dean and have a huge amount of respect for his contributions. And I know that when he has concerns about infringement, he doesn't send letters to individual Segway users asking them to send \$10 each and don't look too closely at the patent. So he knows exactly how to enforce his patents in an effective way. And there are issues related to how the patent litigation system works and what's fair and not. And I think those are being appropriately dealt with at the Judiciary Committee.

I think what we're looking at today is something that is not something that flows into the way Dean Kamen goes about conducting his business and enforcing his patents, and that is making sure people who are targeting end users who buy a product that incorporates someone else's technology aren't victimized when there's a huge cost and information asymmetry, but that the information is out there and there's some transparency so they know who to go to in order to get help and solve their problems. And that's something that I would be arm-in-arm with Dean Kamen in supporting. And I'd be surprised if he would want a business model where he was out sending thousands of letters to people using counterfeit Segways.

Senator AYOTTE. I would agree.

Mr. MOSSOFF. Thank you, Senator.

I think you raise a very, very important point. In fact, at a conference this past September here in D.C., Dean Kamen spoke and he spoke out on the issue of patent trolls. And he actually said, the phrase applies to me. In fact, he said, I am Trolls-R-Us. And he was very proud of that, he said, because I needed investors when I came up with my inventions when I was still working in my parents' basement when I created my first inventions. And he said, so I embraced that division of labor where I was the inventor and there were business persons and other experts and lawyers who could commercialize and enforce my patents for me. And thus, that's why he refers to himself as a troll. And it shows you the difficulties and problems with the labels that we're using and the rhetoric that we're using because it covers lots of different actors in a very complex and heterogeneous innovation economy.

And as you mentioned, small businesses and individual inventors need very strong patent rights. And it's individual inventors and small businesses, who are oftentimes not manufacturing yet, who in negotiating with large companies, are essentially told sue us. If you think we're infringing, then sue us. And in fact, one transactional attorney who testified at the FTC/DOJ workshop last December actually stated that he hears that a lot from his clients and

in deals that he negotiates. That small businesses and individuals are told when attempting to negotiate licenses with large companies: sue us. And then those small companies and businesses are immediately painted as “patent trolls” that are attacking these large companies who are painted as innovators.

And so this is a real concern because small businesses and inventors actually do need very strong patent rights—patent rights that are necessarily weakened by additional burdens that will be imposed upon them, both in trying to license their inventions as well as in trying to enforce them, which is always the backstop that makes licensing possible.

And in this respect, to go back to Attorney General Bruning’s comments and Senator McCaskill’s—your comments about a registry—I think we also need to be aware of the existing legal tools and the implementation of regimes that actually address the issues of disclosure. The Patent Office is about to issue rules following notice and comment on transparency of ownership following President Obama’s Executive Orders last June 4.

And so, we have to always hold in context that the discussion that we’re holding here is part of a very large and vast discussion about revising the patent system. And something that I really hope that we hold in context—that another massive revision of the patent system just 2 years after the America Invents Act, which was also a massive revision to the patent system, creates a lot of uncertainty. And that’s an uncertainty that effects and makes it much more costly not just for large companies to implement innovation into the marketplace, but also small businesses and individuals who are much more sensitive to cost, as Mr. Sinewitz has been reminding us about.

Senator AYOTTE. Thank you, Mr. Mossoff.

Senator MCCASKILL. Thank you, Senator Ayotte.

Let me reassure you, Mr. Mossoff. This committee doesn’t have the jurisdiction or the appetite for any massive change to the patent system. We’re talking about end users and consumer protection—is what we’re talking about.

So, I know, Ms. Samuels—I’m not going to take my full time because we’re going to have two votes at 11:45 and I want to make sure that if either Senator Heller or Klobuchar or Senator Ayotte has anything else to add to the record, they have an opportunity.

I just want to follow up with something you said. I believe you stated that the FTC has authority now, which is correct for end users that are consumers of products in terms of fraud being committed upon them, but I don’t believe they currently have the authority to establish a registry—

Ms. SAMUELS. Correct.

Senator MCCASKILL.—of these letters or require transparency in the letters as to who owns the patent and what patent is actually being asserted in the demand letters.

Ms. SAMUELS. Thank you, Senator.

That is actually what I meant, that the authority the FTC already has extends to what it can do under Section 5, not the registry.

Senator MCCASKILL. Thank you.

Ms. SAMUELS. Thanks for clearing that up.

Senator MCCASKILL. Senator Heller, do you have anything else for the record?

Senator HELLER. I don't.

Senator MCCASKILL. Senator Klobuchar, do you have anything else for the record?

I want to thank all of you very much. We will leave the record open for any submissions.

I especially want to thank you, Mr. Sinewitz, for traveling as far as you have.

And those of you from California, thank you for coming across the continent, and, certainly, thank you, General Bruning, for taking time away from Nebraska to come and talk with us. I hope you continue to educate your fellow attorneys general across the country about this opportunity we have.

You know, I'm old-fashioned about this. I'm not a big fan of Federal law enforcement. I'm a big fan of local law enforcement. I'm a local prosecutor by my background, and I think that a lot of this work can be done on a state-by-state basis much more effectively than we can do from Washington. So good for you and your work, and I look forward to hearing that many of your colleagues across the country have joined your important crusade to protect innocent consumers from these kinds of scams.

Thank you all for being here, and the hearing is adjourned.

[Whereupon, at 11:38 a.m., the hearing was adjourned.]

A P P E N D I X

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. CLAIRE McCASKILL TO
HON. JON BRUNING

Question 1. At the hearing, we heard about several policy proposals that could help protect consumers and small businesses from harmful demand letters. One potential idea widely discussed was the establishment of a demand-letter registry—whether at the Federal Trade Commission (FTC) or at the U.S. Patent and Trademark Office (PTO)—that would increase transparency and facilitate better data on the problem’s extent. What protections for consumers and small businesses would such a registry provide that would address the current harms inflicted on them by demand letters?

Answer. The creation of a demand letter registry would add much-needed protection for consumers and small businesses who too frequently find themselves targeted by unscrupulous patent trolls. The simple knowledge that “someone is watching” can serve as a valuable deterrent to a patent troll who may otherwise feel free to send demand letters scattershot to hundreds of targets around the country without first performing some basic due diligence as to whether those targets actually merit contact.

As it stands now, patent trolls can fairly view the demand letter process as a regulatory “Wild West.” Demands can be made and license fees extracted more or less in the shadows. Even if nothing else is done to address this problem, this relatively simple first step *should be* implemented, because it would provide valuable sunlight on those who are targeting so many of our constituents with unfair and deceptive patent enforcement demand letters.

Question 1a. Do you have an opinion about whether it would be more effective to house such a registry at the PTO or the FTC? Please explain why.

Answer. Though I am not fundamentally opposed to the housing of a demand letter registry at the PTO, I believe the problem of unfair and deceptive demand letters is, primarily, one of consumer protection. Accordingly, the creation of a Federal demand letter registry would best take place within the FTC as the Federal agency best equipped to engage in consumer protection activities.

However, I believe there is a role for state consumer protection authorities to play on this proposal, as well. In Nebraska, we are currently drafting legislation which would include a requirement that any person who sends demand letters to a certain number of Nebraskans over a specified period of time must notify the Attorney General’s Office. Such a notification requirement would do nothing to burden the lawful enforcement of a legitimate patent, but would enable my office to know in real time when such campaigns are underway. That way, if we observe evidence of unfair or deceptive practices in the sending of such demand letters, we can take appropriate action.

Question 2. Another potential idea from the hearing was to require certain baseline disclosures in demand letters to provide recipients with more useful information and to help stem the large numbers of demand letters being sent. Do you believe such mandatory disclosure requirements would protect consumers and small businesses from the current harms inflicted on them by demand letters? Would mandatory disclosure requirements provide a more effective consumer protection solution than a registry?

Answer. Absolutely and I do not view it as an either-or proposition. Mandatory disclosure requirements and the creation of a registry should go hand-in-hand.

Many of the demand letters patent trolls send to targeted small businesses and consumers are heavy on threats but light on specifics. Given the one-sided nature of patent litigation, it is inevitably extremely expensive for a target to defend itself, or even to simply determine whether the “specifics” exist. This creates strong incentives for targets to settle or pay license fees, which in turn keeps the patent trolls’ business model profitable and worth continuing. Requiring more detail in demand

letters would work to level the playing field between trolls and targets, and likely reduce the most egregious examples of demand letter abuse.

Question 2a. Please detail, specifically, the types of information that should be required in demand letters to achieve the goal of improved consumer protection.

Answer. At minimum, every demand letter should include the name, address, and contact information of the owner of the patent, the patent number, an admonishment to seek counsel from an attorney and *specific* factual allegations regarding how the target has infringed or is believed to have infringed on the patent. The fourth item is perhaps most important given how little research so many patent trolls perform before sending demand letters. If enforcers of patents were required to inform a target of why they were targeted, those targets for which there is no *substantive* evidence of infringement would likely not receive demand letters in the first place. This shifts some of the due diligence responsibility back to the patent enforcer, which is appropriate.

Question 3. We also discussed whether current law would allow effective implementation of the various policy proposals to protect consumers and small businesses from unfair or deceptive demand letters. Do you believe the FTC—under its existing Section 5 authority to prevent unfair and deceptive practice or any other statutory authority—has the ability to effectively carry out any of the proposed solutions that you have proposed or that were discussed at the hearing, such as establishing a demand-letter registry or including mandatory disclosure requirements? Please specify which potential solutions the FTC would or would not be able to implement.

Answer. I believe the FTC already possesses the authority to implement either a demand letter registry or specific disclosure requirements. I note that FTC officials have commented publicly on the need to address the problem of patent trolls and that the agency is currently considering launching a broad investigation into the practices, composition, and structure of patent trolls nationwide. The implementation of certain rules to limit demand letter abuse seems a logical next step and entirely consistent with the FTC's consumer protection mission and statutory mandate.

I would also note that I believe states possess the authority under their own consumer protection laws to address this problem. To prevent bad actors from using unfair or deceptive demand letters to extort license fees from legally unsophisticated small businesses and consumers is indisputably a consumer protection problem. Our authority to combat such violations is not and should not be limited by Federal preemption of any type.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. RICHARD BLUMENTHAL TO
HON. JON BRUNING

Question 1. Demand letters are often sent to people who will never see the inside of a courtroom. They will settle—often they will feel that they must settle—before a case is even filed. In your opinion, are the reforms being considered in pending legislation targeted at what happens during litigation adequate to fully address the problem with demand letters?

Answer. I believe there are provisions in the bills currently pending in both the Senate and House which contain valuable increased protections against bad faith demand letters. Furthermore, the provisions in those bills which clarify the FTC has the authority to go after the “worst of the worst” abusers of the patent demand letter process are commendable. I also believe that, though not *specifically* related to consumer protection, addressing the structural issues within our patent system which have allowed patent trolls to thrive is necessary. The pending Senate and House bills each contain provisions which would structurally level the playing field between trolls and their targets. More can be done, however.

Question 1a. Are there additional reforms Congress should consider specifically targeted at the issue of demand letters?

Answer. Yes. I touched on several of them above. Though I believe the FTC is already empowered to create a demand letter registry, Congress should expressly provide for it to ensure it happens in a timely and effective manner. Additional demand letter specificity requirements, such as those discussed above, should be included. Finally, it should remain expressly clear that state consumer protection authorities possess the requisite powers to address unfair or deceptive demand letter abuses which violate consumer protection laws. The states and Federal government must work as partners on this issue, never as competitors.

Question 2. As a former Attorney General, I believe that the states have an important role to play in protecting consumers. Do you agree that states have a role to play in protecting consumers from abusive demand letters?

Answer. Absolutely. In fact, my office has already initiated consumer protection investigations into several entities which have undertaken coordinated demand letter campaigns within Nebraska over the past year. We have engaged in active litigation related to one of those investigations and are preparing patent troll-specific legislation to be introduced in our Legislature's upcoming spring session.

I view consumer protection as being among my office's top priorities. I view the use of unfair or deceptive demand letters to extract costly license fees from small businesses and consumers as clear consumer protection violations. Accordingly, I believe it is my obligation as Nebraska's chief law enforcement officer to aggressively pursue those violations to protect consumers.

Question 3. Are there advantages to state enforcement in this area?

Answer. Yes. Though, as summarized above, I believe there are important steps the Federal government can and should take, there are distinct advantages to state enforcement against unfair and deceptive demand letter practices.

First, my office is invariably going to be more responsive to and aware of consumer protection violations within our state. This is simply a matter of proximity and recognition of the fact that our resources can more quickly be marshalled to address a problem as it arises than the Federal government can.

Second, we have already made the determination that our existing consumer protection laws provide us the tools to go after patent enforcement abuse. Understandably, it may take the Federal government some time longer to come to a point at which it is actually taking enforcement action. Meanwhile, the harm to targets of patent trolls continues unabated and state authorities, especially our nation's Attorneys General, are ideally suited to addressing the problem head on.

Question 4. Should Congress take action to allow states to protect their citizens?

Answer. See answer to question [5].

Question 5. What kind of action would be helpful?

Answer. I will answer questions [4] and [5] together. First, I do not believe Congress needs to take any specific action which would "allow states to protect their citizens." We already have a variety of consumer protection tools at our disposal. To the extent patent troll-specific legislation is useful at the state level, states are already free to pursue such statutes. Vermont has already done so and, as stated above, we plan to follow suit in Nebraska.

Congress should ensure that any action it takes complements state efforts and enables state consumer protection authorities and the FTC to work in concert against patent trolls. The magnitude and complexity of this issue necessitates that we work as partners and not ever engage in jurisdictional turf battles. Accordingly, I would ask that Congress continue to allow for concurrent jurisdiction between the states and the FTC to address unfair or deceptive demand letters from a consumer protection standpoint.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. CLAIRE McCASKILL TO
JON POTTER

Question 1. At the hearing, we heard about several policy proposals that could help protect consumers and small businesses from harmful demand letters. One potential idea widely discussed was the establishment of a demand-letter registry—whether at the Federal Trade Commission (FTC) or at the U.S. Patent and Trademark Office (PTO)—that would increase transparency and facilitate better data on the problem's extent. What protections for consumers and small businesses would such a registry provide that would address the current harms inflicted on them by demand letters?

Answer. A demand-letter registry would be very beneficial to consumers and small businesses. Today, one of the primary reasons that consumers and small businesses pay extortionist license fees to trolls is because the fees—though unjustified—are significantly less than the cost of determining the validity of the asserted patent and its associated claims and determining whether one has actually infringed the patent. Paying these extortionist licensing fees is also, though unjustified—extraordinarily less than the cost of defending an infringement litigation. A publicly accessible and easily searchable demand-letter registry would enable victims of demand-letter scams to contact each other and to act collectively in their common interests. Groups of letter recipients are more likely to stand strong against the abuses of patent trolls, as they will be better able to collectively finance challenges to patents'

validity, and collectively challenge the patent assertions as fraudulent. Knowing that one does not have to fight alone is beneficial; the ability to develop collective strategies and responses will be empowering.

Question 1a. Do you have an opinion about whether it would be more effective to house such a registry at the PTO or the FTC? Please explain why.

Answer. The PTO has extraordinarily qualified staff and surely is capable of developing this database. But the PTO is also extraordinarily burdened with many new programs and modernization efforts, and to my knowledge has not had the opportunity to build publicly accessible databases like the proposed registry.

In contrast, I understand that the FTC has developed registries like this, and done so successfully.

Regardless of where the registry is housed, the PTO should be willing to consider evidence of fraudulent, abusive or otherwise questionable demand-letter tactics that registry analysts uncover, and should use this evidence in its consideration of director-initiated re-examinations and petitions to waive fees associated with re-examinations and post-grant reviews.

Question 2. Another potential idea from the hearing was to require certain baseline disclosures in demand letters to provide recipients with more useful information and to help stem the large numbers of demand letters being sent. Do you believe such mandatory disclosure requirements would protect consumers and small businesses from the current harms inflicted on them by demand letters? Would mandatory disclosure requirements provide a more effective consumer protection solution than a registry?

Answer. Mandatory disclosures aid consumers and small business by reducing the cost of responding substantively to a demand/assertion letter. Lowering the cost of substantive responses reduces the likelihood of unjustified settlements that are due solely to the costs of responding and fighting.

Mandatory disclosure requirements provide needed transparency to each recipient of a patent assertion/demand letter, and they are a necessary supplement to a registry that provides transparency to all recipients. Neither is effective individually, but in combination they are very helpful.

Question 2a. Please detail, specifically, the types of information that should be required in demand letters to achieve the goal of improved consumer protection.

Answer. Five types of information should be required in demand letters:

1. The number of the patent being asserted.
2. The specific claims of each patent that are alleged to have been infringed.
3. The specific technology, functionality or activity, that the defendant is employing or doing, that triggers or implicates each assertion of infringement.
4. The basis of a proposed license amount if any specific license amount is proposed.
5. The names of all other entities that have been sent assertion/demand letters relating to the specified patents.

Question 3. We also discussed whether current law would allow effective implementation of the various policy proposals to protect consumers and small businesses from unfair or deceptive demand letters. Do you believe the FTC—under its existing Section 5 authority to prevent unfair and deceptive practice or any other statutory authority—has the ability to effectively carry out any of the proposed solutions that you have proposed or that were discussed at the hearing, such as establishing a demand-letter registry or including mandatory disclosure requirements? Please specify which potential solutions the FTC would or would not be able to implement.

Answer. I am not an expert on the FTC's Section 5 authority, but my initial concern is that the FTC's authority is limited to (a) investigational authority; and (b) enforcement authority with respect to specific actions and actors. Thus, I am not certain that FTC Section 5 authority is sufficiently broad to regulate either (a) the form or content of demand letters, or (b) to require that demand letters be uploaded into an online registry.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. RICHARD BLUMENTHAL TO
JON POTTER

Question 1. Demand letters are often sent to people who will never see the inside of a courtroom. They will settle—often they will feel that they must settle—before a case is even filed. In your opinion, are the reforms being considered in pending

legislation targeted at what happens during litigation adequate to fully address the problem with demand letters?

Answer. Ninety percent of patent assertions are resolved prior to litigation, but the bills currently being considered by the Congress do not fully address the problems with abusive pre-litigation demand letters. Specifically, these bills do not (a) authorize the FTC to define what data points must be included in a demand letter; (b) require that the FTC use its enforcement authority against unfair and deceptive demand letters; or (c) impose self-executing penalties against those who send abusive demand letters.

Question 1a. Are there additional reforms Congress should consider specifically targeted at the issue of demand letters?

Answer. Five additional reforms should be considered:

1. The Director of the Patent & Trademark Office should be required to consider Director-initiated re-examinations and post-grant reviews when there is evidence of demand letter abuse by a patent owner or its agent.
2. Demand-letter abuse should be punishable by permanent elimination of the patent owner's right to heightened damages, *e.g.*, for willful infringement, or by elimination of all enforcement authority with respect to that patent.
3. Demand-letter abuse should be punishable by a lower-standard for fee-shifting by courts.
4. Upon an administrative holding that a patent owner has sent demand letters abusively (either by asserting a substantively overbroad interpretation of a patent), that patent owner should pay for the costs of the administrative proceeding and should pay a remedial penalty directly to all recipients of the abusive demand letters.
5. Demand letters should be required to include a certification of honesty and good faith with regard to the patent's validity, its interpretation as asserted in the letter, and the infringement that it asserts.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. CLAIRE McCASKILL TO
MARK CHANDLER

Question 1. At the hearing, we heard about several policy proposals that could help protect consumers and small businesses from harmful demand letters. One potential idea widely discussed was the establishment of a demand-letter registry—whether at the Federal Trade Commission (FTC) or at the U.S. Patent and Trademark Office (PTO)—that would increase transparency and facilitate better data on the problem's extent. What protections for consumers and small businesses would such a registry provide that would address the current harms inflicted on them by demand letters?

Question 1a. Do you have an opinion about whether it would be more effective to house such a registry at the PTO or the FTC? Please explain why.

Answer. While Cisco has first-hand experience with the harms of deceptive demand letter practices, the full scope and extent to which deceptive practices are taking place, and the harm it is inflicting on small businesses and consumers, is not known because much of it is not publicized, and it is difficult for recipients of such letters to coordinate and collect the information on their own. A registry would call attention to the magnitude and scope of demand letter campaigns, and make it easier for recipients of letters to gather and disseminate information regarding the demands against them. It would also give everyone the full picture. For example, a demand letter recipient may be more likely to learn that the asserted patents are RAND-encumbered, that certain accused products are already licensed and do not infringe, or that manufacturers have stepped up and initiated litigation to defend their products. A registry would therefore discourage deceptive and unfair practices, while adding a basic level of transparency and accountability that will help protect innocent end users.

Question 2. Another potential idea from the hearing was to require certain baseline disclosures in demand letters to provide recipients with more useful information and to help stem the large numbers of demand letters being sent. Do you believe such mandatory disclosure requirements would protect consumers and small businesses from the current harms inflicted on them by demand letters? Would mandatory disclosure requirements provide a more effective consumer protection solution than a registry?

Question 2a. Please detail, specifically, the types of information that should be required in demand letters to achieve the goal of improved consumer protection.

Answer. In addition to a registry, it is important that demand letters provide adequate notice to the recipients concerning what is being accused, as well as other critical information from which a demand letter recipient can either reach out to the appropriate supplier[s] of infringing technology, or better understand its rights and the patent holder's obligations. At a minimum, demand letters should disclose:

- a list of products which are deemed to infringe, including the manufacturer and model number, and informing them that they may have the right to have the manufacturer defend the case, and providing contact information for the manufacturer;
- the names of the entities which own the patents or benefit from their enforcement and any related entities; and
- a list of all previous licenses granted for those patents, with a notice that if the recipient of the letter is using the products or services of a licensed entity, the recipient may require no further rights or permission from the patent holder, as well as whether there is a relevant licensing commitment to a standards organization.

Question 3. We also discussed whether current law would allow effective implementation of the various policy proposals to protect consumers and small businesses from unfair or deceptive demand letters. Do you believe the FTC—under its existing Section 5 authority to prevent unfair and deceptive practice or any other statutory authority—has the ability to effectively carry out any of the proposed solutions that you have proposed or that were discussed at the hearing, such as establishing a demand-letter registry or including mandatory disclosure requirements? Please specify which potential solutions the FTC would or would not be able to implement.

Answer. The FTC presently has the authority to under Section 5 to prohibit unfair or deceptive acts or practices, and this includes deceptive or unfair demand letter assertions. However, specific legislation requiring a registry and that demand letters include specific information would be helpful in curbing deceptive demand letter practices.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. MARK PRYOR TO
MARK CHANDLER

Question 1. I have heard reports that some foreign governments have formed, or announced intentions to form, state-sponsored patent assertion entities (PAEs). According to these reports, it is unclear how these PAEs might assert their patent holdings in the future and to what extent. Are state-sponsored PAEs something your company is aware of? If so, how would you characterize the nature of such organizations?

Question 1a. Has your company had any experience in dealing with a state-sponsored PAE? If so, could you please describe the nature of the interaction?

Question 1b. Would you please describe any other role, be it positive or negative, you believe state-sponsored PAEs may play in the technology sector?

Question 1c. Do you see a need for Congressional action with respect to state-sponsored PAEs? If so, please describe.

Answer. State-sponsored PAEs have already filed suit against Cisco and other American companies. For example, we have been sued by CSIRO, an agency of the Australian government and our customers have been sued by TR Labs from Canada. These entities are exploiting the imbalances of the American system against American companies.

Furthermore, a new form of large scale well-funded state-sponsored PAE is now emerging in some foreign countries. We have not yet directly interacted with them but are aware that they are accumulating large amounts of capital to purchase large numbers of patents including U.S. patents. In many ways we expect them to function like other PAEs but due to state sponsorship these are unusually large and well-funded. They also are intended to serve national economic objectives in taxing our industries to generate a return for their industries. They will likely harm U.S. companies and consumers but it will be a harm that we have inflicted upon ourselves by having an imbalanced patent enforcement system in the United States. The solution is to reform our own system so that foreign entities cannot exploit it against us.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. RICHARD BLUMENTHAL TO
MARK CHANDLER

Question 1. Demand letters are often sent to people who will never see the inside of a courtroom. They will settle—often they will feel that they must settle—before a case is even filed. In your opinion, are the reforms being considered in pending legislation targeted at what happens during litigation adequate to fully address the problem with demand letters?

Answer. Legislative reforms to patent litigation and proposals to specifically address demand letters are complementary solutions to the problems of meritless patent assertions. Because demand letters often seek an amount that is so low—a few thousand dollars—that litigation is unlikely, the current legislative proposals directed to litigation do not fully address the harm caused by deceptive demand letter campaigns. Also, hundreds of demand letter recipients may pay for a license before a single case is litigated, at which point the damage to such innocent end users is already done. Demand letter reform would therefore address problems not addressed by litigation reform.

Question 1a. Are there additional reforms Congress should consider specifically targeted at the issue of demand letters?

Answer. Congress should pass legislation directed to the problem of demand letters. For example, in my testimony I called for the establishment of a repository at the FTC. Everyone who sent more than ten letters to end users would have to log their letter into the repository and the letters would have to include, among other things, complete information on ownership, the basis for the infringement accusation, and the licensing history of the patents. Making this information broadly available will allow us as suppliers to give the patent assertion entities a fair fight.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. CLAIRE McCASKILL TO
JULIE P. SAMUELS

Question 1. At the hearing, we heard about several policy proposals that could help protect consumers and small businesses from harmful demand letters. One potential idea widely discussed was the establishment of a demand-letter registry—whether at the Federal Trade Commission (FTC) or at the U.S. Patent and Trademark Office (PTO)—that would increase transparency and facilitate better data on the problem’s extent. What protections for consumers and small businesses would such a registry provide that would address the current harms inflicted on them by demand letters?

Answer. Such a registry would provide protection by supplying information—something that the system currently woefully lacks. For instance, if a consumer finds him or herself facing a threat, he or she will often have no idea how to respond. Hire a lawyer? Call the sender? Ignore the letter? Hiring a lawyer to navigate the process is not cheap; often costing well into the thousands of dollars just to understand the scope of the threat and how it relates to the technology at issue. Take the now infamous troll, MPHJ (otherwise known as the “scanner troll”). MPHJ created a series of shell companies with names constructed of random letters,¹ making it nearly impossible to google the letter’s sender and understand the scope of the threat. A robust database would give consumers basic information about who is sending the letter and what kind of threat that entity poses. Does it often sue its targets? If so, it might be worth hiring a lawyer. Does it rarely so? If so, the best advice might be to ignore the letter.

A registry could also include additional crucial content, such as basics on the patent system and resources for how to understand and respond to the immediate threat. (This is something we’ve tried to do at Trolling Effects at <https://trollingeffects.org/learn> and something that the President has already instructed the Patent Office to do; we understand the Patent Office is currently working on education materials in response to that request.)

A registry would also protect consumers by chilling dangerous trolling activities. We believe that trolls target ordinary consumers, end-users, and non-patent-sophisticated parties because of the asymmetry of information problem and the ability of those trolls to hide behind shells. Simply, it is cheap and easy for a party to send out hundreds or even thousands of demand letters and see what kinds of payments come back. In fact, a letter sender need not even be an attorney. A registry’s ability to lift this veil of secrecy would solve the asymmetry of information problem, thus making the patent troll “business model” a less attractive one. Will certain bad ac-

¹See <http://arstechnica.com/tech-policy/2013/01/patent-trolls-want-1000-for-using-scanners/>

tors still exploit the system and target consumers? Probably. But we believe at a much slower rate. We also believe emboldening consumers with information will increase the instances of those consumers fighting back, another important element that will help squelch the trolls' dangerous actions.

Question 1a. Do you have an opinion about whether it would be more effective to house such a registry at the PTO or the FTC? Please explain why.

Answer. I strongly believe the most important thing is to have a publicly available, easily searchable registry. To that end, I believe one held at either FTC or PTO would be effective and efficient. That said, each has unique benefits, which I will discuss in turn.

The FTC has valuable experience in hosting public-facing registries, such as the Do Not Call Registry. While the Do Not Call Registry's submissions are not public facing, the educational materials and outreach are directed to everyday consumers and citizens, the same class of people who would most benefit from a demand letter registry. Moreover, the FTC could monitor submissions and, upon receiving a certain number involving a particular patent or patent holder, could begin an investigation under 15 U.S.C. §45. Finally, and arguably most significantly, the FTC has experience defending consumer interests, unlike the Patent Office, whose sole relevant experience for the most part has been dealing with patent owners.

The PTO, on the other hand, has valuable experience navigating and compiling information on the patent system. It keeps voluminous files on every patent—from application and through its lifecycle. Those databases are notoriously hard to navigate and are not user-friendly, however, which is something that should be considered. Simply put, the PTO is an agency that, for the majority of its life, has been tasked with growing the patent system. However, the PTO has recently shown aptitude and interest in making its site more user friendly and in reaching out to and working with third parties who are not necessarily patent applicants.

Finally, the PTO (not unlike the FTC) could monitor submissions and chose to *sponte* reexamine certain patents. To my knowledge, the PTO has only done this once (for a method of swinging on a swing, of all things²), yet there is no reason to believe it could not institute similar reexams in the future.

Question 2. Another potential idea from the hearing was to require certain baseline disclosures in demand letters to provide recipients with more useful information and to help stem the large numbers of demand letters being sent. Do you believe such mandatory disclosure requirements would protect consumers and small businesses from the current harms inflicted on them by demand letters? Would mandatory disclosure requirements provide a more effective consumer protection solution than a registry?

Answer. I believe certain mandatory disclosures would protect consumers and small businesses from the current harms inflicted by demand letters for many of the same reasons I believe a registry would help. First, such disclosures would provide valuable information to consumers and small businesses who need it to make informed decisions. Second, it would discourage the worst actors who use the guise of the patent system to extort funds from consumers.

I believe that a combination of mandatory disclosures and a registry would be the most effective solution to the problem. That said, if I had to chose just one, I would have a slight preference for a demand letter registry. It is a longer-term solution, which would provide valuable information not just to consumers and small businesses, but to academics and policymakers and others who try to understand the scope of the problem. Also, if constructed properly, it provides a better safeguard against the actions taken by current letter senders to get around disclosure requirements. In short, the registry would impact all bad actors, the disclosure requirement would only impact the bad actors who don't provide enough information. While this is an incredibly dangerous subset of letter senders, it is still only a subset.

Question 2a. Please detail, specifically, the types of information that should be required in demand letters to achieve the goal of improved consumer protection.

Answer. The types of information include:

- Every party that has an ongoing financial interest in the patent(s) at issue.
- The specific patent(s)—and claims of those patent(s)—at issue.
- The products or services that allegedly infringe those claims.
- Any obligations to license the patent(s) on reasonable terms.
- Any current instances of reexaminations of the patent(s) at the PTO or any ongoing litigation surrounding the patent(s).

²U.S. Patent No. 6,368,227 at <http://www.google.com/patents/US6368227>

- If any of the above information is not included, the sender must include a statement explaining why it was not accessible, and what efforts it made to find that information.

Question 3. We also discussed whether current law would allow effective implementation of the various policy proposals to protect consumers and small businesses from unfair or deceptive demand letters. Do you believe the FTC—under its existing Section 5 authority to prevent unfair and deceptive practice or any other statutory authority—has the ability to effectively carry out any of the proposed solutions that you have proposed or that were discussed at the hearing, such as establishing a demand-letter registry or including mandatory disclosure requirements? Please specify which potential solutions the FTC would or would not be able to implement.

Answer. I believe the FTC, under its existing Section 5 authority, could target certain entities currently sending letters for unfair and deceptive practices. However, legislation would be helpful in defining certain practices—such as failure to include certain information in a demand letter—as per se deceptive or unfair.

As to an FTC registry, legislation is likely necessary for its creation, not unlike 15 U.S.C.A. § 6101, *et al*, which authorizes the Do Not Call registry.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. RICHARD BLUMENTHAL TO
JULIE P. SAMUELS

Question 1. Demand letters are often sent to people who will never see the inside of a courtroom. They will settle—often they will feel that they must settle—before a case is even filed. In your opinion, are the reforms being considered in pending legislation targeted at what happens during litigation adequate to fully address the problem with demand letters?

Answer. Certain legislative proposals would help the demand letter problem, but those proposals contain provisions that are directed specifically at letter sending, not litigation. The more traditional litigation reforms that largely currently make up the Innovation Act (H.R. 3309) that is quickly moving through the House would help the demand letter problem inasmuch as they would chill the so-called “troll business model.” So the short answer to the question of whether the pending litigation reforms would “fully address” the demand letter problem must be no.

To be fair, other proposals, such as Sen. Leahy’s Patent Transparency and Improvement Act (S. 1720), do directly address the demand letter problem. For instance, that bill’s current Section 5, entitled Bad-Faith Demand Letters, would define certain practices (“widespread” sending of letters that, for example, make false threats) as violations of existing Section 5. The Patent Transparency and Improvement Act also contains a so-called savings clause that explicitly says it is neither an expansion nor a reduction of its existing Section 5 authority.

Question 1a. Are there additional reforms Congress should consider specifically targeted at the issue of demand letters?

Answer. The reforms I believe Congress should consider that would specifically and successfully address the demand letter problem include:

- Legislating the creation of demand letter registries at either the FTC or PTO (see answers above for details).
- Mandating that certain information be included in demand letters, and when that information is not included the letter sender must detail why.
- Defining certain practices as per se violations of existing FTC Section 5 authority, which would also have the added benefit of triggering state statutes already on the books in various states.

Question 2. Congressional action specifying when the use of demand letters constitutes an unfair or deceptive act or practice could actually limit FTC authority by defining the standard against which the FTC must operate. In your opinion, would such Congressional action constitute an expansion or contraction of FTC authority?

Answer. Such Congressional action could be done in a way to neither expand nor contract current FTC authority. Ideally, legislation could define certain practices as per se deceptive or unfair (some examples would be making false threats or purposely hiding information on who retains an interest in the patent(s) at issue). The legislation should explicitly not preclude the FTC from finding other unlisted practices as violating Section 5.

Of course, by listing certain activities as per se deceptive or unfair, the legislation merely makes the FTC’s job a little easier by reducing the amount of elements it needs to prove in the most egregious cases.

Question 2a. Could Congressional action in this area give companies that are not engaged in wrongdoing greater certainty as to what does and what does not constitute unfair or deceptive conduct? Could this greater certainty actually facilitate licensing activity that is legal, reasonable, and appropriate?

Answer. Congressional action could help shape and create public guidelines about practices that are and are not unfair and deceptive. At a minimum, it could delineate what is per se unfair and deceptive. Resulting FTC rulings, which we believe would be issued more quickly following legislation, would help create even additional certainty.

To be certain, there is undoubtedly a place for legal, reasonable, and appropriate licensing activities. Not only could legislative action help define what that looks like, but it would also push the bad actors out of the market, leaving more space for those acting responsibly.

Question 3. As a former Attorney General, I believe that the states have an important role to play in protecting consumers. Do you agree that states have a role to play in protecting consumers from abusive demand letters?

Answer. Without a doubt. States like Nebraska, Minnesota, and Vermont have been leaders in the fight against abusive patent troll practices.

Question 3a. Are there advantages to state enforcement in this area?

Answer. States are closer to their own business communities and will be able to more quickly assess the entities that pose the greatest risk. The current economic climate also dictates that states are competing to be pro-business. One way to do this is to protect local businesses from threats posed by demand letter abuses. Congress should help incentivize states to continue this trend.

Question 3b. Should Congress take action to allow states to protect their citizens?

Answer. I believe Congress should take action that would allow states to protect their citizens.

Question 3c. What kind of action would be helpful?

Answer. First, as discussed above, Congress could define certain actions as per se unfair or deceptive. This act of defining alone would trigger statutes already on the books in many states.

Second, Congress should make clear that any action it takes will not preempt the efforts of state Attorneys General to bring consumer protection actions based on patent demand letters. Moreover, Congress should confirm that states do indeed have the right to bring such actions.

Third, Congress should clarify that sending unfair and deceptive patent infringement letters into a state satisfies the due process requirement for personal jurisdiction.

Finally, the creation of a registry at FTC or PTO would also benefit the states who want to bring consumer protection actions. States would be able to investigate who is sending letters and to whom, making their job deciding which entities to focus on easier.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. CLAIRE MCCASKILL TO
LARY SINEWITZ

Question 1. At the hearing, we heard about several policy proposals that could help protect consumers and small businesses from harmful demand letters. One potential idea widely discussed was the establishment of a demand-letter registry—whether at the Federal Trade Commission (FTC) or at the U.S. Patent and Trademark Office (PTO)—that would increase transparency and facilitate better data on the problem's extent. What protections for consumers and small businesses would such a registry provide that would address the current harms inflicted on them by demand letters?

Answer. Most retailers do not have the resources to litigate a patent infringement lawsuit, let alone the legal fees to assess purposely vague, unfair, and deceptive demand letters. As such, Congress ought to provide the FTC with more statutory guidance on what, under its existing unfair and deceptive trade practices authority, should be in a demand letter to make them more transparent to the recipient. Consumers and small businesses would benefit greatly from such transparency because it will allow businesses to make more efficient, economical decisions as they investigate the claim. In conjunction with such a provision, an appropriately-scaled demand letter registry could assist small businesses and their counsel, along with public interest groups, in discerning and exposing patterns of demand letter abuse.

Question 1a. Do you have an opinion about whether it would be more effective to house such a registry at the PTO or the FTC? Please explain why.

Answer. If, as requested above, Congress provides the FTC with more statutory guidance as to what should be in a demand letter, it might make sense to include such a registry at the FTC, as it might assist the FTC in discerning targets for enforcement.

Question 2. Another potential idea from the hearing was to require certain baseline disclosures in demand letters to provide recipients with more useful information and to help stem the large numbers of demand letters being sent. Do you believe such mandatory disclosure requirements would protect consumers and small businesses from the current harms inflicted on them by demand letters? Would mandatory disclosure requirements provide a more effective consumer protection solution than a registry?

Answer. Yes, as described above, disclosure requirements would provide more effective consumer protection than a registry. Disclosure in demand letters is a critical component to reform because it will allow businesses to make more efficient, economical decisions as they investigate the claim. They will also be able to spend less money on patent attorneys' fees because the claim will be better laid out.

Question 2a. Please detail, specifically, the types of information that should be required in demand letters to achieve the goal of improved consumer protection.

Answer. At a minimum, disclosure should include: Requiring the letter to identify the owner of the patent, the specific patent alleged to be infringed, and the reasons for the good faith belief that the patent is being infringed.

Question 3. We also discussed whether current law would allow effective implementation of the various policy proposals to protect consumers and small businesses from unfair or deceptive demand letters. Do you believe the FTC—under its existing Section 5 authority to prevent unfair and deceptive practice or any other statutory authority—has the ability to effectively carry out any of the proposed solutions that you have proposed or that were discussed at the hearing, such as establishing a demand-letter registry or including mandatory disclosure requirements? Please specify which potential solutions the FTC would or would not be able to implement.

Answer. Yes, we believe the policy solution proposed above (*i.e.*, giving the FTC additional guidance on demand letters) could be implemented by the FTC since it well comports with the FTC's existing authority under Section 5. In fact, the FTC recently stated that it already has authority under Section 5 to pursue patent assertion entities for unfair methods of competition or false or deceptive acts or practices.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. RICHARD BLUMENTHAL TO
LARY SINEWITZ

Question 1. Demand letters are often sent to people who will never see the inside of a courtroom. They will settle—often they will feel that they must settle—before a case is even filed. In your opinion, are the reforms being considered in pending legislation targeted at what happens during litigation adequate to fully address the problem with demand letters?

Answer. Most retailers do not have the resources to litigate a patent infringement lawsuit, let alone the legal fees to assess purposely vague, unfair, and deceptive demand letters. As such, in addition to litigation reforms (which we generally support), Congress also ought to focus on pre-litigation issues and provide the FTC with more statutory guidance on what, under its existing unfair and deceptive trade practices authority, should be in a demand letter to make them more transparent to the recipient. Consumers and small businesses would benefit greatly from such transparency because it will allow businesses to make more efficient, economical decisions as they investigate the claim. We would note that Section 5 (“Bad Faith Demand Letters”) of the Leahy-Lee “Patent Transparency and Improvement Act of 2013” represents a very meaningful approach to the problem, and we look forward to working the Senate Commerce Committee on this issue.

Question 1a. Are there additional reforms Congress should consider specifically targeted at the issue of demand letters?

Answer. In conjunction with an FTC provision (discussed above), an appropriately-scaled demand letter registry (perhaps housed within FTC) could assist small businesses and their counsel, along with public interest groups, in discerning and exposing patterns of demand letter abuse.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. RICHARD BLUMENTHAL TO
ADAM MOSSOFF

Question 1. Demand letters are often sent to people who will never see the inside of a courtroom. They will settle—often they will feel that they must settle—before a case is even filed. In your opinion, are the reforms being considered in pending legislation targeted at what happens during litigation adequate to fully address the problem with demand letters?

Answer. As a preliminary matter, it is important to recognize that there are no reliable, scientifically valid studies that have definitively proven that there is in fact a *systemic problem* with demand letters requiring legislation making systemic changes to how all patent-owners license their property or assert their property against infringers. The policy debates thus far are defined almost entirely by non-objective rhetoric, such as the term, “patent troll,”¹ and what the Government Accountability Office has described as “nonrandom and nongeneralizable” studies, which means that the studies done thus far are unscientific and unreliable.² Thus, there is no definitive proof yet that there is a widespread, systemic problem with the issuance of demand letters, as opposed to merely a few bad actors who are requesting royalties for potentially bad-quality patents.

In fact, the real concern about the demands for royalties or even threats of lawsuits is that many people believe that the patents are invalid. In other words, the policy concern that needs to be addressed is the *validity* of the underlying property right, as an owner of a valid patent has every right to demand licenses from unauthorized users and to seek relief in court against recalcitrant infringers. For this reason, the pending legislation that proposes significant changes to litigation practices still does not address the real policy concern—the validity of the underlying property right—and instead imposes substantial legal burdens and additional costs on legitimate owners of valid patents.

In recognizing that the real policy concern that animates the many complaints about demand letters is the invalidity of the underlying patents, one can then focus on the proper legal tools that are necessary to address this entirely valid and legitimate concern. In fact, the concern about bad actors improperly using bad patents to squelch legitimate commercial activity in the marketplace is not new; Congress, the courts and the U.S. Patent & Trademark Office (PTO) long ago created many legal tools, and even more exist today, for challenging and weeding out these bad patents. Even more important, the America Invents Act of 2011 (AIA), a product of a six-year policy debate and rightly recognized as “the most significant reform of the U.S. patent system since 1836,”³ vastly expanded these tools as well.

Consider two longstanding examples of such legal tools (among the many that exist). First, potential defendants have long had the right to sue patent owners in Federal court to invalidate patents that might be asserted against them in a future lawsuit. It is a special type of lawsuit called a declaratory judgment action. The Supreme Court recently liberalized the rules for when someone can bring a declaratory judgment action in its 2007 decision in *MedImmune v. Genentech*,⁴ making it even easier for retailers or consumers to initiate proceedings against patent owners when they receive improper demand letters. Second, defendants or potential defendants have long had access to the PTO to challenge improperly issued patents. In 1850, for instance, Isaac Singer instigated a lengthy proceeding at the Patent Office in attempting to invalidate Elias Howe’s patent on the lockstitch following Howe’s demand that Singer pay him royalties, and defendants in all of Howe’s lawsuits repeatedly argued (and reargued) in Federal court that Howe’s patent was invalid as well.⁵

Today, such legal mechanisms continue to exist in the PTO and in the courts, which serve as a check on both bad actors and bad patents. Such legal tools necessarily affect the calculus of individual patent owners who are bluffing in demand

¹ See *Demand Letters and Consumer Protection: Examining Deceptive Practices By Patent Assertion Entities: Hearing Before the Subcomm. on Consumer Prot., Prod. Safety, and Ins. of the S. Comm. on Commerce, Sci. and Transp.*, 113th Cong. 67 (Nov. 7, 2013) (statement of Adam Mossoff, Professor of Law, George Mason University School of Law) p. 3–5, http://www.commerce.senate.gov/public/?a=Files.Serve&File_id=c5cc328a-af61-4f12-bea7-e2ae6fb42ce3

² GOVERNMENT ACCOUNTABILITY OFFICE, INTELLECTUAL PROPERTY: ASSESSING FACTORS THAT AFFECT PATENT INFRINGEMENT LITIGATION COULD HELP IMPROVE PATENT QUALITY 26 (Aug. 2013), <http://www.gao.gov/assets/660/657103.pdf>.

³ Richard Maulsby, *President Obama Signs the America Invents Act*, INVENTORS EYE, vol. 2, issue 5 (Oct. 2011), <http://www.uspto.gov/inventors/independent/eye/201110/americaninvents.act.jsp>.

⁴ *MedImmune, Inc. v. Genentech, Inc.*, 127 S. Ct. 764 (2007).

⁵ See Mossoff, *The Rise and Fall of the First American Patent Thicket: The Sewing Machine War of the 1850s*, 53 ARIZ. L. REV. 165, 187–189 (2011).

letters, because those bluffs may called and courts will make it harder to bring the actual lawsuits and will punish bad-faith assertions. Thus, in the courts, the Judicial Conference's Committee on Rules of Practice and Procedure has officially published proposed revisions to the pleading requirements in patent lawsuits, one of the sources of the much maligned minimal notice requirements in patent infringement complaints.⁶ Additionally, the Supreme Court recently granted cert in two cases that will likely result in liberalizing the rules on the issuance of sanctions in patent cases.⁷

Even more important, at the PTO, the many new, AIA-created review proceedings for eliminating improperly issued patents are just beginning to be implemented and to produce results.⁸

And for those who lack the knowledge or wherewithal to navigate these PTO or court processes, assistance is now provided by many law firms and policy organizations, such as Public Patent Foundation, Electronic Frontier Foundation (EFF), the Berkman Center for Internet and Society, and others.⁹ For instance, the App Developers Alliance has created the "Law School Patent Troll Defense Network," which involves law school clinics providing legal services to individuals or small businesses receiving demand letters or complaints.¹⁰ Moreover, EFF recently announced that it joined with the Berkman Center in filing an inter partes review at the PTO of the notorious "podcasting patent," which has been the subject of thousands of demands letters being sent to individuals, small companies, and large companies.¹¹

In a world in which Internet searches easily and effortlessly produce such information, it is hard to maintain that recipients of demand letters lack the resources and capabilities to respond effectively. The Internet also makes it easier for law firms and organizations to provide this assistance. During the November 7 hearing, for instance, Julie Samuels of EFF stated that filing the inter partes review proceeding at the PTO against the podcasting patent cost "\$30,000 in fees" and that it was "incredibly resource intensive,"¹² but she failed to mention that EFF raised over \$77,000 in just 10 hours in its fundraising campaign on the Internet.¹³ It bears emphasizing the significance of this fact: EFF raised in less than one-half day more than double the \$30,000 it needed to file an inter partes review of one of the patents underlying many improper demand letters being sent to consumers and retailers—the podcasting patent.¹⁴ This certainly proves that there are existing resources and legal tools to address the very problems with improper patents about which EFF and others are complaining.

It is against this backdrop that Congress must assess any proposals to intervene via legislation or regulation in patent licensing and patent litigation practices. First,

⁶See Committee on the Rules of Practice and Procedure of the Judicial Conference of the United States, *Preliminary Draft of Proposed Amendments to the Federal Rules of Bankruptcy and Civil Procedure* (Aug. 2013), available at <http://www.uscourts.gov/uscourts/rules/preliminary-draft-proposed-amendments.pdf>; see also Honorable Katherine O'Malley, *Key Note Speech at Intellectual Property Owners Association Annual Meeting* (Sep. 17, 2013), p. 9, available at <http://www.ipo.org/wp-content/uploads/2013/02/IPO-Annual-Meeting-Keynote-Speech-09-17-13.pdf> (discussing this process).

⁷See *Octane Fitness, LLC v. Icon Health & Fitness, Inc.*, No. 12–1184, 2013 WL 1283843 (U.S. Oct. 01, 2013); *Highmark Inc. v. Allcare Health Mgmt. Sys.*, No. 12–1163, 2013 WL 1217353 (U.S. Oct. 01, 2013).

⁸See generally *Innovation Act of 2013: Hearing on H.R. 3309 Before the Comm. on the Judiciary, 113th Cong.* (Oct. 29, 2013) (statement of David J. Kappos, Partner, Cravath, Swaine & Moore LLP), available at <http://judiciary.house.gov/hearings/113th/10292013/Kappos%20Testimony.pdf>.

⁹On behalf of individual women lacking the funds to pay for expensive DNA testing (and thus lacking the funds to bring a lawsuit), the Public Patent Foundation brought the challenge to the patents on the BRAC1 and BRAC2 genes, which correlated with breast cancer. The Public Patent Foundation ultimately won before the Supreme Court. See *AMP v. Myriad Genetics*, 133 S. Ct. 1747 (2013).

¹⁰See *Law Schools Join App Developers Alliance to Fight Patent Trolls* (Oct. 10, 2013), available at <http://www.ipwatchdog.com/2013/10/15/law-schools-join-app-developers-alliance-to-fight-patent-trolls/>.

¹¹See *EFF Files Challenge With Patent Office Against Troll's Podcasting Patent: Massive Crowdsourcing Effort Leads to Strong Petition Before the USPTO* (Oct. 16, 2013), available at <https://www.eff.org/press/releases/eff-files-challenge-patent-office-against-trolls-podcasting-patent>.

¹²See *Demand Letters and Consumer Protection: Examining Deceptive Practices By Patent Assertion Entities: Hearing Before the Subcomm. on Consumer Prot., Prod. Safety, and Ins. of the S. Comm. on Commerce, Sci. and Transp., 113th Cong.* (Nov. 7, 2013) (statement of Julie Samuels, Senior Staff Attorney, EFF) p. 67 of draft transcript of hearing.

¹³See <https://supporters.eff.org/donate/save-podcasting> ("Wow. In under 10 hours, you met and exceeded our funding goal to bust the bogus, overbroad patent being used to threaten podcasters!").

¹⁴*Id.* (stating that the funding goal was \$30,000).

there is too much rhetoric and too many “nonrandom and nongeneralizable” studies in the policy debates,¹⁵ and too little actual evidence definitively establishing that more revisions to the patent system are needed. Second, while there are certainly bad actors, there are a number of existing legal mechanisms at the PTO and in the courts to address them, especially after the enactment of the AIA just two years ago. Third, and certainly not least, there is too little regard for the serious costs that legislative and regulatory overreach imposes on the individuals and businesses who create the real-world innovative products and services that have become basic commodities of modern life.

Question 1a. Are there additional reforms Congress should consider specifically targeted at the issue of demand letters?

Answer. As discussed above, the real policy concern is the quality and validity of the patents underlying the offers of licenses or threats of litigation being sent to retailers and consumers. Congress should consider reforms that will address this legitimate policy concern by securing full funding of the PTO to ensure complete and timely examination of patent applications. Full funding of the PTO will also ensure proper implementation of the many new administrative review programs created by the AIA to weed out invalid and vague patents that clog the innovation economy.

As former PTO Director David Kappos recently remarked in testimony before the House Judiciary Committee, the U.S. patent system is “the greatest innovation engine the world has ever known.”¹⁶ He rightly cautioned that Congress should exercise restraint and be cautious in accidentally killing “the goose laying our golden egg.”¹⁷ Thus, Congress should ensure that the PTO and the courts have the financial resources to deploy the preexisting tools specifically directed at any low-quality patents, as these are the real scourge of innovation and economic growth.



¹⁵ GOVERNMENT ACCOUNTABILITY OFFICE, *supra* note 2, at 26.

¹⁶ Kappos, *supra* note 8, at 2.

¹⁷ *Id.*