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PATENTS

The authors review state and federal efforts to address the patent troll abuse of sending demand letters to or filing lawsuits against customers who purchase, and use without modification, allegedly infringing products.

Bad Times for Patent Trolls: What the Government Is Doing to Protect Small Businesses



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Patent assertion entities—"PAEs" or, if you are in a bad mood, "patent trolls"—have been around in one form or another for decades. In the past few years, however, their ranks have grown. According to a U.S. Government Accountability Office Report released

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last year, patent infringement lawsuits rose 129 percent from 2007 to 2011, with a 31 percent increase in 2011 alone. Patent trolls account for most of these lawsuits, having filed 67 percent of new patent cases in 2013.¹

Perhaps the most significant development in patent infringement lawsuits is their changing target, as their reach expands past Silicon Valley's high-tech campuses to Main Street. In 2012, patent trolls sued more non-tech companies than tech companies, according to Patent Freedom, which provides market intelligence on patent trolls. This includes small businesses using office equipment as common as document scanners.

In one notorious example, MPHJ Technology Investments sent out over 16,000 letters to small businesses using scan-to-email functions, threatening lawsuits unless the businesses paid licensing fees of \$1,000 or more per employee. When many businesses did not respond, MPHJ sent draft complaints to compel settlement despite the fact that the targeted businesses had no role in developing, manufacturing or selling the allegedly infringing technology. This was bottom-feeding behavior just this side of extortion—a plaintiff with no intention of truly litigating to the merits, using the court system to extract settlements well below the cost of actual litigation.

State and federal governments are not sitting by idly. In the past year, the White House, Congress, the Federal Trade Commission and numerous state attorneys

¹ RPX Corporation, 2013 NPE Litigation Report (2014).

general have all focused attention on curbing vexatious patent litigation. In this article, we review those recent actions.

I. A Presidential Call to Arms

In his 2014 State of the Union address, President Barack Obama specifically targeted patent trolls like MPHJ and called on Congress to “pass a patent reform bill that allows our businesses to stay focused on innovation, not costly and needless litigation” (87 PTCJ 679, 1/31/14). The president continued this emphasis on curbing abusive patent litigation in February of this year, announcing three new executive actions and reporting on progress the White House had made on the executive actions it announced in June 2013 (87 PTCJ 874, 2/21/14).

These included efforts to develop an online toolkit hosted by the U.S. Patent and Trademark Office. Aimed at empowering businesses that have received cease-and-desist letters like those issued by MPHJ, the toolkit—available at <http://www.uspto.gov/patents/litigation/>—provides answers to common questions, information about patent suits and details about specific patents that can help recipients of cease-and-desist letters understand the risks and benefits of litigation or settlement. Though this toolkit is still relatively new, it stands to arm small businesses with the information they need to pick their best course of action instead of simply giving in to the often empty allegations of trolls’ demand letters and focusing resources on settlement or licensing as opposed to investing in business development and innovation.

The message from the White House has been clear: “the nation that goes all in on innovation today will own the global economy tomorrow. . . . This is an edge America cannot surrender.”

II. Federal Legislators Answer the Call

Building on the passage of the Leahy-Smith America Invents Act in 2011, Congress has shown that patent reform is an issue capable of gaining broad bipartisan support, particularly as it relates to legislation that would protect small businesses. In December 2013, the House of Representatives passed the Innovation Act (H.R. 3309) in a 325-91 vote (87 PTCJ 259, 12/6/13)—a piece of legislation that sponsor Rep. Robert W. Goodlatte (R-Va.) claims “will eliminate the abuses of our patent system by discouraging frivolous patent litigation.” The effect of this bill on needless lawsuits and vexatious cease-and-desist letters could be substantial, and would specifically address the activities of patent trolls like MPHJ.

The Innovation Act is now pending before the Senate, along with parallel legislation including the Patent Transparency and Improvements Act (S. 1720) introduced by Sen. Patrick J. Leahy (D-Vt.) and various pieces of more piecemeal litigation addressing specific problems in the patent system (87 PTCJ 1511, 4/25/14).

The Innovation Act

The Innovation Act outlines a number of legislative changes that would provide protection for Main Street, among them what the bill calls the “Customer-Suit Exception.” In an environment where patent trolls are increasingly targeting businesses and consumers who use

products—as opposed to the companies that manufacture or supply the allegedly infringing technology—this provision would provide important end user protection.

The customer-suit exception would function to stay litigation against end users where the manufacturer or supplier “is a party to the action or to a separate action involving the same patent or patents related to the same covered product or process.” So long as the customer agreed to be bound by the results of the parallel litigation, the costs of litigation would be left to the manufacturer or supplier, avoiding the likely outcome of coerced settlement in the face of substantial litigation costs.

This provision expands the already-existing power of the courts to determine when a later-filed declaratory judgment action by a manufacturer receives priority over a first-filed lawsuit against a customer—a doctrine currently limited in application by restrictive case law.

The Innovation Act would also grant protections to end users in providing that “it is an abuse of the patent system and against public policy for a party to send out purposely evasive demand letters to end users alleging patent infringement.” The bill goes on to state that demand letters should, at the least, include basic information about the patent in question, what is being infringed, and how it is being infringed.” Furthermore, “purposefully evasive demand letters sent to end users should be considered a fraudulent or deceptive practice and an exceptional circumstance when considering whether the litigation is abusive.”

Given their practice of sending vague or unfounded cease-and-desist letters with the intent to extort settlements, this provision places important limitations on trolls’ activities and outlaws threats that lack a reasonable basis in fact and law. The bill also institutes heightened pleading standards that would require plaintiffs to detail each patent and claim allegedly infringing, as well as the products or services alleged to infringe, again requiring a reasonable factual and legal basis for the claims and giving defendants more information with which to assess a complaint.

Also included in the bill is a fee-shifting provision that would allow courts to award “reasonable fees and other expenses” to the prevailing party, “unless the court finds that the position and conduct of the non-prevailing party or parties were reasonably justified in law and fact or that special circumstances make an award unjust.”

While fee-shifting is already available in exceptional cases, only 20 out of nearly 3,000 patent cases filed in 2011 satisfied the current “exceptional case” requirement.² The default fee-shifting outlined in the Innovation Act could have a substantial deterrent effect, given that the current fee-shifting doctrine makes fee awards a remote threat.

Essential to the Innovation Act’s fee-shifting provision is the ability to join a real party in interest to the lawsuit and collect fees from these entities as well—a key component in creating risk for parent companies that assert patents through shell corporations and prohibiting trolls from hiding behind these shells.

² New York Times, “Make Patent Trolls Pay in Court,” June 4, 2013.

Patent Reform in the Senate

While it considers the Innovation Act, two additional patent reform bills are currently pending in the Senate. The most comprehensive of the two—the Patent Transparency and Improvements Act—is narrower than the Innovation Act but addresses several of the same core issues, including fee-shifting and requirements for demand letters.

The demand letter provisions of the Patent Transparency and Improvements Act may prove more stringent than those of the Innovation Act. As with the Innovation Act, a party sending a demand letter may not falsely threaten litigation and must have a reasonable basis in fact and law for issuing the letter. Importantly, any party sending a demand letter that “intentionally misleads” a recipient could also face an FTC investigation.

In contrast, the fee-shifting provision of the Patent Transparency and Improvements Act will in all likelihood pull back from the aggressive position proposed in the Innovation Act. While the Patent Transparency and Innovation Act is still being negotiated, it is likely to impose fee-shifting only where a party does not behave in an “objectively reasonable fashion.”

Other Senate bills approach patent reform in a more piecemeal fashion.

The Transparency in Assertion of Patents Act (S. 2049) co-sponsored by Sens. Claire McCaskill (D-Mo.) and John D. Rockefeller IV (D-W.V.) also requires transparency in demand letters, mandating information about the patent, claim, the alleged infringement, the identity of the entity with rights to assert the patent and any calculation used to arrive at a proposed licensing amount. The bill also empowers the FTC by allowing it to set forth rules prohibiting certain “unfair or deceptive acts” in the sending of demand letters.

The Patent Abuse Reduction Act (S. 1013) sponsored by Sens. John Cornyn (R-Texas) and Charles E. Grassley (R-Iowa) is also before the Senate and raises the pleading requirement for patent infringement actions. The bill also includes a provision permitting fee-shifting unless the plaintiff’s positions were “objectively reasonable and substantially justified,” or unless it would be unjust to award fees.

The Patent Litigation Integrity Act (S. 1612) sponsored by Sen. Orrin G. Hatch (R-Utah) imposes a fee-shifting provision similar to that of the Patent Abuse Reduction Act and also grants judges the discretion to require that plaintiffs that do not manufacture products, with certain exceptions, post a bond against fees and expenses at the outset of a case.

Although none of these bills has passed, it appears likely that the Senate will take action soon. With 42 state attorneys general issuing a letter in February urging passage of a meaningful patent reform and a bipartisan group of 17 senators issuing a similar letter calling for reform in March, some form of legislation seems likely.

III. The States Get Involved

Numerous state legislatures have taken action as well—with Kentucky, Maine, Nebraska, New Jersey, Oregon, South Carolina, Vermont and Wisconsin all passing or proposing bills aimed at curbing patent trolls. If challenged, these bills would face serious federal preemption issues—the states are not free to curtail federal patent law. But one cannot avoid appreciating

the irony: the worst of the trolls may not want to spend the money litigating the constitutionality of these bills and, instead, may very well settle any anti-troll action instead.

State attorneys general have also taken an aggressive role in addressing the activities of patent trolls targeting businesses in their states.

Thus, in May 2013, Vermont became the first state to file a lawsuit against a patent troll under its consumer protection laws.³ Perhaps unsurprisingly, the target of this lawsuit was MPHJ, which had sent letters to numerous small businesses throughout Vermont, including two non-profits in the state. Though this case stalled after being removed to federal court in June, a federal judge remanded the case back to state court on April 16, 2014 stating that the claims relied on state law and reinforcing the states’ ability to bring actions against trolls on consumer protection grounds (87 PTCJ 1430, 4/18/14).

Following this initial suit, several other state attorneys general initiated parallel efforts. In July 2013, Nebraska issued a cease-and-desist letter to MPHJ’s attorneys requiring the company to stop sending demand letters to businesses in the state pending an investigation into MPHJ’s activities by the Attorney General’s office. MPHJ responded by challenging the Attorney General in court and obtaining a preliminary injunction in January 2014 that prevented the Attorney General from enforcing the cease-and-desist letter on First Amendment grounds. Key to this decision was the fact that the Attorney General’s office issued the cease-and-desist letter prior to investigation.

Other states’ efforts have been more successful. In August 2013, Minnesota reached a landmark settlement with MPHJ after investigating the company for violations of state consumer protection laws. As a term of the settlement, MPHJ must cease its demand letter campaign in the state and resume only with the permission of the Attorney General’s office. Though MPHJ has stated that no Minnesota companies paid settlement or license fees, the Assurance of Discontinuance between Minnesota and MPHJ includes a provision requiring a \$50,000 penalty and a refund of any money paid should MPHJ’s statement prove incorrect.

In January 2014, New York also reached a settlement with MPHJ after conducting an investigation that found that MPHJ had sent demand letters to hundreds of businesses in the state without undertaking substantive factual investigations regarding the purported violations of MPHJ’s patents (87 PTCJ 549, 1/17/14). Under the terms of the Assurance of Discontinuance between New York and MPHJ, MPHJ was forced to repay all of the money extracted from businesses in the state. The settlement also imposes obligations on MPHJ for future demand letters, including diligence and good faith in determining potential infringers, and a clear explanation of the factual basis for any proposed licensing fees.

With attorneys general refining their approach, it seems that the states have found a viable trajectory for combating trolling activities that may avoid the federal preemption and first amendment challenges. At minimum, the settlement agreements reached in Minnesota and New York outline limitations on demand letter ac-

³ *State of Vermont v. MPHJ Investments, LLC*, No. 2:13-cv-00170-wks (Vt., filed May 8, 2013) (86 PTCJ 285, 6/7/13).

tivities that should serve as a warning to other trolls looking to target small businesses.

IV. The FTC Takes Aim

The FTC has also taken aim at patent trolls through investigations and announced intentions to sue. As the federal agency charged with consumer protection, the FTC voted 4-0 in September 2013 to launch a broad study of the effect of patent trolls. Using its subpoena power, the FTC aims to gather the most comprehensive body of qualitative and quantitative information on trolls' patent acquisition, litigation, assertion and licensing practices to date (86 PTCJ 1128, 10/4/13). Through an in-depth questionnaire, the FTC will solicit information from patent assertion entities about their corporate structures, demand letters, earnings and other aspects of their activities in order to guide future policies decisions with robust empirical data.

The study is awaiting a second round of public comment before it is submitted for approval to the Office of Management and Budget. In the meantime, FTC Chairwoman Edith Ramirez announced in March that she would not rule out bringing either competition or consumer protection cases against patent trolls pending the outcome of the FTC's study. Indeed, the FTC has already initiated investigations into patent trolls outside the context of the formal study.

The FTC Investigates MPHJ

Among the FTC's first patent troll targets was MPHJ. In July 2013, the FTC subpoenaed MPHJ and its counsel for information regarding MPHJ's patent assertion activities. That December, following MPHJ's subpoena response, the FTC indicated an intent to exercise its broad consumer protection powers and sue MPHJ under Section 5(a) of the Federal Trade Commission Act, 15 U.S.C. § 45(a), which prohibits "unfair or deceptive acts or practices in or affecting commerce."

Along with its threat of a lawsuit, the FTC sent MPHJ a draft complaint that provided a detailed account of MPHJ's activities, as discovered through the FTC's subpoena process. This included a timeline of MPHJ's issuance of letters to 16,465 small businesses across the 50 states and a description of the different approaches MPHJ had used to extract settlement payments.

Specifically, the complaint alleged that MPHJ "falsely threatened thousands of small businesses with

imminent patent infringement litigation when, in truth, [MPHJ] did not intend to take and did not take such action." The complaint further alleged that MPHJ "falsely represented that substantial numbers of businesses had responded to their letters by purchasing licenses . . . when, at the time of the representations, [MPHJ] had not sold any licenses to letter recipients."

MPHJ Launches a Preemptive Strike

In January 2014, before the FTC moved forward with filing its complaint, MPHJ filed its own lawsuit against the FTC and its four sitting commissioners.

The lawsuit challenges the FTC's jurisdiction over MPHJ's conduct and asserts First Amendment rights that would purportedly protect MPHJ's patent assertion activities as notifications of patent rights, inquiries regarding potential infringement, offers of licenses and threats of suit.⁴

The FTC subsequently moved to dismiss MPHJ's complaint, alleging inter alia that the District Courts lacks jurisdiction to enjoin future or pending administrative proceedings. While this motion is pending, the outcome of MPHJ's lawsuit will be key to determining the role the FTC will play in curbing patent trolls' activities.

V. Conclusion

With new legislation on the horizon and the intensified focus of the states and the FTC on investigations and cases against patent trolls, trolls would be well-advised to pull back from the tactics MPHJ exemplifies. Moreover, the public attention and access to increased information about particular trolls may create an incentive for end-user companies to refuse to pay license fees to patent trolls, making trolls' assertion activities less profitable.

The net effect of these efforts is an environment in which trolls can no longer roam freely, and one in which we may expect to see fewer cases against small businesses in the coming years.

⁴ *MPHJ Investments, LLC v. Federal Trade Commission*, No. 6:14-cv-11 (W.D. Tex., filed Jan. 14, 2014) (87 PTCJ 549, 1/17/14).