**Protecting Innovators From Patent Trolls' Favorite Bullying Tactic: Abusive and Fraudulent Demand Letters**

**Testimony of Jon Potter**
**President, Application Developers Alliance**

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Subcommittee on Consumer Protection,
Product Safety & Insurance
"Demand Letters and Consumer Protection: Examining Deceptive Practices by Patent Assertion Entities"

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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 Patent 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 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 an 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 resembles 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.