

Patent Trolls' Hefty Tolls

Lawmakers target shell companies that threaten small businesses with bogus claims of patent violations.

BY JONATHAN GRIFFIN

Vampires, zombies, werewolves (especially the teen variety) and aliens have captured people's interest once again. On TV, at the movies and in books, these fantastical beasts entertain and thrill those brave enough to watch or read about them.

But there is one creature that entertains no one and evokes only groans and sighs when its name is uttered, and that's the "patent troll." These real-life ogres are largely to blame for more than doubling the number of patent lawsuits in the last 10 years, and in 2011 alone cost U.S. businesses \$29 billion in legal fees.

Beyond the Tolkien-inspired name, what is a patent troll? And more important, what, if anything, should state lawmakers do to curb the harm many claim they do to small businesses?

Patent trolls, formally known as patent assertion entities (PAEs), generally are holding or "shell" companies that don't manufacture anything but hold a number of patents, typically purchased legally from bankrupt firms. They make their money by sending threatening letters to companies claiming they have been violating one or more of their (often vaguely defined) patents. The letters say that if the companies pay the license fees to use their patents, they won't be sued.

PAEs usually request unreasonable fees in light of the alleged infractions and often fail to give companies any details about what the patent in question actually covers or how they allegedly infringed upon it.

It is important to note that not all PAEs are trolls. Some benefit the economy by buying patents from small businesses and inventors who may not have the interest or resources to develop the patents and selling them to those who do. These firms also take legal action when the patents are being used unlawfully. Without these firms, many instances of patent infringement would remain unenforced.

But trolls are another matter. While it's certainly legal to sue for patent infringement, PAEs that act in bad faith have come



under fire. Over the past two years, lawmakers in 18 states have passed legislation limiting their activities.

Vermont was the first to do so, last year, because Congress was not addressing the problem and because Vermont lawmakers saw the economic damage trolls were doing.

"Increasingly, growth in economic activity is coming from knowledge-based companies" with huge investments in intellectual property such as patents and trademarks, says Vermont Representative Paul Ralston (D). "If those firms are attacked with bad-faith assertions of patent infringement, it has a chilling effect on business. The firm suffers, the employees and shareholders suffer, the state suffers," says Ralston, a member of the House Commerce and Economic Development Committee.



Representative Paul Ralston Vermont

Jonathan Griffin is a policy specialist who covers intellectual property and patent issues for NCSL.



By the Numbers

Entities that don't manufacture or sell goods or services but own patents—including universities and inventors—are called Non-Practicing Entities (NPEs).

A subset consists of Patent Assertion Entities (PAEs), whose sole function is making patent infringement claims.

3,608

Patent infringement lawsuits filed by Non-Practicing Entities, including universities and individual inventors, in 2013

91%

Portion of the 3,608 suits filed by Patent Assertion Entities—also called patent trolls—many of which states accuse of misleading or deceptive practices

2,600+

Companies sued for alleged patent infringement by Non-Practicing Entities in 2013

Source: RPX Corporation's "2013 Non-Practicing Entity Litigation Report" by Jeremy Brodsky, a senior director in corporate development

opment Committee who pushed for the law.

Often, trolls target small- to medium-sized businesses that cannot afford to fight lengthy court battles, so they willingly pay the amount demanded to settle out of court.

These lawsuits (3,608 in 2013, according to RPX Corporation, which helps companies fight PAEs) are especially crippling to start-up companies, many of which could lose funding because of fears that PAEs and their associated lawsuits and settlements would bleed the company of its initial funding. These threats also cause companies to redirect their resources to fighting these lawsuits and away from developing a product or service.

State attorneys general have been frustrated by

these attacks on their local businesses, but patent litigation has always been considered the realm of the federal government. Patents are filed with the U.S. Patent and Trademark Office and patent litigation is handled in federal court.

Vermont Takes the Lead

Vermont began targeting PAEs when the state attorney general sued MPHJ Technology Investments under Vermont's consumer protection laws, alleging the company engaged in "unfair and deceptive acts" by sending a series of threatening demand letters to many small businesses and nonprofit organizations.

MPHJ tried to have the case moved to federal court, the usual domain of patent litigation. But federal judges

"The key to Vermont's legislation is a careful separation of federal authority and the rights of states."

—REPRESENTATIVE PAUL RALSTON,
VERMONT



More Americans turn to doctors of optometry than any other eye care professional. With a four-year, doctoral-level clinical degree following college and extensive training, optometrists are licensed to correct vision, but they also diagnose and treat eye diseases. And as the need for new advancements in eye care continue, count on optometrists to offer the most comprehensive eye care.

Learn more at AmericasEyeDoctors.org



SEE CLEARLY, AMERICA

wouldn't hear the case because Vermont was suing the company for violating a state consumer protections statute, not for infringing on a federally issued patent. The case now awaits trial.

NCSL reached an MPHJ attorney for comment about the suit. In an email, MPHJ said it believes the Vermont Attorney General's office has shown "complete disregard" for MPHJ's First Amendment rights. Citing a recent court judgment in MPHJ's favor in Nebraska, MPHJ wrote: "[T]his precedent makes it clear that MPHJ's actions were both lawful and protected by the First Amendment. ... MPHJ has now filed a civil rights case against the Vermont AG very similar to the one in which it has been successful against the Nebraska AG and is confident it will ultimately likewise prevail in Vermont."

Vermont lawmakers became involved by passing Act 44 in May 2013, which strengthens the state's consumer protection statutes by prohibiting companies from making bad faith patent assertions. The law gives courts a number of factors to consider when determining if a patent assertion was made in bad faith, which include failing to cite the specific patent in question and failing to describe how the target company's products infringe on those patents. The law also allows the court to consider if the license fee is reasonable in light of the infringement and if the patent troll has a history of sending vague, threatening letters to companies over the same patents.

If a court decides that the patent assertion was likely made bad faith, the PAE can continue pursuing an infringement suit only if it can post a bond to cover court costs. If the lawsuit is found meritless, the target company may recover its costs of litigation and countersue the troll for damages.

Other States Follow Suit

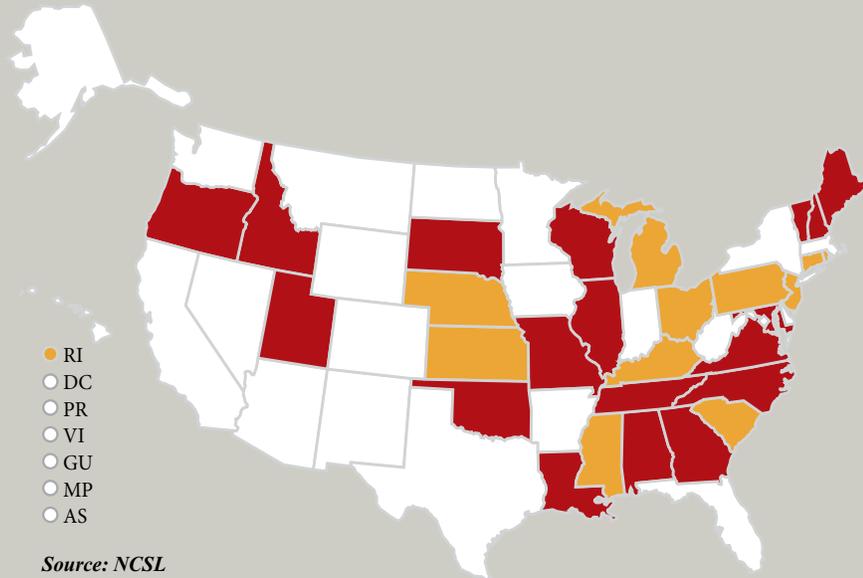
The Vermont General Assembly's innovative response (using a consumer protection law, not patent law) clearly has caught the attention of other state lawmakers, as 17 more states passed bills on patent trolling during the 2014 legislative sessions. By March, Idaho, Oregon and South Dakota had passed legislation, and in April, Alabama, Georgia, Maine and Wisconsin joined the ranks, followed by Louisiana, Maryland, Oklahoma, Tennessee, Utah and Virginia in May. Illinois, Missouri, New Hampshire and North Carolina also passed legislation outlawing bad faith allegations of patent violations.

Most of the laws are structured similarly to Vermont's, with minor variations concerning the limits on the bonds and damages.



Fighting Patent Trolls

- Illegal to make bad faith patent infringement claims
- Bills introduced to make bad faith patent infringement claims illegal



Source: NCSL

“The key to Vermont’s legislation is a careful separation of federal authority and the rights of states,” says Representative Ralston. “The federal government regulates patents. The states have a right to regulate consumer protection.... We created a consumer protection action that can be brought in Vermont state courts and created the framework for a series of penalties designed to deter this behavior.”

Ralston recalls that during committee hearings on the legislation, “targeted companies were often reluctant to testify for fear of reprisals. Those firms that did come forward described a business practice that looks remarkably like extortion,” Ralston says.

Support for the measure was bipartisan, and leading employers and tech companies in the state provided background information and helped draft the legislation, Ralston says. The collaboration allowed lawmakers to hammer out a measure that was not at odds with the state’s colleges and universities (which develop and license patents) or with patent-generating firms such as IBM.

“Our bill focuses on a particular behavior that has been found by a court to be in bad faith, and it protects individuals and companies—both of whom our committee has always considered ‘consumers,’” Ralston says.

The Trigger: Federal Inaction

States are jumping into an area that typically has been preempted by federal law because of congressional deadlock. U.S. Senator Patrick Leahy, a Democrat from Vermont, introduced legislation in November 2013 to empower the Federal Trade Commission to treat bad faith demand letters as unfair acts or practices, and a companion measure was introduced in the House by U.S. Representative Bob Goodlatte (R) of Virginia. The House measure passed, but the Senate bill was ultimately tabled because universities and inventors were concerned it went too far in stopping patent trolls and could limit good faith patent assertions as well.

Once again, in the absence of federal action, states have found a way to protect their citizens without stepping on the toes of the federal government.

While nearly half the states are working to protect their citizens from trolls, many haven’t enacted legislation or are waiting for the federal government to take action in an arena it has typically controlled. Until the issues are resolved, many companies are left to fear attacks by trolls and anything else that goes “bump” in the night.