

Responses of John Dwyer
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to Questions Submitted for the Record
Hearing on “Protecting Small Businesses and Promoting Innovation by Limiting
Patent Troll Abuse”
December 17, 2013

Question of Senator Leahy:

In your testimony, you gave several examples of demand letters that appear to have been sent with minimal diligence and provide only vague assertions of how the recipient is alleged to infringe. What is the impact of receiving these letters on a small business? What resources are currently available to help small businesses that are targeted, and would it be beneficial to have further information resources and support available at the Patent and Trademark Office?

Answer of John Dwyer:

For a small business, receiving a demand letter can be an expensive, distracting, scary proposition. The first problem is finding someone to evaluate the demand. Because of the highly specialized nature of patent law, a small business’s normal attorney may not be competent to evaluate the demand—and for some small businesses and financial institutions, including mine, there may not be an attorney on-staff at all. Cost is another problem. Once the business secures counsel, those attorneys will likely spend thousands of dollars or more simply to give a preliminary answer as to the validity of the patents and infringement theory. This is why demand letters with relatively low “nuisance” value settlements often are successful; an early settlement is often much cheaper for a defendant than fighting.

For a small business, the fear of getting sued is also palpable. Many small businesses will assume they are guilty of infringement simply because they received the

letter, not realizing that many patent trolls send essentially identical generalized demands to many businesses. Litigation is an expensive and uncertain process, and businesses will want to do what they can to manage their risks, even if that means entering into a settlement that may not be necessary.

Resources do exist to help small businesses that are targeted, but they are unfortunately insufficient. For example, many trade associations, including the Credit Union National Association, track patent infringement cases and demand letters as they learn about them. Trade associations can help put those that receive demand letters in touch with one another, and can spot trends as they develop. However, especially at the demand letter stage, the information possessed by trade associations may not scratch the surface of the problem. Many small businesses that receive demand letters are afraid of sharing them, even to a trade association that is “on their side,” because they are fearful of identifying themselves as targets.

It would be extremely helpful to have additional resources available to small businesses. A registry of demand letters from entities that send more than 10 or 20 demand letters in a single calendar year would be one beneficial addition. This database could be maintained by the PTO or FTC and would be publicly available. This is important for a variety of reasons. By providing businesses that receive a demand letter with the ability to communicate with one another, a demand letter registry would assist small businesses in the formation of joint defense groups, which could help reduce defense costs, and would help businesses quickly identify competent counsel familiar with the specific troll at issue. In addition, one of the biggest ways businesses are intimidated is the lack of knowledge of who else has been targeted. As a recipient of a

demand letter, you have no idea if you are the only one, or one of many, who has attracted the patent troll's attention. A registry would immediately tell a recipient others have received letters from the same entity, which might make it more likely a business would fight.

Existing PTO programs should also be strengthened and improved. We share the views of many other members of the financial services industry in encouraging the Committee to make the Transitional Program for the Review of Covered Business Method Patents (CBM), which was created in Section 18 of the America Invents Act of 2011, permanent. We strongly commend Senator Schumer's efforts to do this. Moreover, as implemented by the PTO, the CBM program is unfortunately out of reach to many small financial institutions because the filing and post-institution fees charged by PTO together are more than \$30,000. This is more than the total settlement amount involved in many of the cases confronting small financial institutions, and comes before the substantial legal fees involved in bringing the case to the PTO. We urge the Senate to follow the lead of the House and grant the Director of the PTO the authority to waive the program fees to accommodate community banks and credit unions.

Question of Senator Grassley:

1. What do you believe are the most promising proposals currently being considered by Congress that would help deter abusive activity in the patent system?

Answer of John Dwyer:

There are a number of proposals that could help deter abusive activity in the patent system.

S. 1720 (*Sens. Leahy and Lee*). The Leahy-Lee “Patent Transparency and Improvements Act of 2013” is not a silver bullet, but would go a long way toward solving the problem small businesses face with patent trolls. In particular, we are strongly supportive of Section 5 of the bill, which clarifies that the Federal Trade Commission has enforcement authority over patent trolls that operate in unfair or deceptive ways. This provision could be strengthened by providing the FTC with limited, targeted rulemaking authority so that the Commission has the ability to evolve in its enforcement powers as trolls evolve.

We also are supportive of the efforts to address the concerns of end-users in Section 4 of S. 1720, which provides for the ability to stay an infringement case against a customer if the manufacturer consents in writing. This is an important step for small businesses and would provide needed protection. However, the provision may not go far enough for small financial institutions. Many of our technology service providers, including the ATM manufacturer in my own patent infringement case, refuse to join litigation when an infringement case is brought. We thus encourage adding a right of contribution and/or mandatory joinder to the patent law to enable a more equitable distribution of liability between end-users and suppliers.

S. 866 (*Sen. Schumer*). The “Patent Quality Improvement Act of 2013” would provide needed improvements to the Transitional Program for the Review of Covered Business Method Patents (CBM), an important and powerful tool created in Section 18 of the America Invents Act of 2011. In a short time, the program has already demonstrated its importance. Not only has the PTO been able to examine prior art and issues of subject

matter eligibility to invalidate some low-quality patents, but the courts have better managed their own resources by staying cases pending PTO re-examination.

Unfortunately, Congress artificially constrained the program by including a sunset provision. S. 866 makes the program permanent, ensuring that the full spectrum of low-quality business method patents will be subject to review. We strongly support S. 866 and efforts to strengthen Section 18's potent tools, and commend Senator Schumer's efforts to improve on this important program.

H.R. 3540 (Rep. Polis). The "Demand Letter Transparency Act of 2013," a House bill that does not yet have a Senate companion, would go a long way to helping small businesses faced with unfair and deceptive demand letters. H.R. 3540 requires any entity that sends 20 or more demand letters during any 365-day period disclose certain information to the PTO, and directs the PTO to create a database to make that information publically available. It also requires any demand letter sent to another entity to include certain specified minimum information that would provide demand letter recipients with the ability to quickly evaluate the claims being asserted. We encourage the Judiciary Committee to use H.R. 3540 as a model to strengthen the demand letter provisions in S. 1720.

S. 1013 (Sens. Cornyn and Grassley). The "Patent Abuse Reduction Act of 2013" enhances pleading standards, limits discovery to core documents and would require some fee shifting depending on the outcome of litigation. Enhanced pleading standards will provide much-needed transparency related to the merits or weaknesses of a lawsuit. If plaintiffs are required to specifically identify the accused product as well as asserted claims and factual basis for infringement, would-be defendants will be better

able to make determinations regarding licensing or litigation. The limitations on discovery help balance the costs of litigation. In addition, the focus around core documents could save would-be defendants from exorbitant costs related to document production. Discovery should not require defendants to provide patent trolls with an unlimited window into a company's business operations. S. 1013 would help ensure that the discovery process is no longer abused. S. 1013 would also deter abusive patent litigation by helping to reverse the economic incentives that fuel frivolous patent infringement lawsuits through fee shifting provisions.

S. 1612 (Sen. Hatch). S. 1612 builds on the fee shifting provisions of S. 1013 by empowering the court, on a motion from the defendant, to order the party alleging infringement to post bond to cover the other party's expenses. For cases in which bonds are required, defendants will know fee shifting provisions will be effective by ensuring that patent assertion entities have the money to pay legal expenses at the end of an unsuccessful case.

Question of Senator Grassley:

2. What are some examples of the costs to business and industry from abusive patent litigation and how would legislation help?

Answer of John Dwyer:

The costs of legal fees, settlements, and time are the most direct costs of abusive patent litigation. Patent cases are very expensive and an enormous distraction for companies in many sectors of our economy, and the recent dollar value of settlements is eye-popping. A 2012 study found that defendants and licensees paid non-practicing

entities (NPEs) \$29 billion in 2011; this is a 400% increase from 2005.¹ This follows a 2011 study that details fourteen NPEs earned approximately \$7.6 billion from 2000 to 2010, while the public companies targeted experienced a decline of \$87.6 billion in shareholder value during the same period.²

By empowering NPEs to hold companies hostage, the system forces excess costs onto consumers, and ultimately deters companies from providing products and services. Consumers lose because they cannot access innovative products and pay more for what is available. For credit unions and other not-for-profit entities, the result is even more acute: any money spent on a patent claim is money that is taken out of the products and services for the members and communities these organizations serve.

Legislation is necessary because, under existing law, incentives are misaligned. Companies face the choice of defending themselves through a costly and uncertain litigation process, or settle the claim by paying the NPE licensing fees. Meanwhile, the NPE has nothing to lose: since NPEs do not make anything, they are subject to little or no discovery costs, are often protected from counterclaims, can create shell companies to obscure details that may inform effective defense strategies, and can extract licenses through vaguely worded demand letters with postage the only substantial cost. The imbalance favors NPEs by incentivizing settlement even for meritless claims. Legislation is required to ensure innovation throughout all sectors of the productive economy can continue undeterred.

¹ Bessen, James E., and Michael J. Meurer. "The Direct Costs from NPE Disputes." Boston University School of Law, Law and Economics Research Paper No. 12-34, June 28, 2012.

² Bessen, James E., Michael J. Meurer, and Jennifer Laurissa Ford. "The Private and Social Costs of Patent Trolls." Boston University School of Law, Law and Economics Research Paper No. 11-45, September 19, 2011.

Question of Senator Whitehouse:

Many Rhode Island businesses have been the victims of patent troll abuse, receiving bad-faith demand letters and being forced to settle lawsuits or engage in costly litigation based on dubious patent claims. Small and medium-sized companies, many of whom do not have an attorney on staff, often do not have the resources to effectively fight patent troll abuse, which is why reforms such as prohibiting bad-faith demand letters and allowing manufacturers to stay suits against customers are necessary and appropriate.

Large corporate defendants, on the other hand, may have additional resources at their disposal that could allow them to take proactive steps to combat abuses by patent trolls. Consideration of such steps should be included in the discussion of how to address patent troll abuses.

Independent of legislation to reform the patent litigation system, what are some proactive steps that large corporations that are frequently defendants in patent suits could take to better defend themselves against patent troll abuses? In particular, please address the positive and negative aspects of the following potential actions:

- Referring patent trolls and their attorneys who initiate frivolous lawsuits and fraudulent and harassing conduct to the appropriate law enforcement authorities and disciplinary bodies, including, in the case of attorneys, state bar disciplinary boards;
- Pursuing equitable remedies, such as injunctions against future suits by trolls with a demonstrated record of frivolous litigation, fraud, and harassment;

- Pursuing Rule 11 sanctions against attorneys bringing frivolous suits;
- Increased use of joint defense agreements;
- Purchase of patent litigation insurance;
- Increased licensing and purchase of relevant patents; and
- Simply refusing to pay unjustified claims.

Answer of John Dwyer:

Credit unions, as member owned not-for-profit financial cooperatives that are among the smallest financial institutions in America, support prohibitions on bad-faith demand letters and provisions to allow manufacturers to stay suits against their customers. As is true for many small and medium-sized entities, my credit union does not have an attorney on staff, and the money and time spent on outside attorneys to evaluate and fight the patent claim brought against my credit union could be better spent doing almost anything else.

We are not in a position to know how large companies can respond to patent litigation and demand letters, but we do note the following. We believe that the worst patent trolls should be referred to law enforcement and disciplinary authorities, and believe that Rule 11 should be used aggressively by defendants faced with frivolous litigation. We also believe that increased use of joint defense groups would reduce defense costs.

However, especially at the demand letter stage, it is difficult for individual entities to know which trolls are the worst offenders, or determine who else has received a similar letter to make forming a joint defense group possible. It is the repeat actions of trolls that

often make it obvious which entities are engaged in abusive behavior, but an individual defendant generally has no way of knowing what the troll is doing to others. In theory, trade associations should provide some of the detail to bridge this gap. However, trade associations are often only aware of a fraction of the total assertions at the demand letter stage, as many entities that receive demand letters are reluctant to tell others they have been made targets of the troll. Trade associations, often many levels removed from the entities that receive demand letters, also necessarily lag months behind what a troll is doing day-to-day.

This is why a demand letter registry would be a beneficial addition to the patent system. We believe that an entity that sends more than 10 to 20 demand letters in a single calendar year should be required to enter all letters into a registry that would be publicly available and maintained by a federal agency, perhaps the PTO or FTC. This would provide businesses that receive a demand letter with the ability to communicate with one another, which would allow the efficient formation of joint defense groups, would assist small entities in the identification of counsel, and could reduce defense costs. A registry would also provide the FTC with the information it needs to conduct enforcement proceedings against abusive trolls, and would also remove one of the biggest factors of intimidation – the fear that you, alone, are being targeted.