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TESTIMONY

OF

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ON BEHALF OF THE
CREDIT UNION NATIONAL ASSOCIATION

BEFORE THE
COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

HEARING ON

PROTECTING SMALL BUSINESSES AND PROMOTING INNOVATION
BY LIMITING PATENT TROLL ABUSE

DECEMBER 17, 2013

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John Dwyer
President and Chief Executive Officer
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Chairman Leahy, Ranking Member Grassley, and Members of the Committee:

Thank you for inviting me here to testify at today's hearing. My name is John Dwyer, and I am President and Chief Executive Officer of New England Federal Credit Union, a member-owned not-for-profit financial cooperative headquartered in Williston, Vermont. Nearly 89,000 members have entrusted us with $982 million of their assets. I am testifying today on behalf of the Credit Union National Association (CUNA), the largest credit union advocacy organization in the United States, representing nearly 90% of America's 6,800 state and federally chartered credit unions and their 98 million members.

Mr. Chairman, the mere fact that someone like me is here today is emblematic of how the problem of patent trolls has gotten out of control. I am an accountant by trade, serve a relatively small community that I love, and with the supervision of my volunteer Board of Directors, am in the business of empowering our member-owners to make good financial decisions so they can improve their overall quality of life.

Although my institution sometimes buys technology to use in the service of our members, until about a year and a half ago, patents are not something that ever crossed my mind. I believe that is what Congress intended when it created the patent system to begin with. Financial institutions like ours are the quintessential end-users of technology. Every piece of technology we have in our institution was purchased with good money from a reputable vendor, who we assumed was selling us something free of any claims like these. Legal issues are also generally something that we try our hardest to avoid; although we operate in one of the most highly regulated sectors of our nation's economy, we operate without an attorney on our staff.

My institution is now in the middle of expensive discovery in a patent infringement case I never could have imagined related to our 23 ATM machines. A total of 25 financial institutions, gas stations, and convenience stores from at least six states are or have been part of this case. The case has been a costly and distracting headache, and due to the fact my case is pending, I hope the Committee can appreciate that there are certain things I won't be able to discuss with you today.

But I am happy to discuss how I got here, beginning with an ill-researched, vague demand letter from a company that has made a business out of what, in my opinion, in another context, might look like extortion. It's a business model that has become a drain on the economy, one that tens of thousands of American financial institutions and small businesses hope this Committee will commit to stopping. During my testimony today, I will focus my remarks on my own experience with demand letters, and what the Committee can do to address the problems, including clarifying the Federal Trade Commission's (FTC) enforcement authority, increased transparency requirements, and providing protections to end-users of technology.

A Business Model Based on the Cost of a Stamp: Unfair and Deceptive Demand Letters and their Harmful Effects

In June 2012, my credit union received a letter from an entity vaguely suggesting that one or more of our ATM machines infringed one or more of 13 patents. The letter did not specify which of our, at that time, 21 ATM machines it believed infringed, nor did it link specific ATM machines to specific patents. In fact, it was obvious to me that the entity and its lawyers performed little or absolutely no research prior to demanding money from our credit union, as the letter was addressed to my predecessor, who departed our credit union a full two years earlier. It had other elements that pointed to it being a form letter, as it referred to us as a "bank," even though, as a credit union, we have a different legal structure, are supervised by a different regulator, and have many other ways in which we are substantively different from other types of financial institutions.

The letter also contained absolutely no information as to why the entity believed we infringed, leaving us with no way to evaluate the claims. Rather, the letter provided a simple list of patent numbers. It also did not provide us with a comprehensive list of prior licensees, so we could not tell if the manufacturer of our ATMs entered into a licensing agreement in the past. The letter also did not include a key fact that we later learned: two months earlier, many of the patents on that list were declared invalid by the Federal Circuit, after being held invalid at the Patent and Trademark Office (PTO) and by a district court years before.

Nevertheless, I consulted with a lawyer and conducted due diligence both into the patents and the way our machines work, learning that the way modern ATMs function, there was no possible way our ATMs could infringe. I wanted to confirm a few things with our ATM vendor, however, and dispatched a reply letter to the troll in July 2012 asking for more time to evaluate the claims.

In October, I received another letter from the entity, again addressed to my predecessor, which again repeatedly referred to us as a bank. This letter did not acknowledge my earlier reply. It merely included the same list of patents, including those held invalid at the Federal Circuit, and more explicitly threatened litigation if we could not "amicably settle this matter."

During this letter writing campaign, a scary feeling was wondering if I was alone. When you receive a series of letters like these, you begin to think that maybe the author knows something you don't. Perhaps, you think, the author personally visited one of your ATMs while he was on vacation, and recognized something that triggered an infringement claim in his mind. I'm not a lawyer, but I knew litigation is expensive, risky, and time consuming, so I started to wonder whether I was better off just writing a check to make the issue go away.

Before doing so, I reached out to our state trade association to see if other credit unions were receiving similar demands. I learned that nearly every other credit union across Vermont received similar letters, including, amazingly, some that do not own or operate ATMs.

I also sit on the Community Depository Institution Advisory Council for the Federal Reserve Bank of Boston. Through this group, I learned numerous financial institutions across New England received the exact same letter. I started to conclude that the business model of this entity was to take a directory of financial institutions, dump it into a mail merge program, send out letters, and wait for the settlement checks to roll in.

The troll has recently turned up the heat in its rhetoric. The troll is now sending an initial letter offering "a special one-time *limited time offer* for smaller Banks such as yours to receive a fully paid up sub-license" for $2,000 per ATM. (Emphasis in original). Frankly, this language sounds a bit more like a late-night infomercial than a serious attempt at dispute resolution. For my institution, this demand would be $46,000 based on our current number of ATMs. Should the financial institution fail to respond, they receive a follow-up letter stating that the entity is prepared to file suit "if we are unable to reach an amicable resolution," and attaching the front page of a draft "complaint," containing nothing more than a case caption. In addition, the second letter states that the price to reach a settlement has increased to $5,000 per ATM – an amount 250% higher than the initial demand. For my institution, this demand would be $115,000 based on our current number of ATMs.

In addition, the troll has recently become more aggressive at filing suit. In 2013, this entity actually filed a case against a New York credit union that has no ATMs. We are unaware of a single instance where this entity has prevailed when it has decided to actually go to court.

CUNA believes that the troll has sent many hundreds, if not thousands, of demand letters across the Northeast, Southeast, and Midwest—perhaps coast to coast. Financial institutions are also not unique. 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.

Economic Realities

These letter writing campaigns work because trolls know that an early settlement is much, much cheaper for a defendant than fighting. In almost every case, just to pick up the phone to consult a patent lawyer to determine the validity of the infringement claim and evaluate the demand costs tens of thousands of dollars. Litigation, whether in court or before the PTO in a covered business method proceeding, is even more expensive—and in the latter, as discussed below, the fees just to bring the proceeding could exceed the cost of the demand. Although it violates one's basic sense of right and wrong, paying up makes some economic sense for a credit union of my size.

It is because of their size that small financial institutions are especially vulnerable. Banks and credit unions are filled with staff in the business of managing risk, and in targeting small institutions that may not have a lawyer on staff competent to evaluate the claims, demand letters are sure to reach a captive mass of people who will be afraid of getting sued. Community bank and credit union CEOs like me will be willing to do almost anything to avoid the risk and uncertainty litigation creates.

Unchecked, the problem of demand letters will deter institutions like mine from using new technologies at all. The technologies for which patent demand letters and litigation have become common against credit unions and community banks include some of the things that make financial services most accessible to consumers – ATMs, online and mobile banking, remote check capture, and check processing, just to name a few. CUNA has received calls from credit unions worried about making things like smartphone applications available to their members because they are afraid of getting sued. Many institutions will decide these technologies – however much they help their members – aren't worth the risk. If that happens, consumers lose.

Solving the Demand Letter Problem

CUNA strongly supports Section 5 of the Patent Transparency and Improvements Act of 2013, and though it is not a silver bullet that would solve the demand letter problem, appreciates its inclusion in the introduced legislation. The provision would clarify that the Federal Trade Commission has enforcement authority over patent trolls that operate in unfair or deceptive ways, but it does not provide the FTC with the ability to make rules in this area. We believe the FTC should have the ability to evolve in its enforcement powers as trolls evolve, and rulemaking authority would provide the agency with the means to do this.

Increased Transparency and Disclosure Standards in Demand Letters. In the same way heightened pleading requirements can help keep frivolous lawsuits out of court, minimum disclosure standards would help ensure that only demand letters truly asserting a potentially valid claim of infringement are sent. This would also benefit small businesses and small financial institutions by providing them with information necessary to evaluate the merits of the demand. There are a variety of requirements the Committee could consider, including some or all of the following:

1) A detailed description of each patent allegedly infringed and each claim of each patent that is allegedly infringed;

2) Each claim must include a detailed description of which product, feature, method or process is allegedly infringed, including the name or model number; and how the terms of the asserted claim correspond to the functionality of the accused product/method;

3) A description of the direct infringement, the acts of the alleged indirect infringement that contribute to or are inducing direct infringement;

4) A description of the right of the party alleging infringement to assert each patent identified and patent claim identified;

5) A description of the principal business of the party alleging infringement and ownership of the principal business;

6) A detailed description of any past litigation involving direct or indirect infringement and the status or validity of each patent infringed; and

7) The party alleging infringement must identify and disclose any licenses associated with the asserted patent.

Registry. In addition, an entity that sends more than 10 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 is important for a variety of reasons. First, it would provide businesses that receive a demand letter with the ability to communicate with one another. Knowledge is power in these situations, and knowing who else is dealing with the same problem from the same entity provides information necessary to get others to join in your fight. This would allow the efficient forming of joint defense groups to pool knowledge and strategy, assist small businesses in identifying competent counsel familiar with the specific troll at issue, 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.

End-User and Indemnification Issues

As noted above, credit unions and banks are mainly buyers or end-users of technology and rarely develop it themselves. A particularly frustrating problem for small financial institutions, including mine, is that the vendors that sell us the technology very often refuse to stand by it when an infringement claim is brought. In my case, the manufacturer of our ATMs explicitly told us that we are on our own in defending this case. CUNA understands that other vendors, particularly those that make key technologies necessary for financial institutions to operate in a safe and sound manner, are now explicitly *disclaiming* any representation or warranty as to intellectual property in their agreements. I find this trend troubling for a variety of reasons, especially because vendors are in the best position to know who has the best prior art, what licenses they entered into when they manufactured their technology, the terms of those licenses, and how the technologies they built work from the ground up. Some companies, such as Cisco Systems, have made it a very public priority to defend their customers, and they should be commended for doing so. We worry, however, that companies like Cisco are the exception, rather than the rule.

We appreciate the efforts to address the concerns of end-users in Section 4 of the Patent Transparency and Improvements Act of 2013. However, we encourage the Committee to go further. Because this section makes a stay of a customer's infringement case available only if the manufacturer consents in writing, it may not address the problem faced by many end-users. Indeed, if the trend of technology service providers refusing to stand behind their customers continues, we expect few will consent. We believe that adding a right of contribution and/or mandatory joinder to the patent law would enable a more equitable distribution of liability between end-users and suppliers.

Enhanced Pleading Standards

For many of the same reasons minimum demand letter disclosure standards will provide much-needed transparency related to the merits or weaknesses of a demand, enhanced pleading standards will give would-be defendants better information able to make determinations regarding licensing or litigation. CUNA commends Ranking Member Grassley and Senator Cornyn's efforts in this area. The limitations on discovery and fee shifting in their bill would also help balance the costs of litigation, and would be of great benefit to credit unions like mine when confronting cases like these.

Covered Business Method Patent Program

We also urge the committee to make improvements to the Transitional Program for the Review of Covered Business Method Patents (CBM), which was created in

Section 18(a) of the America Invents Act of 2011. As implemented by the PTO, the program is out of reach to most 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 confronted by 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.

We also encourage the Committee to follow the lead of the House and include language in any Committee Report that clarifies that a demand letter or other pre-litigation communication suggesting that infringement may have occurred can trigger the right to bring a Section 18 proceeding. While we understand this was Congress's intent, outside patent attorneys involved in CBM cases advise us this is not always the case in the real world; much depends on the substance of the demand letter. It is our understanding that the key question is if an entity has been "charged with infringement" in the demand letter such that the petitioner would have standing to bring a declaratory judgment action in federal court. A vague demand letter that does not explicitly say something to the effect of "you infringe" may not meet the PTO's standard. As trolls are savvy, they may word the letter such that it may not rise to the level of being charged with infringement.

We also share the views of many other members of the financial services industry in encouraging the Committee to make the CBM program permanent, and commend Senator Schumer's efforts to do this. We believe that to artificially constrain the program is to ensure that low-quality business method patents remain in the hands of trolls.

Conclusion

Mr. Chairman, for those operating community-based financial institutions, demand letters represent a great and growing threat. We applaud the Committee for addressing these issues and recognizing the threats demand letters can pose to end users of technology.

On behalf of America's credit unions and their 98 million members, thank you very much for allowing me to testify at today's hearing. I am happy to answer any questions the Members of the Committee may have.