

PATENT FILE

Radical reform for patent demand letters



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Quarles & Brady's **Michael Curley** questions if the pending US Transparency in Assertion of Patents Act will create a 'sue first, license later' practice

Senator Claire McCaskill (Democrat for Missouri) does not think much of so-called 'patent trolls'. On 26 February 2014, McCaskill introduced the Transparency in Assertion of Patents Act (S 2049) legislation, that she hopes will "send a message to these bottom feeders" and "protect American consumers and small businesses from scam artists trying to make a quick buck".¹ S 2049 would target the practice of sending vague patent demand letters by requiring such letters to include detailed infringement contentions, among other information. If passed, the bill would radically change pre-litigation practice for all parties engaged in patent licensing and enforcement efforts.

Details of the legislation

S 2049 is directed at any "written communication that states that the intended recipient... is infringing or may be infringing the patent of and bears liability or owes compensation to another". Under the bill, any such communication must include an identification of the subject patent and the claims alleged to be infringed, a detailed description of the accused instrumentality, and a detailed description of how the accused instrumentality infringes the identified claims.² Thus, McCaskill's bill would require that infringement contentions, which are typically served by the plaintiff several months into a litigation, be included in any initial demand letter. The bill also requires additional disclosures including: the identity and contact information for all owners, co-owners,

enforcement entities, and their ultimate parent entities; terms on which licences are available; the method used to calculate any damages alleged to be owed; and whether the subject patents are currently subject to reexamination or post-grant review.³

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Enforcement of these requirements is to be handled by the US Federal Trade Commission (FTC), which is also directed to "promulgate rules to prohibit unfair or deceptive assertions" in patent demand letters. Examples of such assertions include: empty threats that litigation will commence if compensation is not paid, any assertion

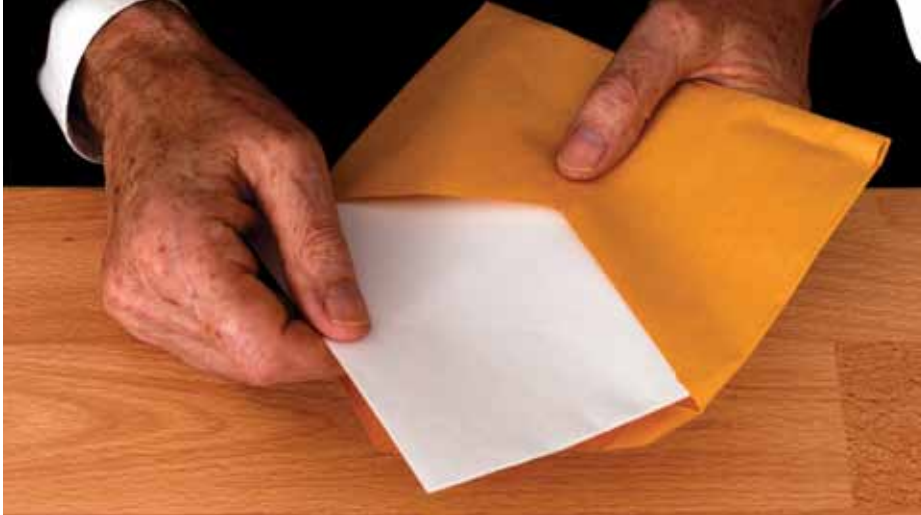
that lacks "reasonable basis in fact or law", and any assertion "that is likely to materially mislead a reasonable intended recipient".⁴ The bill also creates a right of action for state attorneys general and allows for statutory damages in the amount of up to \$16,000 per violation.⁵

The use of deceptive trade practices statutes to target trolls

S 2049 appears to be aimed squarely at practices such as those made famous by MPHJ Technology Investments – the notorious 'scan-to-email' patent troll. According to a draft FTC complaint,⁶ between September of 2012 and November of 2013, MPHJ subsidiaries⁷ sent patent demand letters to 16,465 small businesses, requesting payment of a licensing fees of between \$1,000 and \$1,200 per employee of the target company. These initial letters suggested that MPHJ's licensing campaign had been successful, when in fact, only 17 of 16,465 contacted parties had purchased licences. When these initial letters were ignored, as they routinely were, MPHJ sent more aggressive follow-up letters from counsel. These later letters threatened imminent litigation if a response was not received within two-weeks. The FTC alleges that these were empty threats since, by early November of 2013, MPHJ had not sued a single accused infringer on the scan-to-email patents.

Under the FTC's theory, the false statements included in MPHJ's patent demand letters constitute deceptive trade practices proscribed by 15 USC § 45(a). State attorneys general in Vermont, New York and

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Minnesota have relied on analogous state statutes to combat MPHJ's licensing campaign on the same theories. MPHJ has settled with Minnesota and New York, but responded to the FTC by preemptively suing in the Eastern District of Texas. MPHJ argues that its licensing letters are speech protected by the First Amendment and that FTC is exceeding its jurisdiction by applying 15 USC § 45(a) to MPHJ's activities. S 2049 would short circuit this second argument by explicitly extending the jurisdiction of the FTC and state attorneys general to precisely the behavior engaged in by MPHJ.

Using a hammer to swat a fly?

While S 2049 would effectively shut down shotgun licensing campaigns such as MPHJ's, its impact on other patentees, both of the 'troll' and the non-troll variety, is far less certain. Indeed, if S 2049 is passed, parties that have the stomach for litigation are likely to simply sue prior to sending a demand letter. To understand why this is, it is important to compare the requirements of S 2049 for demand letters with the current patent infringement pleading standard.

Under the US Supreme Court's revisions to the pleading standard set forth in *Bell Atlantic Corp v Twombly* (2007) and *Ashcroft v Iqbal* (2009) (known as *Twombly* and *Iqbal*), a complainant must plead facts that *plausibly* give rise to an entitlement to relief. Traditionally, direct patent infringement is pleaded using Form 18 from the Appendix of Forms to the Federal Rules of Civil Procedure, authorised under Fed R Civ P 84. Form 18 requires only a very generalised allegation of infringement, "The defendant has infringed and is still infringing the Letters Patent by making, selling, and using [accused instrumentalities] that embody the patented invention, and the defendant will continue to do so unless enjoined by this court."⁸ In

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In re Bill of Lading Transmission & Processing Sys Patent Litigation, the US Court of Appeals for the Federal Circuit ratified the continued use of Form 18 despite *Twombly* and *Iqbal*, stating "to the extent the parties argue that *Twombly* and its progeny conflict with the Forms and create pleadings requirements, the forms control".

The continued use of Form 18⁹ is under challenge along many fronts, with several district courts rejecting the Federal Circuit's conclusion in *In re Bill of Lading*.¹⁰ Additionally, the Advisory Committee of the Judicial Conference has proposed amendments to the Federal Rules that would abolish Rule 84 and the Appendix of Forms, including Form 18. Finally, many of the other anti-troll patent reform bills currently under consideration would heighten patent pleading standards to essentially require detailed infringement contentions to be included in the complaint.¹¹ The level of factual detail in a complaint required by these legislative proposals far exceeds what would likely be required by

Twombly and *Iqbal* even in the absence of Form 18.

If legislative efforts to raise pleading standards fail, and either Form 18 is abolished or the courts develop some heightened pleading requirement that comports with *Twombly* and *Iqbal*, S 2049 would likely have unfortunate consequences. Under such a scenario, if an enforcing party chooses to send a pre-litigation demand letter, the letter would be required to disclose the patentee's infringement case at a level of detail beyond what would be required to file suit. The incentive here would be for the enforcing party to file suit and then conduct licensing negotiations on the phone, securely within the protections of Federal Rules of Evidence 408 – offers and negotiations. This would be a much safer path than writing a demand letter, which both gives the accused infringer advanced notice of the strength of the infringement case, and risks drawing the ire of the FTC.

While S 2049 may be an effective weapon against the "bottom feeder" entities at which it is targeted, if passed, it will impact all parties seeking to license patents. While cracking down on the worst actors is a laudable goal, it may not be worth creating a situation where all patentees are incentivised to sue first and make licensing overtures later.

Footnotes

1. http://www.mccaskill.senate.gov/?p=press_release&id=12097
2. S 2049, Sec 2(a)(1-3) available at <http://www.mccaskill.senate.gov/pdf/TransparencyinAssertionofPatentsAct.pdf>
3. id at Sec 2(a)(5-8).
4. id at Sec 2(c)(1-3).
5. id. at Sec 2(g)(1-2).
6. Complaint, *MPHJ Technology Investments, LLC v FTC et al*, 6:14-cv-00011-WSS (WD Tex. 2014) at Exhibit F.
7. MPHJ owns 101 subsidiary Delaware LLCs with cryptic six-letter names like "DesNot" and "CalNeb", with each subsidiary having rights to license MPHJ's patents to a specific industry within a specific range of US zip codes.
8. Appendix of Forms, Form 18, paragraph 3, available at <http://www.uscourts.gov/uscourts/rules/civil-procedure.pdf>
9. For a plaintiff patent complaint, Form 18 applies to allegations of direct infringement.
10. See *Macronix Int'l Co v Spansion Inc*, No 13-679, 2014 US Dist LEXIS 31465 (ED Va 10 March 2014); *Gradient Enterprises, Inc v Skype Technologies SA*, No 10-CV-6712L (WD NY 25 March 2013).
11. See S1013, Patent Abuse Reduction Act of 2013; HR 2639, Patent Litigation and Innovation Act of 2013; HR 3309, Innovation Act.