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Regulating Patent Assertions

Paul R. Gugliuzza

In recent years, a small number of patent holders, often called “bottom feeder” patent trolls, have been abusing the U.S. patent system. These patent holders blanket the country with thousands of letters demanding that the recipients purchase a license for a few thousand dollars or else face an infringement suit. The letters are usually sent to small businesses and nonprofits that do not have the resources to defend against claims of patent infringement. And the letters often contain false or misleading statements designed to scare the recipient into purchasing a license without investigating the merits of the allegations. In response to this troubling behavior, legislatures in over thirty states have enacted statutes that outlaw assertions of patent infringement that are deceptive, false, or made in bad faith.

These statutes, however, may be unconstitutional. The U.S. Court of Appeals for the Federal Circuit, which has exclusive jurisdiction over appeals in patent cases, has held that patent holders are immune from civil claims challenging acts of patent enforcement unless the patent holder knew its infringement allegations were objectively baseless. This rule provides patent holders with nearly complete immunity from liability under the new statutes. In fact, the rule has already immunized two notorious bottom feeders, Innovatio IP Ventures and MPHJ Technology Investments, from liability under state consumer protection and deceptive trade practices laws.

Although the Federal Circuit has sometimes called the immunity afforded to patent holders a matter of the federal Patent Act's "preemption" of state law, the court's immunity doctrine also appears to limit the ability of the federal government to regulate patent enforcement behavior. This is because the Federal Circuit's decisions are not grounded in the Constitution's Supremacy Clause, which is the usual source of preemption doctrine, but in the First Amendment right to petition the government. Unlike the Supremacy Clause, the First Amendment restricts the power of the federal government, not just state governments. Accordingly, the Federal Circuit's immunity doctrine also limits the ability of the Federal Trade Commission to bring unfair competition proceedings against patent trolls and may thwart Congress's efforts to outlaw false or misleading statements made in patent demand letters.

This chapter makes two main arguments. First, the Federal Circuit's immunity doctrine is wrong as a matter of law, policy, and historical practice. Until the Federal Circuit adopted its "objective baselessness" requirement, courts had, for nearly a century, held that patent enforcement conduct could be declared unlawful if it was simply "in bad faith." That flexible, equity-based immunity standard struck an appropriate balance between the goals of punishing extortionate schemes of patent enforcement and respecting patent holders' rights to make legitimate allegations of infringement. But the Federal Circuit has abandoned that standard in the misguided belief that letters between private parties, such as demand letters sent by patent holders to alleged infringers, are protected by the First Amendment right to petition the government. If the Federal Circuit reversed course in future cases, both state governments and the federal government would be able to regulate letters that use

deceptive or false statements to intimidate recipients into purchasing a license, even if the infringement allegations in the letters are not objectively baseless.

Second, state governments and the federal government should share responsibility for regulating patent demand letters. Although patents are usually thought to be a matter for the federal government, not the states, the states have long regulated unfair and deceptive trade practices resembling the demand letters sent by bottom-feeder trolls. State governments also offer critical enforcement resources. They are more accessible to the small businesses, nonprofits, and local governments likely to be targeted by deceptive campaigns of patent enforcement, and the quantity of enforcement actions that could be pursued by numerous states' attorneys general likely dwarfs what the federal government could do. At the same time, federal legislation on patent demand letters would provide a uniform standard for assessing the legality of patent enforcement conduct. Federal legislation could also clarify difficult jurisdictional issues that arise in disputes over the lawfulness of patent assertions.

Ideally, the Federal Circuit will loosen its requirement of objective baselessness, which would allow Congress to pass a statute that: (1) outlaws demand letters sent in bad faith, (2) preempts state laws regulating patent enforcement, (3) permits both state governments and private plaintiffs to enforce the federal statute, and (4) grants the federal courts expansive personal jurisdiction in cases arising under the statute.

Finally, an introductory note about the scope of this chapter: The chapter focuses primarily on unfair or deceptive assertions of patent infringement made in demand letters, for it is those demand letters that have provided the impetus for both state and federal efforts to regulate patent assertions. It should be emphasized, however, that the Federal Circuit's immunity doctrine shields patent holders not only when their

infringement assertions are made in demand letters but also when they file infringement lawsuits in court. Emerging evidence indicates that, although some bottom feeders rely on demand letters alone, many patent holders seeking nuisance-value licenses file lawsuits in addition to (or instead of) sending demand letters (Federal Trade Commission 2016, 4-5). Because the same immunity doctrine applies both to letters and to lawsuits, many of this chapter's critiques of Federal Circuit law could be extended to campaigns that involve litigation in court. That said, future scholarship might also consider whether differences between demand letters and infringement complaints, including the fact that infringement complaints might be more plausibly viewed as petitions to the government within the meaning of the First Amendment, warrant an immunity doctrine that accounts for the context in which infringement assertions are made.

6.1 The Problem: Bottom-Feeder Patent Trolls

In the past decade, scholars and policymakers have fixated on “patent trolls” or, less pejoratively, non-practicing entities (NPEs) (see generally Cotropia et al. 2014). NPEs are often criticized because they do not manufacture products or provide services. Instead, they exist primarily to enforce patents. But the NPE business model is not necessarily nefarious. Research universities, for example, usually cannot commercialize the patents obtained by their faculty, so they license the technology to others and sometimes sue for infringement. NPEs can also help monetize inventions by those who cannot afford to assert their patents in litigation, such as individual inventors and start-up companies.

In the past few years, however, a species of “bottom feeder” trolls has emerged. These patent holders send out hundreds or thousands of demand letters at one time, relying on the high cost of patent litigation in the hope of eliciting a nuisance-value settlement, that is, a settlement payment less than the amount it would cost to investigate the infringement allegations (Lemley and Melamed 2013, 2126). Bottom feeders target small businesses, nonprofits, and even local governments, knowing that those organizations are unfamiliar with patent litigation and likely cannot afford to defend against infringement claims (Chien and Reines 2014, 235).

One well-known bottom feeder is the company MPHJ Technology Investments. In 2012 and 2013, MPHJ sent letters to over 16,000 small businesses throughout the United States. The letters accused the recipients of infringing a patent that covers the use of an office scanner to send documents via email. MPHJ demanded that each recipient purchase a license for about a thousand dollars per employee or else face an infringement suit in federal court.

Another bottom feeder who has engaged in a mass enforcement campaign is Innovatio IP Ventures. Beginning in 2011, Innovatio sent letters to over 8,000 businesses throughout the United States, including bakeries, hotels, and restaurants, claiming that those businesses infringed its patents by providing customers with wireless Internet access. Innovatio demanded that the recipients purchase licenses for about \$2500 each or risk being sued for patent infringement.

The demand letters sent in these mass enforcement campaigns are often rife with false or deceptive statements (Gugliuzza 2015, 1582). MPHJ, for instance, obscured its identity by sending letters through eighty-one shell companies with nonsensical names such as DolVol, GanPan, and JitNom. To intimidate recipients into quickly

purchasing a license, MPHJ threatened to sue if the recipient did not respond within two weeks. But, in fact, MPHJ never sued any of the targets of its mass enforcement campaign. Likewise, both Innovatio and MPHJ falsely claimed that many other businesses had already purchased licenses to their patents.

6.2 Governments Respond

In response to the tactics of patent holders such as Innovatio and MPHJ, both state governments and the federal government have become interested in regulating patent assertions.

6.2.1 State Statutes and State Law Enforcement Actions

Since 2013, legislatures in over thirty states have adopted statutes outlawing deceptive, false, or bad faith assertions of patent infringement (Patent Progress 2016). Statutes outlawing particular acts of patent enforcement are actually nothing new. In 1883, the British Parliament created a “threats action” – a civil claim that could be pursued by persons targeted with groundless threats of suit for patent infringement (U.K. Law Commission 2014). The United States patent laws, however, have never provided such a claim. Rather, a statute passed in Vermont in May 2013 was the first in the United States to condemn specific acts of patent enforcement.

Through August 2016, twenty-one states have adopted statutes modeled after Vermont’s, with some minor variations. The core provision of the Vermont statute states simply: “A person shall not make a bad faith assertion of patent infringement” (Vt. Stat. Ann., tit. 9, § 4197(a)). The statute then lists several factors that courts “may

consider . . . as evidence that a person has made a bad faith assertion of patent infringement” (*id.* § 4197(b)), including:

- The demand letter does not contain: the patent number, the name and address of the patent holder, or “factual allegations concerning the specific areas in which the target’s products, services, and technology infringe the patent.”
- The demand letter lacks the information described above, the target requests the information, and the patent holder fails to provide the information “within a reasonable amount of time.”
- The patent holder has previously filed or threatened to file lawsuits and those threats lacked the information described above or were found by a court to be meritless.
- Prior to sending the demand letter, the patent holder did not conduct an analysis comparing the claims of the patent to the target’s products, services, or technology, “or such an analysis was done but does not identify specific areas in which the products, services, and technology are covered by the claims in the patent.”
- The demand letter demands payment of a license or a response “within an unreasonably short period of time.”
- The patent holder “offers to license the patent for an amount that is not based on a reasonable estimate of the value of the license.”
- “The claim or assertion of patent infringement is meritless, and the person knew, or should have known, that the claim or assertion is meritless.”

- “The claim or assertion of patent infringement is deceptive.”

As these factors suggest, the primary aims of the statute are to ensure that patent demand letters provide accused infringers with specific information about the alleged infringement and to deter patent holders from engaging in deceptive conduct in the hope of eliciting nuisance-value settlements.

In addition to the Vermont model, two other types of state patent-demand-letter statutes exist. In April 2014, Wisconsin became the third state, after Vermont and Oregon, to pass a statute regulating patent enforcement. (Oregon’s statute is similar to Vermont’s.) The Wisconsin statute, which, unlike the widely copied Vermont statute, has not been followed in any other state, outlines in detail the information that a demand letter must include, such as the name of the patent owner, an identification of each patent claim being asserted, an identification of the allegedly infringing product or service, and “[f]actual allegations and an analysis setting forth in detail” the patent holder’s theory of infringement (Wis. Stat. § 100.197(2)(a)). The Wisconsin statute can be violated in two ways: First, if the letter lacks any of the required information, the target may notify the sender that the letter is incomplete. If the sender does not provide the missing information within thirty days, the sender violates the statute (*id.* § 100.197(2)(c)). Second, a demand letter violates the Wisconsin statute if it “contain[s] false, misleading, or deceptive information” (*id.* § 100.197(2)(b)).

A third and final model of state legislation has been adopted in eight states. Rather than prohibiting false or bad faith assertions of patent infringement, these statutes outline specific acts or omissions that violate the statute, such as “falsely stat[ing] that litigation has been filed” against the recipient, seeking compensation for infringement of a patent that has been held invalid or has expired, or failing to include

“factual allegations concerning the specific areas in which the [recipient’s] products . . . infringe[] the patent” (e.g., Okla. Stat. tit. 23, § 112(A)). The statutes also make clear that it is not unlawful to notify others of or to seek compensation for patent infringement, so long as the patent owner “is not acting in bad faith” (e.g., *id.* § 112(B)).

All of the state statutes provide for enforcement by state officials, such as the state attorney general, and most of the statutes create a private right of action for the targets of unlawful infringement assertions. The remedies available in those private suits include equitable relief, compensatory damages, treble damages, and attorneys’ fees (see Gugliuzza 2015, 1593–1594, 1596 n.107, 1598 n.117).

In addition to these new state statutes, attorneys general in several states have begun to use their powers under consumer protection and deceptive trade practices laws to challenge patent enforcement campaigns (*id.* pp. 1599–1600). Vermont’s attorney general, for instance, sued MPHJ in May 2013, alleging that the company’s demand letters violated Vermont’s general consumer protection statute. (The suit was filed two weeks before Vermont’s demand letter statute took effect.) Around the same time, the attorney general of Nebraska began an investigation into whether a law firm representing MPHJ and Activision TV, another NPE, had violated Nebraska’s consumer protection and deceptive trade practices statutes. As discussed below, however, the Federal Circuit’s immunity doctrine may render these law enforcement actions unconstitutional.

6.2.2 Federal Efforts to Regulate Patent Assertions

At the federal level, both Congress and the Federal Trade Commission (FTC) have shown interest in regulating patent assertions. In 2014, the FTC filed an

administrative complaint against MPHJ alleging that the company engaged in deceptive trade practices in violation of the Federal Trade Commission Act. MPHJ settled the case by agreeing to refrain from making deceptive statements when asserting its patent rights in the future (Consent Order 2014). The FTC has also used its subpoena power to investigate patent trolls in an attempt to obtain information about how they operate, issuing an extensive report just as this chapter was going to press (FTC 2016).

In addition, Congress has begun to contemplate legislation that would regulate patent assertions. A bill recently introduced in the House of Representatives, the Targeting Rogue and Opaque Letters (TROL) Act, defines no fewer than seventeen types of communications related to alleged patent infringement as unfair or deceptive acts under the FTC Act. Among other things, the bill would make it unlawful to, “in bad faith”: fail to include a description of how the recipient infringes the patent, state that “legal action for infringement of the patent will be taken against the recipient,” claim that “persons other than the recipient purchased a license for the patent asserted,” or allege that “an investigation of the recipient’s alleged infringement occurred” (TROL Act § 2(a)).

Similarly, a bill recently introduced in the Senate, the Protecting American Talent and Entrepreneurship (PATENT) Act, would outlaw at least eight specific actions taken by persons who engage in “widespread sending” of demand letters, including: engaging in a pattern of falsely threatening infringement litigation; making statements related to patent validity, enforceability, or infringement that “lack a reasonable basis in fact or law”; or sending letters “likely to materially mislead a reasonable recipient” because the letters do not contain information about the patent holder, the asserted patent, or the

recipient's alleged infringement (PATENT Act § 9(a)). Under the bill, the FTC would enforce these prohibitions (*id.*).

The TROL Act has made progress in the House. The initial version was approved by a subcommittee in 2014, and, in 2015, the full committee on Commerce, Manufacturing, and Trade approved a revised version of the bill. But that committee vote was entirely along party lines, and observers have criticized key aspects of the bill, including its express preemption of state statutes regulating patent assertions and its potential intrusion on patent holders' First Amendment rights (see Gugliuzza 2015, 1614 n.213, 1637 n.352). Thus, the prospects for Congressional action to regulate patent assertions seem questionable at best.

6.3 Constitutional Limits on Regulating Patent Assertions

Under current law, opponents of the TROL Act may be correct that the bill violates the First Amendment. The Federal Circuit has held that patent holders are immune from liability based on their enforcement actions unless the patent holder's allegations of infringement were objectively baseless and the patent holder knew those allegations were objectively baseless. This broad immunity rule, however, misinterprets the relevant constitutional provisions and wrongly vitiates courts' long-standing power to condemn acts of patent enforcement that are undertaken, simply, in bad faith.

6.3.1 Judicially Created Immunity for Patent Holders

For decades, persons accused of patent infringement have tried to assert civil claims against overzealous patent holders. Those claims are sometimes grounded in

state law (for example, claims for unfair competition or for tortious interference with business relations) and other times grounded in federal law (for example, claims for unfair competition under the Lanham Act or for violations of the civil RICO statute). The Federal Circuit, however, has held that patent holders are mostly immune from civil liability for their enforcement behavior. According to the Federal Circuit, to strip a patent holder of immunity, the plaintiff must prove not only the elements of its claim, it must also prove, by clear and convincing evidence, (1) that the patent holder's infringement allegations were "objectively baseless," meaning that no reasonable litigant could have expected to succeed, and (2) that the patent holder made its infringement allegations with knowledge of their inaccuracy or with reckless disregard for their accuracy (*Globetrotter* 2004, 1377).

Courts and commentators sometimes call the immunity enjoyed by patent holders a matter of "preemption" because it is most frequently invoked when an alleged infringer relies on state law, such as the law of torts or unfair competition, to challenge a patent holder's behavior in enforcing a federal patent (see, e.g., *Hunter Douglas* 1998, 1338; Johnson 2014, 2027). The term "preemption" suggests that the source of the immunity doctrine is the Constitution's Supremacy Clause, which limits only the power of state governments, not the federal government. In more recent cases, however, the Federal Circuit has made clear that its immunity doctrine stems not from the Supremacy Clause alone, but also from the First Amendment, which *does* limit the power of the federal government. In *Globetrotter*, for instance, the court wrote: "Our decision to permit state-law tort liability for only objectively baseless allegations of infringement rests on both federal preemption and the First Amendment" (*Globetrotter* 2004, 1377).

The Federal Circuit's two-element test for stripping patent holders of immunity is drawn from U.S. Supreme Court decisions on the *Noerr-Pennington* doctrine of antitrust law. That doctrine protects the First Amendment right to petition the government by immunizing defendants from antitrust liability based their pursuit of litigation unless the litigation was a "sham" (*Noerr* 1961; *Pennington* 1965). To establish that litigation was a sham, the plaintiff must show that the defendant's lawsuit was both objectively baseless and filed with the subjective intent to impair competition (*Professional Real Estate Investors* 1993, 60–61). The Federal Circuit has explicitly cited the Supreme Court's test for establishing sham litigation as the basis of its test for stripping a patent holder of immunity from civil liability for patent enforcement activities (*Globetrotter* 2004, 1376).

Under the *Noerr*-based test the Federal Circuit has articulated for stripping patent holders of immunity, most tactics employed by bottom-feeder trolls cannot serve as the basis for civil liability. Because the test requires a plaintiff to show that the patent holder's *infringement allegations* were objectively baseless, false statements about matters peripheral to the infringement claims, such as misrepresentations about how many other persons have purchased licenses to the patents, will not strip a patent holder of immunity (see, e.g., *Innovatio* 2013, 922; *Activision TV* 2014, 13). Moreover, it is very difficult to prove that infringement allegations were objectively baseless. The issue of infringement often turns on the judge's interpretation of the patent's claims. Those decisions are notoriously unpredictable (Burk and Lemley 2009, 1744–1746), making it hard to say that any given infringement allegation was so unlikely to succeed that it was objectively baseless. Also, an accused infringer who seeks to show that a patent is invalid must prove invalidity by clear and convincing evidence (*Microsoft*

2011, 2242). Thus, even if a patent probably does not satisfy validity requirements such as novelty and nonobviousness, a patent holder could still have some probability of success, which is sufficient under Federal Circuit law to immunize the patent holder from liability. An extensive survey of Federal Circuit cases applying its immunity rule confirms that it is extremely rare for a plaintiff to prevail on a claim challenging patent enforcement conduct (Gugliuzza 2015, 1627 n.299).

In fact, two federal district courts have already relied on the Federal Circuit's immunity doctrine to shelter the bottom-feeders Innovatio and MPHJ (*Innovatio* 2013; *Activision TV* 2014). After Innovatio began its enforcement campaign against users of wireless Internet routers, the manufacturers of the routers (Cisco, Motorola, and Netgear) sued Innovatio, asserting a claim under the federal RICO statute and several claims under California state law. The complaint alleged that Innovatio had made numerous false statements in its letters, including statements that it had "successfully licensed thousands of business locations under the . . . patents" and that "the validity of many claims of the . . . patents ha[d] been confirmed by both the Federal Circuit and the United States Patent Office, via both judicial and re-examination proceedings" (*Innovatio* 2013, 920–921). On Innovatio's motion to dismiss, the court accepted the plaintiffs' allegations as true but still dismissed the complaint. Although the plaintiffs alleged that Innovatio had lied in its demand letters, the court reasoned that Innovatio was immune from civil liability because the plaintiffs did not plead that Innovatio's infringement claims were objectively baseless, as the Federal Circuit requires.

Likewise, a federal district court in Nebraska enjoined that state's attorney general from pursuing a state-law case against MPHJ because the attorney general did not allege that MPHJ's theories of validity and infringement were objectively baseless.

The attorney general argued that MPHJ made “false and misleading representations” in its demand letters, such as statements that many businesses had already purchased a license and that it intended to sue recipients who did not purchase a license. But the court held that to strip MPHJ of immunity, the attorney general had to allege that MPHJ’s theories of validity and infringement were objectively baseless, which the attorney general had not done.

In short, it is not hyperbole to say that, under the Federal Circuit’s immunity doctrine, patent holders have a “legal right to lie” in their demand letters (Seidenberg 2014). It is these (legally protected) lies that motivate increased interest by both state governments and the federal government in curbing certain patent enforcement tactics.

6.3.2 Rethinking the Federal Circuit’s Immunity Doctrine

Although it is difficult for a plaintiff to prove that an allegation of patent infringement was objectively baseless, it is not a foregone conclusion that patent holders’ claims of immunity will always succeed. To the extent that challenges to patent enforcement conduct proceed in state court, such as the Vermont attorney general’s suit against MPHJ, those courts could develop a narrower immunity rule than the Federal Circuit, for state courts are not bound to follow Federal Circuit law.

Moreover, the Federal Circuit could – and should – reconsider its case law, as there is a strong argument that the court has erred in granting patent holders broad immunity for their enforcement conduct. As noted, the Federal Circuit derived its immunity test from antitrust law’s *Noerr-Pennington* doctrine, which protects defendants from antitrust liability based on their litigation conduct in order to preserve the First Amendment right “to petition the government for a redress of grievances.” But

the Federal Circuit's reliance on *Noerr-Pennington* and the First Amendment's Petition Clause is a mistake. Most fundamentally, letters sent from one private party to another, such as letters threatening patent infringement litigation, are simply not "petition[s]" to "the government" within the meaning of the First Amendment. Moreover, the holding in *Noerr* was "a construction of the Sherman Act" informed by the Act's purpose to regulate "business activity," not political activity or litigation conduct (*Noerr* 1961, 137–138; see also *California Motor Transport* 1972 (extending *Noerr* immunity to litigation conduct)). But this statutory rationale for immunity from antitrust liability is absent in the context of patent enforcement. In contrast to the antitrust laws, the regulation of litigation conduct or misleading assertions of legal rights is a core purpose of laws used to challenge patent enforcement, such as consumer protection laws and the new state patent-assertion statutes.

By looking to history, the Federal Circuit could better balance the goals of protecting patent holders from liability when they make legitimate allegations of infringement and punishing patent holders when they employ unfair or deceptive tactics. At the time the Federal Circuit was created in 1982, the lower federal courts had, for nearly a century, been addressing the precise question of when a patent holder could be held liable for its enforcement conduct. Those courts enjoined patent holders from making infringement assertions "in bad faith" (see, e.g., *Emack* 1888) – precisely the behavior many of the new state statutes condemn. But the Federal Circuit has largely ignored that long line of decisions, instead demanding that anyone challenging patent enforcement conduct prove that the infringement allegations were objectively baseless (Gugliuzza 2015, 1624–27).

Historically, the courts treated bad faith as a flexible standard with both subjective and objective components (Bicks 1977, 303–304). Under this equity-based immunity standard – as opposed to the rigid “objective baselessness” test mandated by the Federal Circuit – the government could impose reasonable restrictions on patent enforcement, enjoining enforcement campaigns when, for instance, the patent holder conducted no investigation into the alleged acts of infringement (e.g., *Besser Manufacturing* 1951), failed to follow its threats with actual lawsuits (e.g., *Adriance, Platt* 1903), or falsely claimed that a patent’s validity had previously been confirmed in court or in reexamination (e.g., *A.B. Farquhar Co.* 1900). At the same time, cases in which courts enjoined enforcement conduct under the bad faith standard were usually egregious and often involved claims that were objectively weak on the merits (e.g., *Emack* 1888). Accordingly, a bad faith immunity standard, as opposed to the Federal Circuit’s “objective baselessness” rule, would protect patent holders’ ability to provide legitimate notice of their patent rights while also offering the government some leeway to punish unfair or deceptive behavior.

If the cases brought against Innovatio by the router manufacturers and against MPHJ by the Nebraska attorney general had been decided under a bad faith standard, the courts could have held the patent holders’ enforcement tactics to be unlawful. In both cases, the claims challenging those tactics failed because they did not allege that the infringement allegations were objectively baseless. Under a more flexible bad faith standard, however, the courts likely could have condemned the patent holders’ enforcement activities. For instance, it is extremely unlikely that Innovatio and MPHJ investigated the alleged acts of infringement, given that they sent out thousands of demand letters at one time. Moreover, Innovatio made allegedly false statements that its

patents' validity had been upheld in court and in reexamination, and MPHJ never sued the targets of its enforcement campaign. Historically, this is the type of enforcement conduct that courts held to be in bad faith. Thus, a change of course by the Federal Circuit could make a real difference to private plaintiffs and government officials who seek to challenge unfair or deceptive patent enforcement campaigns.

6.4 Regulating Patent Assertions: A Look into the Future

Although the Federal Circuit's immunity doctrine is a significant obstacle to meaningfully regulating patent assertions, it is quite possible that the court will reconsider that doctrine, particularly if it confronts a case involving a mass enforcement campaign by a bottom-feeder troll. Regardless of what the Federal Circuit does, from a legislative perspective, a model of state-federal cooperation is the ideal way to regulate patent assertions.

6.4.1 Federal Circuit Reconsideration of Its Immunity Doctrine

If, as the Federal Circuit claims, the First Amendment mandates broad immunity for patent holders, it might appear as if there is little that governments – state or federal – can do to regulate patent assertions. It is not, however, a forgone conclusion that the Federal Circuit will stick to its “objective baselessness” test. Congress's interest in patent demand letters could encourage the Federal Circuit to revise its immunity doctrine. The Federal Circuit keeps close watch when Congress considers amending patent law and has on numerous occasions altered its case law to align with proposed

legislation (Anderson 2014, 966–969; Gugliuzza 2013, 1827–1828). For instance, in the mid-to-late 2000s, Congress considered several bills to restrict plaintiffs’ choice of venue in patent cases. While those bills were pending, the Federal Circuit – for the first time ever – ordered a district court to transfer a patent case to a more convenient venue (*TS Tech* 2008). After that initial decision, the Federal Circuit issued several more opinions ordering transfer (see Gugliuzza 2012, 346). To date, the patent venue statute remains unchanged, and subsequent proposals to revise venue law in patent cases have made little progress (see, e.g., Venue Equity and Non-Uniformity Elimination (VENUE) Act 2016; *TC Heartland* 2016).

Likewise, during roughly the same time period, Congress was considering proposals to limit damages in patent cases. While those proposals were pending, the Federal Circuit issued several decisions increasing its scrutiny of damage awards. For instance, the court conducted a close review of the facts supporting a jury’s royalty calculation, overturning a nearly \$358 million award against Microsoft as unsupported by the evidence (*Lucent* 2009). The court also rejected the much-maligned “25 percent rule of thumb” as a starting point for the hypothetical negotiation used to calculate a reasonable royalty (*Uniloc* 2011).

Moreover, the Supreme Court has, in two cases in past three years, overturned Federal Circuit case law that, like the court’s immunity doctrine for patent assertions, extended *Noerr’s* objective/subjective test beyond its original antitrust context. In *Octane Fitness, LLC v. ICON Health & Fitness, Inc.* (2014), the Supreme Court abrogated Federal Circuit case law holding that (with some exceptions) a court could award attorneys’ fees against a losing defendant in a patent case only if the prevailing party proved, by clear and convincing evidence, both that the litigation was objectively

baseless and that it was pursued in subjective bad faith (*id.* p. 1754). Instead, the Supreme Court adopted a flexible standard that considers both the “substantive strength of the party’s litigating position” and the “manner in which the case was litigated” (*id.* p. 1756).

Similarly, in *Halo Electronics, Inc. v. Pulse Electronics, Inc.* (2016), the Supreme Court overturned Federal Circuit case law holding that, to recover enhanced damages for patent infringement, the patent holder had to prove, by clear and convincing evidence, both that the infringer acted despite an objectively high likelihood of infringement and that the accused infringer knew or should have known of the risk of infringement (*id.* p. 1928). The Supreme Court again replaced this objective/subjective test with a flexible standard, holding that courts should exercise their discretion to award enhanced damages as a “punitive” sanction for “egregious” infringement behavior (*id.* p. 1932).

In short, the fact that Congress is considering legislation to regulate patent demand letters, coupled with Supreme Court’s repeated rejection of the Federal Circuit’s expansion of *Noerr*’s objective/subjective test, could (and should) spur the Federal Circuit to reconsider its immunity doctrine.

6.4.2 State-Federal Cooperation

Separate and apart from the question of whether the Federal Circuit should relax its immunity doctrine is the question of whether patent assertions should be regulated by state governments or the federal government. Drawing on a pragmatic, functional conception of cooperative federalism (see generally Hills 1998), it seems that *both* state governments and federal governments should play a role in this area.

Congress could, if it chose to do so, expressly preempt state laws governing patent assertions pursuant to the Supremacy Clause. A single, federal statute on patent enforcement would have the benefit of providing a uniform legal standard to govern all patent enforcement activities undertaken anywhere in the country. A uniform standard would, in theory, allow patent holders to better predict whether their actions are lawful or not.

But the benefits of legal uniformity should not be overstated. Several scholars have questioned whether uniformity is a sufficiently important policy goal in the patent system that it should outweigh the benefits of interjurisdictional dialogue and experimentation (see, e.g., Gugliuzza 2014, 48–51; Nard and Duffy 2007, 1623; Ouellette 2015, 74). Indeed, state-by-state regulation in the realm of patent enforcement may have significant deterrence value. Rather than defending against one investigation brought by the Federal Trade Commission, a patent holder might be forced to defend against multiple lawsuits in multiple states, brought by both private plaintiffs and state attorneys general.

State law enforcement agencies also provide substantial enforcement resources. Dozens of states' attorneys general offices, joining together, could monitor and punish deceptive patent enforcement behavior better than the federal government. State governments are also more accessible than the federal government to the small businesses, nonprofits, and local governments most likely to be targeted by bottom feeders. Vermont's pathmarking statute, for instance, was the product of a grassroots effort. Businesses and non-profits in the state that had received spurious demand letters approached their state legislators and attorney general and, together, they drafted Vermont's statute (Gugliuzza 2015, 1590–1591).

An approach to regulating patent assertions that emphasizes the comparative advantages of state governments and the federal government would be optimal. One clear strength of federal regulation – which has not been widely discussed by policymakers or in the academic literature – is that it could provide certainty about which courts can hear cases involving unfair or deceptive patent assertions. The federal district courts have exclusive subject matter jurisdiction over cases “arising under” patent law, meaning that state courts cannot hear those cases. But difficult questions occur when a plaintiff asserts a state-law claim that implicates federal patent law (Gugliuzza 2014, 30–35), such as the Vermont attorney general’s consumer protection lawsuit against MPHJ. MPHJ was able to delay that suit for nearly a year by arguing that the state had improperly filed the case in state court (*MPHJ* 2014). Congress could enact a federal statute governing patent assertions that – without question – placed claims under the statute within the federal courts’ exclusive subject matter jurisdiction.

A federal statute governing patent assertions could also reduce uncertainty on matters of personal jurisdiction. The courts of a particular state may exercise jurisdiction over a defendant only if the defendant has “certain minimum contacts” with that state “such that the maintenance of the suit does not offend traditional notions of fair play and substantial justice” (*International Shoe* 1945, 316). Under the Federal Rules of Civil Procedure, the personal jurisdiction of a federal court is typically the same as the jurisdiction of the courts of the state in which the federal court sits (Federal Rule of Civil Procedure 4(k)(1)(A)). The Federal Circuit has held that a patent holder who merely sends cease-and-desist letters into a state does not subject itself to personal jurisdiction in that state (*Red Wing Shoe* 1998, 1361; see generally La Belle 2010). This rule enables litigants such as MPHJ to argue that the act of sending demand letters into

Vermont is not sufficient to allow a court sitting in Vermont – state or federal – to exercise personal jurisdiction over it. Under that reading of the Federal Circuit’s case law, any litigant who wishes to challenge MPHJ’s demand letter practices must travel to the company’s state of incorporation (Delaware) or principal place of business (likely Texas).

Congress, however, has the power to authorize the federal courts to exercise personal jurisdiction on a nationwide basis (see Federal Rule of Civil Procedure 4(k)(1)(C)). Thus, a federal statute on unfair or deceptive patent assertions could ensure that a patent holder who blankets the country with letters can be sued in any federal district court in the United States. To take a slightly more tailored approach, Congress could, alternatively, create personal jurisdiction in any district into which a patent holder sent demand letters.

Given the respective strengths of state governments and the federal government, the regulatory regime in the proposed federal TROL Act is a reasonable starting point. The Act condemns various types of misleading or deceptive communications made in connection with the enforcement of a federal patent. It also preempts state statutes regulating patent enforcement and instead allows state attorneys general to enforce the federal statute. The regime imagined by the TROL Act thus capitalizes on the federal government’s ability to provide substantive uniformity as well as the states’ enforcement capabilities and responsiveness to the citizens, businesses, and organizations most likely to receive unfair or deceptive patent demand letters.

The TROL Act, however, could be improved in at least two ways. First, the Act goes into too much detail defining prohibited behavior, listing at least seventeen different acts that are illegal under the statute. Because patent enforcement tactics

constantly evolve, Congress would do better to simply outlaw “bad faith” acts in patent enforcement and let the courts and the FTC apply that standard on a case-by-case basis. Although one might insist that Congress needs to make clear precisely what conduct is illegal, the long line of pre-Federal Circuit case law discussed above provides ample guidance about whether enforcement conduct is in good faith or bad faith. A complicated statutory definition of prohibited acts risks obscuring the basic, equitable purpose of imposing limits on patent enforcement activities (cf. Posner 2013, 86–87 (critiquing complex, multifactor legal tests because they obscure the purpose of the relevant law)).

Second, the TROL Act as currently drafted does not provide the jurisdictional clarity that Congress is well-situated to create. The Act would preempt only state statutes that specifically regulate patent enforcement; it would not preempt state consumer protection laws, state laws relating to acts of fraud or deception, or state tort law. Private plaintiffs and state law enforcement officials would continue to rely on those bodies of state law to challenge acts of patent enforcement. As discussed, patent holders can plausibly argue that state-law claims challenging the enforcement of a federal patent fall within the federal courts’ exclusive subject matter jurisdiction. This is particularly true if the patent holder answers the complaint with a counterclaim seeking a declaratory judgment that the relevant state law is unconstitutional under the Federal Circuit immunity case law discussed above (see *Biotechnology Industry Organization* 2007, 1368 (holding that a claim seeking a declaratory judgment that a state law is preempted by federal patent law is subject to the federal courts’ exclusive jurisdiction); see also 28 U.S.C. § 1338(a) (extending the federal courts’ exclusive jurisdiction to cases in which patent-law issues appear only in a counterclaim)). Alternatively, if the patent

holder is sued in federal court, it can emphasize a recent Supreme Court decision suggesting that most state-law claims that involve embedded issues of patent validity or infringement (such as an analysis under one of the new state statutes of whether infringement allegations in a demand letter were meritorious) do *not* fall within the federal courts' exclusive subject matter jurisdiction (*Gunn* 2013).

One way to make clear that civil cases challenging patent enforcement must be filed in federal court would be to preempt *all* relevant state laws regulating patent enforcement, not just the new state statutes (which is the approach of the TROL Act), and to specify that claims under the federal statute *must* be filed in federal court. But, by expressly preempting all state laws regulating patent enforcement, Congress would eliminate the ability of private parties to bring civil actions challenging enforcement conduct, for the TROL Act, as currently drafted, allows enforcement only by the FTC and by state attorneys general.

Yet private enforcement can be an important complement to proceedings brought by government officials. Not only are private parties more directly affected by and better aware of unfair or deceptive assertions of infringement, the possibility of a counterclaim can provide important leverage to a small organization or business in fighting back against a bottom feeder, as illustrated by a recent suit commenced by the non-profit Electronic Frontier Foundation (EFF) on behalf of a business targeted by Shipping & Transit LLC (formerly known as ArrivalStar), a notorious NPE (see Electronic Frontier Foundation 2016). That suit seeks not only a declaration that Shipping & Transit's patents are invalid and not infringed, it also seeks actual and punitive damages under Maryland's new statute governing demand letters. That suit challenging the validity of several patents that have been asserted against hundreds of

individuals and organizations may not have been filed but for the additional incentives provided by the private civil claim available under Maryland law. Thus, if the TROL Act were amended to preempt all state laws governing patent assertions, it should also be amended to permit private parties to pursue claims under the statute in federal court.

In addition to providing no clarity on matters of subject matter jurisdiction, the TROL Act is also silent on the issue of personal jurisdiction. Consequently, cases under the statute could be filed only in federal courts in states in which the patent holder is subject to personal jurisdiction. Because the act of sending a demand letter into a state is, by itself, insufficient to create personal jurisdiction, the number of venues for suits against patent holders who violate the statute is potentially quite small. EFF, for example, was forced to file its recent suit in Florida – the patent holder’s home state – even though the case involved demand letters sent to a small business in Maryland and claims under Maryland law (see *id.*). Congress could, by statute, sensibly expand the federal courts’ personal jurisdiction in cases involving demand letters to allow a recipient to file suit in the state into which the patent holder sent the letter.

6.5 Conclusion

Under the Federal Circuit’s current case law, no government body – state or federal; legislative, administrative, or judicial – will be able to meaningfully police unfair or deceptive patent enforcement. As this chapter has shown, however, the broad immunity the Federal Circuit has conferred on patent holders provides too much leeway for manipulation and harmful tactics. Returning to the equitable, good faith immunity standard would respect a patent holder’s right to make legitimate allegations of infringement while not shielding the extortionate schemes recently deployed by

bottom-feeder trolls. Under a good faith standard, both the states and the federal government could play a useful role in regulating patent assertions. An ideal regime would allow states (and private parties) to capitalize on their superior enforcement capabilities, with the federal government providing a uniform substantive standard and clarifying the vexing jurisdictional matters that arise in legal challenges to patent enforcement conduct.

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