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PATENT REFORM: PROTECTING AMERICAN INNOVATORS AND JOB CREATORS FROM ABUSIVE PATENT LITIGATION

HEARING

BEFORE THE

SUBCOMMITTEE ON
COURTS, INTELLECTUAL PROPERTY,
AND THE INTERNET

OF THE

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HOUSE OF REPRESENTATIVES

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PATENT REFORM: PROTECTING AMERICAN INNOVATORS AND JOB CREATORS FROM ABUSIVE PATENT LITIGATION

WEDNESDAY, MARCH 25, 2015

HOUSE OF REPRESENTATIVES

SUBCOMMITTEE ON COURTS, INTELLECTUAL PROPERTY, AND THE INTERNET

COMMITTEE ON THE JUDICIARY

Washington, DC.

The Subcommittee met, pursuant to call, at 10:04 a.m., in room 2141, Rayburn Office Building, the Honorable Darrell E. Issa (Chairman of the Subcommittee) presiding.

Present: Representatives Issa, Goodlatte, Smith, Jordan, Poe, Marino, Farenthold, Collins, DeSantis, Nadler, Conyers, Lofgren, Johnson, Chu, Deutch, DelBene, Jeffries, and Peters.

Staff present: (Majority) Vishal Amin, Senior Counsel; Eric Bagwell, Clerk; and (Minority) Jason Everett, Counsel.

Mr. ISSA. Good morning. The Subcommittee on Courts, Intellectual Property, and the Internet will come to order. Without objection, the Chair is authorized to declare recesses of the Subcommittee at any time.

As a point of interest, at exactly 11:00, the Subcommittee will recess for a Joint Session of Congress. I ask the audience to be aware that this is a rule of the house and not negotiable for us. Many Members will leave prior to that in order to get seated prior to the start.

Today we welcome everyone to a hearing on "Patent Reform: Protecting American Innovators and Job Creators From Abusive Patent Litigation." In 2011, the America Invents Act became the most substantial reform in U.S. patent law since 1836. The AIA reestablished the U.S. patent system on a global standard. I was proud to be part of that effort, and I am proud to be here today to continue our work to uphold the comprehensiveness and competitiveness of the American patent system.

Our work, however, is not finished. I am convinced that Congress must do its part to stop patent litigation abuse from occurring. We stand ready to work with any and all stakeholders that are interested in helping us improve the patent system. Last Congress, the Innovation Act passed this Committee by a 33 to 5 margin, and went on to pass out of the House on a bipartisan basis with 325

votes. Today I am confident that H.R. 9, the "Innovation Act," will become the law and build on the work of the AIA to protect the American patent system. But before it does that, we want to take one more round of opportunity to hear from stakeholders both publicly and privately to see if, in fact, in every way possible we have addressed the maximum benefit with minimum disruption of existing systems that are working.

As anyone who has worked in patent litigation either as a plaintiff or a defendant or has prosecuted patents themselves, they know that for every patent troll, there is an independent inventor who is inventing, but looks exactly like a troll. Our challenge in this legislation is to make sure that we change the behavior of trolls without overly changing the behavior of those whose business models and real innovation are working to help America today.

Today we will learn more about the cost to our economy by those who engage in patent trolling here in America. This is the land of opportunity. It is the land of innovation. I have said often innovation is done by inventors everywhere, and sadly it is done by lawyers in our court system. It has become too easy for individuals seeking to exploit loopholes in the patent system, bullying inventors and small businesses with frivolous lawsuits that amount to litigation extortion.

Our work here is designed to address fundamental flaws in the patent system, flaws that affect the system as a whole, flaws that, quite frankly, devalue existing patents and hurt innovators. Those who are trying to make it seem like we have written a clumsy bill for the most part have had their say and offered no solutions. It is important that if you come before this Committee, either here or in private sessions, that, in fact, you come with real plausible language. You can come to Republicans. You can come to Democrats. As a matter of fact, you can come to almost every person on the dais here today, and they want to hear your suggestions of how to make this better.

My charge as the Subcommittee Chairman is, in fact, to work with my Ranking Member to make sure that we exceed the 325 votes we had last year on the floor. I believe we can do that by carefully making minor changes and putting in report language that, in fact, will help define this bill in a way that overcomes some of the areas of concern. I look forward to doing that while, in fact, closing loopholes in our litigation system.

The provisions of the Innovation Act will inject transparency, fairness, and effectiveness into the system. That is our goal. We want to work with good actors to make that happen. And I clearly am pleased to have a panel today that have real firsthand expertise. And with that, I recognize the Ranking Member for his opening statement. Three hundred and twenty-six or bust I am told. Thank you.

Mr. NADLER. Thank you, Mr. Chairman. Today we will continue our discussion of how to address abusive patent litigation. I continue to believe that we must pass legislation that will address the scourge of patent trolls which continue to burden businesses across the country. Abusive patent litigation has become a problem not only for large corporations, but for small and mid-sized companies as well.

Legitimate patent litigation is necessary, but too often litigation or the threat of litigation is used as a tool to extort settlements from defendants. Unfortunately, small and medium-sized businesses are especially burdened by these abuses.

Many of the witnesses here today will explain that responding to demand letters and abusive litigation practices decreases the amount of time and resources they can spend on research and development. Most small and mid-sized businesses cannot afford in-house counsel and cannot afford to keep a high-priced attorney on retainer. They need to focus their limited resources on creating what is hopefully the next great innovative. That is what makes them so susceptible to vague, but threatening, demand letters and frivolous, but costly, litigation that prey on their fear of litigation and ignorance of the legal system.

Abuses of the patent system can undermine confidence in the entire system. I am a co-sponsor of H.R. 9, the "Innovation Act," because it is my hope that it will reduce and discourage abusive litigation. The key word is "abusive." I respect that the vast majority of patent cases involve arguably valid claims, but we want to reduce the effects of harmful actions by bad actors. If there are situations where the patent system is being abused, we should do everything we can to correct that situation and make it better for all participants in the patent system.

The Nation's economy depends on effective and enforceable patent rights. The amount of abusive litigation has continued to increase over the years and has now trickled down to small and mid-sized businesses. As we examine ways to address the problem, we must ensure that we limit unintended consequences and provide protection for the enforcement of patent claims brought in good faith.

I have heard from many stakeholders and businesses who have given firsthand accounts of the burdens of abusive patent litigation. I look forward to hearing from today's witnesses about how patent trolls have harmed their businesses and stifled innovation. For example, I would like to hear how small businesses respond to demand letters and bogus lawsuits that are filed against them. What kind of pressure do they feel to settle rather than to fight the demands of patent trolls? I would also like to hear how small businesses will benefit from the proposed changes in the Innovation Act.

I remain a vocal advocate for a strong patent system, and do not want a system that can be exploited by abusive tactics. As we will hear today, the patent troll problem is real and is having real consequences. Once we acknowledge that the problem is real, we must address it. We must find ways to discourage bad actors from filing case after case and gaining settlement after settlement.

This hearing will provide some of the answers to the questions I hear about why we need legislation to deal with patent trolls. Patent trolls often take many businesses by surprise because usually they have had no communications with the plaintiffs prior to being served with the complaint. Surely we can all agree that the system as currently structured needs to be fixed. I look forward to working with colleagues on both sides of the aisle to continue to improve the legislation to ensure that it is fair to all parties and

gets at the root problem of abusive patent litigation. And I hope the statements, stories, and explanations we will hear today will further our efforts to deal with abusive patent litigation.

I thank the Chairman for holding this hearing. I look forward to hearing from the witnesses. And I yield back the balance of my time.

Mr. ISSA. I thank the gentleman. The Chair now recognizes the Chairman of the full Committee, Mr. Goodlatte, for his opening statement.

Mr. GOODLATTE. Well, thank you, Mr. Chairman. Addressing abusive patent litigation, particularly the reforms set out in the Innovation Act, are critical to our Nation's future economic competitiveness. At today's hearing we will learn more about the toll that abusive patent litigation has taken on our economy. And I would like to put my statement into the record and use my time to play a short video showing the stories of folks that have faced this form of litigation abuse.

[Video shown.]

Mr. GOODLATTE. Mr. Chairman, thank you very much. I apologize for the volume, and we will also make it available on our website.

[The prepared statement of Mr. Goodlatte follows:]

Statement of Judiciary Committee Chairman Bob Goodlatte

Hearing on Patent Reform: Protecting American Innovators and Job Creators from Abusive Patent Litigation

10 a.m. Wednesday, March 25, 2015

NOTE: *Chairman Goodlatte's opening statement also included a video on how abusive patent litigation affects American businesses. View it here.*

Chairman Goodlatte: Addressing abusive patent litigation, particularly the reforms set out in the Innovation Act, are critical to our Nation's future economic competitiveness. Last month I along with a large bipartisan group of Members re-introduced the Innovation Act. This bill was the product of multiple discussion drafts and hearings, passing the House, last Congress, with more votes than the landmark America Invents Act of 2011 (AIA).

Today we will hear from witnesses who have faced the abuses of our patent system. Abusive patent litigation is a drag on our economy. Everyone from independent inventors, to start-ups, to mid and large sized businesses face this constant threat. The tens of billions of dollars spent on settlements and litigation expenses associated with abusive patent suits represent truly wasted capital – wasted capital that could have been used to create new jobs, fund R&D, and create new innovations and technologies that "promote the progress of science and useful arts."

Within the past couple years we have seen an exponential increase in the use of weak or poorly-granted patents to send out purposely evasive blanket demand letters or file numerous patent infringement lawsuits against American businesses with the hopes of securing a quick payday.

Many of these abusive practices are focused not just on larger companies but against small and medium-sized businesses as well. These suits target a settlement just under what it would cost for litigation, knowing that these businesses will want to avoid costly litigation and probably pay up.

Such abusive patent suits claim ownership over basic ideas, such as sending a photocopy to email, aggregating news articles, offering free Wi-Fi in a businesses' shops, or using a "shopping cart" on their websites – something is terribly wrong here. The patent system was never intended to be a playground for litigation extortion and frivolous claims.

The Innovation Act puts forward reasonable policies that allow for more transparency and brings fundamental fairness into the patent system and the courts. The bill contains needed reforms to address the issues that businesses of all sizes and industries face from patent troll-type behavior, while keeping in mind several key principles, including targeting abusive behavior rather than specific entities, preserving valid patent enforcement tools, preserving patent property rights, promoting invention by independents and small businesses, and strengthening the overall patent system.

First, we are targeting abusive patent litigation behavior and not specific entities or attempting to eliminate valid patent litigation. When we use the term "patent troll" it is more of an adjective describing behavior than a

noun. Our goal is to prevent individuals from taking advantage of gaps in the system to engage in litigation extortion.

Second, our bill does not diminish or devalue patent rights. The patent system is integral to U.S. competitiveness and we must ensure that any legislative measure does not weaken the overall patent system or violate our international treaty obligations and that it comports with the Constitution.

Third, this bill strikes the right balance – pushing for robust legal reform measures while protecting property rights, promoting invention by independents and small businesses, and strengthening the overall patent system.

Furthermore, supporters of this bill understand that if America's inventors are forced to waste time with frivolous litigation, they won't have time for innovation.

And that's what innovation is really about, isn't it? If you're able to create something, invent something new and unique, then you should be allowed to sell your product, grow your business, hire more workers and live the American dream.

We can no longer allow our economy and job creators to be held hostage to legal maneuvers and the judicial lottery.

Congress, the Federal Courts and the PTO must take the necessary steps to ensure that the patent system lives up to its Constitutional underpinnings.

This bill holds true to the Constitution, our Founders and our promise to future generations that America will continue to lead the world as a fountain for discovery, innovation and economic growth.

We must also remind ourselves that reforming our patent system is not a right or left issue. It is an economic issue, one that is bipartisan, one that will be bicameral and one that will be signed into law.

As we take these steps toward eliminating the abuses of our patent system, discouraging frivolous patent litigation and keeping U.S. patent laws up to date – we will help fuel the engine of American innovation and creativity, creating new jobs and growing our economy.

I look forward to hearing from our witnesses today.

Mr. ISSA. Thank you, Mr. Chairman. It was a powerful message. And with that, we go to the gentleman from Michigan, Mr. Conyers, for his opening statement.

Mr. CONYERS. Thank you, sir. I do not have a video, so I apologize to everybody in advance. If you heard——

Mr. ISSA. We can replay it.

Mr. CONYERS. No, do not replay it. [Laughter.]

Thank you very much. A transcript might be better. One of the important issues that I think should be considered is legislative ways to stop abusive patent litigation because it affects small businesses, and startups, and innovators more profoundly than anybody else. And they rely, these small businesses, on patents. They rely on patents for strong intellectual property protections, and we must not weaken those rights.

Our innovators, whether they create in their garage or basements or as a group in an incubation hub, recognize their patents and their ability to protect them through enforcement in the courts is critical in determining whether their businesses will succeed or fail. Indeed, some angel investors and venture capitalists require ideas to be patented before investment. And they may well be dissuaded from investing if there is a risk that a court will not uphold the validity of those patents or, at a minimum, that there will be substantial litigation costs entailed. And this means that fledgling entrepreneurs will never get off the ground and become a flourishing business employing many Americans, sometimes even thousands of Americans, such as Overstock, which is one of our witnesses today.

Overly broad legislation could engender more, rather than less, litigation and weaken patent enforcement protections, thus discouraging investments in innovation. Instead, I think we should take a cautious approach and not push solutions such as H.R. 9, the so-called Innovation Act, that may end up doing more harm than good to our startup ecosystem. And one way to stop abusive patent litigations is to address the problem of the use of demand letters, so I want the witnesses, and I hope they will discuss how we can curb this demand letter problem as I see it.

Patent litigation opportunists exploit the patent process and the patent litigation system. In particular, they attack patents of weak quality in order to obtain quick settlements, or to bleed the alleged infringers. Individual inventors and small businesses have to decide whether to risk incurring potentially overwhelming litigation costs or enter into a settlement which could make them liable to attack by other abusive patent litigants.

So I look forward to our testimony from the witnesses, and yield back the balance of my time. Thank you.

Mr. ISSA. I thank the gentleman for his kind opening statement. We now have a distinguished panel before us. The witnesses' written statements will be entered in the record in their entirety, and so you may summarize within 5 minutes anything you would like to say. Before you, you have a set of red, yellow, and green lights. This is an early innovation. We all know that green means go, yellow means go faster, and I will not get into what red means.

I would ask, though, that you stay within your 5 minutes as close as possible. I would also further announce that after we recess, we

will reconvene promptly at 12 and take Members that are back as soon as they are at least two Members on the dais.

Pursuant to the Committee rules, I would ask now that all four of you please rise to take the oath. Please raise your right hands.

Do you swear or affirm that the testimony that you are about to give will be the truth, the whole truth, and nothing but the truth?

[A chorus of ayes.]

Mr. ISSA. Please be seated. Let the record reflect that all witnesses answered in the affirmative.

It is now my pleasure to introduce our witnesses. Ms. Kathryn Underwood is president and CEO of Ledyard—thank you. Different opening statement. Okay.

In the correct order, Mr. Mark Griffin is general counsel at Overstock.com. Ms. Kathryn Underwood is president and CEO of Ledyard National Bank. Mr. Todd Moore is founder and CEO of TMSoft LLC, an app manufacturer. And my constituent from Solana Beach, Mr. Bryan Pate, the CEO of ElliptiGO, Inc. And you will see here, I am sure as we go through here, Mr. Pate's very innovative sort of bicycle product, when seen is very memorable. And I would like to thank him for coming from California today so that we would have a panel that included some hometown favorites.

So with that, I will go down the aisle. Mr. Griffin, please.

TESTIMONY OF MARK GRIFFIN, GENERAL COUNSEL, OVERSTOCK.COM, INC.

Mr. GRIFFIN. Thank you, Chairman Goodlatte, and Ranking Member Conyers, and Chairman Issa, and Ranking Member Nadler, and Members of the Judiciary Committee. Thank you for the opportunity to testify today on behalf of Overstock.com and United For Patent Reform about patent litigation abuses.

Dr. Patrick Byrne, the founder of Overstock, recognized that the internet presented some unique opportunities for liquidating excess inventory, and in 1999 founded and launched Overstock.com for that purpose. And at launch we provided excess inventory to retail consumers at significant savings. Since then, since 1999, we have grown from just a handful of employees and suppliers and $1.8 million in revenue to today. We now have 1,500 employees, and over $1.5 billion in revenues, and 3,200 suppliers. The Overstock story exemplifies what is best in the American innovative spirit.

We are a strong respecter of intellectual property. Let me be clear. We own patents ourselves, and we spend much of our annual budget in licensing intellectual property from inventors. Innovation and intellectual property are at the center of our business.

We know innovation, and we also know what abuse is of innovation. It is patent trolls extorting money from productive and profitable businesses by suing on weak patent claims. Patent litigation defense is brutally expensive. The patent trolls know that these excessive defense costs will lead many of their victims to settle rather than fight. Despite the high cost of defense, however, at Overstock.com, we believe that feeding abusive trolls only attracts more trolls, so we follow a spend and defend strategy. We would rather pay real dollars and high defense costs than pay a single dime to a patent troll.

Overstock has been sued 32 times for patent infringement, and we have spent approximately $11 million in our defense. Management and development teams have also spent countless hours supporting our litigation teams instead of spending time at their days jobs in creating innovation and more jobs. In our history, we have settled a few abusive cases, but in doing so we have been instructed that our fight strategy seems to be the better of the two strategies.

While expensive, our fight strategy is a good investment. Coming to understand our history and policy, patent trolls have begun to realize that they need to simply dismiss their cases when they discover that we will fight instead of settle. They simply walk away. Last year when two of these trolls, Execwear and Eclipse, walked away from us empty handed and a bit bruised, our CEO, Patrick Byrne, said "In abusive lawsuits, we spend our legal budget in defense, not on unjust settlements."

But many other retailers and others cannot afford to spend tens of millions of dollars to scare off trolls off their bridges. Moreover, a well-functioning patent system should not impose this kind of tax on innocent operating companies. Congress must intervene to restore balance. Overstock is proud to be a member of United for Patent Reform, which is a broad coalition of diverse American businesses which are pursuing comprehensive solutions to abusive patent litigation. They are businesses across many industries—realty, construction, auto manufacturers, Main Street, and Wall Street alike. We would all rather provide jobs and invest in innovation.

Multifaceted reforms like the following will help us cure economic asymmetries that make patent trolls' extortionate approach profitable. First, it is critical to raise the pleading standards. Patent trolls should say what they are suing over. Many defendants do not know until they have spent hundreds of thousands of dollars to find out. Second, where possible, it is imperative that claims of infringement proceed first against the patent owner and a manufacturer before claims are allowed to proceed between the patent owner and the manufacturer's customers. Trolls often pick on users of products rather than the manufacturers understanding that they will not put up a vigorous defense, and they lack defense information to put up a vigorous defense.

Third, trolls exploit the discovery process to drive up defense costs to force settlements. Requiring patentees to explain and judges to decide what a patent means at a markman hearing before much discovery gets underway would certainly drive early resolutions and avoid unnecessary costs. Fourth, making patent trolls responsible for the costs of their discovery requests that go beyond core documents will stop unreasonable discovery demands made solely for negotiation leverage.

And finally, we need better cost shifting options. Defendants' fees to battle trolls in court range from $1 to $6 million. Trolls do not face such cost risks. They often use contingency lawyers, and they often are set up to be precisely judgment proof. Where a suit is not reasonably justified, the defendant should be able to seek and be able to secure reasonable reimbursement of its reasonable defense costs. Legitimate patent holders should not fear this standard.

One solution will not solve the problem. We need a multifaceted solution. Overstock appreciates the opportunity to come and testify, and I welcome your questions.

[The prepared statement of Mr. Griffin follows:]

Statement for the Hearing
"Patent Reform: Protecting American Innovators and Job Creators from Abusive Patent Litigation"

Before the House of Representatives
Judiciary Committee

Mr. Mark Griffin
General Counsel
Overstock.com, Inc.

March 25, 2015

Chairman Goodlatte, Ranking Member Conyers, and Members of the Judiciary Committee, I am Mark Griffin, General Counsel of Overstock.com, Inc. Thank you for the opportunity to testify before you today on behalf of Overstock, and United for Patent Reform, about protecting American innovators and job creators from abusive patent litigation.

About Our Company

As the twentieth century drew to a close, online shopping was just beginning to emerge. In early 1999, Dr. Patrick Byrne, the founder of Overstock.com, recognized that the Internet presented the ideal platform for liquidating excess inventory. Until the advent of online retail, smaller businesses had no efficient "close-out" merchandising process, and customers looking for bargains had to traipse to brick-and-mortar outlet centers with limited selections. And so, in October of 1999 in Salt Lake City, Utah, with no outside funding and with real innovative vision, Dr. Byrne launched Overstock.com, the premier online business, providing excess inventory to retail consumers at significant savings.

Our website gives customers a simple and convenient way to shop for quality products at the best prices, 24 hours a day -- with a broad selection of more than a million products on the site. We have grown from a handful of employees and suppliers in 1999 to roughly 1,500 employees and over 3,200 suppliers today. We not only deal in discounted, closeout merchandise, but also value-priced brand products of all shapes and sizes, including, furniture, home decor, housewares, bedding and bath, consumer electronics, apparel, jewelry, sporting goods, books, DVDs, and video games. We built our brand on first-rate customer service, and it's paid off: Since 1999 we have grown in revenue from $1.8 million, to $1.3 billion last year. The Overstock.com story exemplifies what is best in the American Innovative Spirit.

About United for Patent Reform

United for Patent Reform is a broad coalition of diverse American businesses who are pursuing comprehensive solutions to abusive patent litigation. Instead of creating new jobs and investing in new technologies, businesses, large and small, across many industries from national realty, construction, auto manufacturers and technology businesses to Main Street retail shops, hotels, grocers, convenience stores, and restaurants, are diverting precious resources to settle with or fight patent trolls.

Our Experience With Patent Assertion Entities

At Overstock.com, we know tech innovation. Dr. Byrne frequently observes that when we started, "We were a lemonade stand, stapled to a small computer; and now we are the opposite: a big computer stapled to a lemonade stand." We thrive on useful, proper innovation. We have to innovate to survive. We are a strong respecter of intellectual property. We own patents ourselves, and we license technologies we need from inventors; we spend a

fair amount of our budget each year buying and licensing intellectual property necessary to our operations. Technology and intellectual property are at the center of our business.

But we also know what abuse of innovation is: It is patent trolls trying to extort money from productive and profitable businesses by suing on weak, vague patents, and banking on the notion that so many of their litigation victims will settle rather than defend themselves, because patent litigation defense is brutally expensive. Overstock.com is not one of those victims. We firmly believe that feeding abusive trolls only attracts more trolls. We follow a "spend and defend" strategy -- we would rather pay real dollars in high defense costs than give a dime to abusive patent trolls.

Since 2004 we have been sued 32 times for patent infringement, and we have spent approximately $11 million to defend these actions. Our lawyers are among the most effective in the business, but they are also efficient and economical; I have no doubt that similarly-situated companies elsewhere pay much higher legal defense fees. And so you can see why so many of them do not want to pay high defense costs; in the short run, it is cheaper and less risky to pay the troll to go away. But the trolls never actually go away. We have in our history settled a handful of cases for small values, though our experience in those cases only reinforced our belief that litigating every unjust assertion of patent infringement is the better strategy.

While expensive, our fighting strategy has proved to be a good investment. Three of our cases were dismissed by the courts during pre-trial motion practice. We won a large case in 2011, invalidating the troll's principle patent. As a result of our approach and the fighting reputation we have earned, with increasing frequency, patent trolls simply dismiss their cases against us when they discover that we intend to fight, rather than settle. In the last three years, for example, 12 trolls have dismissed their cases against us—simply walked away with no settlement payment of any kind. When they want us <u>not</u> to publicize the dismissals, we often refuse. We want everyone to know that trolls leave empty-handed, without a dime of the money that we would rather spend building our business. As Patrick Byrne said last year, when two of those trolls, Execware and Eclipse, walked away from us empty-handed and a bit bruised: "In abusive lawsuits, we spend our legal budget in defense, not on unjust settlements."

While it is rewarding to see this approach pay dividends for us, many other retailers and others who receive frivolous patent demands cannot afford to spend tens of millions of dollars to scare trolls off the bridge. Moreover, a well-functioning patent system should not impose this kind of tax on innocent operating companies. Congressional action establishing national litigation standards applicable in all federal courts can help to reduce the burden of abusive patent litigation and deter abusive practices, so that each company does not need to individually bear the great expense of standing up against trolls on its own.

Legislative Reform

We have heard about a number of possible reforms to the litigation system that would make it less attractive to trolls. Multi-faceted reform would help cure the economic asymmetries that make their extortionate approach profitable against the many companies that lack the resources and the will to stand up to trolls.

First, we believe it is crucial to raise the pleading standards in patent litigation, to make trolls explain their infringement claims in more detail when they file a complaint. Currently, courts do not require that a patent holder explain how a patent is infringed, or even identify the product involved, which makes it nearly impossible for someone who has been sued to evaluate the case and decide how to respond. Adding to the difficulties of a legitimate company facing such a vague lawsuit, trolls can then demand vast amounts of discovery, which is burdensome and very expensive for the defendant. The trolls then have more leverage to extort a settlement, and companies will often settle a case just to avoid those discovery costs -- without ever really knowing whether the suit had any merit at all. Genuine notice pleading, as we have in other areas of the law, will allow defendants to determine what exactly is alleged to infringe and make an informed decision as to how to best proceed with the case, and it will remove one unfair advantage from the trolls' arsenal.

Second, in patent litigation, we need a pecking-order priority between those who merely use an alleged infringing product and those manufacturers or suppliers from whom the user purchases. Patent trolls often prefer to file suits against end-user customers for a technology these customers purchased, but did not manufacture. It is imperative that that claims of infringement proceed first between a patent owner and a manufacturer, before claims are allowed to proceed between the patent owner and the manufacturer's customers. Under current law, anyone can be sued for infringement for using a product, system or method. We don't want to change that. Instead, it simply makes sense for cases against end-users to be stayed in favor of cases involving the manufacturer. Trolls often pick on users of products rather than manufacturers because users are easier targets—the users, not being the original producer, often lack access to the information to form a proper defense. They may not even know that they are using a patented product, and they likely have less familiarity with the patent litigation system than a manufacturer of patented products does. And trolls not only target users, they often target users that are small businesses, who lack not only the information and experience to take on a patent infringement suit, but the legal staff and financial resources. Besides, as long as trolls can sue users and avoid the manufacturers, they stand to garner many unjust settlements without any real risk of having weak infringement claims vigorously contested.

Third, we need a better discovery process. Patent trolls exploit the discovery process to drive up costs, making settlement the less costly option for a troll target. They make extraordinarily broad claims about a patent's scope, and then make correspondingly extensive claims for very

far-reaching discovery. Not only do they put the defendant company to extraordinary costs, but they risk nothing in return, for they make no products and document nothing but their litigation. Legislation should make patent litigation more efficient so that weak cases can be dismissed before too much expensive discovery. For example, requiring patentees to explain, and judges to decide, what a patent means—at the *Markman* hearing—before the majority of discovery would drive early resolutions and avoid unnecessary costs. Indeed, trolls will sometimes drop cases at the *Markman* stage, if their broad and spurious claims are rejected by the judge, and even if they are not, a claim construction before massive discovery will still narrow the issues and focus the case, which promotes quicker and more effective resolutions, often by summary judgment.

Fourth, we need reasonable cost constraints in discovery. For example, trolls should pay for the broad discovery they request, beyond core documents, so that they cannot unjustly ramp defense costs to force settlement. Since trolls don't actually make or create anything, they have few documents to produce. Consequently, most case discovery is one-sided and there is no troll incentive to be reasonable in discovery requests. But only a very few of the thousands of documents routinely produced in troll litigation are ever actually relevant to the dispute, and in today's world of e-discovery and massive record-keeping this all translates to an enormous bludgeon in a troll's hands. Making trolls responsible for the costs of their discovery requests that go beyond the documents needed to decide most patent issues, will stop unreasonable demands made solely for negotiation leverage. And all these decisions could -- and should -- remain squarely within the district court's discretion in managing a case, to ensure that legitimate discovery requests by any party are accommodated.

Lastly, we need better cost-shifting options for judges. Trolls currently have few barriers to litigation with no significant costs. Defendants, on the other hand, face astronomical fees to battle a troll in court: $6 million in legal fees for a large company, and $1 million for a small one, are the cost of doing business in this arena. But trolls face no such risks, and are often set up precisely to be judgment-proof. A stronger fee-shifting statute, and a mechanism to ensure court-ordered fee shifting is enforceable, will strongly deter nuisance suits without any chilling of legitimate suits. Patent law currently allows for fee shifting, and the *Octane Fitness* decision is a helpful step forward in defining "exceptional" cases. It is important, however, that Congress speaks to fee shifting in statute, and give judges better options to deter the rising tide of frivolous troll litigation. Where a suit is truly frivolous, the defendant should be able to seek reimbursement of its reasonable defense costs; no legitimate patent holders need fear such a standard, while the mechanism will surely deter the types of cases trolls routinely file.

An Escalating Problem

Opponents of patent reform claim patent infringement filings are going down, but evidence shows that a record number of patent cases have been filed in recent years. In 2013, that number reached a record high, having increased by 25%.[1] On April 23, 2014, more new patent lawsuits were filed on a single day than on any other day in at least the last 14 years.[2] And so far in 2015, patent lawsuit filing has surged. There were 36% more patent cases filed in January of this year than January of last year[3], and 499 patent litigation cases were filed in February, marking the third straight month-on-month increase in patent lawsuit filing.[4] And to be clear, the alarming majority of these cases are not filed by innovators or owners of patents that they are enforcing in the marketplace; they are filed by trolls, seeking to extract value not by productive use or licensing of patents, but by litigation. Last year, non-practicing entities accounted for 63% of all the patent cases filed.[5] In January of this year, more troll cases were filed than in all of 2004. This is an abuse of the system, and it is escalating. The time is now for meaningful patent reform.

Conclusion

Overstock appreciates Congress' efforts to come to a bipartisan resolution that curbs abuse of the patent system. Considering the significant litigation expenses that Overstock has paid fighting abusive patent litigation, Overstock supports your efforts to help return the rewards of innovation and effort to those who are actually bringing jobs to American workers, and goods to American consumers. The only people who benefit from frivolous patent litigation are the trolls and their lawyers, and that benefit is not enumerated among the original aims of our patent system.

Again, I am honored to have the opportunity today to present our company's experiences which bear on the important questions before you. As you deliberate and discuss the means to fairly adjust the machinery of patent litigation, please remember our voice and the voice of other U.S. retailers. Thank you.

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[1] Price Waterhouse Coopers, "2014 Patent Litigation Study," July 2014, http://www.pwc.com/us/en/forensic-services/publications/2014-patent-litigation-study.jhtml
[2] Ryan Davis, "Draft Patent Troll Bill Spurs Huge Spike in New Suits," Law360, May 2, 2014, http://www.law360.com/articles/533893/draft-patent-troll-bill-spurs-huge-spike-in-new-suits
[3] Lex Machina blog, February 5, 2015 , "Patent case trends and the business of litigation"
[4] Michael Loney, "US Patent Litigation Surges in February, Driven by Software Cases," Managing Intellectual Property, March 10, 2015, http://www.managingip.com/Article/3434536/US-patent-litigation-surges-in-February-driven-by-software-cases.html
[5] RPX Blog on 2014 data, January 9, 2015, "New and Smaller Targets"

Mr. ISSA. Thank you.
Ms. Underwood?

TESTIMONY OF KATHRYN G. UNDERWOOD, PRESIDENT AND CEO, LEDYARD NATIONAL BANK, NORWICH, VT

Ms. UNDERWOOD. Chairman Issa, Ranking Member Nadler, and Members of the Subcommittee, my name is Kathy Underwood, and I am president and CEO of Ledyard National Bank in Norwich, Vermont. And I testify today on behalf of ICBA and the more than 6,000 community banks they represent, and I welcome the opportunity to share my bank's experience with an abusive patent troll and to discuss legislative solutions to the problem.

Ledyard is a $400 million asset community bank with seven branches in New Hampshire and Vermont and just over 100 employees. We are primarily a small business lender, though we are active in mortgage and consumer lending also. We are an integral part of our economic life in the communities we serve.

In 2011, we received a letter from a patent troll's lawyer informing us that he filed a complaint against us in the District Court of Vermont. The complaint, which was 2 inches thick, asserted that our nine ATMs were infringing on his client's patent. However, the troll was willing to settle the litigation on "exceptionally favorable terms" if we responded within 2 weeks. This is a fairly typical demand letter. Similar letters have targeted hundreds and perhaps thousands of community banks.

On its face, the claim was absurd. The patent covered a process of connecting an ATM to the internet. Ledyard's ATMs being older models connect to the bank via closed circuit telephone. Infringement was impossible. We informed the troll of this fact through our lawyer, but he was not interested. His sole interest was enticing a costly settlement from Ledyard and other community banks.

Our lawyers advised us that defending ourselves in patent litigation could be very costly, in excess of a million dollars. We ultimately chose to settle for a significantly smaller amount. Settling was a painful decision that violated my basic sense of fairness. On the other hand, I had to consider the best interests of my shareholders, employees, customers, and the communities that we serve, and I felt it was my duty to view it as a simple economic decision.

Litigation is risky and uncertain, and the costs in terms of dollars and staff time can run much higher than estimated. The settlement demand was a known cost. The risk could be monetized and quickly put behind, allowing us to get back to serving our customers. Sadly, this is exactly the calculation that the patent troll counted on us making. Vaguely-worded demand letters wreak havoc on small businesses where every dollar counts. And to put it plainly, patent trolls practice a legal form of extortion.

Apart from the hard-dollar cost of litigation and settlement, the drain on our management's time, the opportunity costs are also significant. Unchecked, demand letters will deter banks like mine from using new technologies at all. The technologies that support customer access and keep us competitive with other banks—ATMs, online and mobile banking, remote check deposit just to name a few—have become common targets for demand letters. Community

banks have to decide whether they are worth the risk, and if not, our customers lose.

ICBA recommends that this Committee prioritize three solutions that will provide relief for community banks. First, demand letters. Demand letters often lack specific information about the patent, such as the owner and what exactly has been infringed. This Committee can ensure that demand letters contain greater detail. Enhanced transparency will help curb frivolous and abusive lawsuits. ICBA supports legislation that will provide that if a demand letter does not contain clear, detailed, and accurate information about the patent, any civil action brought later would be dismissed.

Second, the covered business model, or CBM Program, should be made permanent. It has proven to be a successful, low-cost alternative to litigation of covered business method patents. In fact, there are several CBM proceedings currently underway that could benefit banks and credit unions of all sizes. The director of the PTO should have discretionary authority to waive the filing fee for the CBM Program, and this would ensure that institutions of all sizes have access to the program to invalidate dubious business method patents.

Third, end users of technologies, such as community banks, should not be on the hook for the infringement claims of trolls. In our case, the vendor assured us that their contracts protected them from an infringement suit against us. Because the vendor develops the product and is best positioned to refute the infringement claims, Congress should ensure that vendors provide appropriate warranties and indemnification to protect the end users.

Thank you, and I look forward to your questions.

[The prepared statement of Ms. Underwood follows:]

Testimony of

Kathryn G. Underwood

President and CEO of Ledyard Bank

Norwich, VT

On behalf of the

Independent Community Bankers of America

Before the

United States House of Representatives

Committee on the Judiciary

Subcommittee on Courts, Intellectual Property, and the Internet

Hearing on

"Patent Reform: Protecting American Innovators and Job Creators from Abusive Patent Litigation"

March 25, 2015

Washington, D.C.

Chairman Issa, Ranking Member Nadler, and members of the Subcommittee, my name is Kathryn G. Underwood and I am President and CEO of Ledyard National Bank in Norwich, Vermont. I testify today on behalf of the Independent Community Bankers of America and the 6,400 community banks they represent, particularly the hundreds and perhaps thousands of community banks that have received deceptive and abusive demand letters from patent trolls. Thank you for convening this hearing on: "Patent Reform: Protecting American Innovators and Job Creators from Abusive Patent Litigation." I welcome the opportunity to share my bank's experience with an abusive patent troll and to discuss legislative solutions to this problem.

Ledyard is a $434 million asset community bank with seven branches in New Hampshire and Vermont and just over 100 employees. We are primarily a small business lender though we are also active in mortgage and consumer lending. Ledyard is integral to the economic life of the communities we serve.

In September 2011, we received a letter from a patent troll's lawyer informing us that he had filed a complaint against us in the District Court for Vermont. The complaint, which was two inches thick, asserted that our nine ATMs were infringing on his client's patent. However, the troll was willing to settle prior to litigation on "exceptionally favorable terms," if we responded within two weeks. This is a fairly typical "demand letter."

On its face, the claim was absurd. The patent covers the process of connecting an ATM to the Internet. Ledyard's ATMs, being older models, connect to the bank via closed telephone circuits. Infringement was impossible. Though we informed the troll of this fact, through our lawyer, it was of no interest to him. His sole interest was enticing a costly settlement from Ledyard and other community banks.

Identical demand letters were sent to four other New Hampshire banks that day. One settled immediately to avoid the hassle and expense of litigation. Pooling our resources, the remaining four of us jointly assessed the claim, spending hundreds of hours of senior staff time in research and consultations. We contacted the company that provided our ATMs. Wouldn't it make sense for the ATM provider to bear the cost of settlement or litigation? Were they not best positioned to defend against the assertion of infringement? Ledyard is no more than the end-user of the ATM; we didn't develop the technology. Unfortunately, that company assured us that their contracts protected them from an infringement suit against the end-user which limited our options.

Our lawyers advised us that the cost of defending ourselves in patent litigation could be very costly, even if we teamed up with the other banks to reduce costs. Legal bills well in excess of $100,000 could be expected if the case went to trial. Even if we won, that cost could not be recovered unless we could establish the claim was frivolous. The cost to settle was significantly smaller than that. We eventually did settle, but I am not at liberty to disclose the settlement amount. It was a painful decision that no legitimate business person should ever have to face. It violated my basic sense of fairness. On the other hand, I had to consider the best interests of my shareholders, employees, customers, and the communities we serve. I felt it was my duty to view it as a simple economic decision. At the time, we had only an estimate of the cost of litigation; it could have run much higher. Litigation is fraught with risk and uncertainty, even when a case, like ours, seems to be air tight. In addition, litigation would have been months-long or even years-long distraction to me and my management team. The settlement demand, on the other hand, was a known cost; the risk could be monetized and quickly put behind us, allowing us to get back to serving the lending needs of our customers.

Sadly, this is exactly the calculation that the patent troll counted on us making. It's the patent troll business model, and it is especially effective when it is targeted at a small business with limited resources. Community banks are filled with staff dedicated to serving customers and managing risk. 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 afraid of getting sued. Community bank CEOs like me are only too eager to avoid the risk and uncertainty of litigation. Patent trolls practice a legal form of extortion.

In a way, Ledyard is fortunate because this same troll later demanded significantly higher settlement fees from community banks like ours. Undoubtedly, they sought to maximize their returns by seeking the exact price point at which a community bank would choose settlement over litigation. Many community banks chose settlement. Although it violates one's basic sense of right and wrong, paying up makes economic sense for a community bank of my size. Other community banks chose litigation and, I am pleased to say, have been successful. I am unaware of a single instance where this troll has prevailed when it actually went to court. However, despite the court losses, the troll continued to send demand letters to community banks and credit unions, seeking to wring as many settlement dollars as possible from unwitting victims.

The business model of a patent troll stands in stark contrast to the business model of a community bank. We foster long-term relationships with our customers. We are invested, often for generations, in our communities. Our prosperity is linked to their prosperity. A patent troll only profits at the expense of their "customers," who are really victims, and drains valuable resources from the economy. While the troll who targeted us is effectively out of business, the abundance of poor quality patents and opportunistic, unethical trolls, ensure that community banks, credit unions, and other businesses, small and large, will continue to be targeted.

What's the economic impact of the patent troll industry? According to a study by Boston University School of Law, the direct costs associated with patent trolling and often litigation are substantial, totaling an estimated $29 billion in accrued litigation and non-litigation costs in 2011. The study does not capture the significant indirect costs borne by our customers. 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 community banks include some of the things that make financial services most accessible to consumers and keep us competitive with larger banks – ATMs, online and mobile banking, remote check capture, and check processing, just to name a few. Many institutions will decide these technologies – however much they help their customers – aren't worth the risk. If that happens, consumers lose.

Solutions

Properly crafted legislation has the potential to significantly curb patent abuse. A number of solutions have been proposed. ICBA recommends that this committee prioritize two solutions in particular that carry the most value in providing relief for community banks.

Demand Letters

Demand letters often lack specific information about the patent, such as what exactly has been infringed, or even the name of the person or entity that owns the patent. With little to go on and a natural aversion to litigation many community banks and credit unions choose to settle.
This Committee can ensure that demand letters contain greater specificity. Enhanced transparency will help curb abusive lawsuits. ICBA supports legislation that would provide that if a demand letter does

not contain clear and detailed information about the patent, including the owner of the patent and what has allegedly been infringed, any civil action that is later brought by the troll would be dismissed. Exceptions should be made for legitimate patent holders—specifically, where the primary business of the patent holder is research, development, and manufacturing or selling goods or services. Also, a written communication between parties regarding an existing licensing agreement would not be covered and the court would be able to waive the requirements if it determines that it is in the interest of justice. This is a narrowly targeted solution that does not interfere with the right of any patent holder to send a demand letter.

Covered Business Method (CBM) Program

The American Invents Act created the Covered Business Method (CBM) program, a post-grant review proceeding within the Patent and Trademark Office (PTO) to re-examine the validity of questionable business method patents. Unfortunately, without intervening action, the CBM program will expire in 2020 once again leaving certain industries exposed to low quality business method patents. The CBM program should be made permanent as it has proven to be a successful low-cost alternative to litigation of covered business method patents. In fact, there are currently several CBM proceedings underway that could benefit banks and credit unions of all sizes.

Additionally, we support language granting the Director of the PTO discretionary authority to waive the filing fee for the CBM program. This provision would be beneficial for smaller financial institutions and could help deter patent trolls from sending abusive and extortive demand letters. It would ensure that institutions of all sizes have access to the CMB program.

End User Indemnification/Warrantee

Community banks often white-label products that are purchased from vendors to serve their customers. As "end-users" of these products and services, community banks should not be on the hook for the infringement claims of trolls.

Community banks are especially vulnerable to the threat of legal action because they lack the resources and market power to fairly negotiate the protections they need when contracting with large sophisticated technology vendors. As was true in my case, the vendors that provide these products and services to community banks often do not stand behind them. As a result, when a community bank is accused of infringement, the vendor, often better situated to refute the claim, sits on the sidelines and refuses to defend their customers. Congress should amend current law to ensure that vendors that sell products or services to community banks provide the appropriate warranties and indemnification to protect the end users from infringement claims.

Conclusion

Thank you again for the opportunity to testify today and share my story, which is sadly typical of thousands of community banks and credit unions. Patent trolls represent a significant and growing threat to free commerce and a drain on our nation's economic resources. ICBA strongly encourages this Committee to take up legislation that includes the recommendations I have described above.

Mr. ISSA. Thank you.
Mr. Moore?

TESTIMONY OF TODD MOORE, FOUNDER AND CEO, TMSOFT LLC.

Mr. MOORE. Good morning. I am Todd Moore. I am a mobile app developer, and my small company is TMSoft. We published the White Noise app that is available for your smartphone and is helping millions of people sleep better at night. It is important to note that I am a named inventor on four patents, but I am here today to tell you my story of being attacked by a patent troll, and speak out about the critical importance of the Innovation Act and how it can help app developers like me and startup innovators nationwide.

I founded my company in 2008 to create smartphone apps. I worked nights and weekends on different ideas while keeping a full-time job to pay the bills. Finally, my White Noise app gained traction and became the number one app on iTunes. It allowed me to quit my job, focus on my startup full time, and hire employees. I was living the entrepreneur's dream, but I never dreamed my biggest danger in my business would be a patent troll.

In 2011, Lodsys sent me a demand letter claiming my app was infringing its patents. Lodsys is a patent monetization firm that does not make any products. The demand letter included White Noise screen shot showing a webpage inside the app with a button that linked to the internet, essentially a hyperlink. I assumed this was a mistake because hyperlinks are common technology. They are the building blocks of the web. Later I discovered numerous other app developers had received similar demand letters. Lodsys wanted us all to pay a licensing fee, or they would sue for patents infringement.

In 2013, Lodsys did sue me and many other app developers. Although the lawsuit was clearly frivolous, I was forced to defend myself. Patent litigation usually costs millions. I did not have that sort of money, and the patent troll knew it. Lodsys was quick to offer me a way out. If I just wired $3,500 to an overseas bank account and agreed not to speak publicly about it, they would dismiss the lawsuit.

Most companies would take that deal, but companies that settle with patent trolls risk catching the attention of other patent trolls to make a quick buck. Thankfully, a non-profit group agreed to defend my company pro bono. Once Lodsys understood we had a free lawyer who would challenge the patent's validity and that we would never pay, it dropped the lawsuit. Trolls are not interested in asserting valid patents and obtaining fair royalties. They are interested in easy settlements and quick paydays that will fund their next set of lawsuits.

Some may testify that weak patents, like the Lodsys patent, would not be approved by the PTO today, but we cannot wait 20 years for thousands of weak patents to expire. Patent quality, however, is not the only issue. Frivolous litigation can be initiated by trolls that unjustly assert infringement when an activity is way outside the scope of the patent. Congress should encourage courts to crack down on this behavior.

The patent troll business is low risk and high reward because patent trolls get free lawyers, and they hide their junk patents in shell companies. They are destroying small businesses while offering society absolutely no benefit. The problem is not with patent licensing, it is with patent abuse.

I have license technology from many companies, and in return we get something useful that improves our own products. That is how legitimate companies use patents to build value. In contrast, with patent trolls you do not get useful technology. You get an agreement that they will not sue you. That is not how our patent system is supposed to work.

Finally, I have heard claims that patent reform legislation will harm small inventors. This is nonsense. I risked my capital to build a business and intent great apps. I support reforms that promote legitimate patents, legitimate licensing, and legitimate enforcement. I am a small innovator, and what harms me is that litigation opportunists are exploiting the patent system. The only way to protect true inventors with real inventions is for Congress to reform the system so it works as intended.

What patent trolls are doing to small businesses like mine is simply wrong. We need common sense reform, like the Innovation Act, that will force patent trolls to think twice about bringing baseless and frivolous lawsuits. The problem is serious, but it is also solvable. Please, shut down the patent troll racket and let small businesses like mine get back to innovating, creating jobs, and building great products that people love.

Thank you.

[The prepared statement of Mr. Moore follows:]

Statement of Todd Moore

Founder & CEO, TMSOFT LLC

Statement for the Hearing "Patent Reform: Protecting American Innovators and Job Creators from Abusive Patent Litigation"

Before the Subcommittee on the Courts, Intellectual Property, and the Internet

March 25, 2015

I am Todd Moore, founder of TMSoft LLC, a Virginia-based developer of mobile apps and games. I'm probably best known for creating the White Noise app for your smartphone which help millions of people sleep better at night. My app has been featured on the Dr. Oz show, Today Show, Fox & Friends and more. Jimmy Fallon even made fun of it on his show with a special, not-so-soothing "Axl Rose" edition.

I am a member of CEA, an association representing over 2,000 of America's most innovative companies. CEA also owns and produces the International Consumer Electronics Show every January in Las Vegas. I am also a board member of the Application Developers Alliance ("Apps Alliance"), a non-profit global membership organization that supports developers as creators, innovators, and entrepreneurs.

Thank you for this opportunity to testify about the importance of the Innovation Act and its critical importance to app developers like me and startup innovators nationwide.

I founded my company in 2008 to create smartphone applications. I worked nights and weekends on different app ideas while keeping a full time job to pay the bills. One of the apps I created, White Noise, started getting a lot of attention in the press and at one point became the #1 app on iTunes. White Noise generated enough revenue so I could quit my job, focus on my startup full-time, and hire employees. I was living the entrepreneurs dream, but I never dreamed the biggest

danger to my business would come from a patent troll.

In 2011 my company received a demand letter from Lodsys claiming my app was infringing on one or more of its patents. Lodsys is a privately held "patent monetizing firm" that does not make or produce any products. I was sued in Marshall, Texas - where I have never been but where patent trolls are a local industry that seems to be enabled and supported by local courts.

The demand letter included a screenshot of White Noise showing a webpage inside the app with a button that opened the iTunes App Store - essentially, a hyperlink. I immediately assumed they had simply made a mistake because hyperlinks are universally common technology - in fact, they are the building blocks of the entire World Wide Web. However, I later found out that numerous other app developers had received similar demand letters. Lodsys wanted us all to pay a licensing fee or they would sue for patent infringement.

Lodsys filed a lawsuit against my company and numerous other app developers in 2013. Although the lawsuit was clearly frivolous, I was forced to defend myself and my company in the court system. I was aware that litigation could cost well into the millions of dollars. I knew I didn't have that sort of money - and the patent troll knew that too.

Lodsys was quick to offer me a way out – all I needed to do was wire $3,500 to an overseas bank account and promise never to speak publicly of the case, and they would dismiss the lawsuit.

Most companies would take that deal without hesitation, but many companies that settle with patent trolls risk catching the attention of other patent trolls looking to make quick profit. Another issue with settling is you won't be able to speak publicly about it because the troll demands a non-disclosure agreement that prevents you and your company from speaking about the terms of the settlement. As someone who likes to speak publicly about technology and the software industry, censorship did not sit well with me.

Through the Apps Alliance, I met Dan Ravicher from the Public Patent Foundation, a nonprofit organization whose mission is to represent the public's interest in the patent system. Dan Ravicher

agreed to defend my company pro bono. Once Lodsys understood that TMSoft would not roll over and pay an easy settlement and that we had a free lawyer who would challenge the patent's validity, it looked for its own escape. Trolls are not interested in asserting valid patents and obtaining fair royalties; they are interested in easy settlements and quick paydays that fund their next set of lawsuits.

Patent trolls have utterly distorted the patent system. Legitimate licensing of patents allows the exchange of valuable technologies for fair prices so that others can use inventions and build great new products and services. Patent trolls, in contrast, destroy value. I was lucky to have a free patent attorney, who estimates that the several hundred hours his team spent on my case would have cost me $190,000 at a typical patent litigation firm. And we had not yet set foot in a courtroom.

It is likely that the Patent and Trademark Office would have not granted the Lodsys patent under today's new rules. But that future-looking solution is not a complete solution, because the Lodsys patent and thousands of low-quality patents were approved by PTO for 20 years under the old rules, and they are ammunition for patent trolls unless Congress acts.

Also notable is that Apple had already licensed the Lodsys patent from Lodsys, and Apple then provided licensed technology to me. Congress must provide end-user protections to users of software (and not only hardware) so that trolls are required to sue the real alleged infringer, not only small companies like mine that generally are easy marks for quick money. In my case the troll would have been forced to sue Apple, Google or Microsoft - and this troll wasn't looking for that kind of fight.

Ignoring patent trolls and hoping they'll go away is not a solution. The patent troll business model is low-risk and high-reward, as trolls get free contingency-fee lawyers and put their junk patent assets in shell companies. They are destroying small businesses while offering society absolutely no benefit.

My small business has licensed technology and media from many companies, and in return we get something useful that improves our

products. That is how legitimate companies use patents to build value and great products. In contrast, with patent trolls, you don't get useful technology that can be used in your product. You get an agreement that they won't sue you. That's not how our patent system is supposed to work.

Finally, I've heard claims that patent reform legislation will harm small inventors. This is nonsense. I risked my capital to build a business and invent great apps. I am not discouraged by reforms that will support legitimate patents, legitimate licensing and legitimate enforcement. I'm a small innovator and what harms me is that the patent system is being exploited by litigation opportunists. The only way to protect true inventors with real patentable inventions is for Congress to reform the system so it works as intended.

What patent trolls are doing to small businesses like mine is simply wrong. We need common sense reforms like the Innovation Act that will force patent trolls to think twice about bringing baseless and frivolous lawsuits. Please shut down the patent troll racket and let small businesses like mine get back to innovating, creating jobs, and building great products that people love.

Mr. ISSA. Thank you.
Mr. Pate?

TESTIMONY OF BRYAN PATE, CO-FOUNDER AND CEO, ELLIPTIGO, INC.

Mr. PATE. Thank you, Mr. Chairman, Mr. Nadler, and Members of the Subcommittee. It is an honor to be here today to share my views on protecting American innovators with you. I am an American innovator. I have spent the last 10 years of my life in a concerted effort to create and build a new industry here in America.

ElliptiGO introduced the first elliptical bicycle to the world in 2010. A photo of our product is on the screen. We currently employ 15 people in our Solana Beach, California headquarters, and we have additional employees in Virginia, Illinois, and New York. Over the past 5 years, we have sold more than 10,000 ElliptiGO cycles, generated more than $20 million in revenue, and in 2013 we were named the sixth most innovative fitness company in the world by Fast Company magazine.

From the beginning, we knew that while our idea was novel, overseas manufacturers could easily copy it and destroy our market by flooding it with cheap, poor quality knockoffs. Indeed, there are a number of Chinese manufacturers who have already replicated our product and are currently advertising it for sale on Alibaba.com and other websites. Photos of them, their factories, and their listings on the screens. They area a real threat, and it is only a matter of time before these knockoffs will hit our shores. Once that happens, the only viable weapons we will have to stop them from destroying the market are our patents.

As an entrepreneur, I am by definition a risk taker and an optimist. Few things scare me. Since learning of H.R. 9, I have spent a significant amount of time trying to understand how it could impact my business. I am here today because there are parts of the bill that scare me. I believe if the bill passes as written, it will have the unintended consequences of adversely impacting American innovators, while perversely protecting unscrupulous competitors.

It appears that in an attempt to address one form of abusive patent litigation, H.R. 9 will create new ways for infringers to abuse the patent system. I will touch on each of my concerns briefly now in hopes of a fuller discussion with you.

Customer stay. I agree that we should stay litigation against innocent end users of an infringing product. However, H.R. 9's stay provision is much broader than that. In fact, it should be called the "manufacturer, trading company, supplier, seller, and end user stay," because it protects all of these actors equally, innocent or not.

Shockingly, the very factories in China that are making exact replicas of our product today and anyone who profits from importing or selling these blatantly infringing copies of our patent and invention here in the U.S. are considered customers and could be protected. I say "protected" because in practice the stay provision permits the companies who profit from manufacturing and selling infringing products to shield themselves from ever being held accountable. This is the provision I fear the most for my business because it presents an enormous risk to companies like mine. I hope

we get to explore it in more detail today. The bottom line is that if the stay provision was law in 2005, I would not have started ElliptiGO.

Joinder. If the joinder provision was law in 2005, I likely would not have been able to start ElliptiGO. Small technology companies like ElliptiGO not only need founders, they also need investors, employees, and, in our case, a licensor to get off the ground. The joinder provision exposes all these individual to personal liability. That is right, personal liability, if the company they support loses a patent enforcement action and is unable to convince the judge that their position was justified. We could not have guaranteed anyone back in 2005 or in 2015 for that matter that this will not happen.

Even if my co-founder and I were willing to take this risk, I know for certain that we would not have been able to secure our patent license, and it would have been incredibly difficult to find investors and employees willing to get involved. At the time, we were pitching these people, Brent worked out of his garage, and I worked in a storage shed. Our only non-human assets were a pending patent and some prototypes. If the folks we were pitching believed that they could end up losing their house because of a future patent litigation involving our company, there is no way our licensor would have licensed his patents to us, and it is very unlikely we would have found enough investors and employees to launch the company. It is one thing to lose $50,000 in an investment you have made on a small, promising company. It is another thing to lose your house because of that investment.

Finally, the fee shifting provision and the heightened pleading standards add complexity to patent enforcement and raise the stakes of patent litigation, making patent enforcement more expensive and protracted. I believe this change disproportionately impacts small companies, and I hope we get to explore these sections as well.

As written, H.R. 9 introduces several incalculable and entirely new risks to the startup ecosystem. I believe that the few people who are willing to take the risks of investing their money, skills, and ideas into a startup today will choose differently if H.R. 9 becomes law. American innovators cannot succeed without these people, so I strongly urge you to address these issues with H.R. 9 before moving it forward.

Thank you for your consideration of these issues, and I look forward to discussing them further.

[The prepared statement of Mr. Pate follows:]

Statement of Bryan Pate, Co-Founder and CEO, ElliptiGO, Inc.
Subcommittee on the Courts, Intellectual Property, and the Internet
March 25, 2015

Chairman Issa, Ranking Member Nadler, and Members of the Subcommittee, thank you for inviting me to appear today to discuss the importance of American innovation and how we can protect it. My name is Bryan Pate. In my career I have served as an officer in the United States Marine Corps, developed new products for a semiconductor equipment company, clerked for a federal judge and worked with a number of Fortune 500 companies as a consultant for McKinsey & Co. I left McKinsey to start the company I now lead and I have been working tirelessly for the past ten years to create and build a new industry right here in the United States.

ElliptiGO

Like many American inventions, ElliptiGO began in a garage as a solution to a problem. In 2005, a lifetime of contact sports and endurance athletics caught up with me and I lost the ability to run for fitness because of hip and knee injuries. I considered cycling, but my experience in triathlon convinced me that bicycle saddles are uncomfortable and that cycling workouts simply take too much time. I started using the elliptical trainer, but found I hated being caged indoors at the gym. It hit me that what I really wanted was a low-impact running device that I could use on the street. I decided to purchase one, only to find that no such device existed.

Surprised and frustrated by that fact, I began to look into running injuries and the size of the potential market for a product like this. Convinced that an outdoor elliptical bicycle would appeal to a large number of people, I called up my friend Brent Teal, a mechanical engineer and fellow Ironman triathlete, to see if he would be interested in developing this kind of a product. A few weeks later we met in a Solana Beach, California coffee shop and drew some rough sketches of the concept on a newspaper. He liked the concept and agreed to do all of the engineering work for free. I agreed to pay for everything we needed to buy. We shook hands and formed a partnership to create the world's first elliptical bicycle.

Brent was already a named inventor on some patents and I was familiar with intellectual property rights, so our first step was to determine whether the idea was

already patented. While nobody had ever built or sold an elliptical bicycle before, it turned out that Larry Miller, the man who invented the indoor elliptical trainer back in 1994, already held issued patents in the U.S. and Taiwan on the idea of an outdoor elliptical bicycle. Fortunately, we were able to secure a license to Miller's patents, which enabled us to continue pursuing the project and bring an elliptical bicycle to market.

Over the course of the next few years we raised money from a number of investors, hired our first employees, and partnered with a manufacturer. Then, in 2010, ElliptiGO introduced the world to the first elliptical bicycle.[1] Since then we have sold more than ten thousand ElliptiGO cycles and generated more than $20 million in revenue. We now employ fifteen people at our headquarters in Solana Beach, California, with additional employees in Virginia, Illinois, and New York and we are continuing to grow.

As an entrepreneur, I am by definition a risk taker and an optimist. Few things scare me. However, I am here today because broad changes to the patent system proposed by this committee scare me. Since I learned about the provisions contained in H.R. 9, I have spent a considerable amount time trying to understand how they will impact my business. I am afraid that if H.R. 9 is enacted as written it will have the unintended consequence of hurting American innovators and companies like mine, while perversely protecting unscrupulous foreign competitors.

A strong patent system is vitally important to small businesses and entrepreneurs. Intellectual property-intensive industries alone support $8.1 trillion of the U.S. gross domestic product, generate 27 million jobs, and pay employees over thirty percent more than other industries. Entrepreneurial startups alone are responsible for over twenty percent of gross job creation in the United States. Sweeping changes to the patent system will have major repercussions in these industries, and threaten the innovative ideas and job growth they generate I will discuss each of my concerns in detail, but the bottom line is this: If H.R. 9 was the law in 2005 then ElliptiGO would not exist today, and I'm sure that many other small job creating businesses like ours would not be here either.

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[1] A photo of an ElliptiGO bicycle is attached to this testimony as Appendix A.

As you will see below, my objections to the Innovation Act arise from the impact it will have to the entire start-up ecosystem. It is not just the entrepreneur that is needed to start companies and create jobs. He must be supported by a large group of other people, all of whom are acting in their own best interests. Start-ups are extremely risky endeavors and there aren't many investors, workers, partners and inventors willing to get involved with them because of these risks. My fear is that this bill will shift the risk/reward calculus for these groups to the point where it simply won't make sense to support a start-up that relies on patented innovations. Without enough support from every element of this ecosystem, start-ups cannot get off the ground. Because patent-based technology start-ups are a significant engine of growth for our innovation economy, if they go away then it will have serious repercussions for the country.

I believe any efforts to stop abusive patent litigation must take into account the impacts they could have on the start-up ecosystem. I implore you to avoid instituting solutions that end up doing more harm than good. I fear that H.R. 9 as written will have that result.

Stay Provision

The "customer stay" provision of H.R. 9 is one of the most alarming parts of the bill. First, the provision is mislabeled. It should be called the "manufacturer, supplier, seller and end-user stay" because every "party accused of infringing a patent or patents in dispute based on a covered product" is entitled to it equally. This means every foreign manufacturer, every foreign trading company, every domestic manufacturer, and every seller of unauthorized copies of our patented product can stay a litigation that has been filed against them. All they need to do is show that there is a separate litigation underway involving a different party accused of infringing the same patent and that other party "makes or supplies" the infringing product at issue. All of these parties have at least 120 days after the initial pleadings are filed to file their stay motion and the court must grant it if they meet the conditions set forth in the bill, all of which appear to be easy to meet. I believe that the stay begs to be abused by infringers and will have the unintended result of crippling the ability of American businesses to fight manufacturers that copy their patented products and flood U.S. markets with cheap, poor quality knock-offs.

The threat of knock-offs being sold in the U.S. is a serious issue for ElliptiGO. We know of a number of Chinese manufacturers who have replicated our product and are currently advertising it for sale on Alibaba.com and other websites.[2] These knock-offs have not yet made their way to the United States, but it is only a matter of time. When these fake ElliptiGO bikes do make it here, the only defense we will have are our nine issued U.S. patents.

If the stay provision is in effect when these knock-offs hit our shores, then we will be in real trouble. For our product, there could easily be more than a dozen different trading companies sourcing from Chinese factories and feeding that supply into the U.S. through a number of sales channels. As discussed, each of the suppliers in China and the sellers in the U.S. would be entitled to take advantage of the stay provision. Nor is the manufacture of infringing products limited to foreign companies. Companies right here in the United States could easily copy our product as well. So, if the stay is enacted into law, I believe it will expose us to an abuse of the patent system that will prevent us from defending our business against unfair infringement by foreign and domestic actors alike.

Once copies of our patented products hit the market, the sellers will likely ignore our cease and desist letters and force us to undertake the significant time and expense of filing a patent infringement action. In response, a Chinese trading company or U.S. manufacturer will likely file a declaratory judgment action against us, requiring the federal court in our infringement action to stay our case against the seller until the suit against the supplier is resolved. This cycle will likely be repeated multiple times by other parties entitled to a stay, causing an endless delay in our ability to get relief through the courts.

Meanwhile, fake ElliptiGO cycles will continue flooding the market unabated, attracting additional sellers of these products and causing our sales to plummet while our legal expenses continue to mount. Because we cannot compete with cheap knock-offs, at some point we will likely be forced to decide whether to sell our business, cease

[2] Photographs of knock-off ElliptiGO bicycles in unlicensed Chinese factories and examples of unauthorized sales listings on Alibaba.com are attached to this testimony as Appendix B.

operations or continue to pursue even more litigation because it is the only means we have available to stop these illegal sales.

Perversely, the stay provision will likely be used to insulate all of these subsequent sellers as well from any suits we file against them, effectively making patent enforcement through the district courts fruitless. While we could file a complaint with the International Trade Commission (ITC) to block the import of infringing cycles, this action will neither prevent the sale of existing cycles in the U.S., nor will it have any impact on domestic suppliers of knock-off ElliptiGOs. So long as there is a stay of litigation against the sellers of infringing products, and manufacturers continue to pop up and sell to retailers, we would likely never get the injunction necessary to stop the sale of infringing knock-offs. This will not only destroy our business and undermine the viability of this industry, but this will also put the public at risk if these products start to fail in the field.

Since we started this company, no one affiliated with it ever expected that we would be left unable to defend it from competitors selling knock-offs of our product. None of us would have gotten involved if we thought that this would end up being the case. Myself, Brent, Larry, all of our investors and all of our employees chose to invest our time, resources, money and skills into making ElliptiGO successful based on the fundamental assumption that we would be able to use the venerable U.S. patent system to defend our company against competitors making and selling products that infringe on our patents. I believe that the customer stay provision will have the perverse result of facilitating the sale of knock-off products here in the U.S and put American innovators at a severe disadvantage in the marketplace.

This is incredibly unfair and I think it will have devastating effects for these innovative American companies, especially small ones. Even if I am wrong about how the situation above will actually play out, I believe that introducing the potential for such abuse by potent and unscrupulous competitors will have a chilling effect on future founders, investors and employees of patent-based start-ups. In any case, there is one thing that I can say for certain: if the customer stay provision was law in 2005 and I knew about it, I would not have started ElliptiGO.

When I headed down this path ten years ago I knew that any mechanical bicycle-like device would be easy to copy and distribute. There's no way I would have left my

lucrative career path to take on the risk of starting a company if I didn't believe that I could use patents to stop companies from making and selling copies of my product here in the U.S. For the reasons outlined above, the stay provision would have eliminated this belief and ElliptiGO would not exist today.

Fee Shifting and Joinder

The fee shifting provision obligates the losing party in a patent infringement suit to prove that its "position and conduct" was "reasonably justified in law and fact or that special circumstances (such as severe economic hardship to a named inventor) make an award unjust." While on its face this provision sounds balanced, in practice, I believe that it will disproportionately and adversely impact small companies like mine.

Patent litigation is complicated and the difference between winning and losing can hinge on a variety of factors, many of which are unpredictable at the outset. Something that appears novel to one trier of fact could be completely obvious to another. Patent enforcement actions can turn on the meaning of one word in a claim and how it is applied to the item at issue. At the time we elect to enforce our intellectual property, we won't have the luxury of being absolutely certain about the validity of our patents, sure of how the courts will construe some of the terminology, or know that we are definitely going to win the case. One thing we will know is that if we lose our case, it will be devastating for our business. That's because we don't have much cash and we aren't profitable. The litigation will be long, very expensive and if we lose, our industry will become much more competitive. The passage of this provision will increase the already high risk litigation poses for us by making patent enforcement actions more expensive if we lose but not changing the reward calculation much if we win.

If we lose, then we will almost certainly have to pay for a mini-trial to determine whether or not our position was reasonable. The provision puts the burden of proof on us, so it is going to cost us much more to prove our case than it will for our competitor to counter our arguments. Moreover, any patent litigation we file will likely be against a large player who will welcome the opportunity to bleed a small competitor of their cash when they have everything to gain and very little to lose. So, the cost of losing a case will go up under this provision even if we prove our case was reasonable. If we fail to meet the burden of proving reasonableness, then our litigation costs will at least double and

we will almost certainly have to shut down our company. The provision creates a large shift in the risk of losing a patent litigation and will cost us money at the outset just assessing this new risk when contemplating whether or not to file suit.

If we win, then we'll have the option of seeking fees. However, we're likely only going to sue large players where there is an opportunity to win a huge award in damages. So, if we win, we will likely win big. Whether or not we get to collect attorneys' fees if we win won't meaningfully change the outcome of the case for us. So, this provision makes a very slight change in the reward side of the litigation equation.

In sum, for a small company, this provision creates a large increase in the risk of defending ourselves and only a small increase in the rewards of doing so. As a result, it's going to cause small companies like us to be less willing to enforce their patents. That devalues investments in innovation and makes small companies less likely to succeed. This chills the motivation for starting the company in the first place.

The joinder provision layers on top of the fee shifting provision and creates an even worse situation for start-ups. When attorneys' fees are awarded and the loser doesn't have the resources to pay them, H.R. 9 gives the winning party the right to collect from an "interested party." These interested parties will likely include the founders, senior employees, the licensor of the patent at issue, and any investor with the "ability to influence" the litigation. I believe that this provision will have devastating consequences for technology start-ups. If the joinder and fee shifting rules of H.R. 9 were law in 2005, I am certain we would not have been able to start ElliptiGO.

Small technology companies like ours can't get off the ground without participation from several types of stakeholders: founders, investors, employees, and in our case, a licensor. The joinder provisions are both so broad and so vague that I believe they will expose members from each of these groups to *personal liability* for unpaid legal fees in the event the start-up they support loses a patent lawsuit and is unable to convince the judge that its position was justified.

From 2005 through 2010, when ElliptiGO was in its nascent stages, it simply did not have the cash on hand to pay an opposing party's legal fees if we lost an infringement lawsuit. That is not unusual for a start-up. If our licensor, Larry Miller, thought that there was the slightest chance that he would be held personally liable for these fees if we enforced his patent, there is no way he would have licensed it to us. At

the time, we were two guys working out of a garage with no real assets other than a pending patent and a prototype. It would have been too risky to put the potential loss of his house into our hands.

Similarly, many of our early investors helped the company with advice and support. All had the ability to influence something as important as the decision to enforce our patent. If they knew that there was a possibility that they would be on the hook for hundreds of thousands of dollars or even millions of dollars in fees, they would have seriously reconsidered investing in our company. It's one thing to lose $50,000 in an investment. It's another thing to be on the hook personally for over a million dollars in legal fees. That's a huge shift in the risk profile of an already risky investment. There are many safer places to put that money and I doubt we would have landed our initial investors under those conditions.

Finally, one of the first employees we hired had recently earned her MBA from Stanford's Graduate School of Business. She could have worked for any number of great companies. If she knew that one of the many risks of working for ElliptiGO included the potential loss of her house from a failed patent enforcement action, I doubt she would have come onboard.

The bottom line is that without the license from Larry Miller, our initial investor group, or our initial set of employees, ElliptiGO would not have been able to get off the ground. I believe that the joinder provision would have made the already challenging process of finding and convincing these people to support us virtually impossible. The fee shifting and joinder provisions introduce a new, incalculable, and very real risk to each segment of the start-up ecosystem. I fear that if it is made law, then even fewer people will be willing to invest their time, money, skills or ideas into bringing new patentable innovations to market.

Heightened Pleading and Discovery

I will touch briefly on two other provisions of the bill that I think will disproportionately impact small businesses: heightened pleadings and discovery sequencing. H.R. 9 requires patent owners to plead a large amount of specific information in their complaint. This includes, but is not limited to: the specific claims allegedly infringed, an identification of the accused process or product that infringes

each claim, the name or model number of every allegedly infringing product or process, or a detailed description thereof, a statement of where each element of each patent claim is contained within the allegedly infringing product or process, and a detailed statement of the nature of the alleged infringer's business. Collecting this information and then paying attorneys to translate it into a detailed complaint will take much more time and cost much more than filing a complaint does now. In fact, it would make filing a complaint to enforce a patent right significantly more onerous than filing a complaint in *any* other type of lawsuit.

More importantly, these added burdens disproportionately impact small companies because they delay the filing process, make enforcing patents more complicated and expensive, and force these companies to incur higher expenses at the beginning of the lawsuit. Moving the cash burden earlier in the process makes it particularly painful for a small company that might have a meritorious case but needs to raise funds in order to pursue a patent litigation. Larger companies with more cash can better handle this added complexity and acceleration of costs, so the adverse impacts of these changes will be felt more by smaller companies.

Finally, limiting initial discovery to matters necessary for claim construction also puts patent holders at a disadvantage against infringing companies. The infringer is in the best position to provide the information about the details of their products so the patent holder can assess to what extent they infringe. In many cases, the patent owner *requires* discovery to learn the details of the infringer's product and business necessary to enforce the patent. Delaying that part of discovery will likely lengthen the overall litigation and make patent enforcement more expensive, riskier and less effective for a patent holder.

The Totality of the Provisions

As you have seen, I have a series of concerns with this bill. I've presented each one individually and I believe each one has a different level of impact on ElliptiGO and companies like it. However, it is particularly concerning that they could all be introduced simultaneously if H.R. 9 passes. Acting together, these provisions will be worse for patent holders than the sum of each individually. For example, the heightened pleading standard will make the customer stay provision even more devastating because

it will lengthen the time between the introduction of knock-off products and the filing of the first lawsuit and it will cost more up front to file that lawsuit. Fee shifting adds complexity to the decision to file a lawsuit. Combining it with the joinder provision dramatically raises the stakes for nearly everyone involved in the company. Adding a delayed discovery process on top of that means that it could take a patent holder much longer to realize that his case is a loser and expose him to even more costs if the fees ended up being shifted. So it's not only that each provision is concerning in isolation - they compound on each other to make each one even more concerning.

At the end of the day, I fear that introducing these five new and complex constraints to patent enforcement will scare off the people who make patent-protectable innovation happen. Folks like myself who are risk-taking optimistic innovators with the capability and willingness to take on the challenge of starting a company to introduce a new innovation to the world. Folks like our investors who are willing to invest $25,000 - $100,000 into a "flier" and get behind a passionate team. Folks like our employees who made a bet on us because they want to be a part of changing the world. And folks like Larry Miller - the American tinkerers who spend years working in their garages for no pay but end up conceiving of things like the indoor elliptical trainer that not only become multi-billion dollar industries of their own, but inspire other tinkerers like me to improve upon their ideas with innovations like the elliptical bicycle.

All of us in this ecosystem make a conscious choice to drive these innovations forward. To do so we forego other opportunities. We assess the risks, scope the potential rewards, and make our best decision based primarily on those two factors. A strong patent system lowers our risk and increases our potential reward. Provisions that weaken our patents increase our risk and decrease the reward. Once the rewards no longer outweigh the risks, investors will invest elsewhere, employees will work elsewhere, tinkerers will tinker but take it no further, and entrepreneurs will keep their jobs at large companies instead of breaking out on their own. When that happens, the results will be devastating for innovation in this country.

Solutions

As discussed above, I support efforts to curb abusive patent litigation. I believe this is a problem Congress and the courts can address together. The Targeting Rogue

and Opaque Letters Act (TROL Act) pending in the Energy & Commerce Committee would give the Federal Trade Commission and state attorneys general wider latitude to address abusive demand letters as an unfair trade practice. That action alone would help provide relief to thousands of small businesses like mine who may be forced to submit to the unfair and unfounded demands of patent trolls in order to avoid the costs and risks of going to court.

I also support the Supporting Technology and Research for Our Nation's Growth Patents Act (STRONG Patents Act), introduced this month in the Senate by Senators Coons, Durbin, and Hirono. This legislation achieves the goal of addressing abuses of the patent system by curbing demand letters, bringing pleading requirements in line with other federal cases, ensuring the U.S. Patent and Trademark Office (USPTO) has the resources necessary to issue robust patents and ensuring balance in patent post-grant and *inter partes* review procedures at the USPTO.

While addressing the most abusive behaviors in our patent system, I believe that the STRONG Patents Act does *not* pose a threat to small businesses the way H.R. 9 does. If the STRONG Act were law in 2005, I still would have founded ElliptiGO and I would be confident in our ability to defend against foreign knock-offs and unfair competition today. I hope that both of these bills become law.

Conclusion

I appreciate the effort this committee has put forth to address the problem of abusive patent litigation. I hope my testimony will be helpful in developing legislation that will do that without adversely impacting the precious and unique innovation ecosystem we have managed to develop here in America. Please encourage innovators and entrepreneurs to bring new innovations to market by doing what you can to reduce the risks and increase the rewards for innovation. Conversely, please avoid passing legislation that makes it riskier and less rewarding to innovate in this country. Because I believe that the provisions of H.R. 9 will do more harm than good to our economy, I strongly urge you not to pass it.

Thank you for providing me the opportunity to testify before you. I very much look forward to answering your questions.

Mr. ISSA. Thank you. Thank you all. I am going to recognize myself first, and there are a great many items there that do bear some looking at. Mr. Pate, I am going to use some of your examples and play off of it since apparently it is a 3-to-1, three like it, you have not yet come around to liking it. But we are going to get you here. You know, if you want someone's vote, first you have to get them on your bill, so there is a little of that.

Scott, I want you to remember that this is close your district, too. He could have employees in your district.

VOICE. I am sure we do.

Mr. ISSA. Yes, listen hard. Mr. Griffin, the amazing thing about this is the provision that I am most concerned about, and I think, Ms. Underwood, it affects you, is, in fact, the idea that a stay on the customer is somehow preventing Mr. Pate from having effective litigation. Ms. Underwood, in your case if the manufacturer had weighted in your nine ATMs, could you give us a range on what this troll was willing to settle for for your products that were not connected to the internet in a patent that required it be connected to the internet?

Ms. UNDERWOOD. The range of the settlement was in the mid-four figure range to settle for those nine ATMs for which we were not violating the patent.

Mr. ISSA. So for me, mid-four figures is $50 grand?

Ms. UNDERWOOD. No, in the $6 to $7,000.

Mr. ISSA. Oh, one more down.

Ms. UNDERWOOD. Yes.

Mr. ISSA. So basically they wanted a nuisance amount that was probably less than you had already spent just having a conversation with your counsel and getting the advice of a patent attorney.

Ms. UNDERWOOD. Exactly, and that was the decision we had to make at that time.

Mr. ISSA. Okay. And, you know, I was in business a long time, and Mr. Moore made a different decision for certain reasons. But it is not uncommon as long as they offer you a settlement cost that is less than your cost of calling your lawyer, you often end up doing it. Mr. Griffin, your company has chosen not do that, not to make these settlements by and large, but you deal with 3,200 manufacturers.

Mr. GRIFFIN. 3,200 manufacturers who manufacture probably over a million products that we offer, any component of which could be subject to patent infringements.

Mr. ISSA. And if there were a stay, knowing that ultimately if your manufacturer lost, did not defend the case properly, you would find yourself at a greater disadvantage, how would you handle that? Let us just assume that a manufacturer under the law, H.R. 9, if the manufacturer agreed to it and you were stayed, how would that affect your participation in the case and your willingness to just forget about it and let it go to the manufacturer? I just want to make sure we get the practical part of what really happens.

Mr. GRIFFIN. As a practical matter, we are usually willing to run the risk. It depends on the situation, but these stays have happened. Judges do stay cases where a manufacturer has agreed to the indemnification, has come in and defended fully the actions.

And my understanding is that the legislation calls for that type of situation. Where there are two cases going on, why should we litigate both? Let the manufacturer that has the best defenses take it.

Mr. ISSA. Now, one quick follow-up because, Mr. Pate, I want to make sure that he has a fair chance to be involved in this, too. If the legislation required that the manufacturer have at least one additional customer, I mean, in other words, if you are the exclusive customer, you would not get a stay. Would that bother you in your situation if you are literally the only customer, the exclusive customer?

Mr. GRIFFIN. I do not think it would bother us all that much. Some relief is better than none, and we think that it is a good thing to have the manufacturer take the defense.

Mr. ISSA. Well, is it not true, to your understanding, that, in fact, in common law, these stays are already part of the process? The legislation is simply codifying what in the Southern District of California, San Diego, already is the practice?

Mr. GRIFFIN. Yes. Yes.

Mr. ISSA. So to your knowledge, do most places around the country grant these stays anyway, let us just say, with the possible exception of the Eastern District of Texas and Delaware?

Mr. GRIFFIN. With the possible exception of the Eastern District of Texas.

Mr. ISSA. Okay. Mr. Pate, I want to be fair to you, but I do want to mention to you that if you go before Judge Moskowitz in the Southern District, Barry is going to grant that stay in all likelihood because that is common law and it is commonly done in most parts of——

Mr. PATE. That is great, and I am really glad we get to talk about this because there is a huge nuance here that I think is being missed. What everyone here on the panel has talked about is being an end user of a product that was the accused infringing product.

Mr. ISSA. Well, Overstock is a seller and distributor.

Mr. PATE. But actually his testimony, sir, was about being an end user, and all the demand letters have been related to being an end user. For things that he sells, he typically has an indemnification agreement with the manufacturer, and I think that is what he was referring to at the end.

The reality, though, is the end user that is getting these demand letters is very different from the Chinese manufacturer of knockoff goods in my mind. Those are two very different actors. If I buy these glasses and get a demand letter that says whoever made these glasses was infringing on a patent, that is a problem. If I make these glasses as an exact rip-off of Hugo Boss or whoever makes these glasses, and then Hugo Boss tries to sue that manufacturer, the Chinese manufacturer, and then that manufacturer is entitled to a stay of the lawsuit? That is where I think the problem is.

Mr. ISSA. So in a nutshell, you are okay if I am using a Wi-Fi or some other product as an end user being stayed.

Mr. PATE. Yes.

Mr. ISSA. Okay.

Mr. PATE. If you are the mom and pop coffee shop, yes. But what my challenge is, as you saw on the screen, there are factories in China with my product on their walls ready to come to the U.S. They are going to get imported. They are going to get distributed to a seller. The person I want to collect from is really everybody in the chain making profits, but in particular the seller.

Mr. ISSA. Okay. And I have got to go to the Ranking Member, and we are going to have a full discussion on this. Just one quick question. Have you been to the ITC, which is the venue that deals with overseas entities and can give you injunctive relief where, in fact, the courts cannot give you injunctive relief?

Mr. PATE. Well, I believe the courts can give me injunctive relief.

Mr. ISSA. Rarely.

Mr. PATE. That is part of the patent——

Mr. ISSA. Under eBay, you are not likely to get it. You will get reasonable royalties.

Mr. PATE. That is an arguable point, sir. But the reality is an injunction is still a part of the monopoly provision of a patent, and the damages provision is attractive. And there are U.S. potential manufacturers——

Mr. ISSA. My time has expired. I just had one question if you could give me a yes or no.

Mr. PATE. Sure.

Mr. ISSA. Have you explored the International Trade Commission, the ITC?

Mr. PATE. I have looked into it. I have not gone——

Mr. ISSA. Okay. So you have not gone to the only court that effectively deals particularly with overseas companies that are offshore and outside the reach of Article 3 courts.

Mr. PATE. That is correct.

Mr. ISSA. Okay, thank you. Mr. Nadler?

Mr. NADLER. Thank you. Let me start by saying that in this whole area, I find myself in an unusual situation. I normally react rather negative to talk about abusive litigation and abusive lawsuits because I am normally in a situation where I believe that lack of access to Federal courts at variable costs to the little guy is the real problem, that the courts have shut off access, narrowed class actions, et cetera. But here in this field of patent trolls, I think the weight is on the other side, and so I talk about abusive litigation and dealing with it.

But I am concerned about some of what Mr. Pate has said, and I want to continue on this end user business. Now, clearly the end user ought to be protected.

Mr. PATE. Absolutely.

Mr. NADLER. But you are saying that we cannot get at the guy in China, the Chinese manufacturer.

Mr. PATE. I cannot get at anyone in the supply chain.

Mr. NADLER. Why can you not get——

Mr. PATE. They all are entitled to a stay.

Mr. NADLER. You cannot jurisdiction in an Article 3 court against them?

Mr. PATE. No. It is because the way the customer is defined in H.R. 9, it applies to anyone who can be subject to a patent infringement lawsuit.

Mr. NADLER. Could you think of a way that we could define the customer in this bill?

Mr. PATE. Yes, sir.

Mr. NADLER. In this bill in a way that would do what we wanted to do——

Mr. PATE. Yes, sir.

Mr. NADLER [continuing]. And we protect the end user. I mean, the whole point really is if I make a new chip and I invent something in the new chip and I get patent on it, and that chip gets put into a bigger chip, which gets put into a device, which gets put into a different device, which gets put into a car or into a jukebox—jukebox, that shows my age—in the restaurant. [Laughter.]

In the restaurant or in the iPhone, you should not sue the guy at the restaurant.

Mr. PATE. Exactly.

Mr. NADLER. Nor should you sue the guy who put in the car, nor this one, nor that one. You should sue the guy who infringed the patent in the chip. How can we do that without subjecting it to the problems that you are saying?

Mr. PATE. I think the key is to focus on the end user. Who do we think of as a customer? I mean, when we say "customer stay," we think of end user, and everybody here is an end user of a lot of things. And I believe all the demand letters that I have read——

Mr. NADLER. If we said only the end user, what about the guy four steps down the chain who is not infringing on anybody's patent. He is putting an iPhone in the car, you know, let us say. And we are not talking about the guy who buys the car. We are talking about the guy who manufacturers the car. But the guy who infringed the patent was the guy who made the chip that was then put into a device that was put in an iPhone that was put in the car. Should we be able to sue the car manufacturer?

Mr. PATE. I mean, that is a great question. I make bicycles, so my world is a lot simpler than that.

Mr. NADLER. Well, one day you may want to put an iPhone on your bicycle.

Mr. PATE. I may, but it seems to me the fundamental philosophy should be whoever is making a profit off of my invention should not be able to do so without a license from me.

Mr. NADLER. But wait a minute. You are the end user. You are making a profit.

Mr. PATE. No, no, no, the ElliptiGO. So we have 23 patents. We invented this bike.

Mr. NADLER. No, no, but the mom and pop restaurant that has a modern iPhone or radio or whatever in the restaurant is making a profit off that. You do not want him sued?

Mr. PATE. No. So maybe it is the profit on the sale of the item. If it is a mom and pop coffee shop using a Wi-Fi router and selling the router as part of their business——

Mr. NADLER. All right, but let us assume it is the guy who made the router, but he is three steps down from the guy who infringed——

Mr. PATE. Can we not cover that with indemnification? Can we not use the indemnification process to cover that? I mean, I have not thought deeply about it because I make bicycles and it is a dif-

ferent situation. We have Chinese knockoffs that are going to flood the retailers——

Mr. NADLER. Let me ask Mr. Griffin what you would say to the same question.

Mr. GRIFFIN. We are an end user. The same question. I believe—I believe—that it is structured right in this legislation where there is a manufacturer in a lawsuit. We are talking about a separate situation where he cannot reach a manufacturer. That is different. I do not think that is covered by this bill. This is a situation that requires that there be a manufacturer in the lawsuit. In other words, some court has jurisdiction. Why not stay it against the sellers, against the end users, and all down the line? I do not think it goes as far as Mr. Pate believes it does.

Mr. NADLER. Mr. Pate, if we were to put in some sort of an exemption or a carve out here for foreign manufacturers in terms of the stay because the courts do not have jurisdiction over them, do you think we could handle your problem that way?

Mr. PATE. I think the challenge is for all the companies that could be knocked off by U.S.-based companies. The issue in my mind for tangible goods that are going to flow through the supply chain, I need to be able to enforce my patents here in the U.S. against a real company in the U.S. And the challenge when you deal with the Chinese companies is there are a lot of shell companies. So they can file a declaratory judgment action against me on the patent, create a lawsuit, and then the real party in interest actually gets to stay it. And there could be 30 of those companies over in China that qualify under the language of H.R. 9.

Mr. NADLER. Thank you very much. My time has expired, and we have to——

Mr. ISSA. For all Members, it is now 10:59 and 45 seconds.

Mr. NADLER. Fifteen seconds to get to the chamber.

Mr. ISSA. I will gavel in about 15 seconds. So we will return promptly at 12:00, and I commend to all of you whatever you would call a lunch, it will be served right around the corner in the basement. Thank you.

[Recess.]

Mr. ISSA. The Committee will come to order. It is now my pleasure to yield time to the Chairman of the full Committee, Mr. Goodlatte.

Mr. GOODLATTE. Well, thank you, Mr. Chairman. I appreciate the hearing, and I appreciate the witnesses' testimony, and I have a question for all of them. First of all, a yes or no question. Do you believe that an inventive company that has patents, employees, builds a product, and sells it to consumers would be considered a shell company? We will start with you, Mr. Griffin.

Mr. GRIFFIN. No.

Mr. GOODLATTE. Ms. Underwood?

Ms. UNDERWOOD. I would guess not.

Mr. GOODLATTE. Mr. Moore?

Mr. MOORE. No.

Mr. GOODLATTE. Mr. Pate?

Mr. PATE. No.

Mr. GOODLATTE. Okay. The good news for you, Mr. Pate, is that as a result of that, your concerns about the joinder provisions in

this bill should be eased considerably because unless you are a shell company, you are not going to be able to be concerned about that joinder provision.

Mr. PATE. Can I respond to that?

Mr. GOODLATTE. Sure.

Mr. PATE. Great. There are two elements about it. I think the joinder provision is particularly damaging to companies in their very early, early stages. So when we secured our very first license to a patent——

Mr. GOODLATTE. If you have got some parts in the garage that you are going to start assembling, you are not a shell company. If you have got an idea that you are working on yourself, you are not a shell company.

Mr. PATE. Where is this shell company language if I can ask, because I do not recall that.

Mr. GOODLATTE. Well, the Innovation Act's fee shifting——

Mr. PATE. Is it in fee shifting or joinder?

Mr. GOODLATTE. Both. The bill's joinder provisions only apply to a plaintiff who has no substantial interest in the subject matter at issue other than asserting such patent claim in litigation. So if you have anything beyond the interest in asserting a patent claim in litigation, you do not have a concern about the joinder provision.

Mr. PATE. So what happens if my operating entity goes bankrupt, and 2 years later my holding company that has all my intellectual property seeks to enforce the patents?

Mr. GOODLATTE. You are still not a shell corporation because you have an interest in perfecting that product.

Mr. PATE. What is my interest?

Mr. GOODLATTE. Your interest is in being remunerated for the idea that you have advanced and you have perfected.

Mr. PATE. So even though my operating company no longer exists, I would still not fall under the joinder provision?

Mr. GOODLATTE. Well, you would fall under the joinder provision in those circumstances, but not an entity that is ongoing. And if you are simply an entity advancing something like that, then you have got to be able to stand behind your product. And then, bear in mind here is the other important part about this. As long as your claim, and basically what you are talking about is a claim based upon your patent that you obtained and you perfected. That claim is only going to be resulting in attorney's fees being awarded against you if your claim has no reasonable basis in law or in fact.

So this is designed to help protect companies like yours, not harm them. And that is why lots of small businesses, including lots of app developers, lots of internet startup companies and so on, want this protection because the flip side of that is that if that shell company that you are trying to describe for me only acquired something from somewhere somehow and is trying to advance it in ways to garner funds that go way beyond what the validity of the patent is, and may, in fact, be why it is a company in bankruptcy because it does not have anything of significant value. That is a situation in which then you the developer of another that is being sued by an entity like that has the protections here.

Mr. PATE. But I do not think the protections are that valuable to a company like mine, the fee shifting, because if I win a patent case, I am going to win big.

Mr. GOODLATTE. Yes, but you are going to be more likely to win if your opponent knows that they have no reasonable basis in law or fact for the defense that they are asserting against you, and, therefore, they are going to be subject to attorney's fees? And by the way, both joinder and attorney's fees, they exist in current law already, and all this bill does is provide greater certainty.

And when you are talking about investors, and when you are talking about inventions, and you are talking about small businesses, the more certainty you can bring to the table, the better off your business is going to be. You have a much, much better ability to determine what the liabilities are and a much greater ability to assert a valid claim and not have to assert it as aggressively or as expensively because somebody is not going to hang around if they are going to have to pay not only their attorney's fees, but yours as well, because they have no reasonable basis in law or fact for the defense that they are asserting.

Mr. PATE. I agree with that. I think certainty is a fantastic thing, and the more certainty we can get, the better. The challenge here is that patent litigation, in my opinion, by definition is very uncertain. What appears obvious to some people is novel to others.

Mr. GOODLATTE. We do not disagree with you. That is why we are doing this bill, and that is why this bill is called the Innovation Act, to bring greater certainty to patent litigation. That is the purpose of this legislation.

Mr. PATE. But I think the certainty goes, in a way, against a legitimate company like mine——

Mr. GOODLATTE. I do not think so.

Mr. PATE [continuing]. In enforcing for a patent.

Mr. GOODLATTE. I do not think so. For all the reasons I just cited, I think it creates greater certainty.

Mr. PATE. And I think——

Mr. GOODLATTE. My time has expired, so I am going to yield back to the Chairman. But I would be delighted to work with you further on this because we want to create the kind of certainty that you desire.

Mr. PATE. Great.

Mr. GOODLATTE. We think, in fact, that is what this bill does.

Mr. PATE. Great. Thank you, sir.

Mr. ISSA. Lively discussion. I thank both of you. We now go for a lively discussion to the Ranking Member of the full Committee, Mr. Conyers.

Mr. CONYERS. Thank you, Mr. Chairman. I wanted to welcome again and thank the witnesses, our general counsel, Ms. Underwood, Todd Moore, and Mr. Pate. Let me ask you, Mr. Moore, would you have succeeded if H.R. 9, as you understand it, had been the law when you started out?

Mr. MOORE. I think if H.R. 9 was already passed, there is a highly likely chance that my company, my small company, would not have been targeted. I truly believe that my small business, as you know, we do not have the means to fight these litigation battles and these frivolous lawsuits.

Mr. CONYERS. Okay. All right.

Mr. MOORE. So I believe that I would have been able to focus on my business.

Mr. CONYERS. What say you, Mr. Pate?

Mr. PATE. Well, again, I think that the two biggest concerns I would have had back in 2005 when I thought of this elliptical bicycle was I am going to get knocked off, so I have got to be able to defend my market, and number two, I have got to be able to raise money, attract employees. And at the time we figured out there was another inventor who had a patent that already issued, so we had to license it from him.

And my concern with the first issue is at the end of the day, if someone is making profits off of my invention here in the U.S., that is wrong. And I should be entitled to seek relief from them, injunctive and damages. And I think the customer stay provision I believe would prohibit me from doing that, and I do not think in 2005 I would have had the confidence to move forward and take all this risk if I did not think I had a very good chance of being able to defend it here in the U.S.

Mr. CONYERS. Let me ask you about the demand letter. How would that have impacted or even addressed abusive patent litigation in your view?

Mr. PATE. Well, I think the demand letter is a great place to focus just listening to the conversation and reading the testimony. It still seems to be the crux of where these extortion settlements come from, and it seems to be an unfair business practice. It is like false advertising or bait and switch. We just had a back and forth with a dealership we were trying to buy a vehicle from and they pulled a bait and switch on us. And I looked at the code for their State, and there was a bait and switch law about it, and it was an unfair business practice. And it seems like if there are businesses out there using fraudulent tactics to extort money from other businesses, it should be able to be handled by the FTC and the courts through an unfair business regime.

Mr. CONYERS. I agree with you. Now, how would the joinder provision have impacted the creation of your company and other startups? It seems that it might have made somebody less likely to want to invest.

Mr. PATE. That is my second biggest concern and why I do not think we would have been able to get off the ground is because to your point, all we had at the time was a pending patent and a prototype. And so, to convince investors, employees, and a licensor to back us was really, really hard. And if we had to tell them that if they give us money, or if they join our company, or if they give us a license to a patent, and we enforce our patent, which is really the only thing we would have at that point, and we lose, then they could be personally liable, lose their house, I do not think we would have gotten investments. I know we would not have gotten the license to the patent. I do not think I would have taken that risk candidly, and I do not think my wife would have let me take that risk.

Mr. CONYERS. Well, what about the discovery limitations in the bill, H.R. 9? When you limit discovery, you are actually starting a suit without getting all the information that you need. And it

seems to me that that is not the best way to go about going into a courtroom.

Mr. PATE. The way I see it is when I go to enforce our patents, which we are going to do because we are going to get knocked off, the more information I can have about what the products are, who is doing it, how they are going about selling it, how much money they are making, the better from my perspective. I see my role as trying to defend our company, so the more information I can get at the outset, the better off I am.

Mr. CONYERS. Now, is heightened pleading going to help you any? The Supreme Court is likely to sign off on this somewhere between now and the end of the year. What do you think? Will that help or hurt in terms of small business?

Mr. PATE. I think the current level of pleading at the Twombly standard is reasonable for patent filings. The level to which disclosure is required up front in H.R. 9 I think would cause more lawyers' fees and just sort of dotting I's and crossing T's out of the gate, and is not necessary. I feel like I could deliver a complaint that has the salient requirements without having to get quite as specific as within——

Mr. CONYERS. Thank you for your discussion.

Mr. PATE. Thank you.

Mr. CONYERS. Thank you, Mr. Chairman.

Mr. ISSA. Thank you, Mr. Conyers. The gentlelady from California, Ms. Chu, is next.

Ms. CHU. Ms. Underwood, your experience is a familiar story for so many small entities throughout our country. I know of credit unions in Southern California who were targeted because of certain features on their websites, and they have to settle given the high cost of litigation. I understand that your bank had to settle, but you know of other community banks that chose to litigate in court and were successful. Despite these losses in court, why do you think the patent troll that targeted you continued to send out demand letters to other parties?

Ms. UNDERWOOD. We were one of the first small community banks in our market to be targeted, and we had not heard of this trolling because it had not hit our State. And there were only four of us that were targeted initially, and we were all very, very small banks. And when we talked to our attorney and he told us what the cost was going to be, could be, in the millions of dollars, in our mind there was no need to begin the process.

I do know that other banks months later after many banks that had been identified were successful in fighting this. But there were a lot of settlements that were far greater than ours afterwards also.

Ms. CHU. And even though they lost in court, they continued to send demand letters out. Why do you think they do that?

Ms. UNDERWOOD. Because they were becoming successful.

Ms. CHU. Because of those large settlements with the others.

Ms. UNDERWOOD. When you weigh the costs of the attorney's fees versus the settlement, it is, as my kids would call it, a no-brainer in making that risk decision. And I think they recognize that, that banks my size cannot afford to fight. And so, the more that they

were successful, and their settlements did increase as time went on, it was worth continuing.

Ms. CHU. You also hold up the Covered Business Method Program at the Patent and Trademark Office as a low cost alternative to litigation. You state that there are several CBM proceedings that are underway at the PTO that can be helpful to banks and credit unions of all sizes. Could you describe how they would benefit?

Ms. UNDERWOOD. How they are benefitting? Well, I think the fact that they are reviewing the patent outside of the suit process certainly does go to benefit the smaller banks. And the fact that many of these patent reviews are being brought by larger organizations who can afford to pay to get the process going does benefit the community banks. As a matter of fact, there is one very well-known DataTreasury patent process that is currently being reviewed, and the list of banks that are involved run from the very large to the very small. And there are many banks that are members of the ICBA that are involved in that that will benefit from that process at the end of the day.

Ms. CHU. Mr. Griffin, Overstock.com is no stranger to patent infringement suits. You have been sued over 30 times in the last 10 years, and it sounds like your company is developing a reputation in which you are known to fight back. In fact, 12 patent trolls abandoned their cases against you when they realized you would pursue litigation. Can you talk about how this strategy is turning out to be a good investment?

Mr. GRIFFIN. It has turned out to be a good investment because we count on our brand as being a fighter in these cases, such that we become an unappetizing target. A lot has been said about demand letters today. Demand letters in my mind are in a different silo than full-blown litigation with a troll. For example, we do see demand letters, but frequently they are unsuccessful and they are not followed by a suit. Many of the trolls who sue us do not file any kind of a demand letter because they know that we might attempt to gain jurisdiction by a declaratory action in our own jurisdiction rather than a favorable venue for the troll.

So for me, these two issues are separate. Yes, we should have more disclosure in demand letters, but it is not any kind of manageable line to correct the problem with patent litigation abuses that we see today.

Ms. CHU. Thank you. Well, actually could I ask——

Mr. ISSA. The gentlelady, please continue.

Ms. CHU. And you won a large case in 2011 where the patent in question was invalidated. Could you give us some details on that case, and what was the effect of that case?

Mr. GRIFFIN. It is a case that we were litigating in the Eastern District of Texas. The demand was for millions of dollars. We were litigating patents that were dating from 1998. In fact, I remember one of the jurors, who wound up being the foreman, stood up in jury selection process and said, "I cannot imagine any patent from 1998 being applicable to the internet today," and that held to be true. The technology was completely inapplicable to what we were doing, and the jury saw it. We were fortunate in that case.

Ms. CHU. Thank you. I yield back.

Mr. ISSA. I thank the gentlelady. We now go to the gentlelady from Washington, Ms. DelBene.

Ms. DELBENE. Thank you, Mr. Chairman, and thanks to all of you for being here with us today. We appreciate it. One of the most frequent complaints that we hear is that companies are shelling out large amounts of money to lawyers to defend themselves from abusive patent litigation, and that is just to get through discovery. In your testimony, Mr. Pate, you said that discovery limits may put patent holders at a disadvantage against infringing companies, making a patent suit riskier for patent holders. And in many cases, the patent holder requires lengthy discovery to learn the details of the infringer's product and business. The first question, have you ever been a party to patent litigation yourself?

Mr. PATE. No, I am not.

Ms. DELBENE. Okay. So I am going to ask you this maybe a little bit theoretically. But first, could you elaborate on why it is so difficult to put together a more detailed claim? And then second, could you comment on how you would react to another company making extensive demands from you to share specifics about your products in business if you one day find yourself on the receiving end of a patent lawsuit?

Mr. PATE. Those are great questions. On the filing a detailed claim, I think we all agree that Form 18 is too wide open, and that there is no reason patent litigation should not be at the same level of notice pleading as every other Federal litigation where you have to actually state a claim that you can show you deserve relief from. And I think for patent litigation, that should include what the patent is and what products appear to be infringing.

The issue I have with H.R. 9 is I just look at it and think to myself, there are a lot of attorney's fees, and crossing T's and dotting I's, and is there going to be a little side litigation about did we fill the complaint out correctly? I mean, it just seems very enumerated.

And when I see things that are very different enumerated, I think of lawyers, you know, finding ways to show that you screwed up the way the enumerations were done. And I think that is a problem. I do not think the philosophy of bringing patent litigation to the level of where all other Federal litigation is in terms of a complaint is a problem. I just think the specificity can get abused, especially if you are a small company.

And if it takes me 4 months to get my complaint in order because my attorneys are not that good or whatever the case may be, I just see that as unnecessary. It is an unnecessary hurdle for me to have to jump over.

Ms. DELBENE. And, Mr. Moore, could you give me your view as well on both of those, on either side, if you are on either side of litigation?

Mr. MOORE. Yes. So my company, you know, was very small when it got sued. We were three people. So when that happens, you are faced to make some difficult decisions, and you reach out to a lot of people in the community, other CEOs, and everyone tells you the same thing. They go, I know how you are feeling and you want to fight back, but let me tell you, they are going to bleed you dry, and there is no way you can win. And when I got a pro bono law-

yer, which is unheard of, I was ready to go all the way through the entire process, discovery, all the way to the end.

But my lawyer actually convinced me, because I wanted to recover his fees, and I wanted to fight. And he said, well, it is going to take years of time. It is a very intrusive process. You are going to have to open up your bank records, everything, files, emails. You have got to realize what you are committing to, and I will tell you this. I have won awards before, and I have not gotten paid.

So when he said that, it infuriates you. As an engineer you want to solve problems, and you want to fix things, and it does not seem like we can do that on our own, and that is why Congress really needs to help and fix this broken system we have.

Ms. DELBENE. But on discovery, in particular, whether you are the one who has a patent litigation against you, but what if you were also trying to defend patents of your own? Do you feel the same way about the discovery provisions?

Mr. MOORE. Yes. I believe that if you have good patents, I do not believe you are going to be affected by this bill. In no way does it say that you are not going to be able to go after people that are infringing on your intellectual property, and I am someone who is listed on numerous patents. So I can tell you I have worked with the patent system, and I think it is valuable, I really do. But I see it today, especially with my company, how it can be abused.

Ms. DELBENE. Thank you. Mr. Chair, I yield back.

Mr. ISSA. Thank you. We will now go to a second round. Mr. Pate, you made some statements, and I want to try to elaborate because I want the record to be clear. In your experience, you have been a law clerk, right, for a Federal judge?

Mr. PATE. That is correct.

Mr. ISSA. So you have seen what Federal judges go through trying to move cases along, right?

Mr. PATE. Yes, sir.

Mr. ISSA. Did you ever clerk while the judge was doing a patent case?

Mr. PATE. No, sir.

Mr. ISSA. But a similar white collar——

Mr. PATE. Many.

Mr. ISSA [continuing]. Civil tort claim normally is broken into two major parts. Did you or did you not do something wrong, and if so, what are the damages, right?

Mr. PATE. That is correct.

Mr. ISSA. And then the second part, we will take down the did you do wrong. It is do you have the ability to pay? What are the assets? How do we get them? What should the judgment read? And we all understand that.

So you mentioned something that concerned me, which is you said you have not actually sued anyone under your patent, but you said you want all the information. And because this is part of the Innovation Act, should not the plaintiff is interested in proving that the patent is, in fact, valid and being infringed, should not the discovery to the greatest extent possible in the shortest period of time get to that question? In other words, as Mr. Griffin, I believe, said in the opening, the markman. Is your patent and their product a match or vice versa. Would you not agree?

Mr. PATE. I am probably not educated enough on the actual flow of a patent litigation, but I think that sounds reasonable.

Mr. ISSA. Okay, thank you. And the reason I ask that is, and I will go to Mr. Griffin or any of the other folks that have been mugged by a patent troll. Normally the troll presents an extensive amount of discovery—who are your investors, what are your contracts, who do you buy from, who do you sell to. In other words, a lot of information that might be interesting, but it does not have anything to do with do you infringe or not.

So I would open it up to each of the witnesses that has some experience about what the discovery process was like to the extent, and I would start with Mr. Griffin because you got the most of it.

Mr. GRIFFIN. We have litigated a lot. Let me just tell the Committee that we have had several cases in which a patent suit was dismissed after markman, but only after we spent hundreds of thousands of dollars in discovery to get to that point. So it makes sense to kind of flip that because that is a legal determination that can precede the discovery.

Mr. ISSA. And for all the audience and people that are trying to understand the record, a markman is determined exclusively by the judge who interprets what the real meaning of the patent is. Is that correct?

Mr. GRIFFIN. That is correct. That is correct. And so, that the facts of the case can then be applied, it makes sense to do that before because then the discovery can be focused, and the parties know what they are doing. We had a case recently in which we received 39,000 pages of infringement contentions that were photo shots that simply came out. And so, even after these very light and thinly-developed complaints are filed, we have enormous allegations.

Why could they not have been more specific to start with? And that particular case was narrowed down to only two claims by the time we got to trial. That is the extent of the work that a defendant has to do to discharge his discovery obligations under current law.

Mr. ISSA. Ms. Underwood, in your case, had you gotten to markman on your case, an element of the patent as you told us was internet connectivity, and you did not have it, right?

Ms. UNDERWOOD. Exactly.

Mr. ISSA. Did your attorneys tell you that you probably would have been able to get the judge to dismiss the case at that point based on not having an element of the patent?

Ms. UNDERWOOD. The attorney's opinion was, yes, that eventually it probably would be dismissed, but after the attorneys' costs exceeded what the costs were to settle.

Mr. ISSA. It was financially reasonable on behalf of your stockholders to settle even though you failed to have an element that in an early markman would have determined that you did not fall under the patent.

Ms. UNDERWOOD. Exactly. There was no research done. The demand letter was very unclear, and clearly just mass mailed.

Mr. ISSA. Mr. Moore?

Mr. MOORE. We never reached that point. As soon as they found out that I had a pro bono lawyer, they were very quick to dismiss the case.

Mr. ISSA. I guess we need more pro bono lawyers.

Mr. MOORE. That would solve a lot——

Mr. ISSA. Anyone in the audience that wants to contact their friends, Washington has no shortage of lawyers. It is the pro bono that is hard to get. Let me just briefly make some people aware of something, and I mentioned my good friend, Judge Moskowitz. I had such a case early on in the 90's at a time in which markmens were new, and the judge did his markman essentially as we were impaneling a jury. And one element of the claim was it had to have a normally open relay that closed in order to do X, Y, and Z. That was my industry. And I only had one relay on the board, and it was normally closed.

But to be honest, the plaintiff in this case—I was a defendant—had my entire customer list, had deposed all of my staff, including my sales staff, not just engineering, had detailed schematics of all my products. And, in fact, the judge, and I do not believe this was incompetence, told me after the fact that once he had made his markman, he knew we had won. He just felt bad not letting it go to the jury, and I am paraphrasing.

That is the reason that I asked you this question is part of the Innovation Act is to try to streamline the process to lower for both the plaintiff and the defendant if, in fact, the plaintiffs believe they really do have a patent that is being infringed, and the defendant quite frankly may really believe that they are innocent, to get to that determination. And, Mr. Griffin, because you have had this experience and you have undoubtedly worked with other people, is it not true that even in the Eastern District of Texas, markmens often make cases settle because either the defendant realizes that they are going to lose, or, quite frankly, the plaintiff realizes they do not have a case?

Mr. GRIFFIN. That is true. That is true. And certainly it narrows the focus of discovery if discovery happens after the markman hearing.

Mr. ISSA. And I will rest my case with that, and yield. We have no other Democrats at this time, so I yield back and go to the Chairman of the full Committee, Mr. Goodlatte. I will not only yield, I will yield the Chair.

Mr. GOODLATTE [presiding]. The Chair recognizes the gentleman from Texas, Mr. Farenthold, for his questions.

Mr. FARENTHOLD. Thank you very much, Mr. Chairman. I appreciate you all being here and say thanks for sharing your experience. One of my concerns with the Innovation Act is that it weakens one of the best tools for weeding out patents, the interparty review and post-grant review process, by replacing the Patent and Trademark Office standard of the broadest reasonable interpretation of the patent claim with the district court construction. Mr. Griffin, as someone who has been directly attacked by weak patents, does this change concern you?

Mr. GRIFFIN. In the cases that we have been involved in so far, we have not used that provision.

Mr. FARENTHOLD. Mr. Moore, do you want to weigh in on that at all?

Mr. MOORE. I am not a lawyer, so I will leave it to Mr. Griffin to answer that one.

Mr. FARENTHOLD. All right. So, Mr. Moore, one of the more disturbing parts of your testimony is the patent troll case you were in, you were asked to send thousands of dollars by wire transfer to an overseas bank account. I mean, this sounds like one of these scams you get in your spam email, not like the American patent system at work. Is this something that happens regularly and that you have heard about, and can you tell me a little bit more about how that happened?

Mr. MOORE. Yes, absolutely. The patent troll instructed my lawyer that the reason was to wire to an international, and it was a different bank account overseas. It was a different company, so we were paying an entirely different company, not the company that was suing my company. He said the reason was to avoid U.S. taxes. He said if we were going to pay domestically through a regular transfer that we would have to pay the taxes.

Mr. FARENTHOLD. That seems like a scam, which kind of brings me to the overall demand letter issue. You have seen a lot of small businesses sue and settle under these demand letters, as Ms. Underwood's bank does. At some point you start to wonder, or at least I start to wonder, if we are going to run out of small business to sue, and we get into the end user. Obviously we have talked about the end user stay provisions and moving it up exhaustively during this hearing.

But you get to the point of you can beat the rap, but you cannot beat the ride, and that is really a good description I think of a lot of litigation, and what the patent trolls rely on. All right, it is going to be hundreds of thousands if not millions of dollars to hire a lawyer. I can beat the rap, but I am going to end with a million-dollar ride.

So let us talk a little bit about demand letter forms. One of the things that we want to do is actually be able to from the demand letter determine the scope of the appropriate and who the true parties are. And I think there is some misunderstanding about the intent. It is not so much to get at the investors, as Mr. Pate has talked about. It is to actually know who the inventors are and what the grounds of the patents are. How do you feel about tightening up on demand letters, Mr. Pate?

Mr. PATE. So I think there is some confusion in terms of where the investors come in as through the joinder and fee shifting as opposed to the demand letter.

Mr. FARENTHOLD. But the idea behind the demand letters is you want to know who is really behind this. And some argue that this is going to chill investors in small businesses. If that business is sued for patent, do they end up having to be, you know, wrapped up in the process even beyond joinder at the demand letter level.

Mr. PATE. So I have not thought deeply about that. My focus on investors and personal liability has always been tied to the joinder provision.

Mr. FARENTHOLD. And do any of the other panelists want to weigh in on the reform of the demand letters? Ms. Underwood?

Ms. UNDERWOOD. I think reforming the demand letter process is key to stopping most of these frivolous attempts to extort money from small businesses. And I think if the letters were more transparent, if they had more detail about the particular patent that was being violated, and identify where or how, what grounds that they have to begin this process——

Mr. FARENTHOLD. So you can make some intelligent decisions——

Ms. UNDERWOOD. Exactly.

Mr. FARENTHOLD [continuing]. Even possibly before a lawyer. One last question with the investors with Mr. Pate. So there is a study out that 55 percent of trolls target small businesses that do not have the resources to fight back. I think that is the reason we got a letter up on the Hill from 140 venture capitalists actually in support of patent reform. This week it came to us.

Since their interests are specifically in the growth and success of small businesses across the country, it seems like venture capitalists should be concerned on both sides of that. It seems at odds with your testimony today. Even though you may not have already been targeted by bad acting plaintiffs, could you help me understand what kind of small business or inventors are targeted by bad actors in the current system and why they are targets?

Mr. PATE. Sure. So venture capital is an interesting thing. I know the National Venture Capital Association is actually opposed to the bill, and I am not sure the number of members they have. I know it is in the multi-hundreds. And a lot of independent companies, large companies have their own venture capital arm, so Intel has a venture capital arm, Google has a venture capital arm. And so that arm may be acting to take a position that is beneficial to the overall organization and not necessarily beneficial to the venture capital wing of the organization. So it will be interesting to see who those venture capital firms actually were.

I think the element that is so concerning for the investors is the personal liability piece in the sense that no investor in my company thinks they have personal liability for anything. And so, to introduce potential personal liability to investors in my company I think is a huge issue. To introduce it for me is a huge personal issue. I am not personally guaranteed anything in my company anymore. I like that. I do not want to go back to a position where I could lose my house because I do something stupid with my company.

Mr. FARENTHOLD. All right. I see I am out of time. Thank you for your indulgence, Mr. Chairman.

Mr. GOODLATTE. Thank you very much. The Chair recognizes the gentleman from Florida, Mr. Deutch.

Mr. DEUTCH. Thank you, Mr. Chairman. And I thank the witnesses for their testimony, and thanks for sticking around so that we could come back and continue this. I just want to say this. I have the same visceral reaction to your stories that I think my colleagues have. And it is clear that too many small businesses and developers have been targeted by intimidating letters, with bogus claims, about vague patents that would not stand scrutiny today. Would not stand scrutiny already.

The media has documented many examples from entities claiming they own patents on shipping confirmation emails, for the on-

line purchases, to the concept of online shopping carts. We get it, and that has to be addressed. Patent trolls send demand letters to hundreds of small businesses, as you have already pointed out, that some of their targets will pay up instead of defending themselves in court.

But unfortunately for them, but thankfully for all of us, some of those targeted by patent trolls have actually had their day in court, and as a result, many of the problems that H.R. 9 claims to address are actually being resolved now by the court system and at the U.S. Patent and Trademark Office. And my concern today about this entire hearing and a lot of this debate all together has been the sense that we have two choices. We have a system where patent trolls are able to do damage to innovators, and creators, and small businesses on the one hand, or we have this bill on the other, and that you would have to choose. I think all of us, including Mr. Pate, would absolutely agree we have to do something about patent trolls.

I would say Florida, not unlike the Chairman's home State, Chairman Issa's home State, is home to world class research institutions who rely on patents to turn their innovations into life-saving and profitable products. Last year in my home district, Florida Atlantic University entered into a licensing agreement with PortNexus and AT&T to bring a professor's technology to market that will disable texting functions in cell phones when a car is in motion and in the driver's seat. Texting while driving makes crashes 23 times more likely. And the licensing of this technology will help bring in revenue for the university. It will create jobs, and, most importantly, it will save lives.

And the abuses that we have been speaking about, that I spoke of earlier, against developers and businesses by patent trolls have little in common with legitimate patent disputes that are vital to universities, that are vital to inventors, and they are vital to researchers. And yet it is those patenting innovations across every brand of technology and life sciences who are going to be dragged into court and into this over broad litigation reform in H.R. 9.

If we go forward with something that is too broad, then that will, I believe, as Mr. Pate said, scare off investors, in this case from investing in the next great discovery like at my own university or universities around the country. Tipping the scales too far in a justified, but overbroad, attempt to stop patent trolls runs the serious risk of undermining one of the great strengths of the American economy.

So I would just ask this question of panel. Is the problem how our entire litigation system works not just for the violator rights of legitimate patent holders, or is the problem bad actors who abuse the system by taking advantage of obscure, overly broad patents that PTO, we all now know, regrets awarding in the first place and would never issue under today's standards? And if the problem is patent trolls, why would we target these bad actors in abusive behaviors with procedural changes that will wind up harming innovators who rightfully expect to be able to defend their property rights in court? Mr. Griffin?

Mr. GRIFFIN. I would love to answer that question. That is a good question. The difference is in the tactics. There are abuses that are

exploited because of the existing state of procedures in the law, and I disagree that these provisions are overly broad. These are narrowly tailored to take care of the abuses.

Mr. DEUTCH. I am sorry. I just realized I do not have a lot of time. I agree completely that trolls should not be able to hide behind shell corporations, and I introduced legislation to address that. There are provisions that I think everyone believes can address that, and we ought to. Likewise, I absolutely think that this idea that a patent troll can send a demand letter and expect to pressure a developer or small business into paying up is also problematic.

But this legislation does not address that at all. There is legislation that addresses the demand letter issue. This does not do it. This only refers to demand letters once we are in litigation.

Mr. GRIFFIN. This is more substantive.

Mr. DEUTCH. It is not more substantive. It only addresses——

Mr. GRIFFIN. I believe it is more substantive.

Mr. DEUTCH. The concern with demand letters is that they are sent—before we get to that point, I just would suggest, Mr. Chairman, that I would urge the Chairman, and I would strongly urge the community that cares so much about these issues that this does not need to be either/or. It does not need to be a current system which has abuses that must be addressed for the benefit of our economy, or a bill that goes so far in the other direction that it will stifle innovation, and that it will prevent the kinds of investments, and will prevent the creators in this country from being able to defend their intellectual property through the patents that they own. And I would yield back.

Mr. GOODLATTE. Well, I thank the gentleman, and I share his concern. That is why we are doing this bill. But I do want to give Mr. Griffin an opportunity to answer the question that you asked him. So we will give him an opportunity to do that right now.

Mr. GRIFFIN. Thank you, Mr. Chairman. No, this is a comprehensive thing. The issue of the demand letters, it seems to me that certain people are focusing altogether too much on demand letters. Demand letters are a problem, and that problem should be fixed. But they are not nearly the universe of problems associated with patent troll litigation abuses.

The economics are all skewed toward the plaintiff, and the defendant is burdened with a lot of costs that are escalated in the manner of the litigation. I think that defending against 30 different actions entitles me to say that. It is very difficult to defend under the current system of litigation that we have. I have seen complaints that are only 6 pages long with no specificity whatsoever, leaving us to try to discover what is going on.

We spend hundreds of thousands of dollars before we can get to a markman hearing. That is simply wrong. A markman hearing that says that this patent does not apply to our processes. That is unfair, and that eats up jobs, it eats up development costs. It eats up innovation in this country. $29 billion are spent annually in this type of abusive litigation. To say this is a demand letter problem is understating the problem.

Mr. DEUTCH. I agree completely. Can I just ask a follow-up, Mr. Chairman?

Mr. GOODLATTE. Sure, go ahead. Go ahead.

Mr. DEUTCH. I agree completely. I am not suggesting for a moment that that is the only problem. What I am suggesting, just to focus on the issue of discovery, if a change is made that prevents any discovery, that prevents the patent holder from learning in discovery that not a patent troll, but an infringer not in a patent troll case, but in a real case where the patent holder's patent is being infringed upon, why would you shut off the possibility of having that patent holder go forward with a claim when something comes up during discovery that they were unaware of because the infringer hid it from them and because it was not apparent? Why would you take that away from the patent holder?

Mr. GRIFFIN. The answer is that in a markman hearing, the determination of what the patent covers is a legal determination. And if the patent does not cover the process that is in question, then the defendant ought to be entitled to dismiss that case before irrelevant discovery takes place, as it does now, over millions of pages of discovery that is unnecessary. Trolls do this to ramp up the costs of the defendants so that they will settle before going trial.

Mr. DEUTCH. I am sorry, Mr. Chairman. I would love to continue this conversation, Mr. Griffin, in my office. I would suggest when we talk about the steps that this legislation goes that are just a bit too far, barring the discovery of electronic communications, for example, strikes me as something that will make it more difficult, again, for the patent holder, a patent holder who is trying to protect his property from upholding that patent against an infringer. But I would welcome the opportunity to discuss it.

Mr. GOODLATTE. And I would love to join in that conversation. There is nothing in this bill——

Mr. DEUTCH. Let us do it in the Chairman's office.

Mr. GOODLATTE. There is nothing in this bill that bars the discovery of electronic communications.

Mr. DEUTCH. We will look forward to having that conversation.

Mr. GOODLATTE. Sure. While we are at it, I am going to ask Ms. Underwood to address another subject here that is of interest. One of the major sources of abusive patent litigation stems from the Federal court's 1998 State Street decision, which opened the door to dubious business method patents, a decision that has brought real harm to our patent system. In recent years, the Supreme Court has helped to repair this damage and reverse the tide of such weak patents through its Bilski and Alice decisions.

Can you speak more to the importance of the American Invents Act transitional program for covered business method patents, and also talk about the amount of capital that community banks invest in startups and small businesses in America, and the real costs of abusive patent litigation on investment in those communities?

Ms. UNDERWOOD. The Covered Business Method Program has been a great program for the banking industry, but clearly for all industries, as you know. It covers any financial transaction, and it has addressed a number of the very large patent suits. And our position is that it would be wonderful to see that become a permanent program available to us, and it would be wonderful to have the PTO have the opportunity to waive any fees so that the community banks could take further advantage of that program.

Mr. GOODLATTE. Thank you. And, Mr. Griffin, are the problems surrounding patent trolling the result of certain plaintiff friendly judicial districts, and what can Congress do to help rebalance the scales so venue is no longer a weapon of choice for those engaging in patent trolling?

Mr. GRIFFIN. I think that is a difficult issue. There are certain dockets that are known to have more patent troll type litigation in them. It might be a good idea to study that to see how many cases are filed. The process, as you know, Mr. Chairman, the judges, and they have local districts and rules that make these districts, I think, more favorable to the patent bar. And that is why we get sued occasionally in remote districts.

But I think these narrow changes that are in the Innovation Act, these targeted things will be useful not only to the courts in those jurisdictions to follow the law, but also to the court of appeals that reviews these decisions. I think that Congress needs to make statutory some of the changes about fee shifting and other things to make this more palatable to these local judges and to specify and give some certainty to a defendant who may wind up spending $1, $2, $3 million to defend a case that was unjustified in the first place, to be able not only to get an order for those fees, but also to be able to recover them at the end of the day, because one without the other is no good.

Mr. GOODLATTE. And that implies conversely your company is probably most often in the position of defending these cases, but there are people with legitimate patent claims who would want those same principles applied to them when they are trying to perfect and protect their intellectual property rights.

Mr. GRIFFIN. And my understanding since the Supreme Court had clarified in the Octane Fitness case this whole idea of fee shifting and other things. My understanding is that 30 of those cases, of the 30 cases that have been filed, actually the orders were 30 percent for plaintiffs. So plaintiffs do recover for unjustified defenses.

Mr. GOODLATTE. As well they should.

Mr. GRIFFIN. As well they should.

Mr. GOODLATTE. And finally, I had a dialogue with Mr. Pate, and my time ran out. I want to give you an opportunity to respond to some of his concerns with regard to the joinder provisions in the legislation, and my point that unless you are essentially a shell corporation, you do not have reason to fear the joinder provisions because they will not apply to you.

Mr. GRIFFIN. I think your point is correct that, in essence, the current business and favored business model of trolls is to have a shell corporation that has no other business other than litigation. As long as we have that distinguishing feature, Mr. Pate should not be concerned. I cannot tell him what his investors ought to be concerned about, but my experience in innovation, and technology, and investors, and everything else is like a law of nature. If there is something to be eaten, there will be something there to eat it. And someone will be interested in funding a company that might have to enforce its patents.

I do not think that it is only one quality, a fearful venture capitalist that will do something on a wonderful product like his. I am going to go out and buy one.

Mr. GOODLATTE. They do it right now, and, in fact, it does not happen with the frequency that I would like to see, and that is why we have this industry of patent trolling. But the courts have the authority right now to pierce the corporate veil and do these things right now.

Mr. GRIFFIN. Yes, they do. Yes, they do.

Mr. GOODLATTE. Thank you very much. Does anything prompt any further questions from the gentleman from Florida?

Mr. DEUTCH. No, thank you.

Mr. GOODLATTE. Thank you, and I want to thank all the witnesses for their testimony today. I think this has been a very helpful hearing. Get the magic words here to end it. And I want to invite all of you to continue to have dialogue with not Mr. Deutch, but other Members of the Committee and the Committee staff. This has been a very open and transparent process for about 2 years now that we have produced this legislation. And it is a very strongly bipartisan legislation that has been transparent in its formation. And it is, I think, important that we keep it that way as we work our way through the process.

We are going to proceed with this legislation. The Senate will proceed with theirs. We will have to work out differences, and then we will work with the Administration as we have, by the way, throughout this whole process. The President endorsed this bill as it came out of this Committee in the last Congress. And that is how you get bipartisan legislation, which is really the only kind of legislation that gets signed into law.

So this concludes today's hearing. I thank all the witnesses for attending. And without objection, all Members will have 5 legislative days to submit additional written questions for the witnesses or additional materials for the record.

And this hearing is adjourned.

[Whereupon, at 1:02 p.m., the Subcommittee was adjourned.]

APPENDIX

Material Submitted for the Hearing Record

Statement of the Honorable John Conyers, Jr. for the Hearing on "Patent Reform: Protecting American Innovators and Job Creators from Abusive Patent Litigation" before the Committee on the Judiciary
Wednesday, March 25, 2015, at 10:00 a.m.
2141 Rayburn House Office Building

Today's hearing provides yet another opportunity to examine the issue of abusive patent litigation and why a targeted legislative approach is necessary.

One of the first issues we must consider is how legislative proposals to stop abusive patent litigation can impact small businesses, the start-up ecosystem, and innovators.

Small businesses and others who rely on patents require strong intellectual property protections. We must not weaken those rights.

Our innovators – whether they create their inventions in their garages or basements or as a group in an incubation hub – recognize that their patents and the ability to protect them through enforcement in the courts is a critical factor in whether their businesses will be a success or a failure.

Indeed, some angel investors and venture capitalists require ideas to be patented *before* investing. But, they may very well be dissuaded from investing if there is a risk that a court will not uphold the validity of those patents or, at a minimum, there will be substantial litigation costs entailed.

This means that fledgling entrepreneurs will never get off the ground and become a flourishing business employing thousands of Americans, such as Overstock, which is one of our witnesses today.

Overly broad legislation could engender more rather than less litigation and weaken patent enforcement protections, thus discouraging investments in innovation.

Instead, we should take a cautious approach and not push solutions – such as H.R. 9, the "Innovation Act" – that may end up doing more harm than good to our start-up ecosystem.

One way to stop abusive patent litigation is to address the problem of the extortionist use of demand letters.

So, I want the witnesses to discuss how we can curb the abusive problem of demand letters.

Patent litigation opportunists exploit the patent process and patent litigation system. In particular, they attack patents of weak quality in order to obtain quick settlements or to bleed the alleged infringers.

Individual inventors and small businesses have to decide whether to risk incurring potentially overwhelming costs of litigation or enter into a settlement which could make them liable to attack by other abusive patent litigants.

We must find a way to stop this insidious problem that threatens the strong culture of innovation in our Nation.

Finally, the Committee needs to conduct further hearings on the changing landscape affecting patents before we take any congressional action.

While I applaud the Chair for holding a hearing last month on recent Supreme Court decisions in the patent arena, the Committee should also hold additional hearings on what actions other government stakeholders are taking in the patent arena.

For instance, we should hear from Michelle Lee, the newly appointed Director of the United States Patent and Trademark Office to hear her views about how we should address abusive patent litigation.

In addition, Director Lee could enlighten us about the conclusions from the Patent Quality Summit that her Office is hosting today and tomorrow.

The Director could also update us on how her Office is implementing the America Invents Act.

We should also hear an update from the Federal Trade Commission about its efforts to combat abusive patent litigation behavior.

Further, the Judicial Conference could share its expertise at a hearing on the effectiveness of lower courts recently adopting model discovery orders or discovery guidelines that limit discovery in patent lawsuits.

The Conference could also inform us of the actions the Supreme Court is taking to eliminate Federal Rule of Civil Procedure Rule 84 and its Form 18, which will lead to the higher pleading requirements of *Twombly* and *Iqbal*.

It could also update us on other proposed amendments to the Federal Rules of Civil Procedure aimed at achieving proportionality in discovery and promoting early and active judicial case management.

These efforts may better address abusive patent litigation in a more targeted approach than the overly broad approach taken by the Innovation Act.

Congress must respond to the problem of abusive patent litigation, but it should do so in a more balanced and effective approach that protects our Nation's entrepreneurs and innovators.

Kathryn G. Underwood
President and CEO of Ledyard Bank, Norwich, VT
On behalf of the Independent Community Bankers of America
Answers for the Record
Committee on the Judiciary, Subcommittee on Courts, Intellectual Property, and the Internet
Hearing on "Patent Reform: Protecting American Innovators and Job Creators from Abusive Patent Litigation"
March 25, 2015

Chairman Goodlatte Question: *Ms. Underwood, one of the major sources of abusive patent litigation stems from the Federal Circuit's 1998 State Street decision which opened the door to dubious business method patents, a decision that has brought real harm to our patent system. In recent years the Supreme Court has helped to repair this damage and reverse the tide of such weak patents through its Bilski and Alice decisions.*

Can you speak more to the importance of the AIA's transitional program for covered business method patents? And also talk about the amount of capital that community banks invest in start-ups and small businesses in America and the real costs of abusive patent litigation on investment in those communities?

Underwood Answer: *Mr. Chairman, the Covered Business Method (CBM) program was created to re-examine the validity of questionable business method patents. To date, it has proven to be a successful low-cost alternative to litigation of covered business method patents. In fact, according to the attached chart entitled "CBM Proceedings that Could Benefit Community Banks and Credit Unions," currently there are several CBM proceedings underway that could benefit banks and credit unions of all sizes. For example, it is my understanding that patents held by the company Data Treasury are currently under CBM review. Data Treasury has brought suit against several community banks including Frost Bank, Bank of the Ozarks, Midsouth Bancorp etc. For these reasons we would advocate for the CBM program to be made permanent.*

In regards to lending, community banks are prolific small business lenders making 55 percent of all business loans under $1 million. Every dollar spent on defending against frivolous claims brought by patent trolls is several dollars that cannot be lent to start-ups or small businesses looking to secure a loan. This is in addition to the hundreds of hours of senior management staff time dedicated to responding to the troll and understanding the claims.

Statement for the Record

Submitted by the American Hotel & Lodging Association

to the

United States House of Representatives Judiciary Committee

for a hearing entitled:

"Patent Reform: Protecting American Innovators and Job Creators from Abusive Patent Litigation"

March 25, 2015

AHLA
AMERICAN HOTEL & LODGING ASSOCIATION

On behalf of the 1.8 million employee U.S. hotel industry, the American Hotel & Lodging Association applauds Congressman Goodlatte for holding a hearing today on the abusive litigation tactics employed by patent trolls every day against businesses of all sizes and from almost all industries. We also commend Congressman Goodlatte and the bi-partisan group of co-sponsors who introduced the Innovation Act, legislation which will go a long way toward limiting the ability of patent trolls to extort money from our hotels, and we hope that this hearing will further lay the groundwork for this legislation.

We are a founding member of the United for Patent Reform coalition which includes companies and trade associations from across the economic spectrum, including home builders, realtors, convenience stores, restaurants, and retails shops, as well as innovative technology companies like Google, Facebook, Samsung, and Cisco. Members of our coalition include some of the largest patent holders in the country, clearly demonstrating that the reforms we seek will not decrease the value of patents or limit their enforceability.

However, when a patent troll, with no interest in pursuing any productive use of a patent it holds, can continuously profit from sending exceedingly vague or deceptive demand letters to small business franchisees who own one or two hotels, and have no in-house legal staff, something is wrong with our patent litigation system. In order to adequately address the problem, we need a multi-pronged approach to patent litigation reform which:

- Requires that patent demand letters accurately include certain basic information;
- Ensures that claims between a patent owner and a manufacturer proceed before claims between the patent owner and the manufacturer's end users, like hotels;
- Creates a stronger presumptive fee-shifting rubric and a mechanism to ensure court ordered fee-shifting is enforceable;
- Requires trolls to pay for the discovery they request beyond core documents;
- Makes patent litigation more efficient so that weak cases can be dismissed before expensive discovery;
- Requires plaintiffs to explain in detail the basis for the alleged infringement when they file complaints; and
- Maintains and improves administrative alternatives to litigation.

We look forward to working with the entire Judiciary Committee to pass forceful legislation that ultimately includes the above-mentioned provisions. Only then will hotel owners, operators and investors be able to stop wasting time and money on defending their businesses from patent trolls, and turn their full focus toward enhancing the guest experience, building new hotels and creating jobs in their communities.

1250 I STREET NW, SUITE 1100 \ WASHINGTON DC 20005 \ 202 289 3100 \ WWW.AHLA.COM

Competitive Carriers Association
Rural • Regional • Nationwide®

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March 25, 2015

The Honorable Bob Goodlatte
Chairman
Committee on the Judiciary
U.S. House of Representatives
Washington, DC 20515

The Honorable John Conyers, Jr.
Ranking Member
Committee on the Judiciary
U.S. House of Representatives
Washington, DC 20515

The Honorable Darrell Issa
Chairman
Subcommittee on Courts, Intellectual Property, and the Internet
U.S. House of Representatives
Washington, DC 20515

The Honorable Jerry Nadler
Ranking Member
Subcommittee on Courts, Intellectual Property, and the Internet
Washington, DC 20515

Dear Chairmen Goodlatte and Issa and Ranking Members Conyers and Nadler:

In recent years, harmful litigation activities of patent assertion entities, also known as "patent trolls," have increased exponentially. While patent trolls have continued to frustrate large high-tech corporations, they have expanded their reach to smaller companies across the country, and their abusive actions can be absolutely devastating for a small company. Like many small and medium sized businesses, competitive wireless carriers are now the frequent targets of patent trolls. Competitive Carriers Association (CCA) commends bipartisan reforms to end these practices.

As now the frequent target, CCA members typically have smaller legal departments – sometimes only one or two individuals – who must marshal resources to defend against claims. Even if outside patent counsel is retained, in-house staff must direct defense efforts, resulting in an unquantifiable time drain and distraction from other business activities, such as network deployments, transactions, or other compliance work—in addition to the added expense of retaining outside counsel.

Wireless carriers are subject to mandates and other industry standards set by federal and international bodies. Sometimes compliance with such standards, even on critically important requirements such as providing 911 services, makes them targets for trolls.

Smaller carriers often lack scope and scale, and in turn negotiating power, in discussions with vendors, and often have difficulty reaching indemnification provisions or less formal protection measures. Conversely, smaller vendors that serve competitive carriers may be more likely to indemnify and defend a carrier, but the resulting burdens and costs disproportionately impact smaller companies, potentially driving them out of the market as a result of trying to defend against a frivolous suit.

Patent trolling has impacts well beyond the carrier initially targeted. Indeed, trolls often target smaller providers first to develop a "war chest" of funds to use in actions against larger companies. This also

provides trolls an opportunity to establish a distorted market license value for the patent based on settlements reached by smaller firms with insufficient resources or who are otherwise unable to successfully fight the claims. When a smaller carrier settles with a troll for a certain amount, the trolling entity often moves on to larger companies, using the previous settlement as the purported market value for a license. Because the small business could not fight back, the problem snowballs throughout the industry, and the troll continues to extort other businesses.

Patent trolls look to line their pockets while killing innovation and eliminating jobs. Trolls do not innovate—they manipulate and destroy small businesses, and their activities must be stopped. CCA's members primary focus is providing service to customers, not fighting costly suits, and would much prefer to build-out a new cell tower in rural America than litigate a frivolous claim. CCA supports and commends all Members of Congress who are leading the fight to address patent troll problems.

Respectfully Submitted,

Steven K. Berry
President & CEO, CCA

Engine

Dear Chairman Goodlatte, Subcommittee Chairman Issa, Representative Farenthold, and members of the Subcommittee on Courts, Intellectual Property, and the Internet:

Engine thanks the Subcommittee on Courts, Intellectual Property, and the Internet for holding a hearing on the impact of patent trolls on March 25, 2015. Engine is a non-profit advocacy and research organization with a network of startups, pioneers, innovators, investors, and technologists. The small companies we work with are fundamentally altering and challenging entrenched business models, ideas, and institutions across all industries. These businesses drive our economic prosperity, create jobs, and improve our lives.

During the hearing, we were pleased to see Representative Farenthold raise a letter we organized from more than 140 early stage investors (also attached) that urges Congress to pass meaningful patent reform legislation this session. Their position is consistent with the opinion of the broader venture community that patent trolls are harming the ecosystem in which they operate, as reflected in a study Professor Robin Feldman conducted of NVCA members. Patent trolls make an uncertain patent system even less hospitable to innovation. And, as reported by Professor Catherine Tucker, this directly leads to less financial investment.

We would also like to take this opportunity to correct a comment made in the testimony of Mr. Bryan Pate, CEO of EliptiGO, Inc. Contrary to Mr. Pate's statement, none of the signatories of this letter is an investment arms of any high-tech company. Signatories represent a range of investment firms—including the more traditional investment arms of banks and telecom companies —and a variety of portfolio companies, including biosciences, cloud services, health analytics, and many others.

We hope that this clarifies the matter for the record, as we would not want to see the motives of these investors misrepresented. Please let us know if we can be of any additional assistance in moving critical reform legislation forward in the weeks and months ahead.

Sincerely,

Julie P. Samuels
Executive Director, Engine

Startup Investors Nationwide Support Broad Patent Reform

17 March 2015

Dear Congress:

Each year, we invest hundreds of millions of dollars in software and information technology businesses and other emerging technologies. Together with other investors, we commit more than $1 billion annually in angel and venture capital that ensures continuing growth of young, high-tech companies employing 1.4 million people. Collectively, we have invested in companies such as Netflix, Twitter, Facebook, Dropbox, Palantir, Kickstarter, and countless other technologies that power American businesses everywhere.

This investment has spurred a startup ecosystem that has created world-changing technologies, and is responsible for all net new job growth in the United States. Despite this, we find our portfolio companies facing a dangerous patent troll problem. When a troll sues, or even threatens, a small startup, the results can be disastrous. Many of us have seen young companies fail in the face of such threats. In fact, a recent survey found that 70% of VCs have portfolio companies that have received patent demands, the majority of which come from so-called patent trolls. This is not sustainable.

To promote continuing growth in our startup economy, we need comprehensive patent reform legislation that will provide small companies the tools to fight back against patent trolls and will curb the worst behavior of the most egregious actors. Specifically, legislation should:

- Increase transparency by requiring patent trolls to specify, in complaints and demand letters, which patent and what claims are infringed, specifically how the offending product or technology infringes, and who is the real owner of the patent(s) at issue.
- Limit the scope of expensive litigation discovery, which pushes companies to pay unjustified settlements priced cheaper than defending against spurious claims.
- Allow courts to use their discretion to require patent trolls to pay legal fees and other costs incurred by prevailing defendants.
- Protect end users of technology (e.g., wi-fi, printers and scanners, and APIs) from being liable for infringements by technology providers.

Many of our companies own patents, and we believe in a robust patent system. We do not want to undermine legitimate enforcement of properly-issued patents by responsible patent owners. Moreover, we are encouraged by recent changes to the system. However, tens of thousands of patents are still issued every year in the high-tech space alone, many of which will end up being exploited by trolls during their 20 years of life. Litigation by non-practice entities has increased tenfold in the last decade and only comprehensive legislation will effectively reverse that trend.

Our Constitution favored a patent system to incentivize innovation and benefit all Americans. Unfortunately that system has been hijacked by some intent on exploiting Patent Office weakness, and all too frequently it now hinders innovation and chills investment, harming the new companies it was designed to foster and imposing a patent troll tax on new technologies. We urge Congress to immediately pass comprehensive patent reform legislation that will restore balance to the system.

The undersigned:

Andrew Ackerman
Managing Director, DreamIt NY

Steve Anderson
Founder, Baseline Ventures

Michael Arrington
Founder, TechCrunch & Partner, CrunchFund

Jack Balletto
Founder, Sunrise Capital

Anamitra Banerji
Partner, Foundation Capital

Luke Beatty
Angel Investor

Thatcher Bell
Managing Partner, CoVenture

Morgan Beller
Partner, Andreessen Horowitz

Greg Bettinelli
Partner, Upfront Ventures

Trevor Blackwell
Co-Founder and Partner, Y Combinator

Zachary Bogue
Managing Partner, Data Collective

Brady Bohrmann
General Partner, Avalon Ventures

David Bradbury
Vermont Center for Emerging Technologies

Bill Brady
Vice Chairman, Credit Suisse

Mike Brown Jr.
General Partner, Bowery Capital

John Burbank

David Lee
General Partner, SV Angel

Greg Lee
Venture Capitalist

John Lee
Partner, SparkLabs Global Ventures

Peter Lee
Managing Partner, Baroda Ventures

Mark Leslie
Managing Director, Leslie Ventures

John Lilly
Partner, Greylock Partners

Jessica Livingston
Co-Founder, Y Combinator

Joe Lonsdale
Co-Founder, Palantir

Trevor Loy
Flywheel Ventures

Ralph Mack
CEO, Mack Capital

John Malloy
General Partner and Co-Founder,
Blue Run Ventures

Chris Marks
High Country Venture

Jim Marshall
Managing Director, SVB

Tom Mawhinney
General Partner, Icon Ventures

Matt McCall
Pritzker Venture Capital Group

Jay McCarthy

Brad Burnham
Partner, Union Square Ventures

John Buttrick
Partner, Union Square Ventures

Kellan Carter
Associate, Ignition Partners

Steve Case
Chairman and CEO, Revolution

Peter Chang
Partner, SparkLabs Global Ventures

Lon Chow
General Partner, Apex Venture Partners

Dan Ciporin
General Partner, Canaan Partners

Jeff Clavier
SoftTechVC

Andrew Cleland
Managing Director, Comcast Ventures

Jeremy Conrad
Founding Partner, Lemnos Labs

Ron Conway
Founder and Managing Partner, SV Angel

Topher Conway
General Partner, SV Angel

Ronny Conway
[A] Capital

Jordan Cooper
Founder, Wildcard & Partner, Lerer Hippeau Ventures

Rafael Corrales
Venture Capitalist

Mark Cranney
Partner, Andreessen Horowitz

Jim McKelvey
Cultivation Capital

Andrew McLaughlin
BetaWorks and Digg

Joe Medved
Partner, SoftBank Capital

Frank Meehan
Partner, SparkLabs Global Ventures

Josh Mendelsohn
Hattery

Jason Mendelson
Co-Founder and Managing Director, Foundry Group

Matt Miller
Managing Director, Walden Venture Capital

Jeb Miller
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Bernard Moon
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Howard Morgan
Partner, First Round Capital

Dave Morin
Slow Ventures

Bubba Murarka
Partner, DFJ Venture

Michael Neril
Venture Capitalist

Kevin O'Connor
Startup Founder & CEO/Angel Investor

Charlie O'Donnell
Brooklyn Bridge Ventures

Mark Cuban
Investor in over 70 startups

Rob DeMillo
Partner, SparkLabs Global Ventures

Satish Dharmaraj
Partner, Redpoint Ventures

Chris Dixon
General Partner, Andreessen Horowitz

Peter Esperago
Cultivation Capital

Brad Feld
Co-Founder and Managing Director,
Foundry Group

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Partner, Canaan Partners

Brian Garrett
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Crosscut Ventures

Will Gaybrick
General Partner, Thrive Capital

Nicole Glaros
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Randy Glein
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Access Venture Partners

Kent Goldman
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Alexis Ohanian
Co-Founder & Executive Chair of reddit

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Stephanie Palmeri
Principal, SoftTech VC

Brian Pokorny
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Shauntel Poulson
Principal, NewSchools Venture Fund

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Managing Partner, GGV Capital

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Managing Director, General Atlantic

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Partner, Commerce Ventures

Gordon Rubenstein
Managing Partner, Raine Ventures

Kevin Ryan
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Chris Sacca
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Greg Gottesman
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Managing Partner, Rethink Education

Greg Gretsch
Managing Director, Sigma West

Nick Grossman
Investor, Union Square Ventures

Bill Gurley
Benchmark Capital

Dave Hanna
Hanna Ventures

David Hehman
Co-Founder, Spartina

Rick Heitzmann
Founder and Managing Director,
FirstMark Capital

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Kirk Holland
Access Venture Partners

Jim Hornthal
Chairman, M34 Capital

Joe Horowitz
Managing General Partner, Icon Ventures

Net Jacobsson
Partner, SparkLabs Global Ventures

Len Jordan
Madrona Venture Group

Todd Steele
Managing Partner, Simon Equity Partners

Kevin Swan
Partner, iNovia Capital

Harj Taggar
Y Combinator

Devin Talbott
Managing Partner and Co-Founder,
Enlightenment Capital

Garry Tan
Partner, Y Combinator

Hemant Taneja
Managing Director, General Catalyst Partners

Brett Topche
MentorTech Ventures

Jorge Torres
Silas Capital

Tomasz Tunguz
Partner, Redpoint Ventures

John Underwood
Managing Director, Goldman, Sachs, & Co.

Roland Van der Meer
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Maynard Webb
Founder, Webb Investment Network

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Paul Weinstein
Founding General Partner, Azure Capital
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Sunny Kantha
Growth Equity/VC Investor

James Kim
Partner, SparkLabs Global Ventures

Alan Knitowski
Angel Investor

Jordan Kong
Investor, Institutional Venture Partners

Josh Kopelman
Partner, First Round

Mo Koyfman
General Partner, Spark Capital

Paul La Londe
Investor, SV Angel

Andy Weissman
Partner, Union Square Ventures

Albert Wenger
Partner, Union Square Ventures

Maurice Werdegar
Partner and CEO,
Western Technology Investment

Steve Westly
Managing Partner, The Westly Group

Fred Wilson
Partner, Union Square Ventures

Qasar Younis
Partner, Y Combinator

Brad Zions
Structure Partners

Statement for the Record
House Judiciary Committee

Subcommittee on Courts, Intellectual Property, and the Internet

Hearing entitled
Patent Reform: Protecting American Innovators and Job Creators from Abusive Patent Litigation

April 1, 2015

On behalf of financial institutions of all sizes represented by the undersigned trade associations, we are writing to commend you for your leadership in holding a hearing entitled, "*Patent Reform: Protecting American Innovators and Job Creators from Abusive Patent Litigation.*" We respectfully request that this testimony be included as part of the hearing record.

We commend Chairman Goodlatte, Subcommittee Chairman Issa, and the other champions of patent reform, for crafting and introducing *H.R. 9, the "Innovation Act,"* which makes progress toward curbing non-practicing entities (NPEs) from targeting businesses with low quality patents.

Patent Litigation in the Financial Services Industry

Patent litigation against the financial services industry has grown dramatically over the last several years. In fact, NPE patent assertions against financial services companies (which account for almost all patent litigation in the sector) grew almost 290% from 2009 to 2013.[1] Moreover, a study by Harvard Business School Professor Josh Lerner found that financial patents are 27-39 times more likely to be asserted in a lawsuit than nonfinancial patents.[2]

No type or size of financial institution is immune. NPE's have brought patent litigation against virtually every type of financial institution, including credit unions, community banks, regional banks, payment networks, insurance companies and even Federal Reserve banks.

Assertions of low quality patents by NPEs against financial institutions not only increase expense and distraction for the financial services industry, they also hinder the ability of the sector to help the U.S. economy grow by providing financial services to households and needed capital to businesses, especially small business. According to the Small Business Administration, in mid-2014, banks had almost $600 billion in small business loans outstanding.[3]

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[1] Public Access to Court Electronic Records. PACER <https://www.pacer.gov>.

[2] Josh Lerner, *The Litigation of Financial Innovations*, 53 J.L. & Econ. 807 (Nov. 2010).

[3] U.S. Small Business Administration, *Small Business Lending in the United States 2013* (Dec. 2014). Venture capitalists are an important part of this debate and provide a valuable service to the US economy. That said, so do the financial institutions that provide the credit to our small businesses and job creators across the country. According to National Venture Capital Association (http://nvca.org/pressreleases/annual-venture-capital-investment-tops-48-billion-2014-reaching-highest-level-decade-according-moneytree-report/), venture capitalists

The NPEs that target the financial services industry come in a variety of forms ranging from failed operating companies to sophisticated firms designed to amass and hold patents solely for the purpose of licensing and litigation. As such we believe that a specific definition of NPE is difficult to identify and far less important than the quality of the patents they are asserting and the transparency, honesty and integrity in which they comport their activities.

Low quality patents, and the tools used to leverage them into meritless tax on innovation is where we hope Congress will focus their efforts. Any reform must enhance transparency and provide the United States Patent and Trademark Office (PTO) with the ability to review patents in light of the Supreme Court's recent *Alice Corp. Pty. Ltd. v. CLS Bank Int'l* decision[4] and, where applicable, against the best prior art.

To that end, we see this as an opportunity to include in *H.R. 9, the "Innovation Act,"* additional language that would help halt deceptive demand letters and litigation based on low-quality patents. We respectfully request that the Committee include language that would (1) address vaguely worded demand letters, and (2) make permanent the Covered Business Method (CBM) program.

Demand Letter Reform

The Financial Services Coalition requests the Committee include a provision in the legislation that would help ensure that demand letters include clear and detailed information, such as the owner of the patent, what entities have a financial interest in the patent, what product or service is allegedly being infringed and how such product or service infringe the patent. Failure to send a clear and detailed demand letter should result in the dismissal of any subsequent civil action by the NPE against the recipient of the vague demand letter.[5]

Too often, NPEs target small business, especially small financial institutions that tend to be end-users of products and services, with vague and deceptively worded demand letters. These demand letters often lack detail about the owner of the patent and how the patent is being infringed. Such information is critical to determining the nature and quality of the claim contained in the demand letter. Without this information, financial institutions have no way to evaluate the merits of the demand letter. This is particularly true when the financial institution is

---

invested approximately $48.3 billion in 2014. According to Small Business Association data, there was approximately $589.7 billion in small business loans outstanding in Q4 of 2014, illustrating that small business lending in 2014 is approximately 1110% more than venture capital funding. In addition to loan volume, the number of deals done by financial institutions is much larger than venture capitalist firms. In 2013, venture capitalists funded 4,188 deals. According to the Small Business Administration, banks made almost 23 million small business loans. In the end, banks lend over $500 billion more capital to small businesses than venture capital firms and they also help fund over 20 million more businesses every year.

[4] 149 F.3d 1368 (2014).

[5] Additional demand letter reform that the Committee may want to consider include (i) a requirement that demand letters be filed with regulators and recorded in a public, searchable database; (ii) codifying that receipt of a demand letter is a sufficient threat of suit to file a CBM petition; and (iii) clarifying that State laws that have been enacted to curb abusive demand letters by patent trolls are not preempted.

not familiar with the technology or process at issue because the product or service was purchased from a vendor.

Vaguely-worded demand letters have been used by NPEs to coerce licensing agreements and the payment of royalties for low quality patents that are likely invalid and not infringed. As others have testified before this very Committee, the patent troll sends a vaguely written demand letter to the financial institution. The financial institution is then faced with a business decision: engage in costly litigation to defend itself against this ambiguous, yet ominous threat, or pay a licensing fee and settle.

Rather than enter a costly and lengthy legal battle, many financial institutions make the economic decision to pay a licensing fee. The NPE then moves on to its next victim. For slightly more than the cost of a stamp and the threat of litigation, NPEs can extract costly settlements from institutions that lack the expertise and resources to fight. Ultimately, these costs are a tax on consumers, stifle innovation, and have the potential to limit product offerings.

Covered Business Method Program

The Financial Services Coalition strongly urges the Committee to include language in H.R. 9 that would make the CBM program permanent and enable the PTO to waive or reduce the fee for small entities.

1. A Permanent CBM Program is Necessary to Ensure that Meaningful PTO Review is Available for All Patents and All Industries

Established in the American Invents Act, the CBM program is a post-grant review program founded on the fundamental principle of fairness – that post grant review should be available and meaningful for every party to the US economy.

CBM is the only viable tool for quickly, efficiently and cost-effectively eliminating covered business method patents that are invalid under *Alice* or in light of use and sale prior art. Without CBM, the federal judiciary is the only vehicle for the *Alice* decision and use and sale prior art to be applied to currently issued business method patents.[6]

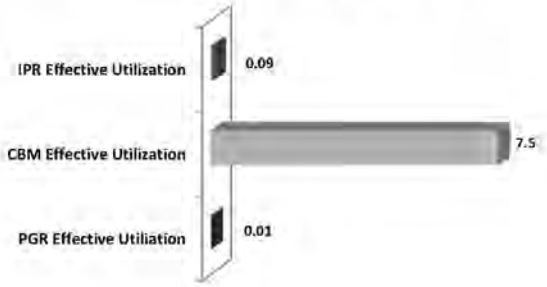
Invalidity based on § 101 and use and sale prior art are the most common grounds for challenging low quality financial patents. Without CBM, the financial services industry and many other industries that are alleged to have infringed a financial patent, are effectively cut out of post grant review while other industries, that do not predominantly rely on § 101 or use and sale prior art, will continue to enjoy a faster, cheaper and more efficient alternative to District

[6] *Inter Partes* Reivew ("IPR") does not allow for a determination as to whether a patent is invalid under § 101 or under use and sale prior art. *See* 35 U.S.C. § 311(b) While Post-grant Review ("PGR") does allow review based on § 101 and use and sale prior art, PGR is not available for the more than 45,000 business method patents that have already issued. *See* P.L. 112-29, § 6(f)(2)(A); 35 U.S.C. § 321(c).

Court litigation through IPR proceedings. To ensure PTO review remains available equally to all industries, CBM should be made permanent.

The criticality of maintaining CBM to ensure meaningful PTO review is available for all industries and all patents is evidenced by CBM utilization. Based on the number of patents eligible for each post-grant program, CBM is by far the most utilized of all of the post-grant programs[7]:

Percent Utilization by Program

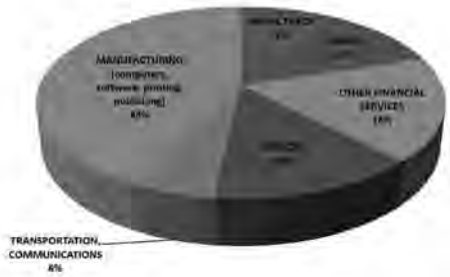


In fact, CBM utilization has exceed PTO projections by about 160%.

2. <u>The CBM Program Benefits A Multitude of Industries and Companies</u>

CBM works for all sectors of the economy. Indeed, the vast majority of companies requesting CBM review are not financial services companies. Brick-and-mortar retailers, on-line retailers, airlines, Internet search engines, traditional computer companies and the United States Postal Service have all been petitioners in the CBM program. This chart shows the utilization of CBM by industry:

[7] Program Utilization is the quotient of number of petitions filed and number of patents eligible for IPR, CBM and PGR respectively.



Moreover, the benefit of CBM is not limited to those companies that file CBM petitions. All companies, and by extension the US economy overall, benefit when CBM is used to clean bad patents out of the system. NPEs that abuse the patent litigation system have found that the standardization and interactivity that makes today's system of electronic commerce work also enables them to use the same low quality business method patents to prey upon every sort of institution from the biggest to the smallest. However, it is this very tactic that allows the benefit of the CBM program to extend far beyond the companies that file CBM petitions. An examination of patents petitioned for CBM review by larger regional banks or integrated financial services institutions shows that many of those same patents have been asserted in lawsuits filed against smaller community banks and credit unions. (See Exhibit A) Similarly, an examination of patents petitioned for CBM review by a range of brick and mortar and on-line retailers have been asserted in litigation against a broad range of companies from hotels, banks, sportswear manufacturers, clothing retailers and others. (See Exhibit B). The CBM performance data clearly demonstrates that the benefits of CBM review extend far beyond CBM petitioners. The collateral benefits of CBM review flow throughout the economy, accruing to every sort of business and consumer.

3. The CBM Program has Numerous Safeguards to Prevent Abuse

Preserving CBM ensures that there is an efficient, cost-effective alternative to litigation for the review of business method patents. Preserving CBM review will not subject patent holders to harassment or abuse.

There are numerous unique safeguards built into CBM review to prevent the harassment of patent holders and ensure that only those patents more likely than not to be invalidated are subject to review:

- Patents only become eligible for CBM review when the patent holder threatens or elects to pursue litigation. Only at that point can those parties charged with infringement of an eligible patent petition for review under CBM.
- CBM review requires meeting a high bar for review. A petitioner must establish that it is "more likely than not" that the patent is invalid in order to gain admission into the program.
- A petition for review under CBM can only be filed when PGR is not an option, meaning

nine months after the issuance of the patent.

- Once a party charged with infringement files for declaratory judgment they are barred from petitioning for relief under CBM program.
- Petitioner in a CBM proceeding in which a final written decision is issued, is estopped from raising grounds of invalidity in a District Court proceeding that were raised in the CBM proceeding.
- There is no mandatory stay under CBM.
- CBM-eligible patents do not include patents for "technological inventions."
- Review under the CBM must be completed within one year from initiation of the review and not more than 18 months from the time the petition for review was filed.

These safeguards are working well. For example, to date, approximately 30% of CBM petitions have been rejected.

4. Making CBM Permanent is a Key Tool to Address Patent Quality

Unfortunately, without intervening action by Congress, the CBM program will expire in 2020, once again leaving certain industries exposed to low quality business method patents. There are many existing patents that have yet to be considered by the PTO via the CBM program that would escape review once the program sunsets. In the absence of extending CBM, NPEs are incentivized to simply wait out the program's expiration before emerging to assert low-quality patents. Moreover, the universe of eligible patents has been expanded in the wake of the Supreme Court's *Alice* decision.[8] Currently, subject matter eligibility is the second most common grounds for invalidation in the CBM program. Without CBM, the only option for defendants in cases involving so-called *Alice* patents will be to pay the hold-up fee or engage in costly litigation. Further, the PTO continues to grant additional CBM-eligible method patents that may benefit from CBM review. For these reasons, allowing the sunset to expire will leave businesses in many sectors and of all sizes subject to abusive behavior.

The Financial Services Coalition supports making the CBM program permanent, as it has proven to be a successful, low-cost alternative to litigation of covered business method patents.

***

[8] *See, e.g.*, Professor Mark Lemley of Stanford Law School stated that "I don't think it's all software patents, but I guess what I would say is a majority of the software patents being litigated right now, I think, are invalid under Alice." (http://www.ipwatchdog.com/2014/09/04/the-ramifications-of-alice-a-conversation-with-mark-lemley/id=51023/). Erich Spangenberg, founder of IPNav, recently expressed his view that "the combination of the AIA and recent Supreme Court decisions, especially Alice, have had the effect of wiping out billions of dollars of value in patents, especially software patents. If some of the more recent 101 (what is patent eligible) decisions are upheld, we are only beginning to understand what Alice means." (http://www.ipnav.com/blog/erich-spangenbergs-patent-predictions-for-2015/). Professor David Hricik of Mercer University School of Law commented that "I've been reading a lot of law professor views, and several (if not many) think software patents are dead, or largely so. . . . My guess is Alice is going to cause us all to bang our heads, stub our toes, and wander through Wonderland for many years to come." (http://patentlyo.com/hricik/2014/06/which-mushroom-alice.html).

The financial industry is comprised of lenders and insurers and asset managers, small and large, operating across the country that succeed by serving consumers and other businesses. The abusive tactics of NPEs not only impact the financial institutions, but impede their ability to serve these consumers and small businesses.

Small businesses are one such customer of financial institutions, and these businesses stand at the center of today's debate on H.R. 9, the Innovation Act. Opponents of demand letter reform and CBM permanence frame the debate with claims that meaningful reform will diminish intellectual property rights, hurting investment in today's small business and entrepreneurs by venture capital firms. The opposite is true. Small businesses and entrepreneurs will be hurt if Congress does not halt the NPEs from targeting financial institutions with low quality patents, deceptive demand letter and frivolous lawsuits.

Small business loans are one product in the suite of important services the financial sector provides to the US consumer and business. Whether it is a home loan or student loan, an insurance product to provide your business economic resiliency during a crisis or your family peace of mind, the financial services sector succeeds when it serves its consumers well.

Unfortunately, NPEs choose to target our institutions (as well as every sort of retailer and internet company) with frivolous demands and abusive litigation based on low quality business method patents.

We appreciate your Committee's leadership to curb abuse arising from the assertion of low quality patents and your work on H.R. 9, the "Innovation Act." The Financial Services Coalition believes this is an important step forward. However, failure to include language that would (1) address vaguely worded demand letters, and (2) make permanent the CBM program would leave a significant and critical portion of the US economy at the mercy of the abusive tactics of NPEs armed with low quality business method patents. We strongly urge the inclusion of these common sense solutions in any Manager's Amendment to HR 9 during the Committee mark-up.

***

Thank you again for your leadership on patent reform and for allowing us to submit testimony for the record.

Sincerely,

American Bankers Association
American Insurance Association
The Clearing House Payments Co., L.L.C.
Credit Union National Association
Financial Services Roundtable
Independent Community Bankers of America
National Association of Federal Credit Unions
National Association of Mutual Insurance Companies

CBM Proceedings that Could Benefit Community Banks and Credit Unions

NPE	CBM Petitioner	# Cases Filed	# Defendants	Representative Defendants
Data Treasury	(i) Jack Henry & Assoc. Inc. (ii) Fiserv (iii) Fidelity National Information Services	27	184	JP Morgan Chase, **Zions Bancorp**, Wells Fargo, Bank of America, Citigroup, Deutsche Bank, Harris Bankcorp, PNC, BB&T, M&T Bank, US Bancorp, **Frost Bank**, Key Bank, **First Citizens Bancshares**, **City National Bank, Bancorp South**, Comerica, UBS, **Patriot Bank**, **Prosperity Bancshares**, Regions Financial, Capital One, **First United Bank & Trust, WoodForest Financial Group, Central Bancorp, Community Trust Bank**, Fifth Third Bancorp, **First Financial Bank, Bank of the Ozarks, Cathay Bancorp, Texas Capital Bancshares, Bank of Novia Scotia, Patriot Bank, Central Bancorp, Community Trust Bank, First Financial Bank, Durant Bancorp, United Central Bank, Metrocorp Bancshares, American National Bank of Texas, First National Bank of Nebraska, Inwood Banchsares, Austin Bancorp, Coppermark Bancshares, MetroBank, Huntington Bancshares, First State Bank, American State Bank, Citizens 1st Bank, Independent Bank, Landmark Bank, People's Bank, Pioneer Bank, Midsouth Bancorp, Hull State Bank, Bankers Bancorp of Oklahoma, The Banker's Bank, First National Bank of Kemp, Texas People's National Bank, Heritage Bank, Collin Bank, Southwest Bancorp, First National Bank of Jasper, Gladewater National Bank, Sulphur Springs Bancshares, Third Coast Bancshares, First Liberty National Bank, Northstar Bank of Texas, East Texas National Bank, Grapeland State Bank, Joaquin Bankshares**
Leon Stambler	MasterCard	30	109	**Guaranty Bank**, Wells Fargo, UBS, **Frost Bank**, Bank of America, Regions Financial, JP Morgan Chase, Citigroup, **BancorpSouth Bank**, Comerica, PNC, BB&T, US Bancorp, **Zions Bancorp**, HSBC, **First National Bank**, Suntrust Bank, **American Bank of Commerce**, Morgan Stanley, **Florida Captial Bank**, Ally Financial, **First National of Nebraska, First Citizens Bancshares**, Barclays, Fifth Third, **Huntington Bancshares**, BMO Harris Bank, **Synovus Financial Corp.**
Pi-Net International	SAP America	120	84	Bank of America, M&T Bank, JP Morgan Chase, UBS, **Citizens Financial**, Capital One, **Bridge Bank, Mission National Bank, Presidio Bank, Focus Business Bank, My Credit Union, San Jose Credit Union, National 1st Credit Union, Inland Valley Federal Credit Union, Cal Poly Federal Credit Union, South Bay Credit Union, 1st Valley Credit Union, Media City Community Credit Union**, Ally Financial, Barclays, Wells Fargo, Citigroup, **Umpqua Private Bank, Fremont Bancorp**.
Intellectual Ventures	(i) Bank of America (ii) PNC Bank	19	22	PNC, **First National of Nebraska**, JP Morgan Chase, Fifth Third Bancorp, Capital One, **Commerce Bancshares**, Suntrust Bank, M&T Bank, US Bancorp, HSBC, **Huntington Bancshares**, Citigroup
Maxim Integrated Products	(i) JP Morgan (ii) American Express	59	34	Capital One, **First United Bank & Trust**, PNC, Comerica, **Key Bank**, BB&T, Bank of America, Wells Fargo, JP Morgan Chase, US Bancorp, Citigroup, BMO Harris Bank, Deutsche Bank, **Navy Federal Credit Union**, USAA,
Secure Axess	(i) T. Rowe Price (ii) Bank of the West (iii) PNC Bank	18	41	Harris Bankcorp, **First National Bank Texas, Zions Bancorp, Citizens 1st Bank, Intouch Credit Union, Frost Bank, Bank of the Ozarks**, Bank of America, **Diboll State Bancshares, American National Bank of Texas, First National Bank Southwest, First National Bank of Nebraska, First Community Bancshares, Austin Bancorp, North Dallas Bank & Trust, First Bank & Trust East Texas, Bank of Montreal**, Comerica, Capital One, BMO Harris Bank, PNC, US Bancorp, Ally Financial, **First Financial Bank, Texas Capital Bancshares, Cadence Bank National Association**, Santander Bank
Soubran, Inc.	US Bancorp	1	1	US Bancorp

Exhibit A

CBM Petitioner	NPE	# Cases Filed	# Defendants	Representative Defendants
(i) Best Buy (ii) Home Depot (iii) GSI Solutions	Pi-Net (Lakshmi Arunachalam)	121	84	Advantage Payroll Services, Ally Financial, **American Eagle Outfitters, Autozone, Areopostale,** Axcess Financial Services, Bank of America, **Best Buy, Chico's Retail Services,** Citigroup, **Dillards, Edible Arrangements,** Focus Business Bank, **Gamestop, Home Depot, JC Penney, Jos. A. Banks Clothiers,** JP Morgan Chase, **Kohl's, Limited Brands, Lowe's Home Improvement, Macy's,** My Credit Union, National 1st Credit Union, **Office Depot, PETCO Animal Supplies, Sears,** South Bay Credit Union, **The Finish Line, Target, Toys R Us,** Umpqua Holdings, **Under Armour, Walmart, Walgreen**
(i) Agilysis, Inc. (ii) Apple (iii) Expedia, Inc. (iv) Starbucks	Ameranth Inc.	49	52	**Apple,** Cash Register Sales & Service, Comcast Corp, **Domino's Pizza, eBay, Inc., Hyatt Hotels,** Ipdev Co., **Live Nation Entertainment,** Lone Tree Technology, **Marriott,** Micros Systems, **Naama Networks, Oracle, Orbitz, Papa John's,** Radiant Systems, **Ritz Carlton, Starbuck's,** Subtledata, Inc., **Ticketfly,** Usablenet, **Yum! Brands**
Acxiom Corporation	Phoenix Licensing, LLC	56	119	Ally Financial, Bank of America, BB&T, Capital One, Citigroup, Comerica, Credit One Bank, Frost National Bank, Fifth Third Bancorp, First National of Nebraska, HSBC, ING, JP Morgan Chase, **Kohl's Corp.**, **Macy's Inc.,** M&T Bank, PNC Bank, Regions Financial, Suntrust Banks, TCF Financial, Toronto-Dominion Bank, USAA, US Bancorp, Wells Fargo
Mastercard	Leon Stambler	109	97	Ally Financial, **Amazon.com,** American Bank of Commerce, **American Eagle Outfitters,** Bank of America, Barclays, **Barnes & Noble Inc.,** BB&T, **Best Buy,** BOK Financial, Capital One, Citigroup, Comerica, **Container Store, Crate & Barrel,** Delta Airlines, Discover Financial, First Data Corp., **Fossil Inc., Gamestop Corp., Gap Inc.,** Guaranty Bank, **Home Depot, JC Penny,** JP Morgan Chase, Legacy Texas Group, **Limited Brands, Lowe's Companies, Macy's Inc.,** Morgan Stanley, **Neiman Marcus, Newegg Inc., Office Depot,** PNC Bank, **Radio Shack,** Regions Financial, **Sears, Signet Jewelers, Target Corp.,** UBS, **Urban Outfitters, Wal-Mart Stores, Walgreen Co., Williams-**

Exhibit B

CBM Petitioner	NPE	# Cases Filed	# Defendants	Representative Defendants
Amazon.com	C4cast.com	27	31	**Amazon.com**, American Express, **Apple, Barnes & Noble**, Capital One, **Dell, Inc., Gamestop Corp., Gametap, LLC, JC Penny, Kohl's Corp., LL Bean, Radio Shack Corp., Sally Beauty Holdings, Sears**, Starwood Hotels, The Hearst Corp., Time Warner Inc.,
Google	SimpleAir Inc.	10	26	**Amazon.com, eBay, Apple,** AWS Convergence Technologies, **CBS Corp, ClearTXT, Inc., ESPN Enterprises, Google, HTC Corp**, Huawei,
Salesforce.com	VirtualAgility Inc.	1	9	Bank of America, BMC Software, Comcast Corp., **Dell Inc.**, **Dr. Pepper Snapple Group**, FedE Corp, Kimberly-Clark, **LivingSocial, Inc.**, Microsoft, **Salesforce.com,** Softbank Corp., The Walt Disney Co., The Weather Channel Inc., Yahoo!
eBay	Purple Leaf LLC	7	10	**Amazon.com**, American Express, Citigroup, **eBay Inc.**, Fiserv, **Google**, Inc., JP Morgan Chase, PNC Financial, SAP, Zuora Inc.
FedEx Corp.	Ronald A. Katz	103	155	American Airlines, AOL, Inc. Bank of America, BB&T, **Brooks Pharmacy, Inc.**, Centerpoint Energy, Charter Communications, Chevron, Citigroup, **Costco Wholesale**, **CVS Caremark, Dillard's, Inc.**, **Eckerd Corp., Federated Department Stores**, Fifth Third Bancorp, Hilton, Humana, JP Morgan Chase, **Kohl's Corp., Kroger Co.**, M&T Bank, **Macy's**, Old National Bancorp., **Petmed Express**, PNC Financial, **Rite Aid Corp., Safeway Inc.**, Sirius XM Radio, Sky Bank, **Target Corp., Tel-Drug, Inc.**, US Bancorp, **Wal-Mart Stores, Whirlpool**
Samsung	Smartflash Technologies	5	32	**Apple, Amazon.com, Game Circus, LLC, Google, HTC Corp., Kingsisle Entertainment, Robot Entertainment**

Exhibit B