



INTELLECTUAL PROPERTY MANAGEMENT

# Extortionist Demand Letters are Wrecking Public Confidence in the U.S. Patent System. It's Time to Stand Up to the Demand.

By Scott Burt  
Senior Vice President and Chief Intellectual Property Officer  
Conversant Intellectual Property Management Inc.

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**DEAR PATENT TROLL: DROP DEAD**

It's an axiom of modern-day political gridlock that Americans can't agree on anything. But patent trolls have succeeded in uniting just about everyone in the country around one urgent task: stopping the victimization of small business through extortionist demand letters.

Last year, Vermont Attorney General Bill Sorrell went after patent troll demand letters using a novel legal strategy: he used the state's existing consumer protection laws to sue the patent trolls who send them. The State of Vermont charged MPHJ Technologies with engaging in unfair and deceptive trade practices by making false claims to recipients of its demand letters. These false claims included:

"Stating that litigation would be brought against the recipients when Defendant was neither prepared nor likely to bring litigation...[implying] that Defendant had performed a sufficient pre-suit investigation, including investigation into the target businesses and their [supposedly] infringing activities, that would be required to justify filing a lawsuit...claiming that] many if not most businesses were interested in promptly purchasing a license from Defendant...[and] using shell corporations in order to hide the true owners of the patents, avoid liability, and encourage quick settlements."

**FIGHTING BACK**

Vermont's suit asked the court to order a permanent injunction barring MPHJ from "threatening Vermont businesses with patent infringement lawsuits" or "engaging in any business activity" in the state that violates Vermont law. It also asked the court to order MPHJ to make "full restitution to Vermont businesses who suffered damages due to Defendant's acts," and impose "civil penalties of up to \$10,000 for each violation of the Consumer Protection Act."

Vermont's suit is still pending, but its effect has already been felt far beyond the state's tiny borders. In the last year alone, Nebraska filed a cease-and-desist order against MPHJ and its attorneys, and New York forced MPHJ to sign a consent decree requiring

**A**dam Carolla, one of the most popular bloggers in the U.S., is sued by a patent troll. The story goes viral. Across the country, state Attorneys General are using consumer protection laws to guard their small businesses from predacious patent trolls. And here's something previously unthinkable: the President of the United States, in the 2014 State of the Union address ("It's the country's most valuable political real estate," noted one D.C. veteran), urged Congress to "pass a patent reform bill that allows our businesses to stay focused on innovation, not costly and needless litigation."

The greatest long-term threat to the U.S. patent system does not come from its professional opponents—those large businesses and their political allies who stand to profit from enfeebled patent rights. A deeper harm is caused by unscrupulous patent trolls who use extortionist "demand letters" to victimize small businesses. This practice, we believe, is wrecking public confidence in the U.S. patent system—and by extension, profoundly weakening the bedrock belief in the great economic benefits conferred by patent-protected inventions.

Yet even as damage caused by demand letters spreads, most legitimate patent licensors whose businesses depend upon continued legislative and public trust stand idly by, doing little or nothing to address it. Well-insulated within the patent industry's cozy professional bubble, we are, in effect, fiddling like a modern-day Nero while innovation's Rome burns.

**FAR-REACHING IMPACT**

Why the disconnect? Most people in the patent licensing industry understand that patent troll demand letters are a significant economic problem for U.S. small business community, costing millions of dollars in settlement fees and legal costs annually. What's not grasped is that phony demand letters are an even greater political problem for our industry and for the patent system as a whole. Let's quickly review the problem.

Patent trolls, typically operating through shell companies, send form letters to dozens, hundreds, or even thousands of apparently random small businesses at a time, claiming with little or no evidence that they are "infringing" the troll's patents. The senders demand so-called "licensing fees" ranging from \$1,000 to \$50,000 or more (depending on the size of the business) to avoid a patent infringement lawsuit that could cost these businesses far more to defend against in court—even if the business owner is innocent of any infringement.

It's true that comprehensive, nationwide data on the extent of the demand letter problem and its economic impact is hard to come by or doesn't exist. But there is mounting anecdotal evidence that the deluge of demand letters is at the very least harming one of the nation's most critical job creation sectors, small businesses and startup companies. The reported impact usually takes the form of hiring delays, reduced R&D spending, or a negative change in product or business strategy. One study reported that 70 percent of 200 venture capitalists surveyed had invested in startup companies that later received extortionist demand letters.

Simply looking at the aggregate economic impact of patent troll demand letters, however, or advocating for more study of the issue before acting, misses their fundamental emotional impact—the intense popular rage that they generate. To understand that, you've got to put yourself in the shoes of a small business owner who is victimized by a patent troll.

## DEMAND LETTERS—SETTLING IS CHEAPER THAN FIGHTING, UNFORTUNATELY

Imagine that one day, out of the blue, you get a certified letter from some shell company or law office you've never heard of before, claiming that the \$39 Wi-Fi router you bought at Office Depot a few months back to communicate with your customers and suppliers is somehow infringing one of the troll's patents. No actual evidence of infringement is provided. No patent claims are cited. Nevertheless, the sender threatens to sue you in United States federal court for patent infringement unless you pay a \$5,000 "license fee."

You have no way of knowing if the letter is legitimate, if its claim that you are infringing a patent is true, or even if the patent itself is actually valid or not. Your regular business lawyer has no clue, either, because the only people sufficiently skilled in reading the specialized legal language of patent claims are patent attorneys. Assuming you find a patent attorney who has time to meet with you, that attorney's rates likely start at around \$500 per hour.

But okay, you figure that spending \$500 or \$1,000 on a patent attorney is better than forking over \$5,000 or more to some thieving patent troll. So you meet with the patent attorney. To your shock, however, he or she quickly reviews the demand letter and advises you that the economically rational decision is to pay the toll from the troll. Yes, you can ignore the letter or outright refuse to pay, but you then risk a ruinous patent infringement lawsuit that could easily cost you at least hundreds of thousands of dollars to defend! You read about heroic business owners who've fought trolls, and won,

it to pay back all monies it extorted from businesses in the state and stop sending deceptive demand letters to any others. In addition, new laws against patent troll demand letters have been enacted in 12 states and are being considered in 24 others.

When was the last time a common cause has united so many states?

It's not just the states that have acted with such surprising vigor. At the federal level, in June 2014, Representative Lee Terry (R-Nebraska) unveiled a draft demand letter bill that would clarify the power of the Federal Trade Commission (FTC) and state Attorneys General to regulate patent demand letters sent in bad faith. The bill is winning broad support.

The FTC itself announced last December that it would sue MPHJ for violating Section 5 of the Federal Trade Act, which bars deceptive trade practices such as threatening litigation without any genuine intention to bring it. MPHJ responded with a suit of its own against the FTC, claiming the agency is overstepping its bounds. It certainly seems as if the tide is turning against MPHJ, at least.

### BEATING THE TROLL TOLL

Even the U.S. Supreme Court has jumped into the fray and helped to pave the way for more effective action against the senders of bad demand letters. In April 2014, the Court issued a ruling in the closely-watched Octane Fitness case that significantly expanded the grounds under which defendants may collect attorney's fees from abusive patent litigants.

The effect was felt almost immediately. One month and two days after the Supreme Court ruled in Octane Fitness, Judge Denise Cote of the Southern District of New York awarded attorney's fees to a startup company called FindTheBest.com after it was victorious in a patent suit filed by a patent troll that had demanded a \$50,000 "license fee" from the startup. The judge also ruled the troll's ridiculously vague patent invalid, thereby making it impossible for the troll to extort other businesses—with that patent, at least.

Although this ruling is significant and likely presages more such victories against patent extortionists, it should be noted that many small businesses don't have the funds required to go to trial rather than surrender. Octane Fitness, based in Minnesota, is seeking reimbursement for \$1.8 million in attorneys' fees, while FindTheBest spent close to \$200,000 to win its case—four times the amount they could have settled for. Although they will now recoup those fees, many other small firms are simply not in a financial position to follow their example.

The breadth of anti-troll sentiment and activity is breathtaking in scope. From Montpelier, Vermont to Washington, D.C.—and from the corridors of our regulatory agencies to the chambers of the U.S. Supreme Court—a clarion call is being heard to stop these extortionist demand letters now! Only an intense popular rage at the patent trolls who corrupt America's venerable and vital patent system could possibly account for such a strong and united effort.

#### AN EMOTIONAL RESPONSE

That rage is felt every day, of course, by the individual owners of thousands upon thousands of small business victims. Take Chris Hulls, the CEO of family social network Life360. When he received a demand letter, he overruled his company's attorneys and sent a rather more personal response to the patent troll.

"Dear Piece of Shit," he wrote. "We are currently in the process of retaining counsel and investigating this matter. As a result, we will not be able to meet your Friday deadline."

Hulls closed his letter thusly: "I will pray tonight that karma is real, and that you are its worthy recipient."

While Hulls' anger is certainly understandable, your own mileage may vary should you adopt a similarly aggressive approach. In Hull's case, the patent troll immediately filed suit in a Florida district court.

because it was the "right thing to do"—but it cost them \$100,000 or more to do so. You don't have that kind of coin.

Oh, and forget about trying to negotiate with the patent troll. Their demand letters often don't include a phone number, just a P.O. Box to which you are told to send a check. Even if they include a phone number, they won't return your calls.

Bitterly, you bite the bullet and write a check for \$5,000—money earmarked for growing your business—plus hundreds more for the patent attorney, who advised you to fold your hand.

Inside, you seethe with anger. Anger at the sheer injustice of it all. And quite often, anger at a patent system that apparently allows such outright extortion to be perpetrated.

Only if you can picture yourself being victimized by such a demand letter can you truly grasp why they — and the abusive practices of patent trolls in general—have sparked such a wave of protest from the business community, the public, and from elected officials.

## POLITICIANS ARE LISTENING—AND ACTING

The National Federation of Independent Businesses (NFIB) and many other retail business groups and trade associations have demanded that the government act. Washington is listening. Only several years ago, very few members of Congress ever gave any thought at all to patent issues. Today, anti-patent sentiment is rampant and Congress seems determined to enact some sort of anti-troll legislation, having been besieged over the last couple of years by thousands of very angry Main Street constituents to do something.

In December 2013, the House of Representatives easily passed the Innovation Act. This act targeted the use of shell companies, required greater details about infringement allegations, and included a "loser pays" provision. However, the Senate's companion bill, the Patent Transparency and Improvements Act, stalled repeatedly and was ultimately withdrawn by Senator Patrick Leahy (D-Vermont) owing to justifiable concerns that it would have severe unintended consequences on legitimate patent holders.

The enthusiasm for new laws curbing patent trolls hasn't waned. In June 2014, only two weeks after Sen. Leahy withdrew his bill, the House of Representatives launched another attempt. Rep. Lee Terry (R-Nebraska) unveiled a draft demand letter bill that would clarify the power of the Federal Trade Commission (FTC) and state Attorneys General to regulate patent demand letters sent in bad faith.

The bill is winning broad support.

At the state level, meanwhile, a dozen states have already enacted laws to curb abusive patent demand letters, and 14 other states are actively considering legislation to do the same. In addition, the Attorneys General of several states have brought suit against trolls who send these letters using existing consumer protection laws against making false claims to extort money.

One of the most successful suits took place in New York, where in January 2014 state Attorney General Eric Schneiderman forced MPHJ Technologies, LLC to sign a consent decree requiring it to repay all the money it received from businesses in the state. MPHJ, using various shell companies, had falsely claimed in demand letters it sent to businesses that it had analyzed each target company's scanning systems and determined these to be in violation of its patents. In fact, MPHJ had merely sent form letters to hundreds of companies of a certain size and industry classification without investigating or uncovering any evidence whatsoever of infringement.

What is this if not outright extortion? This is what so many ordinary citizens and small business owners are so furious—and with good reason.

If they know history, they will be wondering, “Where is the patent system of Thomas Edison? What happened to a patent system that helped transform a largely agrarian United States in the 19th century into the global leader of the Industrial Revolution, and in the 20th and 21st centuries, into the world's most prosperous and economically powerful nation?”

Have patent trolls now turned it into little more than a protection racket and a tax on small businesses?

As an industry and as professionals, we should forthrightly condemn the practices of bad actors that are victimizing the innocent—just as responsible members of other industries condemn the predatory practices of bad actors in their fields. Then we must do our part to root them out. Only by doing so can we revitalize and reaffirm the demonstrable truth that the American patent system plays a vitally important role in the innovative process and the economic strength we all enjoy.

But instead, many in our industry sit silently on their hands, fearful of getting embroiled in controversy or of giving opponents of the patent system more ammunition with which to criticize and attack it. At the recent Global IPBC industry conference in Amsterdam, many speakers condemned patent trolls, yet no action plans were proposed. Some licensors even continue to write about “the so-called”

## One Dollar, Five Patents, and 16,465 Victims

One thing you can say about patent trolls: They sure are cowboys! In fact, one of the biggest patent trolls of all time is a cowboy hat-wearing Texas lawyer by the name of Jay Mac Rust.

In 2012, Mr. Rust bought five patents from an inventor named Laurence Klein for exactly \$1. He then set up 101 separate limited liability companies (LLCs) shells, each with bizarre six letter names like IsaMai, BriPol, and HarNol. No one but Mr. Rust knows what those acronyms mean. But thousands of Mom and Pop small businesses—16,465 to be exact—soon found out that they translate as “trouble.” Each of these businesses received a “demand letter” from one of Rust's shell companies accusing them of patent infringement and demanding roughly \$1,000 per employee if they wanted to avoid a minimum six-figure (and possibly seven-figure) lawsuit in U.S. federal court.

### A RANDOM ATTACK

How did Rust's parent company MPHJ Technologies and its hydra-headed hundred-and-one LLCs decide which small business to target? Simple. His lawyers selected a random batch of companies listed in public records as having 1 – 49 employees, then 50 – 99 employees, and so on. Then they began moving up the food chain, making unsubstantiated accusations of patent infringement—starting with those least able to fight back.

There's a word for that: “bully.”

The good news, as you'll discover elsewhere in this paper, is that states' attorneys general in Vermont, Nebraska, and New York have sought to impose another word for Mr. Rust's patent troll profit rodeo: “illegal.”

Then there's another patent troll cowboy by the name of Martin Jones, who claims to have invented a telephone-based system back in the early 1990s that notified parents when school buses were due to arrive to pick up their kids. Somehow, Mr. Jones has made the rather large assumption that his pre-Internet invention covers all means

of vehicle-tracking anywhere in the world, using any technology now or yet to be invented.

Have you ever checked a UPS tracking number over the web for an online order that was shipped to you? Mr. Jones's company, ArrivalStar, might like to talk to you about paying a "royalty" on his patents.

Except that he never actually wants to talk to anyone, let alone negotiate. ArrivalStar regularly sends "demand letters" to small and mid-sized companies, knowing their attorneys will say it's cheaper to pay a high five-figure "settlement fee" than the mid-six figure to low seven-figure cost of fighting in court.

#### TRANSIT CALLS A HALT

The outcome was different when ArrivalStar picked on the wrong crowd, however. After the company took the unusual step of suing public transit agencies—Seattle, Chicago, and Boston forked over high five-figure settlements—the American Public Transit Association (APTA) finally took him to court in an effort to invalidate his patents.

Mr. Jones quickly settled rather than face a real test of his patents. He promised to never again sue or threaten to sue a public transit agency or its vendors.



patent troll problem, as if thousands of small business victims were somehow merely imagining it all. Denial should not be tolerated in our industry.

## STAND UP TO THE DEMAND

At Conversant, we believe it's time to step up and help deal with the scourge of patent troll demand letters. So we've launched a "Stand Up to the Demand" campaign designed to help small businesses identify and respond to extortionist patent demand letters. We're not doing this for practical business gain, because small businesses are not our partners or licensees. Rather, we have launched this campaign because it's the right thing to do, and we hope it will help restore public trust in our industry and in our patent system as a national engine of economic progress and competitiveness.

The first phase of our campaign features a web site with an infographic quiz that helps business owners distinguish a bad demand letter from a legitimate notice letter, and view sample demand and notice letters as well as a video. We're inviting the public to share their stories of how they are dealing with patent trolls. We're also linking to other resources, such as the website, operated by the U.S. Patent and Trademark Office (USPTO), that's designed to offer advice to small businesses that believe they have been the victims of abusive demand letters. And there's a link to a free web-based tool launched by RPX, a provider of patent risk management solutions, that helps small business owners research the background and litigation history of the senders of demand letters, to the extent these are known.

Former USPTO director David Kappos has described the U.S. patent system as "our country's investment plan—a giant 401k through which we pay a little extra now for more great innovations in the future." As a vital guarantor of our nation's future, the patent system certainly warrants that description. Let's not forfeit our future by allowing patent trolls to corrupt it today.



**conversant**

INTELLECTUAL PROPERTY MANAGEMENT

**Corporate Headquarters**  
11 Hines Road, Suite 203  
Ottawa ON, Canada K2K 2X1

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