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Troll Tamers: State Attorneys General's Role in the Patent Reform Debate

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Over the last two years, federal and state legislators, regulators, judges, and State Attorneys General (AGs) have found themselves at the center of a national debate over how non-practicing entities (NPEs) assert claims to intellectual property. Particularly controversial has been the practice of some NPEs—also referred to as "patent trolls"—sending demand letters or filing lawsuits containing baseless or frivolous patent infringement claims and threatening litigation if the recipient does not pay a licensing fee. This practice has impacted large and small businesses alike in every industry, from high-tech to retail to construction. The focus on bad-faith infringement claims subsequently has expanded to a wide-ranging discussion of the need for more sweeping reforms to the patent system and how far such reforms should go, including what should be patentable and how should patent litigation be conducted.

AGs have been at the leading edge of much of this activity. Lawsuits by the Vermont and Nebraska AGs against patent trolls have led to legislation in more than a dozen states specifically to prohibit bad-faith patent infringement claims. The Federal Trade Commission (FTC) also is involved in litigation over its authority to take action against patent trolls. More recent attention has been on Congress, which, spurred in part by AGs, has considered a number of bills reforming patent litigation. As Congressional reform efforts have stalled, the states, and particularly AGs, likely will continue to lead in this area as the debate continues not only about stopping patent trolls, but how to balance innovation with intellectual property rights and economic growth.

AGs and State Action

Vermont AG Bill Sorrell's first-of-its-kind unfair and deceptive trade practices lawsuit against an alleged patent troll was a key catalyst in the current debate over patent reform. In May 2013, AG Sorrell's office sued MPHJ Technology Investments, LLC, which claims to own a patent for a document scanning process, alleging that it targeted hundreds of small businesses, non-profits, and individuals with demand letters threatening to sue if the recipient did not pay substantial licensing fees.[1] Vermont's suit claimed that the letters were false and misleading and included threats of imminent litigation that MPHJ had no intention of bringing, lacked any evidence that recipients actually were infringing, and used shell companies to conceal MPHJ's true identity.

MPHJ attempted to remove Vermont's suit to federal court, claiming that patent issues are exclusively federal in nature. In April 2014, the Vermont federal court rejected that argument and remanded the case to state court.[2] The court held that the AG's lawsuit did not challenge the validity or scope of the asserted patents, nor would it require any determination of whether

[1] *State v. MPHJ Technology Investments, LLC*, No. 282-5-13 (Vt. Sup. Ct. Washington Unit).

[2] *Vermont v. MPHJ Technology Investments, LLC*, No. 2:13-cv-00170 (D. Vt.).

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infringement actually occurred. The issue was whether MPHJ used false or deceptive statements in its demand letters, a traditional application of state consumer protection laws. Moreover, the AG did not seek to enjoin MPHJ entirely from enforcing its patent rights, but only from doing so in a way that violated Vermont law. The case is now pending in Vermont state court.

The Vermont action spurred action in other states. The AGs of Minnesota and New York settled with MPHJ by early 2014. New York's settlement in particular set forth conduct that the office would use in determining whether patent enforcement actions were brought in bad-faith, including whether the asserting entity conducted a real investigation, provided adequate information about the alleged patent, was transparent about its identity (i.e., did not hide behind shell companies), and made accurate statements about proposed licensing fees.[3] Other AGs also have investigated alleged misconduct involving patents within their states.

In July 2013, Nebraska AG Jon Bruning's office issued a "cease-and-desist" order against counsel for two NPEs, Activision TV, Inc.,[4] and MPHJ, based on similar allegations that the entities had made bad-faith patent infringement claims.[5] However, Activision and MPHJ obtained a preliminary injunction in federal court enjoining the AG from pursuing claims for violation of state consumer protection law on the basis that such action would infringe on the entities' right to enforce their patents and hire counsel of their own choosing. Nebraska has appealed that injunction to the Eighth Circuit Court of Appeals.[6]

Apart from bringing investigations and lawsuits, AGs have played a key role in the development of state legislation addressing patent infringement claims. Fifteen states,[7] most with the backing of their AGs, have now enacted laws prohibiting bad-faith demand letters and lawsuits and empowering their AGs to enforce those laws, and more than ten other states have or will consider such bills. These laws, generally modeled after a 2013 Vermont law,[8] set forth criteria to consider when evaluating whether a demand letter or suit is in bad faith, such as failure to conduct an actual investigation, lack of sufficient detail regarding the asserted patent, and unreasonable fees. Some of these laws allow recipients of bad-faith demands to bring their own enforcement actions independently of the AG.

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[3] Assurance of Discontinuance No. 14-015, *In re Investigation by Attorney General of New York of MPHJ Technology Investments, LLC* (Jan. 13, 2014), *available at* http://www.ag.ny.gov/pdfs/FINALAODMPHJ.pdf.

[4] Not related to NASDAQ-listed Activision Blizzard, Inc., the interactive entertainment software company.

[5] *Activision TV, Inc. v. Pinnacle Bancorp, Inc.*, No. 8:13-cv-00215 (D. Neb.).

[6] *MPHJ Technology Investments v. Bruning*, No. 14-2137 (8th Cir.).

[7] Alabama, Georgia, Idaho, Louisiana, Maine, Maryland, Missouri, Oklahoma, Oregon, South Dakota, Tennessee, Utah, Vermont, Virginia, and Wisconsin. An Illinois law currently is awaiting the Governor's signature.

[8] Codified at 9 Vt. Stat. § 4195 *et seq*.

Federal Action and Court Decisions

Action by AGs has helped spur a flurry of activity regarding patent trolls at the federal level as well. The Obama Administration included reforms to the patent system as a priority in the 2014 State of the Union Address, including calling for efforts to combat patent trolls.[9] The U.S. Patent and Trademark Office (USPTO) subsequently undertook a number of actions to assist those who may be targeted by trolls, such as proposing a rule to ensure that patent owners record and regularly update ownership information when they are involved in proceedings before the USPTO, and providing an online toolkit aimed at empowering consumers and businesses with answers to common questions, information about patent suits, and details about specific patents. However, USPTO has limited ability to regulate patent litigation, and therefore substantial reform must come from Congress.

Congress has considered a dozen or more laws to reform the patent system in various ways. Nebraska AG Bruning has appeared before Congress in support of such efforts, and other AGs also have publicly supported federal legislation. The House of Representatives passed the Innovation Act (H.R. 3309) in December 2013 that went beyond merely prohibiting bad-faith demand letters and suits and, among other things, heighten the pleading standard for patent infringement claims, limit initial discovery, and permit fee-shifting to make frivolous filers pay defense costs in certain circumstances. The Senate has yet to vote on that bill.

More recently, federal legislative efforts largely have stalled as the debate about the extent to which and how the patent system should be reformed has expanded far beyond preventing bad-faith demands and lawsuits. The line between bad-faith demands and proper defenses of intellectual property becomes much harder to discern once efforts go beyond the most egregious examples. In addition, intellectual property involves a complex balance of interests between cutting-edge innovators, established owners of intellectual property, and legitimate entities that assist innovators to monetize their patents, among others. Resolving the tensions and competing concerns of such stakeholders has proven contentious, as attested to most recently by Senator Patrick Leahy's decision in July 2014 to stop pushing for passage of his reform bill, generally regarded as the leading proposal in the Senate.

The FTC also has begun a review of patent enforcement activities, including bad faith demands and lawsuits. Those efforts also have stalled however, as the FTC is currently locked in litigation with MPHJ, which filed a suit—similar to that against the Nebraska AG—seeking to enjoin the Commission from investigating and taking action against patent trolls.[10] In addition, two decisions by the U.S. Supreme Court from earlier this year, which relaxed the standard used by district courts to award fees to a prevailing party in an intellectual property case, may prove to be a double-edged sword.[11] Loser-pays fee-shifting has been a major component of proposed

[9] http://www.whitehouse.gov/the-press-office/2014/02/20/fact-sheet-executive-actions-answering-president-s-call-strengthen-our-p.

[10] *MPHJ Technology Investments, LLC v. Federal Trade Commission*, No. 6:14-cv-00011 (W.D. Tex.).

[11] *Octane Fitness, LLC v. Icon Health & Fitness, Inc.*, No. 12-1184 (2014), and *Highmark Inc. v. Allcare Health Management System, Inc.*, No. 12-1163 (2014),

federal legislation. Therefore, fee-shifting decisions may undermine the urgency of Congressional reform.

AGs and the Future of the Issue

With federal efforts flagging or stalled, the next developments on the issue of patent enforcement once again will come from the states. Vermont's suit, now back in state court, continues to proceed and will be a litmus test of the extent of an AG's consumer protection authority when applied in the patent context, as will the Eighth Circuit's ruling on Nebraska's appeal. Moreover, AGs will continue to support state laws governing permissible conduct in making patent assertion claims, and such laws are likely to raise new issues and influence the national debate as they begin to be enforced by AGs and private plaintiffs. As bad-faith patent demands continue to be a drain on industries and companies big and small, AGs will be key allies for the business community in combating such misconduct.

AGs also will continue to make their voices heard directly with lawmakers and regulators regarding the extent to which further reform is needed. The evolution of this issue, and AGs' role in the process, stands as a key example of the influence that states can have on questions previously regarded as federal in nature, which also include subjects such as data privacy, merger approval, environmental regulations, and healthcare on which AGs have not been hesitant to make their voices heard. The issue of patents often involves conflicting priorities between economic growth, judicial and regulatory efficiency, and innovation, and between stakeholders in government, established industries, cutting-edge innovators, venture capitalists, and consumers. AGs have made valuable contributions in identifying and attempting to balance such competing interests, and they remain well-positioned to continue to do so directly and indirectly as the debate continues.