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Why Technology Customers Are Being Sued En Masse for Patent Infringement & What Can Be Done

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ABSTRACT

Last year, the Children's Hospital of Philadelphia and the AIDS Healthcare Foundation were accused of patent infringement. Their alleged wrongdoing? Purchasing routers and using them to provide wireless services. A small Atlanta-based company called Bluewave, along with hundreds to thousands of small businesses, received demands for royalties for alleged patent infringement. The accusation? Using an off-the-shelf PDF machine. As incredible as they might seem, these mass patent assertions and the harm they cause are real – six out of the top ten patent litigation campaigns have exclusively named technology customers, not suppliers. This has drawn attention from state attorneys generals, Congress, and President Obama. In this article we explain the motives, opportunistic and legitimate, behind these demands, the harm they pose, and what can be done. To do this we draw from numerous sources – including surveys of in-house and outside counsel and our own experience litigating. Good business dictates that technology suppliers should generally step in to take care of their customers. But we find legal and practical barriers exist – demand letters and litigation complaints don't identify the basis for liability, courts have denied declaratory judgment jurisdiction and the right to intervene frequently, and the courts have refused to protect customers from litigation even when suppliers have stepped up. We recommend that Congress and the courts work to (1) confirm the right of suppliers to intervene and bring cases, (2) minimize the burden on customers when suppliers do step up and participate, and (3) incent customer demand letters and complaints to specifically identify the product which gives rise to liability and disclose other basic information, so that customers may assess their own risk and pass on the demand to their supplier. We also provide a host of reforms that federal lawmakers should consider to make end users less attractive targets for patent lawsuits.

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Introduction

Last year, the Children's Hospital of Philadelphia and the AIDS Healthcare Foundation were accused of patent infringement. Their alleged wrongdoing? Purchasing routers and using them to provide wireless services.[3] A small Atlanta-based company called Bluewave, along with hundreds to thousands of small businesses, received demands for a royalties for patent infringement.[4] The accusation? Using an off-the-shelf PDF machine.[5] Recently, the City of Raleigh, the Massachusetts Bay Transportation Authority, and hundreds of cities, transit agencies, and other entities were sued for patent infringement. The offense? Implementing vehicle tracking technology that enabled real-time transit arrival information.[6]

As incredible as this might seem to the casual observer, these mass patent assertions, and the toll they take, are real. Once relatively rare,[7] en masse suits against customers for implementing or using someone else's technology are increasingly commonplace.[8] According to an analysis provided by Patent Freedom, a company that tracks patent suits, six out of the top ten patent litigation campaigns exclusively named companies for whom the adoption of another's technology was the basis for infringement. (Table 1)

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[3] Motion to Compel, *In re* Innovatio IP Ventures v. Cosi, No. 1:11-cv-09308 (N.D. Ill. Aug. 16, 2012) BL No. 385; Innovatio IP Ventures, LLC v. Cosi, Inc., No. 1:11-cv-01638 (N.D. Ill.).

[4] Kris Frieswick, *The Real Toll of Patent Trolls,* INC. (Feb. 14, 2013), *available at* http://www.inc.com/magazine/201202/kris-frieswick/patent-troll-toll-on-businesses_pagen_3.html; Consumer Protection Complaint, State of Vermont v. MPHJ Technology Investments, No. 282-5-13 Wncv (Vt. Sup. Ct., 2012), *available at* http://www.atg.state.vt.us/assets/files/Vermont%20v%20MPHJ%20Technologies%20Complaint.pdf

[5] Id.

[6] Emily Badger, *Why is a Patent Troll in Luxembourg Suing U.S. Public Transit Agencies?,* THE ATLANTIC CITIES PLACE MATTERS (Apr. 23, 2012), *available at* http://www.theatlanticcities.com/technology/2012/04/why-patent-troll-luxemburg-suing-us-public-transit-agencies/1819/; Sys. & Method for Adv. Notification Sys. for Monitoring and Reporting Proximity of Vehicle, U.S. Patent No. 6,714,859, Abstract (filed Jul. 18, 2001), *available at* https://lexmachina.com/members/cases/patent/6714859.

[7] Roger D. Blair & Thomas F. Cotter, *An Economic Analysis of Seller and User Liability in Intellectual Property Law*, 68 U. CIN. L. REV. 1, 3. (finding, based on an empirical analysis, that patent law is "almost never enforced" against customers, in particular private, noncommercial users of inventions).

[8] Technology customers come in many forms, including mere technology adopters who use freely available resources. In this essay, we use the term "customer" in the broad sense.

Table 1: Top Patent Litigation Campaigns in the Last 3 Years[9]

Data Source: Patent Freedom

Campaign (Plaintiff)	**Defendant Count[10]**	**Technology**	**Estimated % of Customer Defendants**
GeoTag Inc	544	Website geolocator	100%
PJC Logistics LLC	517	Vehicle tracking	85-90%
Select Retrieval LLC	223	Data display	100%
Lodsys LLC	192	Customer interactive features	100%
LVL Patent Group LLC	158	Database	100%
Webvention LLC	201	Interactive online environment	100%
Blue Spike LLC	224	Digital fingerprinting	~50%
Unified Messaging Solutions LLC	183	Email	~90-95%
MacroSolve Inc	100	Electronic forms	70%
DietGoal Innovations LLC	109	Diet software	100%

The collective impact of these suits is considerable. The cost of defending a patent lawsuit is staggering, running into 6 and 7 figures[11] – even if the claim is dismissed.[12] Often small companies must enter into relatively expensive

[9] Methodology provided in Appendix A

[10] Includes administrative duplicates.

[11] AM. INTELL. PROP. LAW ASS'N LAW: PRACTICE MGMT. COMM., REPORT OF THE ECONOMIC SURVEY, I-153-I-154 (2011) [hereinafter "AIPLA REPORT"]. The 2011 AIPLA Report of the Economic Survey shows that the average cost of a patent infringement suit where less than $1 million are at risk is $490,000 through the end of discovery and $916,000 inclusive of all costs. Where $1-$25 million are at risk, the average patent infringement suit costs $1.633 million through the end of discovery and $2.769 million inclusive of all costs. Where more than $25 million are at risk, a patent infringement suit costs $3.553 million through the end of discovery and $6.018 million inclusive of all costs.

[12] In our experience, it can cost between $500,000 and $1,000,000 to eliminate meritless claims through summary judgment because many courts will not even consider whether a case lacks merit until after an expensive discovery and expert witness process is complete.

settlements to avoid the financial ruin of a protracted law suit for which they are ill-prepared. Compounding the problem, litigation involving hundreds of customers, rather than a single supplier, creates a coordination burden that drives settlement for cost avoidance, rather than the merits. These matters create a case management nightmare for the legal system. Beyond the courtroom, the frequent mass inclusion of customers in patent lawsuits disrupts business relationships and attaches unwanted liability to the use of off-the-shelf technology. The burden for these suits falls disproportionately on small companies, and too often results in nuisance settlements based on the high cost of defending a patent case, not the merits of the claim.

But the greatest harm of these suits may be to the reputation of the US patent system. For centuries the patent system has fueled American prosperity by protecting ingenuity and incentivizing entrepreneurship. Patents historically have been treated as a specialized but valued part of innovation policy, left to engineers, academics and IP attorneys. Cases such as those described above tarnish public opinion of the patent system in the eyes of main street businesses opinion leaders, and the courts. As an example, a group of retail industries in September 2013 launched a 17-state ad blitz condemning abusive end-user patent suits.[13]

Numerous state AGs have initiated actions,[14] and Congress[15] and President Obama[16] have also proposed curbing abuses. But the right to sue users of patented inventions has long been a feature of patent law, in fact as long as the US has had a patent law.[17] The challenge of crafting narrowly-tailored policies that will succeed in discouraging opportunistic and wasteful suits but operate within the current structure of patent law requires a deep understanding of why

[13] Laura Sydell, "Taking The Battle Against Patent Trolls To The Public" NPR All Things Considered, August 30, 2013

[14] Ryan Davis, "Patent Trolls May Change Tactics After State AGs Get Tough" IPLaw360, August 29, 2013 (describing actions in Vermont, Nebraska, and Minnesota)

[15] See, e.g: H.R. 2639, The Patent Litigation and Innovation Act of 2013 introduced by Blake Farenthold (R-TX) and Hakeem Jeffries (D- NY), "intended to protect downstream users of technology from abusive and costly patent litigation" http://farenthold.house.gov/index.php?option=com_content&view=article&id=1509:congressmen-farenthold-and-jeffries-introduce-bill-to-protect-against-patent-trolls&catid=126:press-releases#sthash.UYjLCm6f.dpuf

[16] Blake Farenthold (R-TX) and Hakeem Jeffries (D- NY) today introduced

[17] Patent Act of 1790, Ch. 7, 1 Stat. 109-112 (April 10, 1790): creating, in patent law, "the sole and exclusive right and liberty of making, constructing, *using* and vending to others to be used the said invention or discovery." (emphasis added)

user suits are happening, how they are being carried out, and the barriers that exist to their speedy and efficient resolution.

Drawing from multiple sources[18] and our own experience litigating customer suits, in this essay we first explain why technology customers– including small companies, consumers, and nonprofits – are increasingly being dragged into the world of high-priced patent litigation, and what happens when they are. Second, we make three suggestions for lawmakers to consider.

In particular, we believe that good business sense dictates that technology suppliers should generally step in to take care of their customers. Promoting the stay of customer suits in favor of a supplier suit,[19] as has been discussed, is a good but insufficient start. As we describe below, numerous other legal and practical barriers impede suppliers who want to step up from doing so– demand letters often don't identify the basis for liability, courts frequently deny declaratory judgment jurisdiction or the right to intervene, and the courts have refused to stay the case as to the customer or prioritize common issues even when suppliers have stepped up.

To clear the barriers to companies standing behind their products, we recommend that Congress and the courts consider (1) confirming the right of suppliers to intervene and bring cases, (2) minimizing the burden on customers when suppliers do step up and participate, (3) incenting customer demand letters and complaints to specifically identify the product which gives rise to liability, so that customers may pass on the demand to their supplier.

Without securing the ability of suppliers to stand behind their products by bringing supplier suits despite their third-party status, stay provisions will be underused. Lawmakers should confirm the rights of suppliers to stand behind their products, where they have standing, and courts should ensure that

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[18] Caselaw, research, a survey of over 500 patent practitioners and in-house counsel conducted in (see Chien et al, "Best Practices in Patent Litigation"; forthcoming), interviews with venture capitalists, in-house counsel, and practitioners at companies that have customers that have been sued and have been sued as customers.

[19] *See* Brian Love & Jim Yoon, *Expanding Patent Law's Customer Suit Exception*, 93 B.U. L. Rev. (forthcoming 2013) (manuscript at 1) (Santa Clara U. Legal Stud. Res. Paper No. 09-13, Mar. 15, 2013), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2234096 (arguing that the courts should use the customer suit exception and stay customers suits more frequently in order to promote litigation outcomes that reflect value of asserted patents, not the cost of defense).

efficiency gains are realized when they do, through the prioritization of common questions and early dispositive rulings. At the demand letter stage, customers deserve to know the basis for the claim, so they can make their suppliers aware of the liability.

In addition we also encourage federal lawmakers to consider ways of making end users less attractive targets for patent lawsuits. The PTO or FTC work with private sector efforts like EFF's Trolling Effects to track demands made of customers to monitor campaigns where large numbers of businesses are threatened and pass that information on to state or other regulatory authorities. The PTO could be given the authority to make all forms of post grant administrative review – CBM, IPR, etc. –available on expedited basis when the number of accused is above a certain threshold, due to the efficiencies that could be captured by their resolution. Lawmakers could also explore providing protections to end users by expanding existing limits on liability when the product used is a staple article or commodity of commerce (see 35 USC 271(c)) or, in most cases, taking treble damages and lost damages off the table when the accused is an innocent end-user.

Within existing law, we encourage courts to use their existing fee-shifting authority to reallocate the burdens of unwarranted customer suits and motivate patentholders to pursue the supplier,[20] rather than hundreds of customers.[21] Where the merits are weak, mass customer suit litigation has become a common but unsavory tactic for collecting nuisance settlements from many sources that leverages the high cost of defense for each customer while reducing the risk of a sustained merits challenge. Expanded fee shifting discourages this approach by increasing the incentives for customers to fight meritless suits and the risk of bringing many meritless suits.

Part One explores why technology customers are being sued en masse for patent infringement and why such suits are unlikely to go away by themselves. Part Two explores the impact of mass customer suits. Part Three discusses why current and proposed solutions are unavailable or inadequate. Part Four discusses solutions to be considered.

[20] Or handful of suppliers.
[21] *Accord* Randall R. Rader, Colleen V. Chien & David Hricik, Op-Ed., *Make Patent Trolls Pay in Court*, N.Y. TIMES (Jun. 4, 2013) *available at* http://www.nytimes.com/2013/06/05/opinion/make-patent-trolls-pay-in-court.html.

Part I: Why Technology Customers Are Being Sued *En Masse* for Patent Infringement And Why The Suits Are Unlikely To Go Away By Themselves

A. *Historically, Technology Customers Were Sued En Masse When Relief Wasn't Otherwise Available*

Suits against mere technology customers are possible because under 35 USC § 271, a patentholder, is permitted to exclude others from a wide variety of acts in the distribution chain, including making, using, selling, offering to sell, and/or importing an invention.[22] Those that encourage or contribute to the infringement are also subject to suit for their actions.[23] This legal regime exposes multiple parties to infringement claims. The manufacturer infringes when it makes its product. The middleman infringes when it resells the product. A customer infringes when it uses the product.[24]

While in theory a patentee has the right to sue multiple participants in the distribution chain, the patentee's right to enforce each judgment is limited by a doctrine known as the single recovery, or one satisfaction, rule.[25] As in tort law, a patentee is entitled to full compensation for acts of infringement but not multiple recoveries for the same injury.[26]

If a manufacturer believes a competitor is infringing a patent, it will usually sue the competitor directly, where a single action can yield royalties that cover all sales. Customer suits, while by no means a novel phenomenon,[27] often do not

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[22] 35 USC § 271(a) (2013).
[23] 35 USC § 271(b), (c) (2013).
[24] *See* Aro Mfg. Co., Inc. v. Convertible Top Replacement Co., Inc., 377 U.S. 476, 484 (1964) (stating, "it has often and clearly been held that unauthorized use, without more, constitutes infringement"). The exclusive right to use dates back to the earliest Venetian patent systems, during which time unauthorized uses could allegedly result in the infringing product being burned or destroyed in front of the infringer. Roger D. Blair & Thomas F. Cotter, *An Economic Analysis of Seller and User Liability in Intellectual Property Law*, 68 U. CIN. L. REV. 1, at fn. 19 (1999) (citing Bruce Willis Bugbee, The Early American Law of Intellectual Property: The Historical Foundations (1960) (unpublished PhD dissertation)).
[25] *See, e.g*. Richard Epstein, *Two Fallacies in the Law Joint Torts*, 73 GEO. L. J. 1377, 1379 (1985).
[26] *See, e.g.* Jerry R. Selinger & Jessica W. Young, *Suing An Infringing Competitor's Customers: Or, Life Under The Single Recovery Rule*, 31 J. MARSHALL L. REV. 19, 19 (1997).
[27] Supreme Court cases that deal with the liability of customers for patent infringement include Birdsell v. Shaliol, 112 U.S. 485, 487 (1884), Kessler v. Eldred, 206 U.S. 285 (1907), Aro Manf'g Co. v. Convertible Top Replacement Co., Inc. 377 US 476, (1964).

make good business sense. Product companies do not want to get a reputation for suing customers. In general, for litigation on the merits, it is more efficient to sue a single supplier than numerous customers. For these reasons customer suits have been, until recently, relatively uncommon,[28] and were often relegated to cases where the supplier is unreachable through district court jurisdiction (e.g. is out of the country), is insolvent, or cannot otherwise provide satisfaction to the patentholder.[29]

B. Technology Customers Increasingly Are Being Sued For Practical and Opportunistic Reasons: To Secure Venue, To Leverage The Threat Of Litigation Cost, To Create Exposure For An Enlarged Royalty Base, and Because Customers are Often Less Sophisticated

Times have changed. Mass suits against technology customers have become too common, involving building block technologies like wi-fi, scanning, email and website technologies. (Table 1) As discussed, the economics of such suits, particularly when the merits are weak, favor large pools of potential targets. That's why some of the most widely used technologies have been the subject of customer suits. It also explains why many sectors of the economy that otherwise have little to do with the patent system, such as retailers, nonprofits, and small businesses, are increasingly finding themselves in the crosshairs – because they use technology. Indeed, retail is among the most highly pursued industries by non-practicing entities.[30]

Another way to measure the prevalence of such suits is to ask companies themselves. When one of us did so, 40% of respondents to two surveys of small companies and startups that had received a demand said the demand was based on their implementation or use of another's technology.[31] Among large

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[28] *See, e.g.* Roger D. Blair & Thomas F. Cotter, *An Economic Analysis of Seller and User Liablility in Intellectual Property Law*, 68 U. CIN. L. REV. 1, 3 (1999) (finding, based on an empirical analysis, that patent law is "almost never enforced" against customers, in particular private, noncommercial users of inventions).

[29] *See, e.g. Birdsell*, ("judgment against one joint trespasser, without full satisfaction, is no bar to a suit against another for the same trespass").

[30] *Exposure by Industry*, PATENT FREEDOM (Aug. 6, 2013), https://www.patentfreedom.com/about-npes/industry/ (showing that among industries, retail has the greatest number of unique operating company defendants and is among the top industries according to several other metrics).

[31] Colleen V. Chien, *Startups and Patent Trolls*, 1 Stan Tech. Law Rev.___ (Forthcoming) (Santa Clara U. Legal Stud. Res. Paper No. 09-12, 2012) *available at* http://ssrn.com/abstract=2146251. Colleen V. Chien, *Startups and Patent Assertion, Report from the New America Foundation* 2013 (provisional title) (Forthcoming)

technology company in-house counsel respondents to a survey question asking whether or not their customers had received demands based on use or implementation of their products, 84% reported that they had (70% based on use, 14% based on implementation).[32]

There is no shortage of reasons for the growth of customer litigation. In some cases, suing customers is practical. As technologies become more decentralized, the line between suppliers and customers can become even more blurry: in one scenario, for example, a customer may infringe only due to its particular implementation or its specification to a manufacturer, not because of the supplier's promotion of a particular use. In another scenario, there may be no main supplier. Changes in technology have also meant that, in some cases, the user may be the only direct infringer, although the supplier can often be, once on notice of the patent, sued for induced and perhaps contributory infringement.[33] In another example, the customer may specify the product requirements (and hence the infringing feature) and source it from multiple suppliers.

But an important reason for recent customer suits, based on surveys of about over 500 law-firm and in-house patent litigators in late spring and summer of 2013, appears to be strategic.[34] Technology customers are attractive targets for those monetizing patents for several reasons. There are more of them: "The patent owner seeks to maximize the number of defendants to maximize the 'return'," said one outside counsel survey respondent. Each customer faces a sizeable legal bill to defend against an infringement allegation and is thus generally motivated to agree to a settlement less than the cost of litigation. Suing customers may allow the plaintiff a better chance to secure a favorable venue.

[32] N=79;

[33] 35 U.S.C. 271(b) and (c). The supplier also likely has liability for internal testing and use, QC, demonstrations.

[34] N = 516 respondents, 122 in-house counsel and 394 outside counsel. The sampling frame, in the case of outside counsel, included ~12,000 randomly selected patent litigant counsel names. 65% of respondents had 10+ years of litigation experience, the rest had 5-10. In the case of outside counsel, closed and open solicitations were made of a sampling frame that included in-house patent counsel at technology and other companies. 95% of respondents were from public companies or companies with $100M annual revenue . See Chien, et al, Best Practices in Patent Litigation (unpublished paper)____Forthcoming,

Suing customers can result in an enlarged damages base, in the words of one survey respondent: “patentee [did] not sue [] suppliers because they have wanted the damages base to be the $400/500 price of a phone rather than the $25 price of a chip or the price (sometimes zero) of the software.”

Suppliers have also been deliberately excluded because they are often more patent-litigation sophisticated and thus more difficult to force into cost-of-defense settlements:[35] “the plaintiff purposefully chose not to sue the developer of the technology, who has an incentive to fight and defend its product,” in the words of one survey-taker. Said another: “Trolls [sue customers, not suppliers] because they seek easy money from defendants who have no idea how the technology works.”

The diversity of motives is reflected in the diversity of customer cases. For example, in the case of patent asserter Lodsys, mobile app developers (among others) have been sued for implementing click-to-upgrade and in-app purchasing functions as instructed though Apple IOS and Android development kits and APIs. Business customers have also been pursued for their installation and use of off-the-shelf Wi-Fi networks and PDF scanners, in the Innovatio and MPHJ cases, respectively. Finally, Select Retrieval sued “more than 140 companies” in September 2011,[36] over a single patent that claimed to cover selecting and displaying information from a database on a website. This functionality does not appear to be provided by a single provider/providers but instead implemented by web designers working for the defendants and others.

For these practical and opportunistic reasons, then, it is unlikely that customer suits will go away in the near term. New campaigns – for example brought by Innovative Wireless in April 2013, against hotel chains[37]– are taking place. The costs, as detailed below, are growing.

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[35] *See also*, Love and Yoon, supra note __.

[36] John Koetsier, *Patent Trolls Calling? Here’s How Build.com CEO Chris Friedland Fought Back*, VENTUREBEAT (Jul. 9, 2012, 5:01 PM), http://venturebeat.com/2012/07/09/patent-trolls-fight-back/.

[37] Matt Rizzolo, *Innovative Wireless Solutions LLC Accuses Hotels (and Others) of Infringing WiFi/Ethernet Patents Formerly Owned by Nortel*, THE ESSENTIAL PATENT BLOG (Apr. 24, 2013),

Part Two: The Impact of Customer Suits

A. *Customer Suits are Generally Disfavored As Inefficient And Unfair*

Courts have long expressed concern about the judicial economy and fairness of customer suits. For instance, courts, when enjoining customer suits, have cited the need to "prevent needless litigation"[38] and "guard against the possibility of abuse."[39] "Judicial economy" is served when the manufacturer's action "would resolve all charges against the customers … including liability for damages."[40] In a case where liability derives solely from the customer's use of the technology as intended, the main factual issues are identical – whether or not the patent is valid and infringed by the use of the invention as intended by the manufacturer, independent of the customer's implementation choices. Additional inefficiency from customer suits comes from the sheer number of defendants, sometimes in the hundreds. One needs only to witness a single case management conference or joint defense group meeting involving scores of lawyers to appreciate the stunning waste of time and resources. Even the relatively straightforward task of drafting a joint defense agreement can involve dozens of drafts, a blizzard of emails, and scores of attorney hours. Moreover, each defendant's ability to influence a joint defense involving hundreds of entities is limited to the point where due process questions legitimately arise.

B. *Customer Suits Disrupt Business Relations*

Being sued is rarely a pleasant experience, but when a company is sued for following the directions of their supplier, the customer relationship is harmed. While the opportunistic behavior of patentees is often blamed for customer suits, suppliers also are criticized. As detailed in a December 2012 letter written by the American Bankers Association,[41] which represents banks of all types and sizes:

> "Although banks are increasingly the target of NPEs [non-practicing entities] funded by venture capitalist firms, this shake down of the industry

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http://essentialpatentblog.com/2013/04/innovative-wireless-solutions-llc-accuses-hotels-of-infringing-wifiethernet-patents-formerly-owned-by-nortel/.

[38] Bechik Products, Inc. v. Flexible Products, Inc. 225 F.2d 603, 606 (2d Cir. 1955).

[39] *Spread Spectrum Screening LLC v. Eastman Kodak Co.*, 657 F.3d 1349, 1355 (Fed. Cir. 2011).

[40] *Kahn v. General Motors Corp.,* 889 F.2d 1078 (Fed. Cir. 1989).

[41] See Appendix B.

> has been accomplished in part with TSPs [technology service providers] that, through contractual provisions, transfer the operational and legal risk associated with their products and services to banks and the financial services community…
>
> As in the case of [a patentholder called ATL], several TSPs refused to pass along assurances to banks even when requested and/or negotiated in bad faith knowing that smaller community banks rely upon them to provide technological and enhanced services."

Unhappy customers are not good for business. As the Supreme Court put it in 1907, commenting on a patentholder's campaign against a company's customers: "No one wishes to buy anything if with it he must buy a law suit."[42] Because of the suits at issue, the suppliers "customers ceased to send orders [], and even refused to pay for those which had already been delivered." [43] Indeed, many businesses have stopped adopting technology altogether to avoid patent infringement claims –for example, scanning to a USB stick to avoid infringing a PDF machine patent, not offering Wi-Fi to customers to avoid Wi-Fi patents,[44] or, in some cases exiting the business or business line.[45]

C. *Customer Suits Make Technologies Sourced From Small Companies Less Attractive and Less Valuable*

The operational impact of customer suits means that the decision to defend a customer is largely a business, rather than legal decision. This has another consequence – small companies, as suppliers and adopters – are more likely to be significantly impacted by such suits.

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[42] Kessler v. Eldred, 206 U.S. 285, 289 (1907).

[43] *Kessler*, at 289.

[44] These are actual company responses to the demand described above, relayed to the authors through the surveys and interviews described herein.

45 *See, e.g.* Chien, *supra* note __, at 13 (showing in FIG. 1 that 13% of the respondents indicated that a PAE demand caused the business to exit or to exit the business line or to pivot their business strategy), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2146251; Colleen V. Chien, Best Practices in Patent Litigation Survey, at 5, *available at* http://www.slideshare.net/slideshow/embed_code/20486191 (indicating that 8.3% of survey-takers indicated that the impact of a PAE campaign was to exit the business line).

As adopters, small companies are less likely to negotiate the indemnity terms of their purchase or have the "buying power" of larger customers. They therefore have less clout to demand the protections of technology suppliers than do larger companies.

Harm has also been experienced by small company technology suppliers. For example, because growing revenue and customers is a critical milestone in a new company's development, startups are particularly sensitive to disruptions to their customer relationships. As one interviewee put it, "[NPEs] also have become adept at going after the customers of software companies -- they threaten to sue your customers, who then pressure you to settle." A startup that might otherwise fight a demand cannot do so when being pressed to pay the NPE by its customers.

Having a customer involved in the suit can change the dynamic and make it harder to resist settlement. As one venture capitalist said: "we got a nuisance suit from an NPE who actually sued our clients and given the disruption to our business we choose to settle rather than pay the expense to fight [] in [] [EDTX]. Spending in the millions to initially fight then settle reduced our hiring and development of new products. [][W]ith expenses already approaching $1 million and nervous customers we had no choice [but to settle]."

The leverage of customers and the threat of suit can harm the small company, even if no suit is actually filed. As a veteran litigator put it, "small companies lose two ways. First, large customers force the suppliers into indemnification agreements that impose uncapped exposure on the supplier for a relatively small amount of revenue. Second, large customers can force suppliers to take over a defense and indemnification obligations even if there is no obligation. The small supplier cannot afford to upset their large customers. As a result, these companies can face legal bills (regardless of merits) that greatly exceed the revenue that they received from selling product to the big customer."

At the supplier selection stage, the perception that a smaller company may not be financially able to stand behind its product has also impacted purchasing decisions – in some cases, companies have decided to shift their purchasing away from small suppliers, due to concerns about the small supplier's ability to indemnify them in the event of loss.[46] When their customers are sued, small companies have told us, they are less able to afford the harm to customer relationships that may result, and are therefore left with shouldering a greater relative burden for the suits.

Finally, the specter of opportunistic patent lawsuits in some cases have had an impact on the value of small technology companies. As one venture capitalist told us:

> "[A] negative impact that [patent suits][] are having on the VC industry is the increased difficulty of exiting companies (selling them to big public companies). Because acquisitions often trigger IP lawsuits…acquirers are now putting huge indemnifications in the deals, up to the size of the whole deal in several cases we have seen. That means that the full value of the deal paid to the shareholders of Company X may have to be paid back if [there is a suit]. []Those kinds of clauses will prevent deals from happening, and they also point to the level of risk that buyers are seeing, which presumably is slowing down the rate at which they are acquiring small innovative companies."[47]

Part Three: Current and Proposed Solutions to En Masse Customer Litigation Are Inadequate

Though current and proposed law provides opportunities for manufacturers to cut off mass customer litigation, such as taking advantage of the customer-suit exception or seeking to intervene in the customer suits, these solutions often are unavailable and, even when available, often prove inadequate.

For example, courts have created a "customer suit exception" in an effort to curtail customer suits, especially those viewed as motivated by "a desire to intimidate smaller businesses" by electing to sue customers rather than the manufacturer itself.[48] The customer suit exception "is an exception to the general

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[46] Survey responses and interviews. Said one interviewee, legal counsel at a large bank: "If I have big company on one hand, and small company on the other hand – this is real [sic]– we've gone with the bigger provider because the indemnity would wipe [][the small company] out."
[47] Chien Telephone and e-mail interview with venture capitalist (Jun. 2013).
[48] Ricoh Co. v. Aeroflex Inc., 279 F.Supp.2d 554, 557 (D. Del.2003).

rule that favors the forum of the first filed action,"[49] allowing "litigation against or brought by the manufacture of infringing goods" to take "precedence over a suit by the patent owner against customers of the manufacturer."[50] However, even codifying a strong customer suit exception, while well worth consideration, would not be sufficient.

Specifically, codifying the customer suit exception doctrine does not necessarily address a number of common situations. It does not address cases in which courts find the manufacturer lacks declaratory judgment jurisdiction. It does not address cases where the customers receive demand letters, but are not sued.

A. *The Customer Suit Exception Doctrine Doesn't Address The Risk that Suppliers Are not Allowed to Step Into Current Disputes*

Courts have denied declaratory judgment jurisdiction to suppliers seeking to intervene in a variety of situations. Some courts have declined to find declaratory judgment jurisdiction for the supplier where the accused product can be used by customers in ways that would not implicate the patentee's infringement accusations.[51] Courts have declined to find declaratory judgment jurisdiction where the supplier has not represented in concrete terms that the duty to indemnify does in fact exist.[52]

Further, courts have been reluctant to find standing where the patentee alleges that the supplier's product, by itself, does not infringe.[53] Also, although a supplier might otherwise fear suit as an indirect infringer, a patentee can cut off jurisdiction on this basis by stating that it does not currently have a sufficient basis to make such an allegation.[54]

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[49] Tegic Commc'n Corp. v. Board of Regents of Univ. of Tex. Sys., 458 F.3d 1335, 1343 (Fed. Cir. 2006).
[50] Katz v. Lear Siegler, Inc., 909 F.2d 1459, 1464 (Fed. Cir. 1990).
[51] *See, e.g., Adobe Systems Inc. v. Kelora Systems LLC*, 2011 WL 6101545, at *5 (N.D. Cal. 2011), *Proofpoint, Inc. v. InNova Patent Licensing, LLC*, 2011 WL 4915847, 3 (N.D.Cal. 2011), *Ours Technology, Inc. v. Data Drive Thru, Inc.*, 645 F.Supp.2d 830, 837 (N.D. Cal. 2009); *see also, e.g., Fujitsu Ltd. v. Nanya Technology Corp.,* 2008 WL 3539503, at *3 (N.D. Cal. 2008) (finding that declaratory judgment jurisdiction exists only if the conclusion that customers infringe would compel the conclusion that the manufacturer also infringed).
[52] *See, e.g., id., Barnhardt Mfg. Co. v. Illinois Tool Works, Inc*., 2010 WL 1571168, *4–*6 (W.D. N.C. 2010).
[53] *Microsoft Corp. v. Webxchange, Inc.*, 606 F. Supp. 2d 1087, (N.D. Cal 2009), *Microsoft Corp. v. WebXchange Inc.*, 2009 WL 3534845, at *4 (D. Del. 2009).
[54] *Microsoft Corp. v. Webxchange, Inc.*, 606 F. Supp. 2d 1087, (N.D. Cal 2009).

While we understand the courts" reluctance in some of these settings, a supplier suffers an adverse business impact when its customers are sued. Regardless of the exact legal relationship or the possibility of non-infringing implementations, a company is hurt when its customers are sued for using its product as instructed. Suppliers understandably are reluctant to make indemnity representations;[55] indeed for a small supplier, this representation could have a material impact on its value. But if the company wants to step in, for sound business or other reasons as described above, generally this should be permitted. If there are common questions across the defendants, efficiencies related to the common basis for their liability – their use of the supplier's product – can be captured.

B. *The Customer Suit Exception Doctrine Doesn't Address When Patentees Have Sent Letters, but Not Yet Initiated Cases*

MPHJ, using a portfolio of patents over scanning, has sent letters to hundreds of small and some large businesses and nonprofits yet not sued them. MPHJ has also not sued makers of scanning devices because, it claims, the devices need to be implemented in the customer's wireless network in order to infringe. Several barriers to efficient resolution of letter campaign-based threats existed.

First, it's unclear whether or not the manufacturers have standing to bring a DJ action. In addition, where the letter doesn't clearly identify the basis for liability – which specific products, and what specific features it is alleging are infringing – it creates a burden for the small customer to hire an expensive lawyer to fend for itself. If threat letters did clearly identify the accused products and features, the customer could more easily assess its own risk. It could choose to turn off the feature or provide notice to the supplier of the demand and seek indemnity.

C. *The Customer Suit Exception Doctrine Doesn't Address The Court's Unwillingness to Allow Suppliers to Intervene in Certain Cases*

[55] Said one interviewee who works for a company that provides online tools as part of their service offering: "Certain services are like utilities – []margins are razor thins. We don't charge a lot of money. We won't provide an indemnity [] [as] one case would knockout the product, make it impossible to offer."

The customer-suit exception also does not address uncertainty regarding whether or not the supplier can intervene. In some cases, suppliers have been denied the opportunity to intervene in a customer suit, for example when the customer allegedly has modified the supplier's product or if the supplier's product is only part of the infringing system or method.[56]

A manufacturer's attempt to intervene may also be denied if the purpose is to seek to stay the action in favor of a declaratory judgment action filed by the manufacturer.[57] Further, attempts to intervene may be rebuffed if the attempt is not made quickly enough.[58]

Yet, we believe intervention, followed by stay so that facts common across various defendants for whom the supplier is responsible can be adjudicated, is frequently appropriate and efficient.

Part Four: What Should be Done?

We believe that suppliers have the right to stand behind their products, and that a comprehensive set of policies should be considered to remove practical and legal barriers to the entry of suppliers into disputes brought against large numbers of customers. We believe that if lawmakers do more to make it possible and practical for suppliers to get involved, the cost and frequency of these suits will be reduced.

Proposal #1: Remove Practical and Legal Barriers to Suppliers Assuming Defenses and to Courts Efficiently Hearing Customer Cases

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[56] *See, e.g., Select Retrieval v. Altrec, Inc.* (D. Or. 2013) (denying supplier's motion to intervene on the basis that it was not clear that supplier's product was implicated in plaintiff's allegations); iWork Software, LLC v. Corporate Exp., Inc., 2003 WL 22494851 (N.D. Ill. 2003) (denying supplier's intervention because it appeared the accused products were modified by customers and not as supplied by the supplier).

[57] *See, e.g., Technology Licensing Corp. v. Thomson, Inc.*, 2010 WL 529456, *1 (E.D. Cal. 2010) (intervention sought solely to seek to stay the action, but parties appear able to adequately represent the interests of the movant).

[58] *See, e.g., Synqor, Inc. v. Artesyn Technologies, Inc.*, 2011 WL 735746, *1 (Fed. Cir. 2011) (denying manufacturer's motion to intervene because the manufacturer knew of the district court litigation and did not intervene until appeal), *National Institute for Strategic Technology Acquisition and Commercialization v. Nissan of North America*, Case No. 11-11039 (S.D. Mich 2012) (denying supplier's motion to intervene, filed after claim construction arguments, because it was untimely and sought only to relitigate claim construction issues of which the supplier was aware before claim construction arguments).

If customer patent threats on a mass basis are wasteful and harmful, what can be done to minimize them? First, we believe that patent disputes are litigated most efficiently when they are resolved based on the common facts and defenses by the party in the best position to do so–normally, though not always, the technology supplier.[59]

To encourage suppliers to step up and stand behind their products, the barriers to their early involvement need to be reduced. A supplier must be able to determine early that its product is implicated by a customer suit and they must be confident that they will predictably be allowed to join the litigation. Once the supplier is involved, the efficiency payoff needs to be realized. If there is no stay, suppliers may be punished for becoming involved via the complication of two lawsuits.

Two recent campaigns illustrate the issues.

> Lodsys:[60] printer manufacturers, ecommerce companies, game developers, website-survey providers, owners of websites with interactive chat, and mobile app developers have been sued and pursued for implementing, for example, click-to-upgrade and in-app purchasing functions, though Apple IOS and Android development kits and APIs. Apple intervened, asserting its license covers its developers; Google asked the Patent and Trademark Office to revisit the validity of some of the patents. New defendants have been added despite these developments, and the court has denied defendants' requests to stay.[61]
>
> If post grant review proves successful, many of the proceedings, against new and old defendants, will have been mooted. However, it appears that many defendants will not make it that far as scores of them have settled already. Staying the case and hearing the dispositive issues early might enable much earlier resolution of this case.

[59] We recognize that there will be situations where the supplier is not the best party to litigate the case–for example, when the customer is the party specifying the technology outside of the guidance of the supplier, jurisdiction over the supplier is lacking, or the supplier is insolvent.
[60] Description based on research of pleadings, internet sources, and interviews of this campaign performed by Professor Chien and her research assistants.
61 https://lexmachina.com/cases/2000005858/documents/4000087136.pdf

Innovatio:[62] using a portfolio of 31 patents directed at the 802.11 wireless communication standard (most of which are expired or lapsed), Innovatio has made demands of over 13,000 small and large end-users of wi-fi technology using devices sold by Cisco, Netgear, Apple, and others.[63] Innovatio contests the essentiality of the patents to the 802.11 standard and the obligation to license the patents on reasonable and non-discriminatory terms. Five wi-fi suppliers brought DJ actions and the case has been consolidated but the request to stay the customer suits was denied.[64] Discovery has been taken on some of the hotels accused of infringing.[65]

In this litigation, the stay was denied. Although the case was consolidated, suppliers were unable to eliminate the burden on adopters on whom discovery was still propounded. The technology is off the shelf Wi-Fi. A stay on customer-specific discovery, while issues of license obligations and claim construction were heard first, would have reduced the cost of litigation.

Accordingly, we propose that lawmakers consider the following ideas:

Require Demand Letters and Litigation Complaints to Contain More Information From Which Customers Can Assess the Risk and Basis for Liability: Private ordering can't take place if a customer does not know on what basis it is being accused of infringement or information from which it can assess the claim. Congress should consider requiring demand letters to specify which of the products and features allegedly infringe, any existing licenses to the patent with manufacturers of such products, who the real party in interest behind the assertion is, whether the

[62] Description based on research of the pleadings, internet research, and interviews performed by Professor Chien and her research assistant.

[63] *Abusive Patent Litigation: The Impact on American Innovation & Jobs, and Potential Solutions Before the Comm. on Judiciary*, 113th Cong. 4 (2013) [hereinafter *Abusive Patent Litigation*] (statement of Mark Chandler Senior Vice President & Gen. Counsel, Cisco Systems, Inc.) *available at* http://judiciary.house.gov/hearings/113th/03142013_2/chandler%2003142013.pdf.

[64] Complaint for Declaratory Judgment, at 1, SonicWall, Inc. v. Innovatio IP Ventures, 1:12-cv-00426 (N.D. Ill. 2011); Complaint for Declaratory Judgment, at 1, Cisco Systems, Inc. v. Innovatio IP Ventures, 1:11-cv-00425-LPS (N.D. Ill. 2011) (Motorola filed jointly with Cisco); Complaint for Declaratory Judgment, at 1, Netgear, Inc. v. Innovatio IP Ventures, 1:11-cv-01139-LPS (D. Del. 2011); Complaint and Jury Demand, at 1, Hewlett-Packard Co. v. Innovatio IP Ventures, 1:12-cv-02773 (N.D. Ill. 2012).

[65] *In re* Innovatio IP Ventures, LLC Patent Litigation, MDL No. 2303, No. 1:11-cv-9308 (N.D. Ill. Aug. 22, 2012).

patent is in past or present litigation, or whether the patent is subject to an ongoing administrative review. This is also true for complaints filed in Court, which are too often accepted in bare bones form.

These basic facts are not readily accessible to the public, yet they are well within the knowledge and ability of the patent holder to communicate. When a party makes a demand or files suit, this basic information should be included as a requirement of keeping a patent in force, not unlike a maintenance fee payment, with the same sort of administrative penalties available for non-compliance. These sorts of requirements would leverage existing regulatory infrastructure and apply narrowly to asserted patents, rather than all patents.

<u>Confirm Right to DJ/Intervene</u>: Congress and the courts should make it easier for the real party in interest to defend its product and assume the defense on behalf of targeted users. This will allow a real party in interest to participate promptly and it will allow customers to know who to look to for support.

<u>Stay:</u> Where many customers have been threatened or sued, if a supplier has entered the litigation within a reasonable period of time, stay the litigation or if there is no distinct litigation, stay the litigation as to customers.

<u>Case Staging</u>: Once a supplier has entered a case, assuming it is early enough, common dispositive issues – such as defenses or claim construction – should be prioritized to enhance efficiency in the resolution of the case.

<u>Proposal #2: Make End-Users Less Attractive Targets of Patent Lawsuits</u>

As described earlier, a subset of user cases is motivated by the desire to gather numerous nuisance settlements from unsuspecting customers. Suing the customers of others, when the supplier of is readily available, is a unique hallmark of these cases. We believe that policymakers can do numerous things to make end-users less attractive targets of patent assertion.

<u>Offer Expedited and Broad-Based Post-Grant Administrative Review</u>: Patents that are asserted against a large number of companies deserve more attention from the patent system because of the efficiencies that can be captured by early

adjudication of their validity. We propose enabling patents that have been asserted over a certain number of times – for example, through a demand letter that has been sent to over 25 companies to be subject to expedited post-grant review, on all grounds of invalidity and for any co-pending litigation to be stayed pending outcome of the review.

Track Demand Letters/Cooperate with State or Other Authorities: The PTO or FTC work with private sector efforts like EFF's Trolling Effects to track demands made of customers to track campaigns where large numbers of businesses are threatened and pass that information on to state or other regulatory authorities. The PTO could be given the authority to make all forms of post grant administrative review – CBM, IPR, etc. –available on expedited basis when the number of accused is above a certain threshold, due to the efficiencies that could be captured by their resolution.

Limit Customer Liability: Lawmakers could also explore providing protections to end users by expanding existing limits on liability when the product used is a staple article or commodity of commerce (see 35 USC 271(c)) or, in most cases, taking treble damages and lost damages off the table when the accused is an innocent end-user. In most cases, the patentholder would still have the ability to enforce its patents (by directly going after the supplier).

Fee-Shifting:

When a patentholders sues customers en masse and loses, the customers should be reimbursed for the costs, fees, and hassle. Expanded fee shifting discourages this approach by increasing the incentives for customers to fight meritless suits and the raises the risk of a campaign of meritless suits.

CONCLUSION

The grown of mass customer litigation in the patent area is a problem. Although, like many tough problems, there are no silver bullets to solve this problem, we propose tailored initiatives worthy of consideration. Reforms are needed and we hope this discussion helps highlights the issue and informs the conversation.

APPENDIX A

PatentFreedom: Methodology for Counting Customer Suits

PatentFreedom (the "Company") maintains a comprehensive database of patent litigations, focusing on NPEs, which it defines as "any entity that earns or plans to earn the majority of its revenue from the licensing or enforcement of its patents." It offer subscriptions to its database and professional services (custom research and advisory) to clients. PatentFreedom's database capabilities enable it to track patent litigation campaigns that use the same set of patents asserted against a series of operating companies over time. Using this information, the Company generated a list of the top patent litigation campaigns, based on number of defendants named, initiated between January 1, 2010 and June 30, 2013. For each of the 15 campaigns, the company identified a total of 813 patent infringement lawsuits filed as part of the campaigns, broken into 2,889 individual operating company parties. The Company tagged each operating company party as either a 'customer' (implementer or end-user) or a 'supplier', based upon a manual review of the following 3 data fields:

1. the underlying technology covered in each campaign based on a quick review of the patents-in-suit,
2. the industry of the operating company party (derived from their self-reported primary NAICS codes)
3. the allegedly infringing products captured from the filed complaints

As an illustration, a software company, whose web-based email products (built by the company itself) were alleged to be infringing patents covering web-based messaging features, was tagged as a 'supplier'. On the other hand, a retail company (whose core products/services clearly do not include email products), sued for implementing a similar web-based messaging feature on its website based on following the instructions of a technology vendor on its website, or a company that used an off the shelf product as instructed by the manufacturer, was tagged as a 'customer.' For a minority of cases where one or more of the 3 data fields were not available, the Company used other available information, such as the company's website, to estimate its industry or products and services, and make the determination. While in the majority cases were clear, some were arguable and not easy to determine. The Company then analyzed the entire data set to calculate the % distribution of the total number of operating companies sued in each campaign into 'customers' vs. 'suppliers.'

American Bankers Association
Building Success. Together.

APPENDIX B

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December 21, 2012

John Lyons, Office of the Comptroller of the Currency, Chairman
Federal Financial Institutions Examination Council
Task Force on Supervision
3501 Fairfax Drive
Arlington, VA 22226-3550

Dear Mr. Lyons:

This letter is written by the American Bankers Association on behalf of the banking industry to alert the Board of Governors of the Federal Reserve System (FRS), the Federal Deposit Insurance Corporation (FDIC), and the Office of the Comptroller of the Currency (OCC) (each individually, Agency, and collectively, Agencies) to increasingly pervasive operational and legal risks confronting banks of all sizes due in part to actions by technology service providers (TSPs). We respectfully request that the Agencies incorporate evaluation of these practices into the FFIEC supervision programs associated with TSPs, paying particular attention to efforts by TSPs to inappropriately shift, through contractual provisions, operational and legal risks related to their products and services to banks.

The Agencies have statutory authority to supervise third-party service providers that enter into contractual arrangements with their regulated financial institutions.[1] Agency examiners conduct examinations of financial institutions and their TSPs based on guidance in the *FFIEC Information Technology Examination Handbook* (IT Handbook) and the *Federal Regulatory Agencies' Administrative Guidelines* (Guidelines). These Guidelines describe the process the Agencies follow to implement the interagency programs for the supervision of all TSPs, including those in the Multi-Regional Data Processing Servicers (MDPS) program.

Under the Guidelines, the TSP examination process the Agencies follow is based in part on the identification of existing or potential risks that could adversely affect serviced financial institutions. The examination process is also designed to evaluate TSP policies and practices to ensure they help client financial institutions comply with applicable banking laws, rules, regulations, and guidance. Finally, as part of the TSP examination process Agencies monitor significant changes in products, services, or risk management practices that could adversely affect risk profiles of TSPs or those of their client financial institutions.

The Agencies, as demonstrated by the most recent revisions to the IT Handbook and Guidance (October 2012), are well aware that banking, like many industries, rely upon technology, software and other intellectual property to support and attract customers and provide services through the Internet and mobile devices. The growing use of technology by commercial

[1] 12 USC 1464(d)(7), 1867(c)(1).

industries to compete and service consumers and consumer payments via the Internet has resulted in a great many risks and challenges for all enterprises to consider. Banks, in tandem with the Agencies, continue to face and balance a great many risks related to the provision of such services.

As the use of these services expands, managing operational and legal risks associated with them has become increasingly sophisticated. But while the banks and Agencies have focused their time and attention on ensuring the continued strength of the banking sector, the legal landscape has shifted and allowed a different set of risks to take center stage at many banks. Within this current environment, banks are increasingly the target of demand letters and lawsuits alleging patent infringement for existing bank operations, processes and technology, whether created, licensed or otherwise obtained from third parties.

What has changed is that the risk of patent infringement now impacts every industry, including banking, retail and technology. To provide the scope of this issue, the number of patent infringement actions filed annually in the United States has increased close to three hundred percent (300%) over the last two decades. Many of these actions are filed by non-practicing entities (NPEs), who seek targets, including banks, to license the use of their patents non-traditionally – not to innovate, but rather solely to create a lucrative revenue stream for the entity.

Several contributing factors precipitated this increase in infringement litigation. The Federal Circuit's State Street Bank & Trust Co. v. Signature Financial Group, 149 F.3d 1368 (Fed. Cir. Jul. 23, 1998) decision abolished a long held business method patent exception. A major backlog at the U.S. Patent and Trademark Office (USPTO) along with a successful push by technology companies to protect and patent software has significantly impacted the current patent landscape. In all cases, the broad patent claims and patents of dubious quality that resulted from the early 2000's are primarily used by NPEs as part of their business model. Patents are used to generate license fees and settlements as revenue and NPEs do not create products or services.

The impact to innovation and the costs associated with NPE activity are staggering. This past year, two professors at Boston University concluded a study entitled "The Direct Costs of NPE Litigation" that found the direct costs of NPE patent assertions totaled about $29 billion in 2011, up from $7 billion in 2005. Further, small and medium-sized entities made up 90% of the companies sued by NPEs, accounted for 59% of the defenses, and paid about 37% of the aggregate costs in 2011. With banks now a growing target for NPEs, the level of bank resources across the country dealing with patent litigation and/or the threat of suit continues to grow exponentially.

For example, Automated Transactions, LLC. (ATL) targeted more than 120 banks in New England, New York, New Jersey and Georgia in less than a year time frame. ATL claims that the transactions facilitated by the use of the banks' ATMs infringe one or more of ATL's patents. Despite an April 23, 2012 decision by the Federal Circuit to affirm the Board of Patent Appeals and Interferences ruling that claims 1-14 of ATL's U.S. Patent No. 6,945,457 were invalid, ATL continues to assert its remaining patents against banks and has also filed suit against several banks.

This is just one example of what banks have grappled with since the early 2000's. Although banks are increasingly the target of NPEs funded by venture capitalist firms, this shake down of the industry has been accomplished in part with TSPs that, through contractual provisions, transfer the operational and legal risk associated with their products and services to banks and the financial services community.

In fact, increasingly, TSPs are unjustifiably passing along legal and operational risk to banks by creating and amending bank contracts that disclaim all warranties and fail to fully indemnify banks for the products and/or services being provided. Instead, bank contracts include loopholes and carve outs that disadvantage banks and subject them to hidden risks, risks the TSPs are in many cases well aware of but that the bank would have difficulty detecting. The potential for patent liability is an extremely technical area of the law; one that banks are not accustomed to nor have the expertise to manage in-house. Patent litigation is also extremely expensive – to defend against patent infringement claims a bank may spend upwards of $1M on legal fees alone. This figure does not take into consideration penalties or fees assessed by the court or a jury finding. Clearly, this practice adversely affects the risk profiles of TSPs' clients, financial institutions

As in the case of ATL, several TSPs refused to pass along assurances to banks even when requested and/or negotiated in bad faith knowing that smaller community banks rely upon them to provide technological and enhanced services. Other TSPs required banks to execute amendments to existing contracts seeking to pull back on any prior assurances or indemnities related to products or services provided under contract. Further, when contacted by banks after being confronted by ATL, TSPs routinely turned away banks and told them that they had had no obligations as it relates to the products and services purchased or licensed by the banks. This example highlights the issue at hand.

The failure of TSPs to manage the risks associated with the products, services and technology offered to the banking industry introduces unanticipated and unmanageable patent liability and consequences to banks of all sizes. There are currently several NPEs trolling the banking industry. A few of those are currently involved in litigation in Texas against multiple banks in Texas. Others have instituted suit against banks in New York and Delaware. Most often, NPEs simply demand money to license their questionable patents with the hope that the threat of a lawsuit will be enough to scare banks into paying them quickly. Since the NPEs goal is to make as much money as quickly as possible, the threat is often enough to secure payment from most banks without in-house technical expertise to manage patents and NPE assertions. And while the banking industry is in dire need of the arsenal necessary to fight off these unwarranted attacks by NPEs that impact bank capital levels, the current patent landscape is compounded by this surreptitious practice.

We highlight the current landscape because the uncertainty of NPE lawsuits and activity as well as the lofty costs associated with patent litigation against banks create a safety and soundness concern for banks of all sizes. If a bank chooses to defend itself against NPE claims, a 2011 survey by the American Intellectual Property Law Association reports that the mean costs associated with patent litigation is $1.6 – $2.8 million if the amount in controversy is between $1 and $25 million. Note that these costs exclude judgments and damage awards. Even if a NPE does not sue, but instead seeks to extract a payment from a bank to license its ill-gotten patent, the bank and its board is faced with not just annual payments to the NPE, but also attorney costs due to the technical nature of patents and patent law.

Continuing to allow TSPs to disproportionately shift operational and legal risks related to their products and services to banks further burdens banks in the current landscape and sets dangerous precedents as technology continues to expand into areas such as cloud computing and mobile payments. NPEs will undoubtedly use the same tactics relating to these technologies and TSPs will respond by continuing to attempt to shift risks that are rightfully theirs to banks. Just as the Agencies hold banks responsible for bank operations, products and services, so to should vendors be held accountable for their operations, products and services, especially when those vendors service a highly regulated industry, like banking.

Due to these concerns, the ABA respectfully requests that the Agencies, as part of their MDPS Program and TSP examinations, place enhanced emphasis on the evaluation of contractual provisions that shift operational and legal risks to the bank. We also request that, given the substantial transaction volume conducted at ATMs and the significant bank client base that several ATM vendors serve, the Agencies consider expanding the MDPS program to include TSPs providing these mission-critical applications.

Further, we solicit the Agencies support in examining the threat created by NPEs and the current patent landscape to bank safety and soundness. This is an issue that should be of particular importance to the FFIEC IT Examination Subcommittee. We would welcome the opportunity to brief them on this issue and work together to further refine an industry approach to address not just vendor concerns, but also the decimation that is currently occurring as NPEs continue their barrage against the banking industry.

We look forward to hearing from you and hopefully, working together with you on addressing these issues on behalf of the banking community. If you have questions, please feel free to contact Lauren Bowers at lbowers@aba.com or Doug Johnson at djohnson@aba.com.

Sincerely,

Dawn Causey
General Counsel