

Reining in Patent Trolls, State by State

(Originally Published in the Los Angeles Daily Journal on October 14, 2014, p. 9; simultaneously published in the San Francisco Daily Journal on October 14, 2014.)

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In *State of Vermont v. MPHJ Technology Investments LLC*, 14-1481 (Fed. Cir., Aug. 11, 2014), the U.S. Court of Appeals for the Federal Circuit held that it lacked jurisdiction to hear a case alleging bad faith patent assertion brought by the state of Vermont against a patent assertion entity, pursuant to the state's consumer protection statute.

Over the course of 2014, efforts to crack down on “patent trolls” — i.e., patent assertion or nonpracticing entities that exist solely for the purpose of acquiring and asserting patent rights against practicing businesses (entities that make products and provide jobs in their communities) — have dramatically increased. On the federal level, such efforts have had little success with the most recent effort, the Innovation Act of 2013, a law intended to restrict the activities of patent trolls, dying in Congress in May of this year when the Senate was unable to reach agreement over the fee shifting and bond provisions of the bill. The act would have moved patent infringement actions towards a “loser pays” system, contrary to the American rule requiring each party to bear its own costs.

At the state level, however, the situation is markedly different. The states, perceiving patent trolls to be damaging to their businesses, have not waited for Congress to act. Rather, since Vermont enacted the nation's first anti-patent troll legislation in May 2013, 14 other states including Alabama, Georgia, Idaho, Louisiana, Maine, Maryland, Missouri, Oklahoma, Oregon, South Dakota, Tennessee, Utah, Virginia and Wisconsin have enacted similar legislation. In addition, anti-patent troll legislation is presently pending in the legislatures of at least 11 other states including Illinois, Kentucky, Michigan, Mississippi, New Jersey, New Hampshire, North Carolina, Ohio, Pennsylvania, Rhode Island and South Carolina.

Because patent law is subject to the exclusive jurisdiction of the federal courts, state anti-patent troll legislation has focused on what is commonly perceived to be one of the most egregious activities of patent trolls — the sending of demand letters to businesses threatening patent infringement litigation unless a business agrees to take a license from the entity. States are unhappy with this practice because, in the states' view, the demand letters are frequently sent without any pre-suit analysis as to whether the target businesses actually infringe any claims of the asserted patents and often contain (allegedly) false or deceptive representations. The state statutes attempt to prohibit such demand letters by creating a statutory cause of action for bad faith patent assertion. The state statutes typically attempt to define when a demand letter has been sent in bad faith by establishing a nonexclusive list of factors for a court to consider.

Such factors typically include whether the demand letter contains the patent number, identifies the patent owners, and specifically identifies the products or services alleged to infringe the identified patents, demands payment of license fee in an unreasonably short period

of time, or contains false or deceptive statements. More controversially, the statutes typically further define evidence of bad faith to include whether the patent assertion entity conducted a detailed pre-suit investigation to establish the merits of the infringement claim.

Vermont's anti-patent troll statute is exemplary and establishes that bad faith is shown if: "Prior to sending the demand letter, the person fails to conduct an analysis comparing the claims in the patent to the target's products, services and technology, or such an analysis was done but does not identify specific areas in which products, services, and technology are covered by the claims in the patent." State statutes like Vermont's raise issues of federal preemption because the statute arguably requires a state court to apply federal patent law in determining whether a patent assertion entity has conducted a sufficient pre-suit investigation.

The Vermont statute and those like it are an unusual development in American law because they provide a recipient of a demand letter with a "threat" cause of action; the recipient need not wait to see if the patent assertion entity will actually follow through with its threatened litigation. Rather, the recipient can immediately file an action in state court seeking injunctive relief from further threats, as well as money damages, exemplary damages, and attorney fees and costs, upon demonstrating that the demand letter was sent in bad faith, as defined by the state statute — all without any determination as to whether the asserted patent is actually valid and infringed.

The question of whether the state anti-patent troll statutes are preempted by federal patent law is presently an open question. An early test suggests that carefully worded statutes are not preempted.

In a case believed to be the first of its kind, Vermont sued the notorious patent troll MPHJ Technologies Investments LLC in state superior court under the Vermont consumer protection statute. Vermont sought to enjoin MPHJ from sending demand letters threatening patent infringement to Vermont businesses. MPHJ claims to own patents that cover "scan to email" functionality common to many office copying and scanning systems. MPHJ is alleged to have sent more than 10,000 demand letters to businesses demanding a license fee of about \$900 to \$1,200 per employee for use of its technology.

Vermont's suit alleged that MPHJ violated the Vermont consumer protection act because MPHJ performed no due diligence to confirm whether the recipients of its demand letters were likely infringers, falsely implied that a pre-suit investigation had been performed, falsely stated that the business community had responded favorably to MPHJ's licensing program, and falsely stated that litigation was likely absent taking a license.

Shortly after Vermont filed suit in state court, MPHJ removed the action to district court asserting that federal question jurisdiction was established because the validity, infringement and enforcement of the patents at issue fell within the exclusive jurisdiction of the federal courts. Vermont thereafter moved to remand the case back to state court on the grounds that the claims presented were consumer fraud claims based solely upon state law.

The district court found in favor of Vermont. Per the court, “the Federal courts have exclusive jurisdiction of all cases arising under the patent laws, but not of all questions in which a patent may be the subject-matter of the controversy.” *State of Vermont v. MPHJ Tech. Investments LLC*, 13-00170 (D. Vt. April 14, 2014). The court found that federal patent law did not “create” the cause of action and that all issues needed to resolve the claims were capable of resolution in state court without disrupting the federal-state balance approved by Congress. MPHJ appealed.

On appeal, the Federal Circuit noted that the state was “targeting bad faith conduct irrespective of whether the letter recipients were patent infringers or the patents were valid.” Otherwise however, the Federal Circuit did not address preemption issues. Rather, the Federal Circuit found that it lacked jurisdiction to hear the case pursuant to 28 U.S.C. Section 1447(d), which states that an order remanding a case to the state court from which it was removed is not reviewable on appeal. Per the Federal Circuit, it was precluded “from second guessing the district court’s jurisdiction determination.”

The end result is that MPHJ is presently foreclosed from the federal courts and will have to litigate Vermont’s claims in superior court, which it likely views as a decidedly unfavorable forum. The Federal Circuit’s and the district court’s rulings are important nationally because they represent the “first shots” fired over the validity of state anti-patent troll legislation.

The validity of state anti-patent troll legislation is of particular importance to California where a number of vested interests have competing views on the subject. To-date, the state’s research universities and, in particular, the University of California, have generally disfavored anti-patent troll legislation, whereas the majority of the state’s tech industry appears to favor such legislation.

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