

Prepared Statement of Mark Chandler
“Demand Letters and Consumer Protection: Examining Deceptive
Practices by Patent Assertion Entities”
November 7, 2013

Chairwoman McCaskill, Ranking Member Heller, members of the Subcommittee, I am grateful for the opportunity to appear before you today and describe our experience with a new kind of consumer scam that we are seeing with increasing frequency.

This is deceptive behavior of the kind that has long existed but now comes clothed in language like “patent infringement” and “innovation.” The goal is the same as in many old-fashioned consumer rip-off schemes that the government has long taken action against – trying to scare or convince people to pay something they don’t owe or buy something they don’t need. The direct victims are not large companies like Cisco Systems, but small businesses, non-profit organizations and individuals.

I am involved because I need to defend my customers. But we need your help.

We need a little sunshine to disinfect this dark corner of the patent world - because once the practices used by these scam artists are exposed, and the harm to their victims better understood, these rip-off artists will be forced to change their ways.

Introduction

I am Senior Vice President and General Counsel of Cisco Systems. We are a 30-year old company, founded by two Stanford graduate students, who

developed the key technology to allow different computer systems to communicate with each other.

Our products are used every day by billions of people around the world, and we sell everything from the core switches and routers that make up the backbone of the Internet, to Wi-Fi systems people use in their homes and businesses, to telephone and video conference systems used by tens of millions of businesses and consumers.

Our annual revenue is approximately \$50 billion, and we directly employ 36,510 people in the United States and indirectly provide jobs to hundreds of thousands more.

We hold over 10,000 U.S. patents and file many hundreds of new patent applications every year. Our patents portfolio is regularly rated among the strongest in the telecommunications industry. Most importantly, our products are used in tens of millions, and perhaps over 100 million, American homes and businesses.

Earlier this year I testified in front of your colleagues on the Judiciary Committee about the scourge of abusive patent litigation practices.¹

I am pleased to report that your Judiciary Committee colleagues and their counterparts in the House of Representatives are working to make patent litigation fairer and more efficient.

¹ *Abusive Patent Litigation: The Impact on American Innovation & Jobs, and Potential Solutions; Hearing before the House Judiciary Committee (Mar. 14, 2013) (statement of Mark Chandler)*, available at http://judiciary.house.gov/hearings/113th/03142013_2/chandler%2003142013.pdf (last visited Nov. 4, 2013).

² *In re Innovatio IP Ventures, LLC Patent Litig.*, MDL No. 2303, 2013 WL 5593609 (N.D. Ill.

We are also hopeful that your Finance Committee colleagues and their counterparts on the House Ways and Means Committee will soon work to assure that International Trade Commission procedures can no longer be used for shakedowns by non-practicing entities that do not truly want an exclusion order. Exclusion orders are the only remedy available from the I.T.C., but often non-practicing entities only want to leverage the threat of such an order to obtain money to which they are not entitled.

These reforms, which focus on litigation abuses, however, don't address the kind of rip-off I'm describing today – a rip-off that targets small businesses and consumers with threat letters, deception, and intimidation tactics.

Examples: Innovatio

Our first story begins with a lawyer named Noel Whitley, who bought patents related to Wi-Fi from his former employer – a great American chip company, Broadcom – and then worked with a team of Chicago lawyers, the Niro firm, which specializes in representing patent assertion entities, to target legitimate businesses.

He created a company which he cynically called “Innovatio,” since innovation is the last thing that the company does. Broadcom sold the patents because they were near their expiration date, heavily licensed to Broadcom's competitors and subject to binding commitments to license on fair and reasonable terms.

So Mr. Whitley and the Niro firm came up with a scheme. He sent over 14,000 letters to small businesses, cafes, bakeries, inns and hotels, a children's health clinic – anyone who he thought might be using Wi-Fi.

Mr. Whitley's team of lawyers and licensing "consultants" told these non-profits and small businesses: "I represent an individual who has suffered injuries as a result of your company's business." They went on to say, "We are highly confident that the Innovatio portfolio covers effectively ALL currently implemented embodiments of Wi-Fi technology in use today."

They didn't tell them that a huge proportion of Wi-Fi devices were already licensed, because of Broadcom's cross licenses and the license Broadcom kept for itself, and that therefore they might not even need any further permission or licenses from Innovatio. Instead, they claimed that almost a billion dollars had been collected in royalties already; referring mostly to amounts paid to Broadcom by its arch-competitor Qualcomm to resolve numerous U.S. and foreign legal claims that had almost nothing to do with these patents.

They also claimed that thousands of companies had already paid Innovatio as well. They didn't tell their targets that the patents related to industry standards and therefore had to be licensed on fair and non-discriminatory terms – something that all three of the former owners including Broadcom had irrevocably promised to do. Instead they told them, that "[W]e wish to license your company at a very affordable rate – far less than the cost of patent litigation. I can quote you a rate of less than \$3000 per location" – this for patents that a Federal court recently determined were worth pennies per chip.²

And he didn't tell them that the manufacturers of the products, including

² *In re Innovatio IP Ventures, LLC Patent Litig.*, MDL No. 2303, 2013 WL 5593609 (N.D. Ill. Oct. 3, 2013).

Cisco, were suing Innovatio to defend their customers. Instead he misrepresented to them that the equipment manufacturers, “have not stepped in to defend any of their users. This means we can still sue your client and they cannot expect equipment manufacturers to aid in their defense.”

Finally, for those businesses who had the temerity to resist, Innovatio enumerated thousands of pages of documents that would have to be reviewed by counsel to even begin to defend against Innovatio’s allegations, meaning thousands of dollars in legal fees. Unfortunately, thousands of businesses may have fallen for this scam.

So, although Innovatio cloaks its business in the patina of patents and patent infringement, the reality is that Innovatio is just a modern take on an old scam.

Innovatio conducts its racket by sending letters containing mistruths and omissions to thousands of consumers in an attempt to obtain money from these targets to which Innovatio is not entitled.

And, unfortunately, Innovatio is only one example of this emerging type of consumer fraud.

Project Paperless/MPHJ

There have been numerous news articles about a similar scam by an entity that originally was called Project Paperless and which ultimately became known as MPHJ. Project Paperless engaged in a letter-writing campaign

demanding \$1,000 per employee from their targets.³ An online project⁴ discovered that some of the partners in Project Paperless's law firm likely had an ownership interest in the patents. Soon after the revelation of this inconvenient truth, Project Paperless dropped its lawsuits and sold the patents to another shell company called MPHJ Holdings, after which threatening letters started coming from a full alphabet soup of strangely named shell companies including AccNum, AllLed, AdzPro, CalNeb, ChaPac, FanPar, FasLan, FulNer, GosNel, and HunLos.

State attorneys general in Minnesota, Nebraska, and Vermont have taken various actions against MPHJ to protect business and consumers in their respective states from MPHJ's deceptive practices. For example the Vermont attorney general's action against MPHJ lists MPHJ's lies and abusive practices in gory detail including:⁵

1. MPHJ entities sent threatening letters without doing any actual investigation of whether their patents were being infringed.
2. MPHJ forced its targets to do the work of analyzing infringement
3. MPHJ deliberately targeted small businesses without ready access to sophisticated representation
4. MPHJ told its targets that it had a successful established licensing program when in fact it had signed very few licenses with an average licensing fee of \$900.

³ See Joe Mullin, *Meet the nice-guy lawyers who want \$1,000 per worker for using scanners*, arstechnica (Apr. 7, 2013), available at <http://arstechnica.com/tech-policy/2013/04/meet-the-nice-guy-lawyers-who-want-1000-per-worker-for-using-scanners/> (last visited Nov. 4, 2013).

⁴ See Stop Project Paperless website - <http://stop-project-paperless.com/the-patents/> (last visited Nov. 4, 2013).

⁵ Consumer Protection Complaint in *Vermont v. MPHJ Technology Investments, LLC*, No. 282-S-13WNCV (Vt. Super. Ct.) (filed May 8, 2013), available at <http://www.atg.state.vt.us/assets/files/Vermont%20v%20MPHJ%20Technologies%20Complaint.pdf> (last visited Nov. 4, 2013).

5. MPHJ's letters indicate that litigation would be imminent if a license deal was not signed almost immediately yet MPHJ had never actually filed suit.

Minnesota reached a settlement with MPHJ forcing them to cease and desist from targeting Minnesota businesses.

Helferich

Cisco also is aware of another such entity, Helferich Patent Licensing, LLC ("Helferich"). Helferich was founded in 2007 "for the purpose of commercializing, licensing, and enforcing" patents relating to delivery of content to a cell phone. Although Helferich had already licensed its patents to cell phone manufacturers, it sought to double dip by demanding payment from hundreds of companies who sent text messages to those very same licensed cells phones.

Helferich's letters told its end user targets that companies that paid up immediately would get a discounted rate but threatened that this rate would go up if the target didn't pay up within 60 days.

Numerous companies entered into licenses, but the New York Times and others decided to fight back. In the New York Times case, the District Court found that the original license to the cell phone manufacturers meant that no further license to the users was needed.

We can only hope that Helferich was exaggerating when it claimed that over 100 companies already had signed licenses that it turned out none of the companies needed.

USEI

Another example is an entity called United States Ethernet Innovations, LLC (“USEI”). USEI purchased a group of patents that were about to expire from 3Com prior to 3Com’s acquisition by Hewlett-Packard.

In addition to filing numerous lawsuits, USEI has sent licensing threat letters to hundreds (or possibly thousands) of end user businesses. USEI’s letters assert that Ethernet technology is covered by their patents and their technology “is utilized in many day-to-day business activities within corporations, including internet connections, data transmission, retail transactions, corporate transactions, networked security system cameras, point of sale information, and inventory management systems.”

The letters further warn that USEI has hired “the largest and most successful plaintiff’s law firm in the world” and has recently filed infringement lawsuits, but that it was willing to offer a license to a “select group” of entities such as the letter target in order to avoid “protracted litigation.”

We understand that USEI has refused to provide its targets with information that would help them determine whether they actually need a license. For example, we understand that USEI has refused to disclose to its targets what entities already are licensed, a disclosure that would allow the target to determine whether the products it was using already were licensed and thus for which the target user did not have to pay. Targets of USEI’s licensing campaign have included department stores, markets and other end user businesses both large and small.

Cisco’s customers have received licensing demands from many of these shake down campaigns. In each case, the campaigns are inherently

deceptive. The patents are often invalid or irrelevant to their targets or already licensed. The target end-users do not get a real picture of the licensing history and the real likelihood of suit. The massive deceptive letter writing campaigns are just a way for the scam artists to get far more money than their patents are worth (if they are worth anything at all) just like in any other scam.

Recommendations

Much of what we have said here is based on Cisco's own experiences and what Cisco's own customers have told us about their experiences.

But we do not know the scope and extent of the deceptive practices in which these entities are engaging. Our customers, the end user consumers that these entities are targeting and which we are seeking to protect, know even less. That is why your help is needed.

There are four simple steps that would make it much harder for these scam artists to use deceptive letter writing schemes to extract money to which they are not entitled from end user/consumer targets:⁶

First, require anyone sending patent demand letters to more than ten entities who are NOT the manufacturers of the accused products to file the letters in an on-line registry to be maintained by the FTC. The public, the targets of the campaigns and the FTC need to know the full picture.

⁶ My proposal is very consistent with the White House's recommendations for reforming the patent system. See *Fact Sheet: White House Task Force on High-Tech Patent Issues (June 4, 2013)*, available at <http://www.whitehouse.gov/the-press-office/2013/06/04/fact-sheet-white-house-task-force-high-tech-patent-issues> (last visited Nov. 4, 2013).

Second, require anyone in that category to include in the letter a list of products which are deemed to infringe, including the manufacturer and model number, and informing them that they may have the right to have the manufacturer defend the case, and providing contact information for the manufacturer.

Third, require any such letter to include the names of the entities which own the patents or benefit from their enforcement and any related entities.

And fourth, require the letters to include a list of all previous licenses granted for those patents, with a notice that if the recipient of the letter is using the products or services of a licensed entity, the recipient may require no further rights or permission from the patent holder. Also, the letter should say if there is a relevant licensing commitment to a standards organization.

By adding a basic level of transparency and accountability, these simple steps will help protect innocent end users.

The paycheck I get every other week says “Cisco” on it, but every cent comes from my customers. That is why I am passionate about making sure my customers who trust us to supply them with products don’t get ripped off by these predators.

And when these predators are forced to come to me, I can guarantee they will get a fair fight.

Thank you. Please let me know if you have any questions.

