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BILL ANALYSIS

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Senate Bill 289 (as enrolled)
Sponsor: Senator Margaret E. O'Brien
Senate Committee: Judiciary
House Committee: Judiciary

Date Completed: 12-27-16

RATIONALE

Under Article I, Section 8, Clause 8 of the United States Constitution, Congress has the power to "promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Rights to their respective Writings and Discoveries". To implement this provision, Congress has established the system of patents and copyrights, which is codified in Title 35 of the United States Code. A patent is a right granted by a government to an inventor to exclude others from making, using, or selling an invention for a defined period of time; usually, this period is 20 years from the date the patent application is filed with the United States Patent and Trademark Office. In recent years, there have been complaints about questionable attempts to enforce alleged patent rights.

Patent rights are enforced primarily through an infringement suit, or the threat of such a suit. Generally, those who practice the invention described in a patent are the plaintiffs in an infringement suit, and are the most likely to issue a demand letter (correspondence informing a person that he or she is potentially infringing the claims of a patent, and requesting the person to pay for a license to use the patented invention). Some entities, however, purchase patents and assert them against potential infringers in order to receive a licensing fee without practicing the disclosed invention. Some believe that this practice is an abuse of the intellectual property system, particularly when a demand letter includes little or no information relating to the patent being asserted or who owns the patent in question. To address this issue, it has been suggested that certain practices relating to demand letters be treated as unlawful.

CONTENT

The bill would create the "Bad-Faith Patent Infringement Claims Act" to do the following:

- **Specify that it would be an unlawful practice, in connection with the assertion of a United States patent, to send a written or electronic communication to a person stating in bad faith that the target infringed a patent and was liable or owed compensation to another person, if the communication made certain false statements or if other conditions applied.**
- **Authorize the Attorney General to conduct civil investigations, enter into an assurance of discontinuance, bring civil actions, and promulgate rules.**
- **Allow a court to assess various civil fines for violations of the proposed Act.**
- **Make it a misdemeanor, punishable by one year's imprisonment and/or a maximum fine of \$2,500, to disclose confidential information in violation of the Act.**
- **Allow a person aggrieved by a violation of the Act to bring an action in circuit court, and if the person prevailed, allow the court to order injunctive relief and award costs and fees, actual damages, and exemplary damages.**

- **Allow the court, on a motion by the plaintiff, to order the defendant to post a bond equal to a good-faith estimate of a target's cost to litigate the claim, and an amount reasonably likely to be recovered, up to \$250,000.**
- **Allow the court to waive the bond requirement if the defendant had available assets equal to the amount of the proposed bond or for other good cause.**
- **Provide that the proposed Act would not make it unlawful for a person that owned or had the right to license or enforce a patent to take certain actions.**
- **Specify that the Act would not apply to a communication sent by an owner or licensee that was using a patented invention in connection with research and development of products and services, an institution of higher education, certain technology transfer organizations, or a person seeking a claim for relief arising under certain Federal laws.**

The bill would take effect on October 1, 2017.

Unlawful Practices

Under the proposed Act, it would be an unlawful practice for a person, in connection with the assertion of a United States patent, to send or cause another person to send a written communication, including an electronic communication, that stated in bad faith that the target was infringing or had infringed a patent and was liable or owed compensation to another person, if one or more of the following applied: a) the communication falsely stated that an action seeking administrative or judicial relief had been filed against the target or an affiliated person; b) the assertion contained in the communication lacked a reasonable basis in fact or law because the person asserting the patent did not have the current right, and did not represent a person that had the current right, to license or enforce the patent, the communication sought compensation for a patent that had been held to be invalid or unenforceable in a final, unappealable or unappealed judicial or administrative decision, or the communication sought compensation because of activities undertaken after the patent expired; or c) the communication did not contain all of the following information necessary to inform the target or an affiliated person about the patent assertion: the identity of the person asserting a right to license or enforce the patent, the number of the patent issued by the United States Patent and Trademark Office alleged to have been infringed, and the factual allegations concerning the specific areas in which the products or services obtained by the target or an affiliated person infringed the patent.

"Target" would mean a person that purchases, rents, leases, or otherwise obtains a product or service in the commercial market that is not for resale in the commercial market and that is, or later becomes, the subject of the patent infringement allegation.

Authority of the Attorney General

The Attorney General could do all of the following related to unlawful practices under the proposed Act: a) conduct a civil investigation, b) enter into an assurance of discontinuance, c) bring a civil action, and d) promulgate rules under the Administrative Procedures Act.

Subpoena. On the ex parte application of the Attorney General to the circuit court in the county where the defendant was established or conducted business or, if the defendant were not established in this State, in Ingham County, the circuit court, if it found probable cause to believe that a person had engaged, was engaging, or was about to engage in an unlawful practice under the proposed Act, and after an ex parte hearing, could issue a subpoena compelling an individual to appear before the Attorney General and answer questions under oath relating to an alleged violation of the Act. An individual served with a subpoena could be accompanied by counsel when he or she appeared before the Attorney General.

The subpoena could compel the individual to produce the books, records, papers, documents, or things relating to the alleged violation. During an examination of documents and things under the subpoena, the court could require an individual who had knowledge of the documents and things or the matters contained in them to attend and give testimony under oath or acknowledgement.

The subpoena would have to be served in the manner provided and subject to the provisions that applied to service of process on a defendant in a civil action commenced in the circuit court.

The subpoena would have to include notice of the time, place, and cause for the taking of testimony, the examination, or the attendance and would have to allow at least 10 days before the date of the taking of testimony or examination, unless the court shortened that time for good cause. The subpoena would have to include the name and address of the individual to be examined. If the name were not known, the subpoena would have to give a general description sufficient to identify the individual or particular class or group to which he or she belonged. The subpoena also would have to include the following:

- A reference to the proposed Act and the general subject matter under investigation.
- A description of any document or thing to be produced with reasonable specificity as to indicate fairly what was demanded.
- A return date within which any documents or things would have to be produced.
- Identification of the members of the Attorney General's staff to whom any documents or things would have to be made available for inspection and copying.

At any time before the date specified in the subpoena, on motion for good cause shown, the court could extend the reporting date, or modify or set aside the subpoena.

Documents, things, or other information obtained by the Attorney General under an investigation would be confidential records of the Office of the Attorney General and would be exempt from disclosure under the Freedom of Information Act. The Attorney General could not make the documents, things, or other information available for public inspection or copying, or divulge them to any person except as follows: a) to other law enforcement officials, b) in connection with an enforcement action brought under the proposed Act, or c) on order of the court, to a party in a private action brought under the Act. An individual who knowingly disclosed information designated confidential by the Act, except as otherwise permitted or under court order, would be guilty of a misdemeanor and could be imprisoned for a maximum of one year or fined up to \$2,500, or both.

An individual on whom a subpoena was served would have to comply with its terms unless otherwise provided by a circuit court order. An individual who knowingly did any of the following would be subject to a civil fine of up to \$10,000: a) without good cause failed to appear after being served with a subpoena, b) avoided, evaded, or prevented compliance, in whole or in part, with an investigation, including by removing from any place, concealing, destroying, mutilating, altering, or falsifying any documents or things in the possession, custody, or control of a person subject to the subpoena, or c) concealed relevant information.

The Attorney General could file a petition in the circuit court of the county in which the individual subpoenaed was established or conducted business or, if the individual were not established in this State, in the Ingham County Circuit Court for an order to enforce compliance with a subpoena or the Act. A person that violated a final order would be subject to punishment for civil contempt.

Assurance of Discontinuance. If the Attorney General had authority to institute a civil action (as described below), he or she could accept an assurance of discontinuance of an alleged unlawful practice from the person that was alleged to have engaged, was engaging, or was about to engage in the practice. An assurance would not constitute an admission of guilt and would not be admissible in any other proceeding. The assurance could include a stipulation for one of more of the following: a) the voluntary payment by the person of the costs of investigation, b) an amount to be held in escrow pending the outcome of an action, or c) an amount for restitution to an aggrieved person.

An assurance of discontinuance would have to be in writing and could be filed with the Ingham County Circuit Court. The court clerk would have to maintain a record of such filings. Unless rescinded by the parties or voided by a court for good cause, the assurance could be enforced in the circuit court by the parties. The assurance could be modified by the parties or by a court for good cause.

Civil Action. If the Attorney General had probable cause to believe that a person had engaged, was engaging, or was about to engage in an unlawful practice and gave notice as provided, the Attorney General could bring an action to restrain the person by temporary or permanent injunction from engaging in the practice. The action could be brought in the circuit court of the county where the person was established or conducted business or, if the person were not established in this State, in the Ingham County Circuit Court.

Unless the court waived notice on good cause shown at least 10 days before an action was commenced, the Attorney General would have to notify the person of the intended action, and give the person an opportunity to cease and desist from the alleged unlawful practice or to confer with the Attorney General in person, by counsel, or by other representative as to the proposed action before the proposed filing date. The notice could be given to the person by first-class mail, postage prepaid, to his or her usual place of business, or if the person did not have a usual place of business, his or her last known address. If the person were a corporation, the notice could be given only to a resident agent who was designated to receive service of process or to an officer of the corporation.

In an action brought as provided above, the court could award investigation and enforcement costs. The court also could assess the defendant a maximum civil fine of \$50,000. A person that knowingly violated the terms of an injunction or judgment would be subject to a maximum civil fine of \$5,000 for each violation.

On petition of the Attorney General, the circuit court could enjoin a person from doing business in the State if the person persistently and knowingly evaded, or prevented compliance with, an injunction issued under the proposed Act.

Civil Action by Target & Bond Requirement

A target or an affiliated person aggrieved by a violation of the proposed Act, could bring an action in the circuit court. The court could award the following remedies to a prevailing plaintiff: a) an injunction prohibiting further written communication related to the unlawful practice giving rise to the action, b) actual damages, c) costs and fees, including reasonable attorney fees, and d) exemplary damages in an amount equal to three times the actual damages.

On a motion by the plaintiff and a finding by the court that there was a reasonable likelihood that the defendant had violated the Act, the court could require the defendant to post a bond in an amount equal to a good-faith estimate of the plaintiff's cost to litigate the claim and an amount reasonably likely to be recovered as damages, costs, and fees, conditioned on payment of any amount finally determined to be due to the plaintiff. The court could not order a bond that exceeded \$250,000 to be posted.

The court could waive the bond requirement if it found that the defendant had available assets equal to the amount of the proposed bond or for other good cause shown.

Applicability of the Act

Subject to the proposed prohibitions, it would not be an unlawful practice for a person that owned or had the right to license or enforce a patent to do any of the following:

- Advise others of that ownership or right of license or enforcement.
- Communicate to others that the patent was available for license or sale.
- Notify another of the infringement of the patent.
- Seek compensation because of past or present infringement or for a license to the patent.

The Act would not limit rights and remedies available to the State or to any person under any other law and would not alter or restrict the Attorney General's authority under the Michigan Consumer Protection Act with regard to conduct involving assertions of patent infringement.

The proposed Act would not apply to a written or electronic communication sent by any of the following: a) an owner or licensee of a patent that was using the patented invention in connection with research, development, production, manufacturing, processing, or delivery of products or materials, b) an institution of higher education as defined by the Higher Education Act of 1965 (20 USC 1001), c) a technology transfer organization whose primary purpose was to facilitate the commercialization of technology developed by an institution of higher education, not-for-profit research institute, or health system, or d) a person seeking a claim for relief arising under 21 USC 355, 35 USC 271(e)(2), or 42 USC 262.

(Section 355 of Title 21 prohibits a person from introducing or delivering for introduction into interstate commerce any new drug unless an application has been submitted and approved by the Food and Drug Administration. That section also prescribes the contents and procedures for submitting applications for new drugs and abbreviated new drug applications (applications for the approval of generic drugs). Section 271(e)(2) of Title 35 specifies that it is an act of infringement to submit the following, if the purpose of the submission is to obtain approval to engage in the commercial manufacture, use, or sale of a drug, veterinary biological product, or biological product claimed in a patent, or the use of which is claimed in a patent, before the expiration of the patent: a) an abbreviated new drug application, or an application for a new drug in which the investigations regarding the safety and effectiveness of the drug were not conducted by or for the applicant, for a drug, or use of a drug, claimed in a patent, b) an application for new animal drugs under the Federal Food, Drug, and Cosmetic Act, or the Virus-Serum-Toxin Act, for a drug or veterinary biological product that is not manufactured with site-specific gene manipulation techniques, and the product or use of the product is claimed in a patent, or c) an application seeking approval of a biological product. Section 262 of Title 42 pertains to the licensing and regulation of biological products.)

BACKGROUND

Patents & Patent Trolling

As described above, a United States patent is a right granted by the Federal government to an inventor to exclude others from making, using, or selling an invention for a period of 20 years from the filing date of the patent application. To be eligible for a patent, an invention must be: a) patentable subject matter, b) useful, c) novel, and d) nonobvious.¹ An application is filed with the United States Patent and Trademark Office (USPTO), and is examined for compliance with applicable laws and regulations.

Once granted, a patent is considered personal property and is treated accordingly under law. While only an inventor who is an individual can file for a patent, any legal person can own a patent. A patent can be licensed, assigned (bought and sold), abandoned, donated to the public, or used to secure a debt obligation. Enforcement of a patent is through a civil action for infringement. Under 35 USC 271(a), a person who imports, makes, uses, or sells a product covered by a patent is liable as an infringer. This is considered direct infringement. A person also can indirectly infringe by actively inducing another to infringe, or selling, offering to sell, or importing a component of a material part of a patented invention knowing the component was made or adapted for use in an infringement.² At a minimum, an infringer is subject to damages equaling a reasonable royalty, but a damages award may include lost profits, and if the infringement is deemed willful, treble damages.

Many entities that hold patents do not ultimately practice the patented inventions. These entities are called nonpracticing entities (NPEs). There are various reasons why an entity may choose not to practice a patented technology. Many universities are considered NPEs, as are some large companies.³ Another group of NPEs is known as "patent assertion entities" (PAEs). These

¹ 35 USC 101-103.

² 35 USC 271(b)-(c).

³ See Mark A. Lemley, "Are Universities Patent Trolls?", 18 Fordham Intellectual Property, Media and Entertainment Law Journal 611 (2008) for an in-depth discussion of university patent licensing and technology transfer activities. Large industrial entities often purchase large numbers of patents related

companies operate by purchasing patents and holding them in a portfolio. The patents might come from a variety of sources, e.g., a failed business or a small-scale inventor. A PAE will not practice the art and generally will not grant a license preemptively. Instead, the PAE will monitor the market for products or processes that could infringe on a patent in its portfolio. When infringement activity is suspected, the entity issues a demand letter requesting that the suspected infringer take a license to avoid being sued. Occasionally, a demand letter might express only a vague statement or assertion that the party to whom the letter is addressed might be infringing an unnamed patent or patents. This practice is often referred to as patent trolling.⁴

Federal & State Efforts to Control Patent Trolling

Federal legislation has been proposed to curb certain practices of PAEs; however, none has been passed by Congress. In the most recent Congress, two bills were introduced to amend Title 35 to address PAEs, among other things. The first of these bills, S. 1137, or the "PATENT Act", proposed to allow the Federal Trade Commission to impose penalties on an entity that engaged in the practice of sending false or misleading demand letters that represented that the recipient was liable for patent infringement. Another bill, H.R. 9, or the "Innovation Act", was a reintroduction of a similar measure from the 113th Congress. That bill proposed to require a party alleging patent infringement to include in its pleadings specific information relating to the patent and the accused instrumentality (patentable subject matter) alleged to infringe the asserted patent. The bill also would have required the USPTO to study and report to Congress with recommendations regarding, among other things, the prevalence of bad faith demand letters and the extent to which the practice causes a negative impact on the market.

Since early 2013, states also have attempted to alleviate the perceived problems of PAEs through the legal mechanisms available to them. Most of these efforts center on a PAE's practice of issuing vague or misleading demand letters. In May 2013, Vermont enacted the first state law regulating patent trolls.⁵ As of July 2016, according to the National Conference of State Legislatures, at least 32 other states had enacted similar measures. Some of these efforts attempt to differentiate between a "good faith demand letter" and a "bad faith demand letter". One of the common mechanisms for doing this is to amend the state's unfair or deceptive trade practices law, while other laws or bills create, or would create, a new act governing the practice of issuing demand letters.

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument

According to the Michigan Credit Union League and the Michigan Bankers Association, within the last few years, financial institutions have received increased demand letters asserting the infringement of dormant or obscure patents. Michigan manufacturers also have expressed concerns about the threat of lawsuits contained in demand letters. These letters often include vague information, if any is provided, as to what product is infringing the patent, what patent is being infringed, or who owns the patent. They often encourage settlement for amounts of money that are less than what it would cost to litigate a patent infringement claim, or to hire an attorney to review the claim for merit. The letters cause undue stress and expense, are an abuse of the patent system, and create negative economic effects by discouraging small business formation and technological innovation. Although action by Congress would be appropriate to reduce this practice,

to the technology they research, manufacture, and sell. These patents might be used to develop new technology or conduct research, but they also can be asserted in a counterclaim against a party who has claimed infringement, often with the idea of settling litigation before trial.

⁴ For a more detailed explanation of patents, patent law, and PAEs, please see the Senate Fiscal Agency article, "A Summary of Patent Troll Activity and State Law", *State Notes* Fall 2014 at: <http://www.senate.michigan.gov/sfa/publications/notes/2014notes/notesfal14jem.pdf>.

⁵ Eric Goldman, "Vermont Enacts The Nation's First Anti-Patent Trolling Law", *Forbes*, 5-22-2013.

efforts at the Federal level to regulate demand letters and to penalize bad actors have not been forthcoming. Thus, states have had to act.

By making certain practices illegal and providing for remedies, the bill would discourage PAEs from sending numerous cease-and-desist letters to businesses and individuals to collect a quick licensing fee. At the same time, the bill would protect the rights of intellectual property owners to use demand letters sent in good faith to enforce their patents.

Opposing Argument

Federal law generally governs the issuance of patents and infringement of those patents. Any effort at the State level to govern patent law could run into Federal preemption issues. The bill likely would not curb activity by PAEs as much as it would require those entities to assert their claims more carefully. It would be more effective to train businesses to prepare for and handle potential infringement actions than to try to change State law. Generally, PAEs that mail vague demand letters send multiple letters, perhaps hundreds of them. These entities seldom have the resources for protracted legal battles and prefer to settle asserted claims of infringement quickly with minimal effort. Often, a response letter from a patent attorney explaining why a target is not infringing a patent is sufficient to ward off a PAE's attempt to draw a quick settlement. Such letters are relatively inexpensive and do not require changes to State law.

Legislative Analyst: Jeff Mann

FISCAL IMPACT

The bill would have an indeterminate fiscal impact on the Department of Attorney General. According to the Attorney General's office, the bill would increase its litigation costs; however, an estimate of the amount of those additional costs is indeterminate and dependent on the number of actual cases the office would have to litigate. The Department has indicated that, depending on the increase in cases, it could have to hire additional staff. The current estimated statewide average cost for one FTE is approximately \$90,000 annually.

In addition, the bill would create a misdemeanor penalty for a violation involving the disclosure of confidential information. Any increase in misdemeanors could increase demands on local court systems and jails. Any associated fine revenue would be provided to public libraries.

Fiscal Analyst: Ryan Bergan
Joe Carrasco

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.