

**INTERNET RETAILERS' COMMENTS
TO FEDERAL TRADE COMMISSION AND
U.S. DEPARTMENT OF JUSTICE
CONCERNING PATENT LITIGATION**

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INTRODUCTION

Following a joint conference held on December 10, 2012, the Federal Trade Commission and the U.S. Department of Justice invited interested persons to submit comments on their experience with patent litigation brought by non-practicing entities. The Internet Retailers identified in the Attachment submit these comments to make plain that this is a national problem that deserves a national solution.

BACKGROUND

The Internet Retailers submitting these comments reflect the diversity of the United States retail industry in 2013. They sell a wide range of products—from fashion-wear to electronics—from locations throughout the country. Some have hundreds of retail stores; others none. Some made their names with their print catalogs; others sell only on-line. One bond these companies *do* share is their success in online sales, reflected in their high standing among America's leading e-commerce firms. And it is the fact that they operate websites, as opposed to operate stores, or operate toll-free numbers, or even sell products, which have placed them squarely in the sights of non-practicing entities asserting patent claims.

The Internet Retailers' success in establishing prosperous online retail operations has not, however, changed who they are, namely, retailers whose primary business is selling goods, not designing websites or writing source code. Notwithstanding that fact, the Internet Retailers have found themselves repeatedly responding to patent

infringement claims asserted not against products they design, make, or sell, but against the retail websites through which they market and sell those products. Moreover, these claims are often asserted, whether in a licensing demand or a patent infringement complaint, against basic, and ubiquitous, building-blocks of those websites, without regard to what code or algorithm performs those functions. More and more, retailers are being asked to defend lawsuits under (or to take licenses to) patents asserted against computerized versions of retailing concepts that have been around for ages—the display of catalog-style images and text *on a web page*; the ability to interact with a live customer service representative *over the Internet*; the ability to flip back to previously viewed product pages *on a website*—without any regard to the myriad of ways in which those ideas are actually implemented or the details that differentiate one website from another.

The Internet Retailers are turning to their in-house or outside counsel time and again to ask whether a patent-owner is really claiming to have a patent to such broad domains of basic online retail activity. As a practical matter, the answer they get back from counsel too often is only a muddled statement that what the asserted patent covers really depends on how much time and money the retailer is willing to spend to litigate it through claim construction to judgment and up on appeal. The high level of uncertainty regarding the proper scope of patent claims asserted against retail websites, combined with the high costs that must be incurred to achieve certainty, make it

virtually impossible for the Internet Retailers to value properly each case brought against them, and so make it correspondingly tempting to ignore the merits of the asserted claims and evaluate whether litigation is worth defending or a license worth taking based solely on the costs of defense.

The “carefully crafted bargain” of the patent laws “for encouraging the creation and disclosure of new, useful, nonobvious advances in technology and design in return for the exclusive right to practice the invention for a period of years” has been turned on its head. *Bonito Boats, Inc. v. Thunder CraftBoats, Inc.*, 489 U.S. 141, 150–51 (1989). In its place, the patent laws of this brave new world discourage innovation in e-commerce unless and until the Internet Retailers and other successful businesses pay a needless toll for the privilege of using old and obvious technology *not* clearly disclosed in any patent asserted against them.

ANALYSIS

The face of patent infringement litigation is changing. The meteoric rise of patent litigation can largely be laid at the feet of non-practicing entities, a/k/a patent assertion entities, patent monetizers, or patent trolls. Due to the natural asymmetry in cases between retailers and the non-practicing entities, in which the retailers must incur the lion’s share of the costs of discovery and face the risk of an adverse jury verdict awarding a portion of their online sales to the plaintiff claiming to have invented the Internet, there are hydraulic pressures to settle such cases regardless of the merits.

A confluence of factors—the rise of non-practicing entities, the explosive growth of e-commerce patents, the concentration of patent infringement litigation in a handful of overburdened district courts, the uncertainty of outcomes, and the expense of litigation—have combined to create an untenable situation. Non-practicing entities frequently, if predominantly, assert software patents against defendants. Computer-implemented patents are *more* likely to be litigated yet *less* likely to survive a validity challenge. At the same time, lawsuits under computer-implemented patents filed by non-practicing entities are the *least* likely to reach claim construction, let alone judgment on the merits. In other words, external factors, chiefly expense and uncertainty, are leading accused infringers to settle the very cases that the merits suggest they ought to defend most vigorously.

This scenario eviscerates a basic premise of the patent system enshrined in the Constitution. *See United States v. Singer Mfg. Co.*, 374 U.S. 174, 199 (1963) (White, J., concurring) (when a patent is invalid, “the public parts with the monopoly grant for no return, the public has been imposed upon and the patent clause subverted”).

The Rise of the Non-Practicing Entity. It is beyond dispute that non-practicing entities are the new face of patent litigation. In a recent study, researchers concluded that plaintiffs whose business is to extract money from patents through litigation and licensing, as opposed to developing products under those patents, accounted for 40% of all patent cases filed in 2011, up from the already significant figure of 22% in 2007. *See*

Sara Jeruss, Robin Feldman & Joshua Walker, “The America Invents Act 500: Effects of Patent Monetization Entities on US Litigation,” at 5 & 43–57, *Duke Law & Tech. Review*, forthcoming (available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2158455); see also James Bessen & Michael J. Meurer, “The Direct Costs from NPE Disputes” at 2, Boston Univ. School of Law Working Paper No. 12–34 (June 28, 2012) (available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2091210) (non–practicing entity litigation affected 5,842 defendants in 2011). In her presentation at the December joint conference, Professor Chien of Santa Clara University Law School reported that her research indicates that upwards of 60% of all patent cases in 2012 were filed by non–practicing entities. The direct impact of non–practicing entity litigation on the economy has been measured at \$29 billion for 2011. Bessen & Meurer, *supra*, “Direct Costs” at 2.

The growth of this industry cannot, however, be attributed to the success of the non–practicing entity business model if one measures success by litigation victories on the merits. Non–practicing entities are far less likely to win their cases than other patent infringement litigants. See John R. Allison, Mark A. Lemley & Joshua Walker, “Patent Quality and Settlement Among Repeat Patent Litigants,” 99 *Geo. L.J.* 677, 680 (Mar. 2011) (non–practicing entities win 9.2% of their cases, while “[o]nce–litigated patents win in court almost 50% of the time”) (brackets added).

Given their rapid rate of growth, non–practicing entities must be measuring success by some other yardstick than the quality of their patent holdings, a conclusion

bolstered by the fact that non-practicing entities rarely take their lawsuits to claim construction or summary judgment. *See* Jeruss, Feldman & Walker, *supra*, at 6, 37 (“Looking at the timing of the settlements, the data suggest that patent monetizers rarely proceed to trial, or even to a summary judgment decision. When they do proceed to the summary judgment stage, monetizers win even more rarely.”); *see also* Allison, Lemley & Walker, *supra*, at 709 (roughly 90% of non-practicing entity cases settle without a judgment on the merits). In short, non-practicing entities are filing more and more cases despite empirical evidence that their patents are low-quality.

The Weakness of Computer-Implemented Patents. Most of the plaintiffs that sue the Internet Retailers are non-practicing entities, and the large majority of the patents asserted against the Internet Retailers are software or computer-implemented patents. The combination of non-practicing entities and computer-implemented patents is an especially toxic brew for Internet Retailers. Software patents have proliferated vastly. A 2008 estimate put the number of software patents at over 200,000. *See* James Bessen & Michael J. Meurer, *Patent Failure* 22 (2008). Of these, some 11,000 covered some aspect of the Internet. *Id.* at 8–9. Like patents held by non-practicing entities, computer-implemented patents do not often survive litigation, and thus appear to be of lower than average quality. As with patents held by non-practicing entities, software patent-owners are less likely to prevail on the merits of a patent claim, with an overall win rate of only 12.9%. Allison, Lemley & Walker, *supra*, at 680. At the

same time, Internet patents are between 7.5 and 9.5 times *more* likely to be litigated. John R. Allison, Emerson H. Tiller & Samantha Zyontz, “Patent Litigation and the Internet,” 2012 Stan. Tech. L. Rev. 1, 6 (Feb. 14, 2012). Again, the patents most likely to be litigated are the least likely to survive battle-testing.

The Concentration of Patent Litigation. The past several years have witnessed a concentration of patent infringement litigation in a handful of districts. Measuring the concentration by the number of defendants per district—which provides a more accurate measure than cases per district, given the presence of large multi-defendant patent infringement litigation in some districts prior to the enactment of the America Invents Act, which has now been replaced by multiple lawsuits that the courts often consolidate as though they were multi-defendant cases—two jurisdictions have become the true home courts of patent litigation: the Eastern District of Texas with 3,163 active defendants in 2011; and the District of Delaware, with 2,458 active defendants in 2011. See James C. Pistorino & Susan J. Crane, *Eastern District of Texas Continues to Lead Until America Invents Act Is Signed* (2012) (available at http://www.perkinscoie.com/files/upload/PL_12_03PistorinoArticle.pdf) at 3 & Figs. 1–2; see also Judicial Business of the United States Courts, Fiscal Year 2011, Tables C–1 and C–7 (available at <http://www.uscourts.gov/Statistics/JudicialBusiness.aspx#supTables>) (E.D. Tex.: 603 patent cases of 2,614 total cases pending as of September 30, 2011 ; D. Del: 586 patent cases of 1,549 total cases pending as of September 30, 2011).

To put these numbers in perspective, these two judicial districts had 5,621 patent infringement defendants in 2011, while the next eight districts combined had 4,521 defendants among them. Pistorino & Crane, *supra*, at 3 & Figs. 1–2. Of those trailing eight, only the Central District of California had more than 1,000 patent defendants in 2011. *Id.*

Furthermore, the Eastern District of Texas has historically granted an unusually low number of summary judgment motions. *See* Y. Leychkis, “Of Fire Ants and Claim Construction: an Empirical Study of the Meteoric Rise of the Eastern District of Texas as a Preeminent Forum for Patent Litigation,” 9 Yale J.L. & Tech. 193, 216 (2007) (comparing 10% summary judgment grant rate in the Eastern District of Texas with, *e.g.*, the 40% national average). Thus, accused infringers increasingly find themselves sued by parties who are not interested in a judgment on the merits in a small number of jurisdictions, often far from the headquarters of the alleged infringers, with dockets overcrowded with a disproportionate number of patent cases in which they will be unlikely to secure a judgment until after several years of litigation and a trial.

Uncertain and Expensive Outcomes. It will come as no surprise to anyone with a passing familiarity with patent litigation to state that such litigation is expensive, and growing more so. *See* S. Tokic, “The Role of Consumers in Deterring Settlement Agreements Based on Invalid Patents: the Case of Non-Practicing Entities,” 2012 Stan. Tech. L. Rev. 2, 8 (Jan. 9, 2012) (highlighting trend in patent litigation costs). The median

cost of litigating a patent case through trial is \$650,000 where less than \$1 million is at risk; \$2.5 million where between \$1 and \$25 million is at risk; and \$5 million where there is more than \$25 million at risk. *See American Intellectual Property Law Association, Report of the Economic Survey 2011.* The discovery phase alone costs \$350,000 in the first category, \$1.5 million in the second category, and \$3 million in the third category. *See id.* Even if a dispositive motion could be filed and granted immediately after the close of discovery, accused infringers must pay handsomely for the privilege.

Furthermore, in a discovery fight between a non-practicing entity that consists of a post office box located in a law office near the local courthouse, and an Internet retailer sued because it sells millions, or billions, of dollars of products each year, the result is pre-ordained. The retailers alone face the crippling cost and distraction of discovery, and often the risk of producing their most sensitive information, from source code to financial information, to business plans, in cases in which their co-defendants may be their primary competitors. While the America Invents Act has offered the promise of separate trials, the reality is that in litigation filed by a single plaintiff against multiple, unrelated defendants, the lawsuits are often consolidated *sua sponte* for pre-trial proceedings. *See, e.g., GeoTag, Inc. v. Frontier Communications Corp., et al.*, Case No. 2:10-cv-265 (E.D. Tex. Aug. 31, 2012) (scheduling order that multiple, unrelated defendants be consolidated under a single docket number, and that they name a “Lead

Defendant” “for briefing and arguing the claim construction issues raised in this case”). Given the small number of cases proceeding to trial, the promise of a separate trial is cold comfort to a retailer required to coordinate pretrial proceedings with a few of its fiercest rivals.

Some retailers have adopted a policy of fighting non-meritorious patent claims asserted by non-practicing entities regardless of the cost of defense, either on principle or in the hope of deterring future lawsuits by non-practicing entities. That strategy, however, is not for the faint-of-heart, and thus continues to be the exception to the rule. *See, e.g., Sovereign Software LLC v. Newegg, Inc.*, 705 F.3d 1333 (Fed. Cir. 2013) (invalidation on obviousness grounds of a claimed patent by a non-practicing entity over the “shopping cart” feature on the website after years of litigation and an adverse \$2.5 million verdict); *Orion IP, LLC v. Hyundai Motor America*, 605 F.3d 967 (Fed. Cir. 2010) (invalidation on anticipation grounds of a claimed patent by a non-practicing entity over a computerized parts feature on the website after years of litigation and an adverse \$34 million verdict).

In the rare case in which the non-practicing entity litigates the merits of its patent claim, even losing is little deterrent from continuing to demand licensing fees because new defendants still face the same daunting calculus—it is almost always less expensive to settle than to litigate, even when one knows that the patent claim is dubious. Notwithstanding the fact that Overstock.com was found summarily not to

infringe its patent, *Furnace Brook LLC v. Overstock.com*, 230 Fed. Appx. 984 (Fed. Cir. 2007), non-practicing entity Furnace Brook sued and settled with numerous other retailers for four more years until other retailers finally shut down the licensing scheme on collateral estoppel grounds. *Furnace Brook LLC v. Aeropostale, Inc.*, 447 Fed. Appx. 165 (Fed. Cir. 2011).

And, under the fee-shifting statute, 35 U.S.C. § 285, the odds of recovering attorneys' fees for accused infringers are slim, because they must show by clear and convincing evidence that the patent-owner brought a frivolous claim, engaged in inequitable conduct, or engaged in litigation misconduct. *Highmark, Inc. v. Allcare Health Mgmt. Sys., Inc.*, 687 F.3d 1300, 1308 (Fed. Cir. 2012). Cases upholding such recoveries are as rare as hen's teeth. *See Eon-Net LP v. Flagstar Bancorp*, 653 F.3d 1314, 1327 (Fed. Cir. 2011) (defendant spent over \$600,000 to litigate a case it could have settled for \$75,000 or less).

Further, victory in patent litigation is likely to be fleeting. Empirical studies suggest that the federal courts have a high reversal rate on the (often) case dispositive issue of claim construction. *See* Ted L. Field, "'Judicial Hyperactivity' in the Federal Circuit: an Empirical Study," 46 U.S.F. L. Rev. 721, 734-35 & Table 1 (Winter 2012) (collecting studies showing a claim construction reversal rate of between 33% and 44%); *see also* David L. Schwartz, "Courting Specialization: An Empirical Study of Claim Construction Comparing Patent Litigation Before Federal District Courts and the

International Trade Commission,” 50 Wm. & Mary L. Rev. 1699, 1708 (2009) (“[I]n almost every patent case claim construction is a dispositive issue.”) (brackets added). The evidence also suggests that the Federal Circuit has a higher reversal rate in patent cases versus non-patent cases both within the Circuit and compared with non-patent cases decided in other circuits. Field, *supra*, at 776. Even after winning an expensive trial, then, an accused infringer’s odds on appeal may be little better than a coin flip.

Judge Young of the District of Massachusetts put the conundrum facing the litigants and trial courts this way:

In most cases the trial judge, with the “satisfaction that proceeds from the consciousness of duty faithfully performed,” General Robert E. Lee, Farewell Address to Army of Northern Virginia (Apr. 10, 1865), and a reversal rate among the several circuits ranging from two to fourteen percent, has the added satisfaction of knowing that he has probably resolved the parties’ dispute and that they can get on with their business. Not so here.

Here the parties have fought each other to a standstill and any “victory” is pyrrhic. Given the monetary stakes involved and a Federal Circuit reversal rate exceeding forty percent, this Court is no more than a way station—an intermediate irritating event—preliminary to the main bout in the Federal Circuit. Whatever the merits of such a system, it is undeniably slow and extraordinarily expensive. The most this Court can say is, “Good luck and Godspeed.”

Aspex Eyewear, Inc. v. Altair Eyewear, Inc., 818 F. Supp. 2d 348, 365 n.8 (D. Mass. 2011).

This is the modern reality of patent litigation that faces the Internet Retailers, none of which is a software company or computer services provider. They find themselves routinely accused of infringing patents asserted against some aspect of their

websites in lawsuits far removed from their places of business. Although the evidence suggests that certain e-commerce patents are of questionable quality and validity and are asserted by patent-owners not interested in testing their merits, the Internet Retailers must decide in each case whether to invest the considerable resources in fighting these claims through trial and an appeal to the Federal Circuit, resources they stand little chance of recouping at the bitter end of litigation.

The anecdotal evidence of the Internet Retailers' experience lines up with the empirical evidence cited above: the assertion of e-commerce patents by non-practicing entities is a problem that is both growing and growing worse, and thus requires a decisive solution. As their e-commerce sales increase, the Internet Retailers find that they are Velcro for e-commerce patent claims from non-practicing entities—one of the companies submitting these comments is currently defending over a dozen such claims. Not only is this company attempting to fend off over a dozen such claims, in several instances different non-practicing entities assert that different patents cover the exact same functionality on the website.

As part of the efforts by the Federal Trade Commission and the U.S. Department of Justice to understand the scope of this problem, we hope that you will speak directly with some of the company officials who face the day-to-day distractions and expense of handling, litigating, and settling such claims. These company officials will deliver the same urgent message: because the traditional tools that parties use to combat non-

meritorious claims fail to weed out weak patent claims asserted by non-practicing entities, additional measures are warranted.

It is folly to think that the dense thicket of such patents asserted against retailers can be effectively managed with the pruning shears of the Federal Circuit, which can only decide the cases that reach it, and can only decide cases one at a time. If Congress is not prepared to address this matter further, we hope that the FTC, the U.S. Department of Justice, and other responsible government officials, will look closely to see if there are other tools in the woodshed, such as Section 5 of the FTC Act or the antitrust laws, available to combat this serious drag on innovation and competition.

CONCLUSION

The Internet Retailers respectfully request that the Federal Trade Commission and the U.S. Department of Justice take action to combat patent litigation abuse by non-practicing entities.

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Respectfully submitted,

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Attachment
Internet Retailers Submitting Comments

Balsam Brands	Redwood City, California
Brown Jordan International, Inc.	St. Augustine, Florida
Chico's FAS, Inc.	Fort Myers, Florida
Columbia Sportswear Company	Portland, Oregon
Crutchfield Corporation	Charlottesville, Virginia
David's Bridal, Inc	Conshohocken, Pennsylvania
DSW Inc.	Columbus, Ohio
Enterprise Holdings, Inc.	St. Louis, Missouri
J. Crew Group, Inc.	New York, New York
Jill Acquisition, LLC	Quincy, Massachusetts
L. L. Bean, Inc.	Freeport, Maine
Parke-Bell, Ltd., Inc.	Huntingburg, Indiana
PetMed Express, Inc.	Pompano Beach, Florida
Presidio International, Inc.	New York, New York
Safeway Inc.	Pleasanton, California
Skymall, Inc.	Phoenix, Arizona
The Talbots, Inc.	Hingham, Massachusetts
Walgreen Co.	Deerfield, Illinois