



Testimony of

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On behalf of the

Independent Community Bankers of America

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Committee on the Judiciary

Subcommittee on Courts, Intellectual Property, and the Internet

Hearing on

**“Patent Reform: Protecting American Innovators and Job Creators
from Abusive Patent Litigation”**

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Chairman Issa, Ranking Member Nadler, and members of the Subcommittee, my name is Kathryn G. Underwood and I am President and CEO of Ledyard National Bank in Norwich, Vermont. I testify today on behalf of the Independent Community Bankers of America and the 6,400 community banks they represent, particularly the hundreds and perhaps thousands of community banks that have received deceptive and abusive demand letters from patent trolls. Thank you for convening this hearing on: "Patent Reform: Protecting American Innovators and Job Creators from Abusive Patent Litigation." I welcome the opportunity to share my bank's experience with an abusive patent troll and to discuss legislative solutions to this problem.

Ledyard is a \$434 million asset community bank with seven branches in New Hampshire and Vermont and just over 100 employees. We are primarily a small business lender though we are also active in mortgage and consumer lending. Ledyard is integral to the economic life of the communities we serve.

In September 2011, we received a letter from a patent troll's lawyer informing us that he had filed a complaint against us in the District Court for Vermont. The complaint, which was two inches thick, asserted that our nine ATMs were infringing on his client's patent. However, the troll was willing to settle prior to litigation on "exceptionally favorable terms," if we responded within two weeks. This is a fairly typical "demand letter."

On its face, the claim was absurd. The patent covers the process of connecting an ATM to the Internet. Ledyard's ATMs, being older models, connect to the bank via closed telephone circuits. Infringement was impossible. Though we informed the troll of this fact, through our lawyer, it was of no interest to him. His sole interest was enticing a costly settlement from Ledyard and other community banks.

Identical demand letters were sent to four other New Hampshire banks that day. One settled immediately to avoid the hassle and expense of litigation. Pooling our resources, the remaining four of us jointly assessed the claim, spending hundreds of hours of senior staff time in research and consultations. We contacted the company that provided our ATMs. Wouldn't it make sense for the ATM provider to bear the cost of settlement or litigation? Were they not best positioned to defend against the assertion of infringement? Ledyard is no more than the end-user of the ATM; we didn't develop the technology. Unfortunately, that company assured us that their contracts protected them from an infringement suit against the end-user which limited our options.

We received an estimate from a law firm that it would cost us jointly \$52,000 to defend ourselves in litigation. Even if we won, most of that cost would not be recovered. The cost to settle was somewhat smaller than that. Under the terms of the settlement – we and the other three banks eventually did settle some months later – I am not at liberty to disclose the settlement amount. Choosing to settle was a painful decision that no legitimate business person should ever have to face. It violated my basic sense of fairness. On the other hand, I had to consider the best interests of my shareholders, employees, customers, and the communities we serve. I felt it was my duty to view it as a simple economic decision. At the time, we had only an estimate of the cost of litigation; it could have run much higher. Litigation is fraught with risk and uncertainty, even when a case, like ours, seems to be air tight. In addition, litigation would have been months-long or even years-long distraction to me and my management team. The settlement demand, on the other hand, was a known cost; the risk could be monetized and quickly put behind us, allowing us to get back to serving the lending needs of our customers.

Sadly, this is exactly the calculation that the patent troll counted on us making. It's the patent troll business model, and it is especially effective when it is targeted at a small business with limited resources. Community banks are filled with staff dedicated to serving customers and managing risk. In targeting small institutions that may not have a lawyer on staff competent to evaluate the claims, demand letters are sure to reach a captive mass of people afraid of getting sued. Community bank CEOs like me are only too eager to avoid the risk and uncertainty of litigation. Patent trolls practice a legal form of extortion.

In a way, Ledyard is fortunate because this same troll later demanded significantly higher settlement fees from community banks like ours. Undoubtedly, they sought to maximize their returns by seeking the exact price point at which a community bank would choose settlement over litigation. Many community banks chose settlement. Although it violates one's basic sense of right and wrong, paying up makes economic sense for a community bank of my size. Other community banks chose litigation and, I am pleased to say, have been successful. I am unaware of a single instance where this troll has prevailed when it actually went to court. However, despite the court losses, the troll continued to send demand letters to community banks and credit unions, seeking to wring as many settlement dollars as possible from unwitting victims.

The business model of a patent troll stands in stark contrast to the business model of a community bank. We foster long-term relationships with our customers. We are invested, often for generations, in our communities. Our prosperity is linked to their prosperity. A patent troll only profits at the expense of their "customers," who are really victims, and drains valuable resources from the economy. While the troll who targeted us is effectively out of business, the abundance of poor quality patents and opportunistic, unethical trolls, ensure that community banks, credit unions, and other businesses, small and large, will continue to be targeted.

What's the economic impact of the patent troll industry? According to a study by Boston University School of Law, the direct costs associated with patent trolling and often litigation are substantial, totaling an estimated \$29 billion in accrued litigation and non-litigation costs in 2011. The study does not capture the significant indirect costs borne by our customers. Unchecked, the problem of demand letters will deter institutions like mine from using new technologies at all. The technologies for which patent demand letters and litigation have become common against community banks include some of the things that make financial services most accessible to consumers and keep us competitive with larger banks – ATMs, online and mobile banking, remote check capture, and check processing, just to name a few. Many institutions will decide these technologies – however much they help their customers – aren't worth the risk. If that happens, consumers lose.

Solutions

Properly crafted legislation has the potential to significantly curb patent abuse. A number of solutions have been proposed. ICBA recommends that this committee prioritize two solutions in particular that carry the most value in providing relief for community banks.

Demand Letters

Demand letters often lack specific information about the patent, such as what exactly has been infringed, or even the name of the person or entity that owns the patent. With little to go on and a natural aversion to litigation many community banks and credit unions choose to settle.

This Committee can ensure that demand letters contain greater specificity. Enhanced transparency will help curb abusive lawsuits. ICBA supports legislation that would provide that if a demand letter does

not contain clear and detailed information about the patent, including the owner of the patent and what has allegedly been infringed, any civil action that is later brought by the troll would be dismissed. Exceptions should be made for legitimate patent holders—specifically, where the primary business of the patent holder is research, development, and manufacturing or selling goods or services. Also, a written communication between parties regarding an existing licensing agreement would not be covered and the court would be able to waive the requirements if it determines that it is in the interest of justice. This is a narrowly targeted solution that does not interfere with the right of any patent holder to send a demand letter.

Covered Business Method (CBM) Program

The American Invents Act created the Covered Business Method (CBM) program, a post-grant review proceeding within the Patent and Trademark Office (PTO) to re-examine the validity of questionable business method patents. Unfortunately, without intervening action, the CBM program will expire in 2020 once again leaving certain industries exposed to low quality business method patents. The CBM program should be made permanent as it has proven to be a successful low-cost alternative to litigation of covered business method patents. In fact, there are currently several CBM proceedings underway that could benefit banks and credit unions of all sizes.

Additionally, we support language granting the Director of the PTO discretionary authority to waive the filing fee for the CBM program. This provision would be beneficial for smaller financial institutions and could help deter patent trolls from sending abusive and extortive demand letters. It would ensure that institutions of all sizes have access to the CMB program.

End User Indemnification/Warranty

Community banks often white-label products that are purchased from vendors to serve their customers. As “end-users” of these products and services, community banks should not be on the hook for the infringement claims of trolls.

Community banks are especially vulnerable to the threat of legal action because they lack the resources and market power to fairly negotiate the protections they need when contracting with large sophisticated technology vendors. As was true in my case, the vendors that provide these products and services to community banks often do not stand behind them. As a result, when a community bank is accused of infringement, the vendor, often better situated to refute the claim, sits on the sidelines and refuses to defend their customers. Congress should amend current law to ensure that vendors that sell products or services to community banks provide the appropriate warranties and indemnification to protect the end users from infringement claims.

Conclusion

Thank you again for the opportunity to testify today and share my story, which is sadly typical of thousands of community banks and credit unions. Patent trolls represent a significant and growing threat to free commerce and a drain on our nation’s economic resources. ICBA strongly encourages this Committee to take up legislation that includes the recommendations I have described above.