Legal Department

Federal Trade Commission
Study of the Evolving IP Marketplace

June 9, 2009

Statement of Keith Agisim
Bank of America Corporation

I am pleased to submit these comments, on behalf of Bank of America, in connection with the Federal Trade Commission's study of the Evolving Intellectual Property Marketplace.

Bank of America is one of the world's largest financial institutions, serving individual consumers, small- and middle-market businesses and large corporations with a full range of banking, investing, asset management and other financial and risk management products and services. The company serves approximately 55 million consumers and small businesses with more than 6,100 retail banking offices, more than 18,500 ATMs and award-winning online banking services with nearly 30 million active users. Bank of America is among the world's leading wealth management companies and is a global leader in corporate and investment banking and trading across a broad range of asset classes serving corporations, governments, institutions and individuals around the world.[1]

The modern financial services marketplace is highly dependent upon innovation for business growth and customer service.[2] Bank of America, indeed the entire US banking system, is actively engaged in the creation and integration of technology into ever expanding complex global financial systems that provide consumers and businesses

[1] Bank of America, https://www.bankofamerica.com/index.jsp.

[2] *See, e.g.*, Robert C. Merton, *Financial Innovation and Economic Performance*, 4 J. Applied Corp. Fin. 12 (1992); Merton H. Miller, *Financial Innovation: The Last Twenty Years and the Next*, 21 Fin. and Quantitative Analysis 459 (1986).

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access to financial services and products, such as online and mobile banking, worldwide ATM networks and electronic stock exchanges, virtually anywhere, anytime.

The financial services industry is a vital part of the U.S. economy. In 2007 (the last year for which comprehensive statistics are available) assets of the financial sector grew to over $100 trillion. The financial services industry's gross domestic product (GDP), excluding the real estate sector, reached $1.1 trillion in 2006, accounting for nearly 8.3% of the nation's GDP. Financial services companies employed 6.1 million people in 2007, accounting for 5.4% of total U.S. private sector employment. [3]

Fundamental to the operation of the financial services sector is the interoperability of complex financial systems that facilitate the movement of data relating to every type of financial transaction, from accurate customer account information, to complex securities trades, to credit and debit card transactions, to over-night electronic transfers of funds, between and among financial institutions and the federal reserve, federal home loan banks and other global financial and monetary institutions.[4] The network of financial technology infrastructure is so fundamental that it has been designated as critical national infrastructure by the Department of Defense under the "Financial Services Defense Sector Critical Infrastructure Protection (CIP) Program." The CIP Program refers to the safeguarding of systems and assets essential to the minimum operation of the economy and government.[5]

Given the importance of the financial services sector to the nation's economy and infrastructure, it is important that the patent system work for this industry. Currently, it does not.

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[3] The Financial Services Fact Book 2009 (The Insurance Information Institute and The Financial Services Roundtable, publishers).

[4] Robert M. Hunt, *Business Method Patents and U.S. Financial Services*, Federal Reserve Bank of Philadelphia, Working Paper No. 08-10, at 6-10 (2009).

[5] Defense Finance and Accounting Service, http://www.dfas.mil/more/fsscip.html. In addition to banking and finance, the other industries deemed critical to national infrastructure under the CIP Program include telecommunications, energy, transportation, water systems and emergency services.

Historically, traditional business methods and related systems to implement those business methods were not patentable.[6] This view, however, was profoundly changed by the Federal Circuit's 1998 decision in *State Street v. Signature Financial Group.*[7] In *State Street*, "the Federal Circuit held that the fact that an invention could be characterized as a 'business method' was not a bar to patentability, and thereby laid to rest what had been the so-called business method exception to patentability."[8] As a result of this decision, the U.S. patent system has seen an explosion in applications for business method patents. "Between 1997 and 1999 new applications for business method patents tripled, and have more than tripled since then. Today, about 11,000 new applications for patents on business methods are filed each year, which suggests there will be a significant growth in the number of patents granted. Over 40,000 of these applications are currently pending."[9]

This proliferation of business method patents has, in turn, resulted in a flood of patent litigation in the financial services industry. The prevalence of patent litigation has been recognized by banking executives:

> Make a list of the four or five top litigation risks facing your bank today. Once you are done putting together your list, write down one more issue that probably did not make your list the first time around: patent infringement.[10]

Financial regulators are also cognizant of the rise in patent infringement suits.[11]

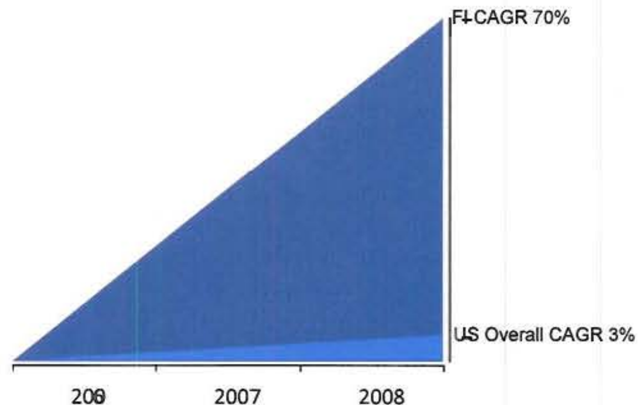
Professor Josh Lerner of Harvard Business School has empirically studied litigation in the financial services industry. He found that the "risk of patent litigation

[6] For example, the Supreme Court had repeatedly held that using a computer to perform a business algorithm was generally not patentable. *E.g., Parker v. Flook*, 437 U.S. 584 (1978); *Gottschalk v. Benson*, 409 U.S. 63 (1972).
[7] 149 F.3d 1368 (1998).
[8] Stroock Special Bulletin, *Business Methods Under Attack – Is State Street in Jeopardy*, at 2 (Feb. 27, 2008) (available at http://www.stroock.com/SiteFiles/Pub592.pdf).
[9] Hunt, *supra* note 4, at 3.
[10] Bill Boger, Greg Taylor, Lauren Bowers, *Beware of Patent Trolls*, ABA Banking Journal (July 2007).
[11] *See, e.g.*, Federal Financial Institutions Examination Council, *Risk Management of Free and Open Source Software*, Financial Institution Letter (Oct. 21, 2004).

[in financial services] is far greater than that in other fields."[12] Specifically, Professor Lerner concluded:

> [F]inancial patents are being litigated at a rate 27 to 39 times greater than that of patents as a whole. Even relative to the most extensively litigated major category of patents (drugs and health), the rate is more than an order of magnitude higher. The rates are also far greater than that in the early years of an emerging industry where the extent and breadth of patent protection was initially ambiguous, biotechnology.[13]

As the chart below illustrates, over the last three years the compound annual growth rate ("CAGR") for patent litigation against the nation's largest banks is almost 70%; over this same period, the CAGR for patent litigation overall in the United States is approximately 3%:



This litigation is almost exclusively commenced by non-practicing entities (NPEs)[14] and has affected all members of the financial services industry, including banks, their technology suppliers and even central banks.[15] Lawsuits have targeted

[12] Josh Lerner, *The Litigation of Financial Innovations*, Harvard Business School, Working Paper 09-027, at 14 (2008).

[13] *Id.* at 2. Professor Lerner concluded that the rate of litigation of biotechnology patents in the early years of such litigation was one-fifth the rate of litigation in the financial services industry today. *Id.* at 14.

[14] The financial services companies actually responsible for designing, implementing and operating financial services systems rarely assert patents against each other. Instead, established market practices enable the financial services community to exchange technology without resorting to litigation.

[15] *See, e.g., Trade Card v. Bank of America*, 509 F. Supp.2d 304 (S.D.N.Y. 2007); *Yodlee Inc. v. Ablaise*, No. 4:06CV07222 (N.D. Cal.); *Advanced Software Design Corp. v. Federal Reserve Bank of St. Louis*, No. 4:07cv00185 (E.D. Missouri).

every aspect of the financial services industry, including customer call centers,[16] futures and options exchanges,[17] exchange traded funds,[18] Treasury bonds,[19] check imaging and processing,[20] point-of-sale transactions,[21] gift cards,[22] tax refund cards,[23] ACH payments,[24] electronic payment systems,[25] electronic mortgage applications,[26] electronic loan applications,[27] electronic credit card applications,[28] automated debt settlement,[29] annuities,[30] tax strategies,[31] SWIFT payments,[32] savings programs,[33] card reward programs,[34] marketing of financial products,[35] and online banking.[36] In a number of these cases, very large licensing fees and damages awards are being paid that are disproportionate to the economic value of the patented subject matter.

Financial services institutions are particularly vulnerable to litigation designed to extract damages awards and licensing fees that do not reflect the economic value of the patented invention. This vulnerability is driven by the nation's need for an integrated and cohesive banking system, the emergence of NPEs and the proliferation of business method patents.

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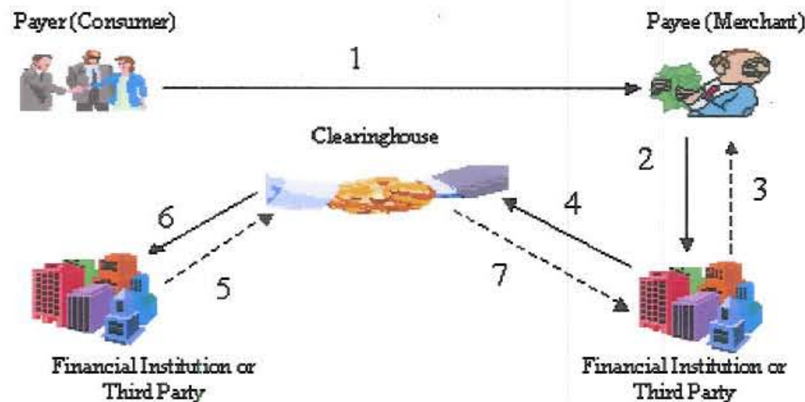
[16] Steve Bills, *Patent Lawsuit Involving Citi Seen Having Big Implications*, American Banker (July 27, 2005).
[17] *See, e.g., Electronic Trading Sys. Corp. v. The Board of Trade of the City of Chicago*, No. 3:99-CV-1016 (N.D. Tex.).
[18] *See, e.g., American Stock Exchange, LLC v. Mopex, Inc.*, No. 00-cv-05943 (S.D.N.Y.) (declaratory judgment).
[19] *See, e.g., eSpeed, Inc. v. BrokerTec USA LLC*, 417 F.Supp.2d 580 (D. Del. 2006).
[20] *See. e.g. , DataTreasury Corp. v. Wells Fargo & Co.*, No. 2:06-cv-00072 (E.D. Tex.).
[21] *See, e.g., Verve LLC v. Hpercom Corp.*, No. 05-CV-0365 (D. Az.); *LML Patent Corp. v. JPMorgan Chase, et al.*, No. 2:2008cv00448 (E.D. Tex.).
[22] *See, e.g., Every Penny Counts, Inc. v. First Data Corp., Inc.*, No. 8:078-cv-1245 (M.D. Fla.).
[23] *See, e.g., H&R Block Tax Serv. V. Jackson Hewitt Tax Serv.*, No. 6:2008cv00037 (E.D. Tex.).
[24] *See, e.g., LML Patent Corp. v. Telecheck Serv., et al.*, No. 04-858 (D. Del.).
[25] *See. e.g., Actus LLC v. Bank of America, et al.*, No. 2:09CV00102 (E.D. Tex.).
[26] *See, e.g., Eon-Net, LP v. Flagstar Bancorp, Inc.*, No. C05-2129 (W.D. Wash.).
[27] *See, e.g., IMX, Inc. v. LendingTree LLC*, 469 F.Supp.2d 203 (D. Del. 2007).
[28] *See, e.g., NextCard LLC v. American Express Co., et al.* No. 2:07-CV-00354 (E.D. Tex.).
[29] *See, e.g., DebtResolve, Inc. v. Appollo Enter. Solutions*, No. 1:2007cv04531 (S.D.N.Y.).
[30] *See, e.g., Lincoln Nat'l Life Ins. Co. v. Transamerica Life Ins. Co.*, No. 1:2004cv000396 (N.D. Indiana).
[31] *See, e.g., Wealth Transfer Group LLC v. Rowe*, No. 3:06-cv-00024 (D. Conn.).
[32] *See, e.g., Network Signatures v. ABN Amro*, No., 8:06-CV-00629 (C.D. Cal.).
[33] *See, e.g., Every Penny Counts, Inc. v. Bank of America*, No. 2:07-cv-42-FtM-29SPC (M.D. Fla.).
[34] *See, e.g., Meridian Enter. v. Citibank, et al.*, No. 2:03CV01083 (D.N.J.).
[35] *See, e.g., Constellation IP LLC v. Allstate Corp., et al.*, No. 5:07CV00132 (E.D. Tex.); *Phoenix Licensing LLC v. Chase Manhattan Mortgage Corp., et al.*, No. 2:07CV00387 (E.D. Tex.).
[36] *See, e.g., Datatern, Inc. v. Bank of America, et al.*, No. 5:08CV00070 (E.D. Tex.); *Stambler v. JPMorgan Chase, et al.*, No. 2:08CV00294 (E.D. Tex.); *TQP Dev. LLC v. Barclays, et al.*, No. 2:09CV00088 (E.D. Tex.).

In order for consumers, investors and businesses to complete virtually any financial transactions with each other, regardless of which institution holds their respective accounts, the financial services industry must function in an integrated and cohesive manner. This is illustrated in the following example of how a consumer purchases goods with a check:



This figure above depicts the typical interbank check clearing and settlement process through a Federal Reserve Bank or clearinghouse. In step 1 the consumer uses a check to pay a merchant for goods or services. The merchant accepts the check for payment. At the end of the day, the merchant deposits the check with its financial institution for collection (steps 2 and 3). The merchant's bank then presents (*i.e.*, sends) the check to a Federal Reserve Bank or private clearinghouse (step 4). The check is sent to the consumer's bank (step 6), and the account of the consumer's bank is debited and the account of the merchant's bank is credited (steps 5 and 7).[37]

This interconnectedness is accomplished through the creation and operation of complex financial systems, such as trading and exchange networks.[38] NPEs pray upon the need for a highly interconnected infrastructure to assert patents against the entire industry. Almost 87% of patent infringement suits against the largest 20 U.S. banks

[37] Federal Financial Institutions Examination Counsel, http://www.ffiec.gov/ffiecinfobase/booklets/Retail/retail_02a_.html.
[38] Hunt, *supra* note 4, at 8-9.

name multiple financial services companies as defendants. Some of these lawsuits name 20, 40 or even 60 separate financial institutions in a single action, claiming that each financial institution's system infringes the patent-in-suit.[39] NPEs are pursuing this strategy because it exponentially increases the potential return of each suit filed.

Moreover, the extensive use of complex financial systems makes the task of calculating damages more difficult because the asserted patents typically purport to cover only a component of the entire financial system at issue. Damages calculations in financial services cases are further complicated because plaintiffs' damages theories are often based on the number of financial transactions performed or total assets under management.[40] Not only are these methodologies contrary to the manner in which licenses and contracts for the procurement of technology are actually structured in the financial services industry, these measures relate to the value of a complex financial system itself and have no relation to the economic value of the patent-at-issue.

The risk of overcompensation in financial patent litigation is further heightened because most of the patents-in-suit are business method patents. Business method patents are not unique to the financial services industry. However, financial services institutions have been substantially impacted by litigation involving such patents:

> The extent of uncertainty surrounding financial patents increased substantially after the *State Street* decision. . . . After the decision, questions about the future of business method patent awards, the scope of these grants, and the size of the monetary damages associated with the infringement of financial patents have proliferated.[41]

A particular aggravation in the case of business method patents is the existence of a high number of poor quality patents. The Federal Circuit has recognized this problem. In its *en banc* decision in *In re Bilski*, the court concluded:

> Another significant problem that plagues **business method patents** is that they **tend to be of poor overall quality**. *See eBay Inc. v. MercExchange,*

[39] *See, e.g., DataTreasury, supra* note 20; *Stambler; supra* note 36.
[40] See, e.g., *Lincoln Nat'l Life Ins. Co. v. Transamerica Life Ins. Co.*, No. C 06-110-WP, Verdict Form (Feb. 13, 2009) (damages base equal to assets under management).
[41] Lerner, *supra* note 12, at 4.

> *L.L.C.,* 547 U.S. 388, 397, 126 S.Ct. 1837, 164 L.Ed.2d 641 (2006) (Kennedy, J., joined by Stevens, Souter, and Breyer, JJ., concurring) (noting the "potential vagueness and suspect validity" of some of "the burgeoning number of patents over business methods"). Commentators have lamented "the frequency with which the Patent Office issues patents on shockingly mundane business inventions." Dreyfuss, *supra* at 268; *see also* Pollack, *supra* at 106 ("[M]any of the recently-issued business method patents are facially (even farcically) obvious to persons outside the USPTO."). **One reason for the poor quality of business method patents is the lack of readily accessible prior art references. Because business methods were not patentable prior to *State Street,* "there is very little patent-related prior art readily at hand to the examiner corps**." Dreyfuss, *supra* at 269.
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> Furthermore, information about methods of conducting business, unlike information about technological endeavors, is often not documented or published in scholarly journals. *See* Russell A. Korn, *Is Legislation the Answer? An Analysis of the Proposed Legislation for Business Method Patents,* 29 Fla. St. U.L.Rev. 1367, 1372-73 (2002). **The fact that examiners lack the resources to weed out undeserving applications "has led to the improper approval of a large number of patents, leaving private parties to clean up the mess through litigation**." Krause, *supra* at 97. [42]

The Patent and Trademark Office (PTO) agrees with the Federal Circuit. In the Fall of 2002, Wynn Coggins, the head of the business method art unit at the PTO stated that "[i]t can be extremely difficult to indentify business methods that may have been in common practice or common knowledge in an industry, but have not been documented properly, nor dated, nor disclosed in a form that is easily accessible to patent examiners."[43] Academic studies concur with the Federal Circuit and the PTO.[44]

Finally, the financial services industry is at a heightened risk of damages awards and licensing fees that exceed the true economic value of the patents-at-issue due to the rise of NPEs. Recent years have seen a dramatic increase in non-practicing entities (NPEs) and a corresponding increase in patent litigation

[42] 545 F.3d 943, 1007 (emphasis added).

[43] Wynn Coggins, *Prior Art in the Field of Business Method Patents*, U.S. Patent and Trademark Office (Fall 2002).

[44] Andrew Kopleman, *Addressing Questionable Business Method Patents Prior to Issuance: A Two-Part Proposal*, 27 Cardozo L. Rev. 2391 (2006); William Fisher and Geri Zollinger, *Business Method Patents Online*, The Berkman Center for Internet and Society, Harvard Law School (June 22, 2001).

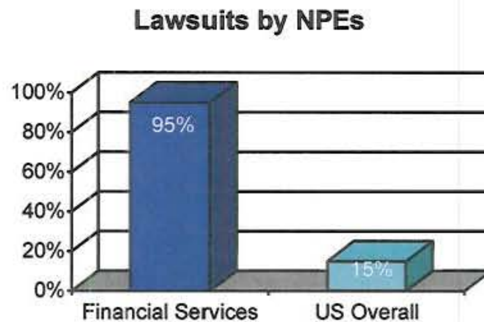
involving NPEs. There are "220 distinct NPEs (a number which continues to increase). Since 1985, these NPEs have been involved in litigation with over 3,500 different operating companies in over 2,200 distinct actions. And the pace of activity is clearly increasing. Nearly 75% of the suits between these NPEs and operating companies were filed since 2003."[45]

The dramatic growth in the number and litigiousness of NPEs has been driven by a tremendous influx of money from hedge funds, venture capital firms and other investors into this emerging "asset class." "[I]t is estimated that investments in NPEs has grown to between $6 billion and $8 billion."[46] NPEs use this money to purchase patents on the secondary market. They typically do not use the patents to create or sell any products or services. Instead their sole business is litigation. Thus, NPEs are not accretive to the financial infrastructure of the U.S.; instead they have erected a toll on one of the nation's most vital assets.

Many NPEs are their capital to fund litigation against the financial services industry. Professor Lerner concluded that the prevalence of NPEs in financial services litigation "is much greater" than in other industries.[47] These NPEs are disproportionately targeting the largest financial institutions. The most frequent defendants in financial patent litigations are, predominantly, "major investment banks, trading exchanges, and other established financial institutions."[48] Professor Lerner concluded that "the strongest determinant of a firm being a defendant in financial patent litigaton is its scale."[49] As illustrated in the chart below over the last five years more than 95% of patent litigation against the nation's 20 largest banks was commenced

[45] PatentFreedom, https://www.patentfreedom.com/research.html.
[46] RPX Corporation, http://www.rpxcorp.com/svc_problem.html.
[47] Lerner, *supra* note 12, at 10.
[48] Lerner, *supra* note 12, at 11.
[49] Lerner, *supra* note 12, at 24.

by NPEs; in contrast, only 15% of cases overall involve NPEs[50]:



The combination of business method patents, the structural requirements of the financial services industry and the emergence of NPEs who exploit these features has been extremely costly to financials services institutions. Until the patent system as a whole, including the law on damages, is reformed, one of the nation's critical infrastructures, banking and finance, is at risk of being held hostage by NPEs.

On a final note, during FTC hearings on patent reform, the Commission heard testimony claiming that reforms to the patent system would dry up funding to small, start-up companies. In particular, the claim was made that venture capital was a primary source of funding for start-up companies, and that proposed reforms would undermine the ability of small businesses to secure financing as they would be unable to defend their intellectual property against infringement. In reality, the primary source of funding for all businesses, particularly small businesses and start-ups, are commercial banks, not venture capitalists.

[50] RPX, *supra* note 46.

According to the Small Business Administration's 2008 report to the President entitled "The Small Business Economy," small business loans from financial institutions totaled over $2 trillion in 2007.[51] The largest banks (those with domestic assets $10 billion) account for 65.2% of small business loans and 75.6% of total assets lent to small businesses.[52] In contrast, the venture capital industry disbursed $29.9 billion to small businesses in 2007.[53]

By any measure, the role that commercial lending institutions play in funding start-up ventures and small businesses dwarfs that of venture capital. It is unlikely that commercial lenders would seek changes to the patent system that would undermine the stability of these investments, or to a primary source of demand for lending. To the contrary, the stability and predictability gained by comprehensive reform of the patent system would make loans to start-ups and small businesses more attractive. Further, by reducing the costs and uncertainties of frivolous patent litigation to financial services institutions, additional capital can be redirected away from litigation, and better applied toward lending.

Thank you for the Commission's on-going consideration of this critical issue. Please let me know if I may ever be of assistance in this process.

Sincerely,

Keith Agisim
Associate General Counsel – Global Intellectual Property
Bank of America

[51] Small Business Administration, *The Small Business Economy*, at 38 (Table 2.5) (2008).
[52] *Id.* at 39.
[53] *Id.* at 44-45.