



The American Antitrust Institute

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**Federal Trade Commission  
Antitrust Division, United States Department of Justice  
Comments of the American Antitrust Institute on Patent Assertion Entities**

The American Antitrust Institute (AAI) appreciates the opportunity to comment on current issues surrounding patent assertion entities (PAEs) presented in the Patent Assertion Entities Activities Workshop (PAE Workshop) jointly held by the Federal Trade Commission (FTC) and Antitrust Division, Department of Justice (DOJ).<sup>1</sup> The AAI is an independent and nonprofit education, research, and advocacy organization whose mission is to advance the role of competition in the economy, protect consumers, and sustain the vitality of the antitrust laws. AAI is managed by its Board of Directors with the guidance of an Advisory Board consisting of approximately 130 prominent antitrust lawyers, law professors, economists, and business experts.<sup>2</sup> AAI has long been involved in issues at the intersection between competition and intellectual property law regimes.<sup>3</sup>

*PAEs in General*

As FTC Chairman Leibowitz stated in his opening remarks at the PAE Workshop, “[p]atent issues raise a minefield of problems,”<sup>4</sup> and PAE activities contribute to many of them. AAI applauds the FTC and DOJ for their undertaking to explore and address the wide range of critical competition policy issues presented by the PAE phenomenon. We would like to encourage the antitrust agencies to consider grounds for challenging potentially anticompetitive PAE practices of the kind discussed below with their existing enforcement tools. AAI, like the FTC and DOJ,<sup>5</sup> also supports the proposal of the United States Patent and Trademark Office (PTO) to require recordation of real-party-in-interest (RPI) ownership information throughout application pendency and patent term, which would help to mitigate some abusive PAE practices.<sup>6</sup>

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<sup>1</sup> *Patent Assertion Entities Workshop*, FED. TRADE COMM’N, <http://www.ftc.gov/opp/workshops/pae/>; *Patent Assertion Entity Activities*, U.S. DEP’T OF JUSTICE, <http://www.justice.gov/atr/public/workshops/pae/index.html>.

<sup>2</sup> AAI’s Board of Directors alone has approved this filing for AAI. The individual views of members of the Advisory Board may differ from AAI’s positions.

<sup>3</sup> For a description of AAI activities, research, and analysis, see *American Antitrust Institute*, [www.antitrustinstitute.org](http://www.antitrustinstitute.org).

<sup>4</sup> Jon Leibowitz, Chairman, Fed. Trade Comm’n, Patent Assertion Entities Workshop Opening Remarks of FTC Chairman Jon Leibowitz as Prepared for Delivery 1 (Dec. 10, 2012), *available at* <http://www.ftc.gov/speeches/leibowitz/121210paeworkshop.pdf>.

<sup>5</sup> *In the Matter of Notice of Roundtable on Proposed Requirements for Recordation of Real-Party-in-Interest Information throughout Application Pendency and Patent Term*, U.S. DEP’T OF JUSTICE & FED. TRADE COMM’N, Dkt. No. PTO-P-2012-0047 (Feb. 1, 2013), *available at* <http://www.justice.gov/atr/public/comments/292147.pdf>.

<sup>6</sup> Notice of Public Roundtable and Request for Comments, 77 Fed. Reg. 70385 (Nov. 26, 2012). See also *Comment of the American Antitrust Institute*, AM. ANTITRUST INST., *available at* <http://antitrustinstitute.org/~antitrust/sites/default/files/AAIPTOletter.1.25.13.pdf>.

AAI appreciates the antitrust agencies' efforts to clarify the definition of PAE and the differences between a non-practicing entity (NPE) and a PAE. An NPE may encompass any patent holder that does not practice its patents. For some NPEs, the primary reason for non-practicing is lack of resources or public interest mission. This type of NPE includes universities, research institutes, non-profit organizations, start-ups, and some individual inventors. They do not generally raise the kinds of significant competition concerns discussed below and, for that reason, do not warrant the degree of close scrutiny suggested herein.<sup>7</sup> PAEs, however, do not practice patents because their business model is to purchase and hold patents solely to use for asserting or threatening to assert them in court in order to obtain large license fees from operating companies that are already using the patents in their products. Only these NPEs are PAEs, or (to use a less neutral term) "patent trolls."<sup>8</sup> A careful focus on PAEs as defined in this narrow fashion can enable the antitrust agencies to address competition concerns without unnecessarily impinging upon incentives to innovate.

PAEs are playing an important and growing role in patent litigation. It is reported that the number of new patent cases initiated by PAEs increased from 569 in 2006 to 2,544 in 2012 (through December 1, 2012). More specifically, in the year of 2011, PAEs brought 1,509 cases in federal district courts against 2,995 companies – a 211% increase from the number of companies sued in 2005, when PAEs brought 453 cases against 933 companies.<sup>9</sup> PAE cases increased from 19% of all new patent suits in 2006 to more than 60% in 2012 (through December 1, 2012).<sup>10</sup> It is further reported that "PAE-generated revenue cost defendants and licensees \$29 billion in 2011, a 400% increase from 2005," and that "no more than 25% of this flowed back to innovation."<sup>11</sup> These figures suggest a move far away from the original purpose of patent protection – to reward and facilitate innovation. Remarkably, PAEs reportedly lose 92% of the time when cases are actually litigated.<sup>12</sup>

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<sup>7</sup> There are other federal statutes regulating these kinds of NPEs. For example, the Bayh-Dole Act aims: to use the patent system to promote the utilization of inventions arising from federally supported research or development; to encourage maximum participation of small business firms in federally supported research and development efforts; to promote collaboration between commercial concerns and nonprofit organizations, including universities; to ensure that inventions made by nonprofit organizations and small business firms are used in a manner *to promote free competition and enterprise without unduly encumbering future research and discovery*; to promote the commercialization and public availability of inventions . . . .

35 U.S.C. § 200 (emphasis added). However, these NPEs are not absolutely unrelated to PAEs. As will be discussed later, Intellectual Ventures (IV) is a well-known PAE. Cornell University is a limited partner in one of IV's investment funds, and the university's relationship with IV is at "mostly arm's length." In addition, the University of Texas invested a total of about \$28 million in two IV funds. What is more, the University of New South Wales in Australia has a licensing agreement with IV. Jeff Hargarten, *U Invests in A "Patent Troll"*, THE MINN. DAILY, Apr. 23, 2012, <http://www.mndaily.com/2012/04/23/u-invests-patent-troll>.

<sup>8</sup> THE EVOLVING MARKETPLACE: ALIGNING PATENT NOTICE AND REMEDIES WITH COMPETITION, FED. TRADE COMM'N 8 (2011), *available at* <http://www.ftc.gov/os/2011/03/110307patentreport.pdf> [hereinafter FTC PATENT REPORT].

<sup>9</sup> Kirk Victor, *Patent Litigation Gets Attention of FTC, DOJ*, FTC WATCH, Jan. 15, 2013, at 3.

<sup>10</sup> *Transcript, Patent Assertion Entity Activities -Session 1/4*, FED. TRADE COMM'N (Dec. 10, 2012), *available at* <http://www.ftc.gov/video-library/transcripts/121210paept1.pdf>.

<sup>11</sup> *Id.*

<sup>12</sup> Leibowitz, *supra* note 4, at 3.

### *Competition Issues Surrounding PAEs*

PAE activities present some serious competition problems. We acknowledge at the outset that a PAE's mere assertion or enforcement of the patents it acquires, without more, cannot be an antitrust violation. We also agree with several panelists at the PAE Workshop that PAEs may perform valuable services and enhance market efficiency by enabling innovators to monetize their patents. In addition, we agree that antitrust law cannot solve the problem of longstanding flaws in the patent system that some PAEs have so successfully exploited. Antitrust law, however, can address abusive PAE practices that adversely affect competition in important technology markets.

#### *I. Threats to Operating Companies' Innovation and Development*

We did hear at the PAE Workshop considerable discussion concerning what appear to be abusive and potentially anticompetitive PAE practices. These practices are the focus of this comment. First of all, PAEs' assertions of longstanding patents against operating companies' existing products can become huge distractions to those companies and result in "higher prices, reduced output, and stifled innovation for consumers."<sup>13</sup> PAEs' concentration on those kinds of highly profitable litigation strategies attracts investment from third parties such as hedge funds to finance their lawsuits.<sup>14</sup> They operate "on similar terms to private equity and venture funds," seek "to make most of [their] money on carried interest," and "forge ahead with weak patents" to "reinforce their bargaining position with future targets."<sup>15</sup> This trend appears to push patent use from facilitation and reward of innovation to the proliferation of holdup outcomes. Defending against these patent infringement claims is usually much more expensive than the settlement cost. PAEs often assert vague software patents, which are very difficult to defend against because the alleged infringers cannot identify the scope of those patents.<sup>16</sup> They may concentrate on maximum lock-in and holdup situations by asserting patents late in the patent term.<sup>17</sup> Therefore, even if a

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<sup>13</sup> Michael A. Carrier, *Antitrust Enforcement and Trolls*, RUTGERS LAW SCHOOL-CAMDEN 1, available at <http://www.justice.gov/atr/public/workshops/pae/comments/paew-0002.pdf>.

<sup>14</sup> Richard Ehrlickman, *Hedging Your Intellectual Property Bets*, INTELLECTUAL PROP. MAGAZINE, May 2012, at 53, available at <http://www.ipofferings.com/drawings/may12/HedgingYourIPBets-IPM-May2012.pdf>.

<sup>15</sup> Michael A. Carrier, *Patent Assertion Entities: Six Actions the Antitrust Agencies Can Take*, CPI ANTITRUST CHRONICLE, Jan. 2013, at 7 (quoting Nigel Page, *IV Shifts Gear*, IAM MAGAZINE, 4 (2009), available at <http://www.iam-magazine.com/issues/article.ashx?g=2c2a2269-4563-4558-98cc-9b631ce95854>; Brian T. Yeh, *An Overview of the "Patent Trolls" Debate*, CRS REPORT R42668, at 13 (Aug. 20, 2012)). PAEs operate like venture funds. For example, A PAE named Mosaid agreed to finance its acquisition of Nokia's patents through "royalties from future licensing and enforcement revenues," and its ownership of these patents would be "subject to minimum future royalty milestones." *Id.* Also, PAEs may provide a specified level of returns to their investors. Another PAE, Intellectual Ventures (IV) would need to generate a 25% return each year in order to be successful. Its lifetime revenue expectation would be \$40 billion over a 10-year period and \$244 billion over a 20-year period. The shares of Acacia, a PAE, enjoyed a growth rate of more than 30% a year from 2002 to 2007. Its inventors include investment companies like Oppenheimer Funds, Fidelity and Vanguard. *Id.*

<sup>16</sup> Ryan Davis, *USPTO Urged to Limit Vague Software Patents, Curb "Trolls"*, LAW360 (Feb. 12, 2013), <http://www.law360.com/ip/articles/404912/uspto-urged-to-limit-vague-software-patents-curb-trolls->.

<sup>17</sup> Carrier, *supra* note 15, at 9. PAEs file more than 70% of all patent claims within the final three years of the patent term. Brian J. Love, *Let's Use Patent Fees to Stop the Trolls*, WIRED, Dec. 20, 2012, <http://www.wired.com/opinion/2012/12/how-to-stop-patent-trolls-lets-use-fees/>.

defendant or a prospective defendant believes that the case has little if any merit, it may still need to settle to avoid the higher litigation cost and the inevitable risk of losing.<sup>18</sup> PAEs' pursuit of these enforcement actions exploits the fact that their targets face high switching costs and lock-in effects, forcing their acceptance of abusive license terms if there is virtually any risk of losing in litigation.

Moreover, PAEs can pursue exceptionally aggressive patent litigation because, unlike operating companies, they do not confront the risk of counterclaims or reputational constraints. Because PAEs do not manufacture or sell products, they cannot be infringing any patent.<sup>19</sup> PAEs also do not share an operating company's concern to avoid irritating customers or other third parties with which it needs to interact by developing a reputation of caring only about excluding rivals even at the expense of innovation and consumers.<sup>20</sup> What is more, unlike the operating companies, PAEs produce few documents, do not incur heavy discovery burdens since they have no business other than patent licensing and litigation,<sup>21</sup> and may pay only a contingency fee to their lawyers.<sup>22</sup> If patent

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<sup>18</sup> For example, the Federal Circuit noticed in 2011:

[m]eritless cases . . . unnecessarily require [a] district court to engage in excessive claim construction analysis before it is able to see the lack of merit of the patentee's infringement allegations. In this case, [the defendant] expended over \$600,000 in attorney fees and costs to litigate this case through claim construction. . . . Viewed against [the plaintiff's] \$25,000 to \$75,000 settlement offer range, it becomes apparent why the vast majority of those that [the plaintiff] accused of infringement chose to settle early in the litigation rather than expend the resources required to demonstrate to a court that the asserted patents are limited to processing information that originates from a hard copy document. Thus, those low settlement offers — less than ten percent of the cost that [the defendant] expended to defend suit — effectively ensured that [the plaintiff's] baseless infringement allegations remained unexposed, allowing [the plaintiff] to continue to collect additional nuisance value settlements.

*Eon-Net LP v. Flagstar Bancorp*, 653 F.3d 1314, 1327 (Fed. Cir. 2011).

<sup>19</sup> The Federal Circuit also articulated:

[A PAE plaintiff in patent litigation] placed little at risk when filing suit. [In this case, a]s a [PAE], [the plaintiff] was generally immune to counterclaims for patent infringement, antitrust, or unfair competition because it did not engage in business activities that would potentially give rise to those claims. And while [the plaintiff] risked licensing revenue should its patents be found invalid or if a court narrowly construed the patents' claims to exclude valuable targets, [the plaintiff] did not face any business risk resulting from the loss of patent protection over a product or process. Its patents protected only settlement receipts, not its own products.

*Id.* at 1327–28.

<sup>20</sup> Former FTC Commissioner Rosch commented on reputational constraint when he concurred in the FTC's decision to block Ovation's contemplated acquisition of NeoProfen from Abbott. He argued that Ovation's initial acquisition of Indocin from Merck was anticompetitive because it eliminated "reputational constraints" faced by Merck. Because Merck had a large portfolio of popular pharmaceutical products, if it sold Indocin at a monopoly price, that could damage its reputation and its sales of other more profitable drugs. Absent such reputational constraints, Ovation could and did raise the price of Indocin substantially. *Fed. Trade Com'n v. Ovation Pharm., Inc.*, Concurring Statement of Commissioner J. Thomas Rosch, *Fed. Trade Comm'n* 1 (Dec. 16, 2008), *available at* <http://www.ftc.gov/os/caselist/0810156/081216ovationroschstmt.pdf>.

<sup>21</sup> The Federal Circuit stated again in 2011:

[A PAE plaintiff in patent litigation has] the ability to impose disproportionate discovery costs on [the defendant]. This is, at least in part, because accused infringers often possess enormous amounts of potentially relevant documents that are ultimately collected and produced. . . . The Federal Rules of Civil Procedure, as well as the local discovery rules and policies of a number of district courts, allow for liberal discovery, and it is not uncommon for an accused infringer to produce millions of pages of documents, collected from central repositories and numerous document custodians. Those discovery costs are generally paid by the producing party . . . increasing the nuisance value that an accused infringer would be willing to settle for in a patent infringement case. In this case, it is notable that the district court stayed all discovery that did not relate to claim construction issues, and, while [the defendant]

wars between operating companies can be called “mutually assured destruction,” in the PAE context, “mutually assured” has been separated from “destruction.”

Additionally, PAEs not only go after the companies that manufacture allegedly infringing products, they may also target the companies’ downstream customers that use those products. The customers may be small businesses and often lack experience in patent litigation, so they are more likely to accept PAEs’ proposed unreasonable licensing terms. Those manufacturers have been trying to find ways to protect their customers from PAEs’ harassment, without success to date. For instance, Cisco, Motorola and Netgear brought a suit under the Racketeer Influenced and Corrupt Organizations Act (RICO Act) against Innovatio IP Ventures, a PAE, alleging that the defendant had made false statements in the threatening letters it sent to thousands of their customers that used their products to set up Wi-Fi networks.<sup>23</sup> These claims, however, have been dismissed on *Noerr-Pennington* grounds because the manufacturers could not establish that the PAE’s threats were so “objectively baseless in the sense that no reasonable litigant could realistically expect success on the merits.”<sup>24</sup> This standard appeared arguably insurmountable when the lawsuits in question are patent litigation, because a patent’s scope is often uncertain. Although these manufacturers have been unsuccessful so far,<sup>25</sup> their case has sent PAEs a strong message that product manufacturers may actively explore available strategies to protect their customers.

Because of the risk of unexpected and even baseless lawsuits by PAEs, market incumbents (especially small businesses) may have to bear significantly increased litigation, licensing and invent-around costs while potential new entrants (especially small businesses) may hesitate to enter a market. The distractions caused by PAEs may significantly harm innovation. Small companies face a particularly difficult situation. They may not be able to find investors and may even have to exit the U.S. market because of the risk of PAE challenges. Even if they receive venture capital funding, they may have to avoid announcing it, because PAEs may begin to target them upon learning that

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expended over \$600,000 to litigate this case, that amount would have substantially increased if the district court had allowed full discovery.

*Eon-Net*, 653 F.3d at 1327.

<sup>22</sup> Carrier, *supra* note 15, at 7.

<sup>23</sup> In re Innovatio IP Ventures, LLC Patent Litigation, MDL Docket No. 2303, Case No. 11 C 9308, \*2 (N.D. Ill., Feb. 4, 2013)

<sup>24</sup> *Id.* at \*8; See also *Profl Real Estate Investors, Inc. v. Columbia Pictures Indus., Inc.*, 508 U.S. 49, 57 (1993). Admittedly, this *Noerr-Pennington* issue can be a hurdle against actions addressing PAE practices, and it deserves more attention than it has received to date. Another district court also applied it recently. See *Apple, Inc. v. Motorola Mobility, Inc.*, No. 3:11-cv-00178-BBC, 2012 WL 3289835, at \*12–\*14 (W.D. Wis. Aug. 10, 2012). Cf. *Eon-Net*, 653 F.3d at 1326–29 (finding that a PAE and its lawyers engaged in litigation misconduct and filed objectively baseless litigation in bad faith, awarding the operating company attorney fees, and imposing Rule 11 sanctions against the PAE). These district courts might be inappropriately treating abusive litigation tactics as protected speech immune from challenge under the *Noerr-Pennington* doctrine, and the FTC and DOJ should work together to provide more sophisticated amicus support for defeating this argument as it plays out on appeals and other future litigation.

<sup>25</sup> The plaintiffs alleged, among other claims, that Innovatio failed to meet its obligation to license some of its patents under F/RAND terms. *Innovatio IP Ventures*, Case No. 11 C 9308, at \*4–\*5. As will be illustrated later, the FTC has taken a strong position that such conduct constitutes an unfair method of competition in violation of Section 5 of the Federal Trade Commission Act. Cisco’s loss might suggest the difficulty the FTC would face to test its position in court. However, AAI encourages the FTC to utilize its Section 5 authority to condemn this kind of anticompetitive conduct.

information. They may not even want to speak publicly on the PAE problems they face for that same reason.<sup>26</sup> Several operating companies complained about this problem during the PAE Workshop. Hewlett-Packard's Cynthia Bright said that 60% of HP's current docket of 50 pending patent suits are PAE lawsuits.<sup>27</sup> Cisco's Neal Rubin reported that "effectively all of Cisco's patent litigation is brought by PAEs."<sup>28</sup> A PAE panelist, RPX,<sup>29</sup> acknowledged that in 2011 Apple was sued 48 times by PAEs, that 74 PAE cases were pending against Apple at the time of the PAE Workshop, and that businesses with revenues under \$ 1 billion comprised 63% of PAE respondents in 2011.<sup>30</sup> The vice general counsel of Rackspace stated that PAE litigation defense was this small company's fastest growing expense category, that since 2010 the company has experienced a 500% jump in legal expenses defending PAE cases,<sup>31</sup> and that 90% of their 2012 litigation expense was on PAE suits.<sup>32</sup> Google's David Drummond once summarized, "Patents were meant to encourage innovation but lately they are being used as a weapon to stop it."<sup>33</sup>

## II. Competition Concerns in Standard Setting Context

"Standards are an important engine driving our modern economy . . . ."<sup>34</sup> The adverse effects of PAEs' litigation and licensing strategies may be magnified in the standard setting context if there are standard-essential patents (SEPs) within a PAE's patent portfolio and these SEPs are subject to F/RAND (Fair, Reasonable and Non-Discriminatory) license commitments. In fact, in the course of amassing huge portfolios in the information technology and communications fields, a PAE will almost surely obtain at least some F/RAND-encumbered SEPs. The FTC has conveyed unequivocal messages in both its consent order approving the Robert Bosch GmbH-SPX merger (Bosch Order) and enforcement action against Google/Motorola (Google Order) that a previous SEP owner's F/RAND commitments must bind successors and that a F/RAND-encumbered SEP owner should not generally seek injunctive relief against implementers of the standard in question.<sup>35</sup> Any failure to

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<sup>26</sup> Davis, *supra* note 16.

<sup>27</sup> *Transcript, Patent Assertion Entity Activities - Session 2/4*, FED. TRADE COMM'N (Dec. 10, 2012), available at <http://www.ftc.gov/video-library/transcripts/121210paept2.pdf>.

<sup>28</sup> Victor, *supra* note 9, at 3.

<sup>29</sup> RPX alleged that it was not a PAE but engaged in the business of "defensive patent aggregation." *Transcript, Patent Assertion Entity Activities - Session 2/4*, *supra* note 27.

<sup>30</sup> Victor, *supra* note 9, at 4.

<sup>31</sup> *Id.* at 3, 4.

<sup>32</sup> *Transcript, Patent Assertion Entity Activities - Session 2/4*, *supra* note 27.

<sup>33</sup> Steven Levy, *The Patent Problem*, WIRED, Nov. 13, 2012, <http://www.wired.com/opinion/2012/11/ff-steven-levy-the-patent-problem/all/>.

<sup>34</sup> Tracy Russo, *Standard Setting and Competition*, THE JUSTICE BLOG, U.S. DEP'T OF JUSTICE (Nov. 8, 2012), <http://blogs.justice.gov/main/archives/2553> (quoting Renata Hesse, Deputy Assistant Att'y Gen., U.S. Dep't of Justice, Antitrust Div., Remarks at the Intellectual Property Rights Patent Committee of the American National Standards Institute (Nov. 8, 2012)).

<sup>35</sup> In the Matter of Robert Bosch GmbH, Decision and Order, Fed Trade Comm'n (2012), available at <http://www.ftc.gov/os/caselist/1210081/121126boschdo.pdf>; In the Matter of Motorola Mobility LLC & Google Inc.,

abide by those admonitions may be an unfair method of competition or an unfair act or practice in violation of Section 5 of the Federal Trade Commission Act in accordance with the standards set forth in the FTC's *N-Data* complaint.<sup>36</sup> In addition, Renata Hesse, the Deputy Assistant Attorney General at the Antitrust Division, stated on February 8, 2013 that SEP holders' actions "to take advantage of the market power that standardization of their patented technology creates by engaging in hold-up" may violate Section 2 of the Sherman Act as well.<sup>37</sup>

PAEs, however, may be less inhibited than operating companies to circumvent prior owners' F/RAND commitments, to demand unreasonable license terms or seek injunctions in court or exclusion orders before the International Trade Commission (ITC) as part of the pressure they can exert on their targets. One important reason is that operating companies generally face particularly strong reputational constraints with regard to their SEPs while PAEs are not affected by that factor. An operating company participating in many standard setting processes over many years has to be concerned with its reputation because it will need to persuade other participants in future standard-setting processes to incorporate its patents into proposed standards over those years. Again a PAE generally has no such concern or interest. In contrast, a PAE's business model would appear to entail a benefit from developing a reputation for aggressive positions that may not ultimately be sustainable, but which are expensive to defeat, which is the very opposite of a reputational constraint. AAI, therefore, urges the agencies to be particularly vigilant in pursuing Section 5 and/or Section 2 claims against PAEs that fail to abide by F/RAND commitments embodied in their SEPs.

### *III. Antitrust Problems in Patent Portfolio Acquisitions Involving PAEs*

The manner in which PAEs acquire many patent portfolios may raise serious issues under Section 7 of the Clayton Act or Section 5 of the Federal Trade Commission Act. A significant transparency problem is inherent in many PAEs' patent aggregation practices. A PAE may aggregate a massive portfolio, use it to threaten many potential infringers, and demand portfolio-wide licenses. However, it often at the same time refuses to disclose the patents it owns or even which patents it believes are being infringed. Without knowing if they are actually infringing anything or what they are paying for, the targets of these threats, especially the smaller start-up businesses but large operating companies as well, often see no attractive alternative to acquiescing in an expensive portfolio-wide license. Moreover, the aggregation process typically combines many weak patents with a smaller number of strong patents; the net effect is to artificially boost the exclusionary power of the weak patents as if they were strong patents. If any SEP is within the portfolio, a portfolio-

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Decision and Order, Fed. Trade Comm'n (2013), *available at* <http://www.ftc.gov/os/caselist/1210120/130103googlemotorolado.pdf>.

<sup>36</sup> In the Matter of Negotiated Data Solutions LLC, Statement of the Federal Trade Commission, Fed Trade Comm'n (2008), *available at* <http://ftc.gov/os/caselist/0510094/080122statement.pdf>.

<sup>37</sup> Renata B. Hesse, Deputy Assistant Att'y Gen., Antitrust Div., U.S. Dep't of Justice, Presented at Global Competition Review 2nd Annual Antitrust Law Leaders Forum: IP, Antitrust and Looking Back on the Last Four Years, 16 (Feb. 8, 2013), <http://www.justice.gov/atr/public/speeches/292573.pdf>. In support of her argument, she discussed *Broadcom v. Qualcomm*, a case decided by the Third Circuit in 2007. The court held that a patent holder's intentional misrepresentation that it would license its patents on F/RAND terms after they were incorporated into the standard and the standard setting organization (SSO)'s reliance on such promise when setting up the standard while there were alternative technologies available might constitute a Section 2 violation. *Id.* at 19–20; *Broadcom Corp. v. Qualcomm, Inc.*, 501 F.3d 297, 314 (3d Cir. 2007).

wide license demand may make the entire portfolio a *de facto* standard-essential portfolio.<sup>38</sup> As the Supreme Court held in *Broadcast Music*, a bundled or package license might not by itself violate antitrust law as long as any party can obtain individual intellectual property licenses in lieu of a license covering the whole package.<sup>39</sup> However, in the PAE context, how can a party threatened by a PAE demand for a license to an entire patent portfolio negotiate individual licenses if the PAE refuses to disclose what patents are within it? To make matters worse, after amassing a huge portfolio and successfully forcing licenses to it, the PAE may spin off a part of it to another PAE that may then threaten some of those same targets with infringement suits. So accepting a portfolio license from the first PAE may not bring patent peace – the second PAE wants its take too, and the first may again threaten to assert patents outside the portfolio-wide license that the licensee previously accepted.

Again, the central problem is PAEs' refusals to disclose the patents within their patent portfolios. Intellectual Ventures (IV)'s Peter Detkin said during the PAE Workshop that, as no investor would like to disclose his or her investment portfolio, IV does not disclose the patents it owns.<sup>40</sup> To make matters worse, IV has created more than 1,276 shell companies to hide its patents.<sup>41</sup> Another PAE, Acacia, controls 250 patent portfolios via its subsidiaries.<sup>42</sup> Even if an operating company wants to license some of those patents before it introduces its products, it will not be able to find where they are. The PTO's pending RPI recordation proposal is a very desirable part of the solution, as AAI explained in its recent comments to the PTO.<sup>43</sup> But the FTC should also

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<sup>38</sup> Carrier, *supra* note 13, at 1. It is valuable because of its size rather than the validity or strength of each patent in it. Some operating companies argue that there may in fact be three kinds of patents in technology markets: SEPs, implementation patents and differentiating patents. In the smartphone world, Implementation patents include “the features that consumers would expect to find in any smart phone they would be willing to purchase.” And differentiating patents refer to the patents that serve to differentiate the patent owner's products from its competitors' products in the market. Alden F. Abbott, *RIM's Prescription for Patent Peace in the Smartphone Arena*, FTC WATCH, July 16, 2012, at 10. Research In Motion (RIM, now Blackberry) argues that implementation patents should receive the same treatment as SEPs. *Id.* at 11. Some companies have introduced the concept of “commercially essential patents” whose meaning is unclear. Some people think they may be essential to some popular yet optional features of standards, which sounds similar to implementation patents. Fiona M. Scott Morton, Deputy Assistant Att'y Gen. for Econ. Analysis, Antitrust Div., U.S. Dep't of Justice, Presented at Charles River Associates Annual Brussels Conference: Economic Developments in European Competition Policy: The Role of Standards in the Current Patent Wars 9 (Dec. 5, 2012). Google submitted a letter to the United States Senate Judiciary Committee arguing that commercially essential patents should be treated as if they were SEPs. *In Lobbying and Litigation, Google Blurs Distinction between Standard-Essential and Other Patents*, FOSS PATENTS (July 23, 2012), <http://www.fosspate.com/2012/07/in-lobbying-and-litigation-google-blurs.html>. In any event, the concept of “commercially essential patents” represents intriguing questions that need to be subjected more attention and analysis to determine whether they raise antitrust problems.

<sup>39</sup> *Broad. Music, Inc. v. Columbia Broad. Sys., Inc.*, 441 U.S. 1, 6 (1979).

<sup>40</sup> See *Transcript, Patent Assertion Entity Activities - Session 2/4*, *supra* note 27.

<sup>41</sup> Carrier, *supra* note 13, at 1, 2. The existence of countless shell companies may facilitate concerted actions among PAEs which may result in violations of Section 1 of the Sherman Act. See 15 U.S.C. § 1.

<sup>42</sup> Carrier, *supra* note 15, at 3 (citing *Patent Portfolios*, ACACIA RESEARCH GROUP LLC, <http://acaciatechnologies.com/patentportfolio.htm>).

<sup>43</sup> See *Comment of the American Antitrust Institute*, *supra* note 6. As we noted in our comments, recordation of RPI information can help the antitrust agencies with merger review. *Id.* at 4. This is consistent with the changes made by the agencies in 2010 to the Hart-Scott-Rodino Act introducing the concept of “associates” including entities managed by the acquirer. Carrier, *supra* note 15, at 4 (citing HART-SCOTT-RODINO ANNUAL REPORT, FISCAL YEAR 2011, BUREAU OF



explore the possibility of using its own authority under Section 5 of the Federal Trade Commission Act to impose disclosure requirements. There is a powerful but underappreciated FTC precedent for treating nondisclosure of material information as an “unfair” practice apart from any argument about “deception” from it. In *International Harvester*, the Commission held that that company’s failure to disclose a material safety problem with its tractors was an “unfair” trade practice under Section 5. A PAE’s refusal to disclose what it owns and believes to be infringed during licensing negotiations can also be an unfair trade practice under the *International Harvester* analysis.<sup>44</sup> The FTC may also police these activities through its rulemaking authority as Chairman Leibowitz suggested in his opening remarks at the PAE Workshop.<sup>45</sup>

Transfers of large patent portfolios (often including SEPs) from operating companies to PAEs may raise particularly serious Section 7 and Section 5 issues when effectuated through “hybrid” arrangements in which the operating company transferees play an ongoing role. These transactions may entail significant potential for anticompetitive raising rivals’ costs, creating market power and facilitating its exercise, and creating both ability and incentive to engage in exclusionary conduct.

There are several such hybrid PAE models.<sup>46</sup> A common strategy is for an operating company to sell a patent portfolio to an existing PAE but to retain some rights. In this way, the patents can be asserted by the PAE against the operating company’s competitors without concern about counterclaims or reputation effects on the operating company’s side. For example, Nokia and Microsoft have transferred many of their patents to Mosaid, a well-known patent holding company, to enforce those patents and then share proceeds with the prior owners.<sup>47</sup> On January 10, 2013, Ericsson announced its plan to transfer to Unwired Planet, a PAE, 2,185 issued United States and international patents and patent applications. In addition to this portfolio, Ericsson is required to transfer 100 patent assets each year to Unwired Planet from 2014 through 2018. Unwired Planet, in return, will grant Ericsson a license to its expanding patent portfolio, among other benefits.<sup>48</sup> A more problematic creature will emerge when multiple operating companies create a new PAE and

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COMPETITION, FED. TRADE COMM’N & ANTITRUST DIV., U.S. DEP’T OF JUSTICE 7 (2011), *available at* <http://www.ftc.gov/os/2012/06/2011hsrreport.pdf>)

<sup>44</sup> In *International Harvester*, the defendant failed to disclose the safety problem it knew or should have known. The concealed facts were material, as they would affect decisions made by prospective purchasers and existing customers. The FTC concluded that the failure to disclose these facts constituted an unfair act or practice. Similarly, a PAE’s patent portfolio is material information which will affect any alleged infringer’s decision as to whether to license or defend. Thus failure to disclose what is in the portfolio should be a Section 5 violation as an unfair act or practice as well. In the Matter of Int’l Harvester Co., 1014 F.T.C. 949, 950–51 (1984).

<sup>45</sup> *Transcript, Patent Assertion Entity Activities -Session 1/4*, *supra* note 10; *See also* Leibowitz, *supra* note 4.

<sup>46</sup> *See* Fiona M. Scott Morton, Deputy Assistant Att’y Gen. for Econ. Analysis, Antitrust Div., U.S. Dep’t of Justice, Presented at Fifth Annual Searle Conference on Antitrust Economics and Competition Policy: Patent Portfolio Acquisitions: An Economic Analysis (Sept. 21, 2012).

<sup>47</sup> Alastair Sharp, *Mosaid Sees Rescue in Its Nokia-Microsoft Deal*, REUTERS, Sep. 1, 2011, <http://www.reuters.com/article/2011/09/01/us-mosaid-idUSTRE7803O920110901>.

<sup>48</sup> *Ericsson Transfers Patents and Patent Applications to Unwired Planet Inc*, REUTERS, Jan. 10, 2013, <http://www.reuters.com/finance/stocks/UIPIP.O/key-developments/article/2673215>.

transfer their own patents to it. This PAE is also free from counterattack or reputational constraints. An example will be MobileMedia. It was created by Nokia, Sony and a licensing group called MPEG-LA and holds their patents.<sup>49</sup> Nokia's Paul Melin at the PAE Workshop said that Nokia sees Mosaid and other PAEs as important to its ability to monetize its own patent investments.<sup>50</sup>

Other hybrids can be even more concerning. Rockstar Bidco LP was founded as a bidding group by several technology giants including Apple, Microsoft, Sony, Research In Motion (RIM, now Blackberry), Ericsson, and EMC.<sup>51</sup> It acquired the bankrupt Nortel Network's 6,000 patents for \$4.5 billion in June 2011.<sup>52</sup> Before approving the deal, the DOJ obtained assurances from Apple and Microsoft that they would license SEPs in the acquired portfolio under F/RAND terms.<sup>53</sup> However, 4,000 of the patents in the portfolio were later transferred to a new entity, Rockstar Consortium Inc., and its CEO reportedly claimed that the promises made by the individual companies did not bind the new entity.<sup>54</sup>

Perhaps the most problematic "patent troll" situation involves several operating companies plus two PAEs forming a new PAE and the new PAE acquiring patents. This new entity emerged in the bankrupt Eastman Kodak's auction of its digital imaging patent portfolio. A consortium submitted the winning bid. It was led by IV and RPX and included 12 technology giants – Adobe, Amazon, Apple, Facebook, Fujifilm, Google, Huawei, HTC, Microsoft, RIM, Samsung and Shutterfly.<sup>55</sup>

Again, these transactions raise serious competition concerns. A PAE may acquire market power in certain technology markets through multiple patent transfers, and it may have considerable ability and incentive to exercise that power through exclusionary conduct against the transferees' competitors that will harm innovation, competition and consumer welfare.<sup>56</sup> In the Rockstar case, for example, Google's principal rivals combined to outbid Google on patents that might be crucial for Google's Android product line, and those patents are now in the hands of the Rockstar PAE

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<sup>49</sup> Ryan Davis, *Apple iPhones Flout Patents Tied to Sony, Nokia, Jury Says*, LAW360 (Dec. 13, 2012), <http://www.law360.com/articles/401398/apple-iphones-flout-patents-tied-to-sony-nokia-jury-says>.

<sup>50</sup> *Transcript, Patent Assertion Entity Activities - Session 2/4*, *supra* note 27.

<sup>51</sup> Robert McMillan, *How Apple and Microsoft Armed 4,000 Patent Warheads*, WIRED, May 21, 2012, <http://www.wired.com/wiredenterprise/2012/05/rockstar/>. EMC later dropped out.

<sup>52</sup> *Id.*

<sup>53</sup> McMillan, *supra* note 51; Albert A. Foer, *Letter to Christine A. Varney, Assistant Att'y Gen., Antitrust Div., U.S. Dep't of Justice*, AM. ANTITRUST INST. (July 6, 2011), *available at* <http://www.antitrustinstitute.org/~antitrust/sites/default/files/Nortel%20letter%20to%20DOJ.7.6.11.pdf>

<sup>54</sup> McMillan, *supra* note 51.

<sup>55</sup> Tom Hals, *Kodak in \$525 Million Patent Deal, Eyes Bankruptcy End*, REUTERS, Dec. 19, 2012, <http://www.reuters.com/article/2012/12/19/us-kodak-patent-sale-idUSBRE8BI0R520121219>.

<sup>56</sup> Carrier, *supra* note 15, at 5–6; *see also* U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, HORIZONTAL MERGER GUIDELINES § 1 (2010).

where they can be enforced against the whole Android ecosystem.<sup>57</sup> We believe that this scheme should be reviewed as a collusion to obtain and utilize a patent portfolio for the purpose of boycotting a competitive technology, which may be in violation of Section 1 of the Sherman Act. In the Kodak case, Kyocera, Nokia and Nintendo filed their objections against the deal, arguing that the agreement failed to include language protecting their affirmative defenses as patent licensees in connection with any legal action taken against any of them and is inconsistent with the conditional sale order approved in July 2012.<sup>58</sup>

These combinations can also generate many opportunities for product competitors and PAEs to communicate and collude.<sup>59</sup> For example, there have allegedly been monthly calls between RPX and Acacia.<sup>60</sup> The “common purpose” analysis in *United States v. Singer Manufacturing Co.* may be helpful in addressing the above-referenced MobileMedia kind of conduct to pierce the PAE veil.<sup>61</sup> Also, after an initial group purchase, the purchaser group may decide to transfer some or all of the patents to a group member or several group members or some new entity created by several group members. It would then be particularly difficult for an outside company willing to license the patents to identify the new patent owner and/or RPI. And these kinds of ownership change may evade antitrust agency conditions or remedies.

In addition, aggregation of patents by complex PAEs may substantially raise entry barriers. These deals may trigger application of the FTC’s 1997 Ciba-Geigy argument that the aggregation would “heighten barriers to entry by combining portfolios of patents and patent applications of uncertain breadth and validity, requiring potential entrants to invent around or declare invalid a greater array of patents.”<sup>62</sup> As the Nortel and Kodak cases suggest, there are likely to be more ailing former technology giants filing for bankruptcy and their competitors can be expected to try to obtain their patent portfolios from the ensuing bankruptcy proceedings. It may thus be desirable for the agencies to develop a set of proactive well-publicized policies to deal with this kind of transaction in order to preserve market competition.

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<sup>57</sup> We hope that the antitrust agencies will aggressively investigate any coalition of leading competitors that appears to be formed or utilized for the purpose of disadvantaging an excluded rival such as by depriving it of access to SEPs on reasonable terms. Later comers to the product standard, like Google in the *Nortel* case, should be beneficiaries of the F/RAND commitments made to the SSO during the standard-setting process. The district court in *Microsoft v. Motorola* has ruled that Microsoft is a third-party beneficiary of Motorola’s contractual obligations to the SSOs. Order on Plaintiff’s Motion for Partial Summary Judgment, *Microsoft Corp. v. Motorola, Inc.*, Case No. C10-1823JLR, at 10 (W.D. Wash., Feb. 27, 2012). The Ninth Circuit in an interlocutory appeal held that this conclusion was not legally erroneous. *Microsoft Corp. v. Motorola, Inc.*, 696 F.3d 872, 884 (9th Cir. 2012).

<sup>58</sup> Maria Chutchian, *Nokia, Nintendo Object to Kodak Patent Sale Order*, LAW360 (Jan. 8, 2013), <http://www.law360.com/ip/articles/405428/nokia-nintendo-object-to-kodak-patent-sale-order>.

<sup>59</sup> This may result in violations of Section 1 of the Sherman Act. *See* 15 U.S.C. § 1.

<sup>60</sup> Carrier, *supra* note 15, at 10 (quoting Tom Ewing & Robin Feldman, *The Giants among Us*, 2012 STAN. TECH. L. REV. 1, 26 (2012)).

<sup>61</sup> In the *Singer Manufacturing* case, the Supreme Court condemned an agreement where three companies pursued a “common purpose” to suppress competition “through the use of [a] patent.” Carrier, *supra* note 15, at 10; *United States v. Singer Mfg. Co.*, 374 U.S. 174, 194–95 (1963).

<sup>62</sup> Scott Morton, *supra* note 38, at 8 (citing *Ciba-Geigy Ltd.*, 123 F.T.C. 842, 882, 893 (1997)).

*Conclusion*

As President Obama commented, PAEs “are essentially trying to leverage and hijack somebody else’s idea and see if they can extort some money out of them.”<sup>63</sup> More actions are necessary to regulate these practices. Again, AAI appreciates the antitrust agencies’ efforts to address the antitrust issues presented by PAEs. We urge both of the agencies to use existing enforcement authorities to police PAE activities and reduce their threat to competition and innovation.

Respectfully submitted,



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<sup>63</sup> Erin Fuchs, *Obama Calls Patent Trolls Extortionists That “Hijack” People’s Ideas*, BUS. INSIDER, Feb. 15, 2013, <http://www.businessinsider.com/obamas-patent-comments-at-google-chat-2013-2>.