The DOJ/FTC Workshop on Patent Assertion Entities: Highlights and Reactions

*By Jonathan Gleklen**

On December 10, 2012, the Antitrust Division of the Department of Justice (DOJ) and the Federal Trade Commission (FTC) hosted a day-long workshop on Patent Assertion Entity Activities. The workshop was oversubscribed, and FTC's conference center was filled with several hundred interested participants who heard from government officials and panelists from academia, industry, and the private bar. The workshop is the latest in a series of hearings and workshops that address intellectual property issues in general and patent assertion entities (PAEs) in particular.[1]

My key impression from the day was that there is broad consensus that the issues raised by PAEs are similar to the issues raised by patent litigation generally and that patent quality and remedies issues need to be considered without regard to who is enforcing the patents. And although the workshop was sponsored by antitrust enforcers, panelists generally rejected any assertion that there was a role for antitrust enforcement where PAEs merely acquired and asserted patents.

Opening Remarks by FTC Chairman Jon Leibowitz

FTC Chairman Jon Leibowitz opened the workshop. Chairman Leibowitz noted the statistics gathered by others that purport to quantify the rate of growth in PAE lawsuits and the costs of such suits. He cited a study concluding that when PAE suits proceed to merits judgments, the PAEs lose 92% of the time, but given that -- according to the same study -- 90% of PAE infringement lawsuits settle, that is hardly a meaningful statistic.[2] In 2011, the FTC lost two out of three of its litigated merger challenges, but nobody would suggest that means much about the nine merger cases that the FTC settled that year via consent decree. Chairman Leibowitz concluded by noting that "[t]he FTC has a number of tools in its arsenal," including authority under Section 5 of the FTC Act to challenge "unfair methods of competition" that violate the antitrust laws and "unfair acts and practices" based on misrepresentation. He did not, however, discuss specific forms of conduct that might justify such relief, though he noted that it seemed "at least to [his] not entirely educated mind on this issue, kind of unsavory" for "operating companies [to transfer] IP to [a] PAE as a means of raising rivals' cost." Chairman Leibowitz described the FTC's use of "policy and advocacy tools," including recommendations regarding improvements to patent notice and remedies. Chairman Leibowitz also added that the FTC had antitrust rulemaking authority, which he acknowledged had been rarely used, and suggested that such rules could be used to require disclosure of the real party in interest-- i.e., the parent of the firm that held the patent, rather than the acquisition vehicle used to acquire the patent. In fact, the FTC has issued only one antitrust rule in its 98-year history, and that rule was repealed in 1994 after 40 years of non-enforcement.

Presentation by Professor Colleen Chien

Professor Colleen Chien of Santa Clara University offered the first presentation of the conference. After providing statistics showing the growth of lawsuits by PAEs,[3] she discussed the economics of PAEs, noting that they could be characterized as "[a] pathbreaking, disruptive technology for monetizing patents that eliminates traditional obstacles to enforcement (and give the little guy a chance!)," albeit one "[a]bout which we don't really understand the consequences, good or bad." She noted that asserting patents is risky and that it can be difficult to recoup the investment litigation, but that PAEs are able to "capture economies of scale, over multiple defendants and campaigns" to reduce that risk. After describing the importance of startups to the economy, Chien noted that individual inventors and small companies are the source of more than 75% of all PAE patents and that patent monetization has been used or considered by almost 25% of startups, but that some startups have also been harmed by PAE infringement claims or demands. So, while on the one hand "PAEs give the little guy a chance and create demand for their patents - this should increase innovation," non-enforcement of infringed patents also has procompetitive benefits by increasing the number of firms that can compete and lowering their costs as they avoid royalties. She closed by identifying patent law reforms that could lower the cost of defense (such as fee shifting), as well as market-based reforms (such as infringement insurance and group defense), noting that in the late 1800s, after facing many infringement suits, the railroads banded together and agreed to collectively

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contribute to the defense of such suits and that antitrust challenges to this collective action had been rejected.

Presentation by Carl Shapiro

Carl Shapiro, a professor at Berkeley and former chief economist at the DOJ's Antitrust Division and member of the President's Council of Economic Advisors, spoke next and addressed the economics of PAEs as well. He noted what he called the "conflicting narratives" regarding PAEs. Shapiro began by characterizing PAEs as firms that specialize in monetizing patents and that "economists generally welcome trade and specialization." Just as trucking companies specialize in shipping goods rather than making them, PAEs specialize in monetizing inventions rather than inventing them, using skills in selecting patents to assert, economies of scale, and their capabilities at negotiation and litigation. At the same time, however, there is some evidence to suggest that PAE litigation is inefficient, with costs to alleged infringers substantially exceeding the returns to inventors, although Shapiro noted that the data (suggesting an average loss by defendants was $152 million per litigation) seemed implausible. Professor Shapiro recommended that the focus should be on "patent origins & targets, not on [the] form of the assertion entity" because there is "no deep distinction" between a patent asserted by a PAE and the same patent asserted by a failed company, individual inventor, or university. Ultimately, we should "not get hung up on whether the invention & patenting function is vertically integrated with the patent assertion function." With respect to patent policy, Shapiro concluded that it "seems like a bad idea to limit the ability of patent holders to use intermediaries to assert their patents," and that it is "better to fix the flaws PAEs are exploiting," such as "patent quality" and "patent remedies," than to "attack the PAE form." And with respect to antitrust policy, Shapiro concluded that "antitrust . . . cannot fix the patent system," and joked with FTC Chairman Leibowitz that "Jon, I don't know from Section 5, so much," but that "even with the powerful Section 5, I'm not sure you can fix the whole patent system." Antitrust will play a limited role because it is "hard to make mere assertion of patents an antitrust violation"; while there is a "clear role for antitrust" if PAEs are "combining substitute [i.e., competing] patents, that is "not what PAEs are generally doing," and there is "no general reason to think" that "combining complementary patents . . . reduces competition." Hybrid PAEs -- those that are controlled by the firms that contributed patents for assertion against their competitors -- should be analyzed by "apply[ing] vertical merger analysis."

Panel on the Realities of Licensing and Litigation Practices

Peter Detkin from Intellectual Ventures and seven other executives from technology companies and PAEs (and one executive of RPX, which acquires patents but does not itself assert them) participated in a panel on the "realities of licensing and litigation practices."[4] None of the participants suggested that they generally saw antitrust issues in PAE activity (although Neal Rubin from Cisco suggested that the FTC could require filings with the antitrust agencies for certain PAE acquisitions, beyond the requirements applicable to all acquisitions under the Hart-Scott-Rodino premerger notification rules, and that the agencies should analyze the impact of particularly larger transactions on competition).

The focus of comments from the panel participants was on patent law reforms. Peter Detkin from Intellectual Ventures suggested that there were "bad actors in every market" and that the focus should be on "flaws in the [patent] system" that "allow these bad actors to exist," identifying both patent quality and patent remedies as issues to be addressed. Paul Melin from Nokia noted that Nokia had been sued by PAEs nearly 100 times since 2007, but that it is also actively monetizing its portfolio of 100,000 patent families through PAEs with the 65-80% of gross revenue from patent assertion being reinvested in R&D, and he said he did not see any need for "fundamental reform" of the patent system. Mary Stich of Rackspace argued that "the root cause of the problem is flaws in the patent system," though these "flaws are exploited by PAEs," and that this disproportionately hurts smaller businesses because they don't have the resources to litigate and it is cheaper to settle. Stich suggested that fundamental changes to the patent system are necessary, arguing that "the pace of innovation in the technology industry [bears] no relationship to the 20-year life of a patent." Cynthia Bright of HP was critical of the ITC's use of exclusion orders in cases involving PAEs that do not manufacture products in the U.S. Neal Rubin of Cisco acknowledged that there was nothing unlawful about suing end users rather than infringing manufacturers, but said that there were high transaction costs that led to an incentive to agree to cheap settlements on weak patents and that he was concerned with the damages theories being asserted against end users. He also characterized PAEs not disclosing their patent holdings as a "deceptive practice" that made it hard to know whether a licensee is getting the patents it needs.

Peter Detkin challenged the points that others made about a need for greater transparency about real party in interest. He stated that Intellectual Ventures (IV) had never sued in any name other than its own, that it has done over $2 billion of licensing deals with sophisticated companies that surely understood what they were getting, and that the reason IV uses different acquisition vehicles is for logistical purposes to track the revenues and costs associated with each portfolio given that not all investors have invested in each portfolio. IV keeps its acquisition activities confidential for the same reason that Warren Buffett does not tell people where he is investing or Disney uses other names when acquiring land for a new theme park; real estate is often held in the name of a trust, but nobody thinks twice about it. While some have claimed that they need to know the real party in interest to know who to contact for a license, he has never heard an actual example of that being a problem, and, indeed, IP Checkups claimed that if it could raise $80,000, it could identify IV's 40,000 patents, yielding a cost of $2/patent.[5]

Remarks by Stuart Graham

Stuart Graham, the Chief Economist at the U.S. Patent and Trademark Office, described the PTO's efforts to improve patent quality, including improvements under rules implementing the America Invents Act. Graham also addressed the question of disclosure of the real party in interest, claiming that firms can have trouble identifying the party that actually owns patents, and that there should be good information about both the relevant technologies (a patent quality issue) and who owns them. Knowing the real party in interest is also important so that the PTO can ensure that a power of attorney is current in each case, to avoid potential conflicts of interest for judges and to implement provisions of the America Invents Act regarding prior art that increase the need for timely and accurate ownership information about patent applications and third party proceedings.

Panel on Potential Efficiencies from PAE Activity

The panel on potential efficiencies from PAE activity was led by Timothy Simcoe, a business professor, from Boston University, and included Ron Epstein (former general counsel of Brocade and head of licensing at Intel, and now CEO of Epicenter IP Group); Anne Layne-Ferrar, an economist with Charles River Associates; Adam Mossoff, a law professor at George Mason, and Graham Gerst, a partner with the Global IP Law Group.

Professor Simcoe identified potential efficiencies in the patent market (including scale and expertise in patent evaluation and license negotiation), efficient risk bearing, and portfolio aggregation (which lowers search and negotiation costs and results in less hold-up because of royalty stacking). PAEs also offer potential efficiencies in an "idea market" by increasing liquidity and creating monetization options for innovators. His presentation dismissed as "red herrings" complaints about the transfer of wealth from alleged infringers to patent owners (because payments are welfare neutral) and patent quality, which he saw as an issue independent of PAEs. He noted that some analyses of PAE activity compare PAE enforcement to a world of broad cross-licensing at low or zero rates, but that this alternative world does not necessarily reflect the only possible alternative equilibrium or one that one should expect going forward.

Ron Epstein noted that 2,000 new companies are started a year in Silicon Valley and that only a fraction of them are successful or even survive. These companies cannot monetize their investment in R&D through the successful sale of products, and must rely on PAEs. Anne Layne-Ferrar followed up by noting that PAEs create "exit value" for innovators, some way for their investors to recognize a return even if the company is not successful selling products, and that this reduces risk, increases funding, and thereby promotes innovation. Adam Mossoff noted that there had always been a secondary market for patents in the U.S.; indeed, one purpose of creating a patent property right is to make them tradable. He described how the "patent wars" of today are actually not very different from the sewing machine patent wars of the 1850s.

Graham Gerst noted that while questions had been raised about whether the money from PAEs made its way to inventors, and that as someone who dealt with innovators and innovative companies every day, he could assure the audience that the money did get to them to fund their innovation. He argued that without PAEs, innovators and inventors "would not get anything." High transaction costs in PAE activity are driven by large companies that absolutely refuse to negotiate with small companies or individual inventors over licenses; the only way to get their attention is to sue them. Ron Epstein agreed, noting that in his view, litigation is not a sign of uncertainty over the validity or scope of patent rights, but it is the "marketing program" because large companies refuse to take a license unless they face litigation.

Fiona Scott Morton, the chief economist at DOJ's Antitrust Division, said that more empirical work was needed. In particular, it was important to understand whether PAEs

discrete portfolios (which could enhance efficiency by eliminating royalty stacking) or disaggregating (because portfolios were being broken up among multiple PAEs, to raise the cost of licensing and raise the costs of the rivals of the original IP owner).

Panel on Potential Harms from PAE Activity

Professor Ian Cockburn from Boston University led the panel on potential harms from PAE activity, which included Thomas Ewing from Avancept; Robin Feldman, a law professor at UC Hastings; Michael Meurer, a law professor at BU; David Schwartz, a law professor at Illinois Institute of Technology/Chicago-Kent Law School, and Brad Burnham, a managing partner at Union Square Ventures.

In his presentation on potential costs of PAEs, Professor Cockburn identified a number of categories of costs. First, reward to PAEs when they assert a patent may be "high" relative to some benchmark value of an asserted patent, although it is hard to determine a benchmark or determine how much higher the reward is. If rewards are too high, this can lead to a misallocation of R&D, higher end-user prices, and less innovation. Second, PAEs may result in "resource diversion," transferring rewards from innovators to the PAEs (though he did not describe how innovators would be compensated without PAEs). The existence of PAEs may also increase the number of lawsuits and associated costs, increase the burden on the PTO of processing speculative or opportunistic applications, and cost society through the redirection of time, money, and talent to PAEs that could be used elsewhere. Third, he expressed concern over what he called "unpooling," splitting an innovator's portfolio among multiple PAEs, which results in higher royalties being paid through royalty stacking. Finally, Cockburn identified a number of potential anticompetitive effects. Because PAEs have little incentive to participate in cross-licensing "truces," prices may increase. PAEs might acquire enough IP to distort pricing if they acquired too many substitute technologies. And there is a risk that innovators could enter into IP transactions with PAEs that raise rivals'costs.

Robin Feldman emphasized that the harms that Professor Cockburn identified need to be understood against the backdrop of uncertainty in the patent system, which means that it is very difficult to know what a patent covers, and this uncertainty allows IP owners to bargain for more value than the patent is "worth." She argued that harms needed to be evaluated in what she called a "market for patent monetization" that was subject to manipulation if it was not regulated. (Nobody else on the panel took up Professor Feldman's idea of a "market for patent monetizition," which is not a market in the sense that economists or antitrust lawyers think about markets. Markets are composed of products that are substitutes.[6] While a patent relating to GSM and CDMA wireless technology might be in a market for wireless technology patents, patents for GSM wireless technology are not in the same antitrust or economic market as patents for microprocessor technology, rendering the concept of a "market for patent monetization" meaningless.) Professor Feldman also expressed concern that even if a firm lacks market power in a market for technology, which she characterized as "markets underneath the layer of the market for patent monetization," it may be able to impact the price of goods in the market. For example, a firm with banking patents could claim that those patents read on automobiles, and if the cost of settling is lower than the cost of litigating a frivolous case, an automaker might settle and pass the cost through to car buyers. Again, no other participant on the panel followed up on this idea, which is inconsistent with well-established antitrust law, which finds conduct (other than collusion among competitors) potentially harmful only when a firm has market power.[7]

Michael Meurer from BU argued that the patent system itself posed a tax on innovation in most industries, though this was independent of the existence of PAEs (and the study was based on a time period before the rise of PAEs). Using an "event study" that looked at the impact of PAE litigation on stock price, he has concluded that PAE litigation resulted in up to $29 billion in accrued costs in 2011.

David Schwartz from the Illinois Institute of Technology/Chicago-Kent Law School argued that any analysis of PAE litigation needs to be compared to a baseline, not to zero, because the alternative to PAE litigation is not zero litigation. He looked at data from a recent article by Robin Feldman and concluded that there was no discernible difference between PAE litigation and litigation brought by other entities in terms of summary judgment win and loss rates and settlement rates. He argued that the harms identified by Professor Cockburn were really harms tied to patents or patent litigation in general rather than to PAEs and that there is little evidence that litigation initiated by PAEs is materially more costly or that the claims PAE assert are materially weaker. He also argued that the costs of PAE litigation from Professor Meurer's study are inflated because the data is not based on a representative sample.

Application of Antitrust to Potential Efficiencies and Harms Generated by PAE Activity

The final panel of the day addressed the application of the antitrust laws to PAE activity. It was introduced by Professor Phil Malone of Harvard Law School and included Carl Shapiro (the economist from Berkeley who previously served as chief economist at the DOJ's Antitrust Division and on the President's Council of Economic Advisors) and four practicing attorneys, Logan Breed (Hogan Lovells), Mark Popofsky (Ropes & Gray), Hanno Kaiser (Latham & Watkins), and Hill Wellford (Bingham McCutchen).

Phil Malone began by identifying several theories that might be applied to PAE activity. With respect to PAE acquisition of patents, one might consider that PAEs do not face the constraints imposed by the risk of an IP counterclaim or reputational concerns with patent assertion, and that this might allow them to charge higher royalties than a practicing entity. One might therefore argue that the acquisition of patents by a PAE violates Section 7 of the Clayton Act (the antitrust merger statute) on the same basis as FTC Commissioner Tom Rosch would have found a violation of Section 7 in the *Ovation* case, which involved the acquisition of a drug by a firm that did not have a competing drug, but that raised prices after its acquisition in ways that the seller had avoided because of reputational concerns. Panelists noted that this theory is controversial, and, indeed, there appears to be no basis for it in the antitrust case law.[8]

The panelists discussed a variety of scenarios and debated whether there might be antitrust theories that could apply. The first scenario involved a firm that transferred IP to a PAE in order to impair its rivals or raise their costs.

Pointing to a recent speech by Fiona Scott Morton, Logan Breed argued that this transfer might be anticompetitive if it allowed the original IP owner to avoid obligations under a license to a rival, forcing the rival to "pay twice" to both the original owner and the PAE. This hypothetical situation describes a nonexistent situation -- unless a patent license expressly provides that it terminates with the sale of a patent, the licensee is protected from claims of infringement even if the patent is sold.[9] Breed also argued that a FRAND commitment made to a standard setting organization may not apply following a patent assignment, allowing the patent owner to raise costs through the evasion of an SSO commitment. But this is an edge case, relevant only to standards-essential patents. Carl Shapiro argued it is hard to see how there is a reduction in competition when a firm uses an agent (a PAE) to attack "more effectively." He emphasized that he was not saying that this was a "good thing," but said he did not see how it was a reduction in competition.

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[1] These include the 2009 FTC hearings and workshop on the Evolving IP Marketplace, which resulted in a report, *The Evolving IP Marketplace, Aligning Patent Notice and Remedies with Competition* (March, 2011), and the 2002 and 2003 FTC and DOJ hearings on Competition and Intellectual Property Law and Policy in the Knowledge-Based Economy. Those hearings resulted in a joint DOJ/FTC report, *Antitrust Enforcement and Intellectual Property Rights: Promoting Innovation and Competition* (Apr. 2007), and an earlier report prepared solely by the Federal Trade Commission, *To Promote Innovation: The Proper Balance of Competition and Patent Law and Policy* (Oct. 2003).

[2] John R. Allison, Mark A. Lemley, and Joshua Walker, *Patent Quality and Settlement Among Repeat Patent Litigants*, 99 Geo. L.J. 677, 694 (2011).

[3] *See* Chien Presentation at 23 (showing PAE lawsuits growing from 29% to 61% of all patent infringement lawsuits between 2010 and 2012). These statistics are skewed, however, by provisions of the America Invents Act, enacted in 2011, that limit the circumstances in which multiple defendants can be joined in a single lawsuit to cases involving the sale of the same accused article, rather than just infringement of the same patent. *See* 35 U.S.C. 299.

[4] The participants were Cynthia Bright (Associate General Counsel, IP Litigation and Public Policy, Hewlett-Packard); Scott Burt (Vice President & Chief Intellectual Property Counsel, Mosaid Technologies, Inc.); Peter Detkin (Founder and Vice-Chairman, Intellectual Ventures); Sarah Guichard (Vice President of Patent & Standards Strategy, Research In Motion (RIM)); Paul Melin (Chief Intellectual Property Officer, Nokia); Neal Rubin (Vice President Litigation, Cisco Systems Inc.); Mary Stich (Vice President and Associate General Counsel, Rackspace Hosting); and Mallun Yen (Executive Vice President, RPX Corporation).

[5] *See* http://www.indiegogo.com/IV-Thicket.

[6] *See generally Brown Shoe Co. v. United States*, 370 U.S. 294, 325 (1962) ("The outer boundaries of a product market are determined by the reasonable interchangeability of use or the cross elasticity of demand between the product itself and substitutes for it.").

[7] *See generally Menasha Corp. v. News Am. Mktg. In-Store*, 354 F.3d 661, 663 (7th Cir. 2004) ("The first requirement in every suit based on the Rule of Reason is market power, without which the practice cannot cause those injuries (lower output and the associated welfare losses) that matter under the federal antitrust laws.").

[8] *See generally* Jonathan Gleklen, *The Emerging Antitrust Philosophy of FTC Commissioner Rosch*, 23 Antitrust 46, 46–47 (2009) (arguing that "Commissioner Rosch's approach is substantially out of step with the consensus that has developed regarding the scope of Section 7 over the last forty years").

[9] *See generally Worley v. Tobacco Co.*, 104 U.S. 340, 344 (1881) ("The assignee of a patent-right takes it subject to the legal consequences of the previous acts of the patentee."); *In re Cybernetic Servs. Inc.*, 252 F.3d 1039 (9th Cir. 2001) (citing *Keystone Type Foundry v. Fastpress Co.*, 272 F. 242, 245 (2d Cir. 1921) ("It had long passed into the textbooks that . . . an assignee acquired title subject to prior licenses of which the assignee must inform himself as best he can at his own risk.")). Indeed, the license may afford immunity from infringement claims even for broader reissue patents granted to the assignee. *See Intel Corp. v. Negotiated Data Solutions, Inc.*, No. 703 F. 3d 1360, 1367 (Fed. Cir. 2012) (Intel licensed under broader reissue patents granted to N-Data because Intel and National Semiconductor, N-Data's assignor, intended that Intel receive "global peace" relating to National's inventions).