



April 5, 2013

The Honorable William J. Baer
Assistant Attorney General, Antitrust Division
Department of Justice
950 Pennsylvania Avenue, NW
Washington, DC 20530

The Honorable Edith Ramirez
Chairwoman
Federal Trade Commission
600 Pennsylvania Avenue, NW
Washington, DC 20580

Re: *Public Comments Regarding Patent Assertion Entity Activities Submitted On Behalf Of Verizon Communications Inc. and USTelecom*

Dear Attorney General Baer and Chairwoman Ramirez:

On behalf of Verizon Communications Inc. and the United States Telecom Association (USTelecom), we respectfully submit these comments regarding patent assertion entities (PAEs) and some of the threats they pose to the patent system. Verizon is a leading provider of high technology products and services that depend on systems that incorporate a large number of components and perform a variety of functions. Verizon frequently must defend against baseless allegations of patent infringement. Verizon also conducts extensive research and owns many patents. Accordingly, Verizon has a strong interest in a balanced patent system that protects legitimate property rights while avoiding the harmful effects of practices that threaten innovation.

USTelecom is the premier trade association representing service providers and suppliers of the telecommunications industry. USTelecom members provide a full array of services, including broadband, voice, data and video over wireline and wireless networks.¹ USTelecom's membership ranges from large publicly traded companies that serve the national market to small rural providers. All of these companies are adversely impacted by the practices of PAEs.

Thanks in large part to the efforts of the Department and the Commission, courts and policymakers have begun to recognize the importance of a balanced patent system that rewards past innovation without unnecessarily chilling future innovation. Those efforts have had a positive impact on the way that courts approach some of the more serious threats that innovators face. While we greatly appreciate these efforts, there is still more to be done.

PAEs exploit the patent system's weaknesses in a way that generates profit for the PAEs, but threatens to undermine the broader patent system and its goals of rewarding innovation without interfering with a competitive and efficient marketplace. In our view, the Department

¹ Verizon is a member of USTelecom, but submits these comments in its individual capacity.

and the Commission should encourage courts to take action to deter some of the PAE's worst practices.

- First, the Department and the Commission should encourage courts to prevent subsequent acquirers of RAND-encumbered patents from extracting the hold-up value of those patents.
- Second, the Department and the Commission should urge courts to take action to reduce the costs of patent litigation in order to foster the public good of private challenges to questionable patents.

I. The Department Of Justice And Federal Trade Commission Should Encourage Courts To Take Action To Prevent The Acquirers Of RAND-Encumbered Patents From Extracting The Hold-Up Value Of Those Patents.

As the Department and Commission are well aware, “[t]he business model of PAEs focuses on purchasing and asserting patents against manufacturers already using the technology” at issue.² By doing so, PAEs put themselves in a position to obtain a payment from the defendant greater than the value of the patented technology over alternatives at the time of design. “At the time a manufacturer faces an infringement allegation, switching to an alternative technology may be very expensive if it has sunk costs in production using the patented technology. That may be true even if choosing the alternative earlier would have entailed little additional cost.”³ Under these circumstances, the PAE can use the threat of an exclusion order to obtain royalties reflecting the hold-up value of the patent—the costs that the defendant would incur if it were enjoined and had to switch away from using the PAE's patented technology.⁴ And when the asserted patent is standard-essential, the PAE can exploit that fact to seek an even higher royalty from the defendant as there may be no other means than the PAE's technology for practicing the standard.⁵ Particularly in the context of multi-feature, multi-component products,

² FED. TRADE COMM'N, THE EVOLVING IP MARKETPLACE: ALIGNING PATENT NOTICE AND REMEDIES WITH COMPETITION 8 (2011) (“2011 IP REPORT”).

³ *Id.* at 5.

⁴ See Edith Ramirez, Commissioner, Fed. Trade Comm'n, Keynote Address at the Wash. State Bar Ass'n 29th Annual Antitrust, Consumer Protection and Unfair Business Practices Seminar and Annual Meeting: Competition Policy for the IP Marketplace 2 (Nov. 8, 2012) (“switching costs give the patent holder the leverage to demand licensing terms that reflect the device maker's own investment, rather than the competitive value of the patented technology”); Edith Ramirez & Lisa Kimmel, *A Competition Policy Perspective on Patent Law: The Federal Trade Commission's Report on the Evolving IP Marketplace*, ANTITRUST SOURCE, Aug. 2011, at 5 (“[r]emedies that permit a patentee to capture the hold-up value of the patent do nothing to improve the alignment between economic value and reward in these situations because the hold-up value of the patent has nothing to do with the economic contribution of the patented technology and everything to do with the sunk costs of the infringer”).

⁵ See U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, ANTITRUST ENFORCEMENT AND INTELLECTUAL PROPERTY RIGHTS: PROMOTING INNOVATION AND COMPETITION 37-38 (2007) (“2007 IP REPORT”); Letter from Thomas O. Barnett, Assistant Attorney Gen., Dep't of Justice, Antitrust Div., to Robert A. Skitol (Oct. 30, 2006), <http://www.justice.gov/atr/>

a PAE's control over a standard-essential patent may give it leverage to extract value properly attributable to features and controls having nothing to do with the PAE's patent.

The Department and the Commission have played a critical role in bringing the problems that hold-up presents—both generally and in the standard-setting context specifically—to the attention of courts and policymakers.⁶ More than just raising awareness, that advocacy has played an important part in convincing courts to make it harder for patentees to extract the hold-up value associated with a patent from an alleged infringer. For example, in *Apple, Inc. v. Motorola, Inc.*, Judge Posner held that when a patentee agrees to license its patent on RAND terms, injunctive relief is inappropriate.⁷ “The purpose of the [R]AND requirements . . . is to confine the patentee's royalty demand to the value conferred by the patent itself as distinct from the additional value—the hold-up value—conferred by the patent's being designated as standard-essential.”⁸ Pointing to the Commission's filing in *In re Certain Wireless Communication Devices, Portable Music & Data Processing Devices, Computers & Components Thereof*, Inv. No. 337-TA-745, Judge Posner concluded that a patentee's willingness to license its patent on RAND terms, and the implicit acknowledgment that a RAND royalty is all that is required for a licensee to practice the patent, is the quid pro quo for the patent's inclusion in the standard.⁹

Cases like *Apple v. Motorola* have made it harder for patentees to extract the hold-up value of their patents from defendants. However, PAEs may still try to obtain the title to RAND-encumbered patents and then attempt to extort standard implementers by demanding non-RAND licensing terms. As the Commission is aware, this problem is more than hypothetical. For example, in the 1990s, National Semiconductor (“National”) worked with a standard setting organization to have its patented technology included in the Fast Ethernet standard. As part of that process, National made a commitment to license its technology to “any requesting party for a one-time fee of one thousand dollars.”¹⁰ National later assigned its Fast Ethernet patents to Vertical Networks, Inc. (“Vertical”). In 2002, recognizing that standard implementers were “locked into” using National's technology, Vertical opted to disregard National's licensing

public/busreview/219380.htm (“Once a particular technology is chosen and the standard is developed . . . it can be extremely expensive or even impossible to substitute one technology for another. In most cases, the entire standard-setting process would have to be repeated to develop an alternative standard around a different technology.”); see also Joseph Farrell et al., *Standard Setting, Patents, and Hold-Up*, 74 ANTITRUST L.J. 603 (2007); Mark A. Lemley & Carl Shapiro, *Patent Holdup and Royalty Stacking*, 85 TEX. L. REV. 1991 (2007).

⁶ See Dep't of Justice and Fed. Trade Comm'n reports and speeches cited *supra* and *infra*.

⁷ 869 F. Supp. 2d 901 (N.D. Ill. 2012).

⁸ *Id.* at 913.

⁹ *Id.* at 914; see also *Apple Inc. v. Samsung Elecs. Co.*, 695 F.3d 1370, 1374-75 (Fed. Cir. 2012) (holding that when “the accused product would sell almost as well without incorporating the patented feature[,] . . . even if the competitive injury that results from selling the accused device is substantial, the harm that flows from the alleged infringement (the only harm that should count) is not,” and injunctive relief is inappropriate).

¹⁰ Complaint ¶ 12, *In re Negotiated Data Solutions LLC*, File No. 0510094.

commitment and demand licensing fees substantially exceeding National's commitment to a one-time thousand-dollar fee.¹¹

Allowing the transfer of title or assignment of rights to free a patent of its RAND encumbrance recreates all of the problems that RAND requirements are meant to address. Once an agreed-upon industry standard gains widespread implementation, the owner of a standard-essential patent is in a position to demand royalties far in excess of the value of the patent (the value of the patented technology over its alternative at the time of design). The owner is able to take advantage of the fact that companies have made specific sunk investments and now face high switching costs, to demand royalties higher than those that could have been obtained before the adoption of the particular technology and the implementation of the standard.¹² This problem is aggravated by the fact that the development of interoperability standards often occurs in industries (like the telecommunications industry) characterized by patent thickets, resulting in standard-compliant products being covered by multiple patent rights claims.¹³ If the holder of any one of the patents that is claimed to be essential to implement any one of the standards could exclude the entire product from the market—either via an exclusion order at the ITC or by extracting royalties that render the product non-competitive—it would be in a position to reap substantially greater benefits from its patent than the patent bargain contemplates.¹⁴

In recognition of the problems presented by allowing the transfer of title to free a patent of a RAND encumbrance, the Commission, Department, and PTO have all acknowledged the importance of requiring RAND encumbrances to run with patents when title to those patents is transferred. The Commission has expressly stated that failing to require such encumbrances to run with a patent harms competition. In *Negotiated Data Solutions LLC*, the Commission concluded that allowing an entity to acquire standards-essential patents subject to a licensing commitment and then renege on that commitment “undermines standard-setting” and “competition,” “raise[s] prices to consumers, and reduce[s] choices.”¹⁵ Industry ““standards are widely acknowledged to be one of the engines driving the modern economy”” and conduct like that at issue in *Negotiated Data Solutions* “threatens to stall that engine to the detriment of all consumers.”¹⁶ Similarly, the Department and the PTO have concluded that, as a matter of

¹¹ *Id.* ¶¶ 20-32.

¹² 2007 IP REPORT at 37-38.

¹³ See FED. TRADE COMM’N, TO PROMOTE INNOVATION: THE PROPER BALANCE OF COMPETITION AND PATENT LAW AND POLICY, ch. 2, at 28-29, ch. 3, at 34-35, 52 (2003) (“2003 IP REPORT”); 2007 IP REPORT at 37-40; Carl Shapiro, *Navigating the Patent Thicket: Cross Licenses, Patent Pools, and Standard Setting*, 1 INNOVATION POLICY AND THE ECONOMY 119 (Adam Jaffe et al., eds., 2001).

¹⁴ See 2011 IP REPORT at 189-90, 194; Statement of Joseph F. Wayland, Acting Assistant Atty. Gen. Antitrust Div. before the Committee on the Judiciary, U.S. Senate 3-4, *Hearing on Oversight of the Impact on Competition of Exclusion Orders to Enforce Standards-Essential Patents Before the Senate Comm. on the Judiciary*, 112th Cong. (2012) (discussing hold up in the standard-setting context).

¹⁵ Statement of the Fed. Trade Comm’n 2-3, *In re Negotiated Data Solutions LLC*, File No. 0510094.

¹⁶ *Id.* at 3 (quoting 2007 IP REPORT at 33).

policy, RAND “commitments should bind subsequent patent transferees”—if RAND “licensing obligations do not travel with a transferred patent, the potential for hold-up from the network effects of a standard may be substantially increased.”¹⁷

Courts can and should take action to prevent the acquirers of RAND-encumbered patents from extracting hold-up payments based on those patents.¹⁸ Supreme Court and Federal Circuit precedents provide all that is needed to do so. As the Supreme Court recognized in *Worley v. Loker Tobacco Co.*, “the assignee of a patent-right takes it subject to the legal consequences of the previous acts of the patentee.”¹⁹ As a result, and as the Federal Circuit noted in *Datatreasury Corp. v. Wells Fargo & Co.*, “legal encumbrances” placed on a patent by a patentee—such as granting a “right to use” to a licensee—“run with the patent.”²⁰ Pursuant to these precedents, a RAND commitment, which is essentially a grant of a “right to use” a patented technology in exchange for a RAND royalty, runs with a RAND-encumbered patent when the rights to that patent are transferred.²¹

The plain text of the Patent Act provides further support for preventing the assignees of RAND-encumbered patents from extracting hold-up payments. Section 271(a) prohibits making, using, offering to sell, or selling a patented invention “without authority.”²² When a patentee

¹⁷ U.S. DEP’T OF JUSTICE & PTO, POLICY STATEMENT ON REMEDIES FOR STANDARDS-ESSENTIAL PATENTS SUBJECT TO VOLUNTARY F/RAND COMMITMENTS 6 n.13 (Jan. 8, 2013); see Renata Hesse, Deputy Assistant Attorney Gen., Antitrust Div., U.S. Dep’t of Justice, Remarks prepared for the ITU-T Patent Roundtable: Six “Small” Proposals for SSOs Before Lunch 9 (Oct. 10, 2012) (SSOs should “[m]ake it clear that licensing commitments made to [a] standards body are intended to bind both the current patent holder and subsequent purchasers of the patents” Doing so “would promote competition among implementers of the standard, potentially benefiting consumers around the world.”).

¹⁸ While Commission enforcement actions like that in *Negotiated Data Solutions* are important, the threat of a § 5 action may not deter the acquirers of RAND-encumbered patents from attempting to extract the hold-up value of those patents. Generally applicable rules that can be invoked by private parties in infringement actions are necessary to stem the threat that such practices pose to standard setting and the patent system. See Renata Hesse, Deputy Assistant Attorney Gen., Antitrust Div., U.S. Dep’t of Justice, Address presented at the Global Competition Review, 2nd Annual Antitrust Leaders Forum: IP, Antitrust and Looking Back on the Last Four Years 19 (Feb. 8, 2013) (“To stop owners of F/RAND-encumbered SEPs from harming consumers through arguably anticompetitive behavior, agencies and private parties may need to resort to judicial remedies.”).

¹⁹ 104 U.S. 340, 344 (1881).

²⁰ 522 F.3d 1368, 1372 (Fed. Cir. 2008); see *id.* (recognizing “the general proposition that because the owner of a patent cannot transfer an interest greater than that which it possesses, an assignee takes a patent subject to the legal encumbrances thereon”).

²¹ The application of the principle that legal encumbrances run with a patent is not limited to RAND commitments. All legal commitments—including pricing commitments designed to mitigate royalty stacking—run with a patent.

²² 35 U.S.C. § 271(a); see *Rhone Poulenc Agro, S.A. v. DeKalb Genetics Corp.*, 284 F.3d 1323, 1327-29 (Fed. Cir. 2002) (construing § 271(a)’s “without authority” language to determine

makes a RAND commitment, that commitment is tantamount to a conditional grant of “authority” to all standard implementers: in exchange for having its technology included in the standard, the patentee authorizes all standard implementers to practice the patent in exchange for a RAND royalty. Thus, so long as a defendant is willing to pay a RAND royalty, it cannot be held liable for infringement because it is not practicing the patent “without authority.”²³ When a RAND-encumbered patent is transferred, the transferee acquires the right to collect the RAND royalties to which the transferor agreed, but the transferee cannot revoke the transferor’s grant of authority to practice the patent in exchange for that royalty.

At the very least, courts should factor in the original RAND commitment when applying the patent law at the remedial stage. The Patent Act permits patentees to recover “reasonable royalty” damages “adequate to compensate for the infringement.”²⁴ While what constitutes a RAND royalty will vary with the patent and standard involved,²⁵ if the party bringing an infringement suit made a RAND commitment, the “reasonable royalty” “adequate to compensate for the infringement” is the RAND royalty. The same holds true when a RAND-encumbered patent is transferred whether or not the RAND commitment runs with the patent for other purposes.²⁶ Indeed, awarding something in excess of a RAND royalty would be inherently unreasonable. It would allow the patentee to benefit twice from its RAND commitment—once by having its technology adopted as part of a standard, and again through the sale of its patent rights at a price reflecting the transferee’s prospect of extracting a hold-up premium. By the same token, it would unreasonably create an incentive for the transferee to ignore the commitments that likely made the patent worth acquiring in the first place and then reward the transferee for succumbing to that incentive.

whether there is a “bona fide purchaser defense to patent infringement [a]s a matter of federal law”).

²³ Cf. *Intellectual Prop. Dev., Inc. v. TCI Cablevision of Cal., Inc.*, 248 F.3d 1333, 1345 (Fed. Cir. 2001) (A license is “a covenant by the patent owner not to sue the licensee for making, using, or selling the patented invention.”).

²⁴ 35 U.S.C. § 284.

²⁵ The patent holder bears the burden of establishing what constitutes a RAND royalty. See *Apple*, 869 F. Supp. 2d at 904-05 (noting that plaintiff had to establish the “price” of the chip); cf. *Brandeis Univ. v. Keebler Co.*, No. 12-cv-01508, slip op. at 12 (N.D. Ill. Jan. 18, 2013) (excluding plaintiffs’ expert testimony that did “use[] a reasonable methodology to calculate the plaintiffs’ damages”); *LaserDynamics, Inc. v. Quanta Computer, Inc.*, 694 F.3d 51, 79 (Fed. Cir. 2012) (“When relying on licenses to prove a reasonable royalty, alleging a loose or vague comparability between different technologies or licenses does not suffice.”).

²⁶ For this reason, cases holding that “evading” a RAND commitment does not “qualify as anticompetitive conduct” or “constitute harm to competition” are of no moment. *Vizio, Inc. v. Funai Elec. Co.*, No. CV 09-0174 AHM (RCx), 2010 WL 7762624, at*5 (C.D. Cal. Feb. 3, 2010); see *Rambus v. Fed. Trade Comm’n*, 522 F.3d 456, 467 (D.C. Cir. 2008). Even if a purportedly RAND-stripping patent transfer does not raise antitrust problems—which it very well may—that does not mean that a transferee can prevail on an infringement claim against a standard implementer willing to pay a RAND royalty or that the transferee could recover more than a RAND royalty for an act of infringement.

And RAND royalties are the only appropriate damages award in these cases; injunctive relief should be unavailable. The entity that makes a RAND commitment cannot obtain an injunction for the alleged infringement of its RAND-encumbered patent. A RAND encumbrance is clear evidence that damages at law will be adequate to compensate for any injury suffered by the patentee—“[b]y committing to license its patents on []RAND terms,” a patentee commits to licensing the patent “to anyone willing to pay a []RAND royalty and thus implicitly acknowledge[s] that a royalty is adequate compensation for a license to use that patent.”²⁷ Transferring the RAND-encumbered patent does not alter the calculus. Indeed, it would make no sense for a court awarding an equitable remedy to conclude that a transferee attempting to eschew a RAND-commitment should benefit from that behavior through an award of injunctive relief. Especially in equity, the transferee’s bad behavior does not entitle it to greater relief.²⁸ Nor does the disregard of the RAND commitment impact the considerations that make injunctive relief unavailable to the transferor.²⁹

In all events, whether in reliance on the arguments submitted herein or on another basis altogether, the Department and the Commission should encourage courts to prohibit the acquirers of RAND-encumbered patents that did not themselves make a RAND commitment from extracting the hold-up value of those patents.

II. The Department Of Justice And Federal Trade Commission Should Urge Courts To Take Action To Lower The Costs Of Patent Litigation In Order To Foster The Public Good Of Private Challenges to Questionable Patents.

The Department and the Commission should also encourage courts to take action to lower the costs of patent litigation and make it easier to defend against nuisance suits, in order to foster the public good of private challenges to questionable patents. The Department and the Commission should, for example, urge courts to view key patent validity issues—such as compliance with the written description requirement—as questions of law that can be addressed

²⁷ *Apple*, 869 F. Supp. 2d at 914.

²⁸ *Cf. Shockley v. Arcan, Inc.*, 248 F.3d 1349, 1361 (Fed. Cir. 2001) (“Equity’s ‘unclean hands’ doctrine demands that [one] who seeks equity must do equity.” (quoting *Mfrs.’ Fin. Co. v. McKey*, 294 U.S. 442, 449 (1935))).

²⁹ The acquirer of a RAND-encumbered patent that attempts to avoid its RAND obligation should not be able to obtain an exclusion order in the ITC, either. As the Commission has recognized, “issuance of an exclusion or cease and desist order in matters involving RAND-encumbered [patent]s, where infringement is based on implementation of standardized technology, has the potential to cause substantial harm to U.S. competition, consumers and innovation.” Third Party United States Federal Trade Commission’s Statement on the Public Interest 1, *In re Certain Wireless Communication Devices, Portable Music and Data Processing Devices, Computers and Components Thereof*, Inv. No. 337-TA-745; see U.S. DEP’T OF JUSTICE & PTO, POLICY STATEMENT ON REMEDIES FOR STANDARDS-ESSENTIAL PATENTS, *supra* note 17, at 6 (in the RAND context “the remedy of an injunction or exclusion order may be inconsistent with the public interest”). This is true whether or not the acquirer of a RAND-encumbered patent wants to acknowledge its obligations. Either way, an exclusion order would threaten to create anticompetitive hold-up in industries where access to standards-essential patents is required, risk increasing costs to consumers, and reduce consumer choice innovation.

on summary judgment. The Department and the Commission should also encourage courts to address case dispositive issues and the scope of relief available as early as possible so as to reduce the costs of litigation and make it more likely that an accused infringer will litigate. Courts should also be persuaded to make clear that litigation practices that intentionally and unnecessarily drive up costs warrant the imposition of fees under § 285. Changes of this sort will help ensure that the costs of patent litigation do not deter private parties from pursuing the public good of challenging questionable patents.

Nuisance-value patent suits “are a daily fact of life for most corporate legal departments.”³⁰ These suits are made possible, in large part, by the staggering costs of infringement litigation. Suits with less than \$1 million at stake cost, on average, \$350,000 through discovery and \$650,000 through trial.³¹ The average suit in which \$1 million to \$25 million is at stake costs \$1.5 million through discovery and \$2.5 million through trial.³² Suits with more than \$25 million at stake on average cost \$3 million through discovery and \$5 million total.³³ In recognition of the expenses that are the unavoidable result of their infringement allegation, PAEs can offer to settle for a figure just below the costs of taking the case through discovery, thus making the decision to settle—even in suits where a company is not infringing or is confident that the asserted patents are invalid—a rational one.³⁴ The Federal Circuit has recognized as much, noting the propensity of PAEs to “exploit[] the high cost to defend complex litigation to extract a nuisance value settlement from” an alleged infringer.³⁵ Moreover, the possibility that a PAE will connect on a Hail Mary infringement allegation provides further motivation for defendants to settle for nuisance value.³⁶

³⁰ Ranganath Sudarshan, *Nuisance-Value Patent Suits: An Economic Model and Proposal*, 25 SANTA CLARA COMPUTER & HIGH TECH L.J. 159, 160 (2008).

³¹ AM. INTELLECTUAL PROP. LAW ASS’N, REPORT OF THE ECONOMIC SURVEY 35 (2011).

³² *Id.* Lest there be any doubt, these costs are not high by choice. Defendants employ all manner of tactics—such as bidding out litigation services and entering into fixed fee agreements—to reduce costs.

³³ *Id.*; see ALAN R. THIELE ET AL., THE PATENT INFRINGEMENT LITIGATION HANDBOOK: AVOIDANCE AND MANAGEMENT 125 (2010). One study concludes that patent assertion by non-practicing entities cost practicing firms \$29 billion in 2011 alone. See James E. Bessen & Michael J. Meurer, *The Direct Costs from NPE Disputes* 18-19 (Boston Univ. School of Law, Law & Economics Research Paper No. 12-34, 2012). The lion’s share of that \$29 billion constituted attorneys’ fees and payments to non-practicing entities. A review of the financials of publicly-traded non-practicing entities indicates that “no more than a quarter of” this \$29 billion tax on innovation “flows to innovative activity,” such as R&D. *Id.*

³⁴ See Brian T. Yeh, Cong. Research Serv., R42668, *An Overview of the “Patent Trolls” Debate* 1 (2012) (“PAEs often offer to settle for amounts well below litigation costs to make the business decision to settle an obvious one.”).

³⁵ *Eon-Net LP v. Flagstar Bancorp*, 653 F.3d 1314, 1327 (Fed. Cir. 2011), *cert. denied*, 132 S. Ct. 2391 (2012) (affirming imposition of sanctions for bad faith infringement suit).

³⁶ The enormous cost of defending against an allegation of infringement is even more problematic when a small business is the defendant. For these businesses, the fees associated with defense may exceed their revenue. That makes the decision to settle all but automatic.

These dynamics might make settlement an attractive option in any infringement suit, but PAEs are uniquely positioned to exploit them. As the Federal Circuit has recognized, unlike entities that practice their patents and produce goods, PAEs “place[] little at risk when filing suit.”³⁷ While a PAE “risk[s] licensing revenue should its patents be found invalid or if a court narrowly construe[s] the patents’ claims to exclude valuable targets,” it does “not face any business risk resulting from the loss of patent protection over a product or process.”³⁸ PAEs have not built manufacturing facilities, supply chains, and brand recognition that could be undermined by an invalidity finding. A PAE’s “patents protect[] only settlement receipts, not its own products.”³⁹

The high costs of defending against infringement allegations that make nuisance suits possible threaten a critical aspect of the overall patent system. Private patent challenges are the second part of a two-part system of patent quality checks. The *ex parte* system of granting patents is not meant to be the exclusive means of weeding out invalid patents.⁴⁰ The patent law “affirmatively encourage[s] litigation challenges to the validity of granted patents” to serve as a backstop to identify other unwarranted patents.⁴¹ The high costs of patent litigation critically undermine the viability of the cross-check that private litigation provides and correspondingly reduce the public benefits that flow from private patent challenges. Invalid patents have significant innovation-stifling and anticompetitive effects—they unjustifiably discourage invention for fear of infringement and grant patent protection where none is warranted.⁴² Patent validity challenges clarify the boundaries of ambiguously drafted patents and clear the way for competition and follow-on innovation by putting the world on notice about a patent’s validity (or

³⁷ *Eon-Net LP*, 653 F.3d at 1327-28; see Colleen V. Chien, *From Arms Race to Marketplace: The Complex Patent Ecosystem and Its Implications for the Patent System*, 62 HASTINGS L.J. 297, 300 (2010) (PAEs “are invulnerable to patent counterattack and therefore have little to lose from patent litigation besides legal fees.”).

³⁸ *Eon-Net LP*, 653 F.3d at 1327-28.

³⁹ *Id.* Several companies recently gave congressional testimony on the devastating impact of infringement suits brought by non-practicing entities. See, e.g., Statement of Mark Chandler, Senior Vice President & Gen. Counsel, Cisco Systems Inc. 3, *Hearing on Abusive Patent Litigation: The Impact on American Innovation & Jobs, and Potential Solutions Before the H. Comm. on the Judiciary*, 113th Cong. (2013) (Cisco’s “ability to innovate and invest in the future . . . is being hindered by PAE litigation, the scale of which we have never seen in our company’s history.”); Statement of Janet L. Dhillon, Exec. Vice President, Gen. Counsel & Corporate Secretary 4, *Hearing on Abusive Patent Litigation: The Impact on American Innovation & Jobs, and Potential Solutions Before the H. Comm. on the Judiciary*, 113th Cong. (2013) (“the cost of defense is why so many of these cases settle without a judgment on the merits, which means that companies often settle even though no actual infringement might have occurred”).

⁴⁰ See, e.g., 2003 IP REPORT at 9 (noting the conditions at the PTO that “impede its ability to reduce the issuance of questionable patents”).

⁴¹ Joshua D. Sarnoff, Bilcare, KSR, *Presumptions of Validity, Preliminary Relief, and Obviousness in Patent Law*, 25 CARDOZO ARTS & ENT. L.J. 995, 1044 (2008).

⁴² See, e.g., T. Randolph Beard et al., *Quantifying the Cost of Substandard Patents: Some Preliminary Evidence*, 12 YALE J.L. & TECH. 240 (2010); Christopher R. Leslie, *The Anticompetitive Effects of Unenforced Invalid Patents*, 91 MINN. L. REV. 101 (2006).

invalidity). Accordingly, “the public interest supports judicial testing and elimination of” invalid patents.⁴³

Nuisance suits demonstrate the impact that high patent litigation costs have on the publicly beneficial activity of challenging patent validity. Driven, at least in part, by the exorbitant costs of defense, cases brought by non-practicing entities settle 89.6% of the time.⁴⁴ Nearly half of litigated patents, however, are held invalid.⁴⁵ That means that there is likely a broad swath of patents being asserted by PAEs that, if litigated, would be held invalid.⁴⁶

The high costs of defending against an allegation of infringement also frustrate the patent system’s metric for valuing a patentee’s inventive contribution. The Patent Act allows a patent holder to “exclude others from making, using, offering for sale, or selling the” patentee’s invention.⁴⁷ Those who violate the patentee’s right to exclude are liable, where appropriate, for

⁴³ *In re K-Dur Antitrust Litig.*, 686 F.3d 197, 215 (3d Cir. 2012); see *Cardinal Chem. Co. v. Morton Int’l, Inc.*, 508 U.S. 83, 100-01 (1993) (explaining the “importance to the public at large of resolving questions of patent validity” and noting the danger of “grant[ing] monopoly privileges to the holders of invalid patents”); *Pope Mfg. Co. v. Gormully*, 144 U.S. 224, 234 (1892) (“It is as important to the public that competition should not be repressed by worthless patents, as that the patentee of a really valuable invention should be protected in his monopoly.”); Mark A. Lemley, *Rational Ignorance at the Patent Office*, 95 Nw. U. L. Rev. 1495, 1515 (2001) (Challenging patent validity in litigation serves the public good by reducing the “social cost of issuing bad patents.”); Ranganath Sudarshan, *supra* note 30, at 170; see *id.* at 169 (“the litigation process is the real crucible in which to test a patent’s validity and scope”); see J. T.S. Ellis, III, Symposium, *Distortion of Patent Economics by Litigation Costs* 23, 24 (1999) (“the pernicious effect of the escalating expense of patent litigation is that it artificially discourages court challenges to patent validity and thereby contributes to the risk that invalid patents will pollute the market.”).

⁴⁴ John R. Allison, Mark A. Lemley & Joshua Walker, *Patent Quality and Settlement Among Repeat Patent Litigants*, 99 GEO. L.J. 677, 694 (2011).

⁴⁵ See John R. Allison & Mark A. Lemley, *Empirical Evidence on the Validity of Litigated Patents*, 26 AIPLA Q.J. 185, 205 (1998).

⁴⁶ See Statement of Dana Rao, Vice President of Intellectual Prop. & Litigation, Adobe Sys. 7, *Hearing on Abusive Patent Litigation: The Impact on American Innovation & Jobs, and Potential Solutions Before the H. Comm. on the Judiciary*, 113th Cong. (2013) (“PAEs do not want their often weak or questionable patents to be scrutinized. Indeed, studies show that PAE patents taken to trial fail more than eighty percent of the time. Instead, their goal is to have defendants pay settlement fees, as large and as fast as possible. By suing 100 defendants for \$50,000, they can make a quick \$5 million without ever testing the merit of the patent.”). It may be that the patents at issue in litigated suits are more likely to be held invalid than the patents at issue in settled suits—a strong invalidity case may, in some circumstances, embolden an accused infringer to forgo settlement in favor of litigation. That does not, however, undermine the assertion that PAEs are able to avoid litigating the validity of many potentially invalid patents because of the costs of litigation. All else being equal, a defendant becomes less likely to litigate an infringement allegation as the cost of doing so increases.

⁴⁷ 35 U.S.C. § 154.

lost profits and a “reasonable royalty for the use made of the invention by the infringer.”⁴⁸ The Patent Act thus sets the parameters for defining the value of a patent. But settlements forced by the high costs of patent litigation allow patentees to reap benefits from a patent wholly untethered from what the Act contemplates. Rather than being rooted in the invention’s value over alternatives at the time of design, the settlement value is dictated by the cost of litigation. A likely-invalid patent with large associated discovery burdens will be valued higher than an unassailably valid patent with minimal associated discovery burdens. That makes no sense. This adverse impact on valuation is not limited to the settled suit—it can also distort future damages awards. Patentees can seek to use the settlement extracted as the basis for a future settlement demand.

The Supreme Court has time and again stressed the importance of ensuring that our patent system protects future innovation. Most recently, in *Mayo Collaborative Services v. Prometheus Laboratories, Inc.*, a unanimous Court noted that it had “repeatedly emphasized” “that patent law” should not operate so as to “inhibit further discovery” and “future innovation.”⁴⁹ The high costs of defending against infringement allegations do just that. The resources of innovative companies are needlessly depleted and innovation-stifling patents that would be invalidated through publicly beneficial private challenge remain valid.

In recognition of the harm to the public good that results from the high cost of defending against infringement allegations, the Department and the Commission should encourage measures to make patent litigation more efficient.⁵⁰ Fortunately, the Department and the Commission will not be starting from scratch—several recent judicial developments have made it easier for private parties to challenge the validity of questionable patents through litigation. The Federal Circuit’s holding in *Bard Peripheral Vascular, Inc. v. W.L. Gore & Assocs., Inc.*, “that the threshold objective prong of the willfulness standard enunciated in *Seagate* is a question of law” “best decided by the judge” is one example.⁵¹ Empowering district courts to rule on legal issues that can preclude expensive trips to the jury makes it easier for defendants to engage in the beneficial activity of challenging bad patents. In the same vein, courts have recognized the importance of ruling on case dispositive issues and motions that impact the cost of litigation as early as possible.⁵² *In re EMC Corp.*’s holding limiting joinder to cases “where the accused

⁴⁸ *Id.* § 284.

⁴⁹ 132 S. Ct. 1289, 1301 (2012).

⁵⁰ Increasing the efficiency of patent litigation will, of course, benefit not only defendants in patent suits, but plaintiffs as well.

⁵¹ 682 F.3d 1003, 1005-07 (Fed. Cir. 2012).

⁵² See *In re EMC Corp.* Misc. No. 142, slip op. at 4 (Fed. Cir. Jan. 29, 2013) (stressing the “importance of addressing motions to transfer at the outset of litigation” because doing so “prevent[s] the waste of time, energy and money” and “protect[s] litigants, witnesses and the public against unnecessary inconvenience and expense.” (quoting *Van Dusen v. Barrack*, 376 U.S. 612, 616 (1964))); *Parallel Networks, LLC v. Abercrombie & Fitch*, No. 6:10CV111, 2011 WL 3609292, at *1, *10 (E.D. Tex. Aug. 12, 2011) (addressing “case dispositive” issues—here claim construction—as early as possible helps to resolve cases “in a timely and economic manner,” and can reduce the time it takes to litigate an infringement case from a matter of years to a matter of months).

products or processes are the same in respects relevant to the patent” and that have “shared, overlapping facts” may assist litigants as well.⁵³ Making it possible for each defendant to launch a full, individual defense without being hemmed in by the needs of unrelated co-defendants may make it easier to cost-effectively defend against infringement allegations. And the Federal Circuit’s recent reaffirmation in *Eon-Net LP* and *Raylon* that an award of attorneys’ fees is justified when patentees “lodge[] frivolous filings and engag[e] in vexatious or unjustified litigation” is also useful.⁵⁴ Cases reminding the district courts that they have the latitude to impose fees in appropriate cases may deter practices that needlessly drive up litigation costs, at least at the margins.

In future patent cases that, like *Bard, In re EMC*, and *Eon-Net*, present an opportunity to make reviewing patents more efficient, the Department and the Commission should encourage courts to take action to do so. For example, the Department and the Commission should make clear that recognizing key validity issues as questions of law, not fact, has significant implications for litigation efficiency. Accordingly, the Department and the Commission should urge the Federal Circuit to, among other things, reconsider its view of whether § 112’s written description requirement is a question of law or fact. The Government has already clarified that compliance with the written description requirement is a question of law.⁵⁵ In *Ariad Pharmaceuticals, Inc. v. Eli Lilly & Co.*, however, the Federal Circuit suggested that whether a patent complies with the written description requirement is a question of fact.⁵⁶ The Government clearly has the better of the argument; questions related to compliance with the written description requirement are of a piece with questions addressing claim construction and enablement, which are both questions of law.⁵⁷ In addition to being the best reading of the Patent Act, the Government’s position has the further salutary benefit of providing a legal test that can be enforced early in the litigation process, which in turn encourages companies to serve the public good by litigating patent validity rather than settling. As *Bard* recognized in the context of willfulness, when an issue is treated as a question of law it allows the issue to be more easily pressed before trial, reducing the costs of infringement litigation and increasing the odds of a true test of the patent’s strength.

Moreover, the Department and the Commission should promote practices that make defending against infringement suits more palatable. Any rule that allows for a patent suit’s “early resolution offers substantial savings to the parties and the court in terms of resources and time.”⁵⁸ Consequently, courts should be urged to approach cases in a manner that allows

⁵³ 677 F.3d 1351, 1359 (Fed. Cir. 2012).

⁵⁴ *Eon-Net LP*, 653 F.3d at 1324; see *Raylon, LLC v. Complis Data Innovations, Inc.*, 700 F.3d 1361, 1371 (Fed. Cir. 2012) (remanding case for a determination whether imposition of attorneys’ fees was warranted).

⁵⁵ See Tr. of Oral Argument at 9, *Kappos v. Hyatt*, 132 S. Ct. 1690 (2012) (No. 10-1219) (“the ultimate question of whether the written description is sufficient is a question of law”).

⁵⁶ 598 F.3d 1336, 1351 (Fed. Cir. 2010).

⁵⁷ See *Markman v. Westview Instruments, Inc.*, 517 U.S. 370, 384 (1996) (claim construction); *Raytheon Co. v. Roper Corp.*, 724 F.2d 951, 960 n.6 (Fed. Cir. 1983) (enablement).

⁵⁸ Peter S. Menell et al., *Patent Case Management Judicial Guide* 1-15 (Univ. of Cal. Berkeley Public Law Research Paper No. 2114398, 2d ed. 2012).

dispositive legal issues to be addressed early in the litigation—before discovery where possible—and that eliminates unnecessary costs. Courts should relatedly be encouraged to rule on the scope and type of available relief at the earliest possible stage in the litigation so that defendants with meritorious defenses will not fold in the face of an intimidating demand for relief.

The Department and the Commission should also encourage courts to apply 35 U.S.C. § 285 to discourage practices that intentionally and unnecessarily increase patent litigation costs. As relevant here, a case may be deemed exceptional under § 285 where there has been “misconduct during litigation, vexatious or unjustified litigation, conduct that violates Federal Rule of Civil Procedure 11, or like infractions.”⁵⁹ When a defendant prevails in an infringement action, courts consider the plaintiff’s “litigation behavior” in determining whether a case is exceptional.⁶⁰ For instance, the Federal Circuit has recognized that when a patentee “prolongs litigation in bad faith, an exceptional finding may be warranted.”⁶¹ With these factors in mind, courts would be justified in concluding that practices that drive up the costs of litigation in an attempt to force settlement—and thus avoid the question of the validity of the asserted patent—warrant the imposition of fees under § 285.

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We are grateful to the Department of Justice and the Federal Trade Commission for their efforts to effect positive change in the patent system and for considering these comments. If we can be of any further assistance, please do not hesitate to contact us.

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⁵⁹ *Serio–US Indus., Inc. v. Plastic Recovery Techs. Corp.*, 459 F.3d 1311, 1321-22 (Fed. Cir. 2006).

⁶⁰ *MarcTec, LLC v. Johnson & Johnson*, 664 F.3d 907, 916 (Fed. Cir. 2012).

⁶¹ *Computer Docking Station Corp. v. Dell, Inc.*, 519 F.3d 1366, 1379 (Fed. Cir. 2008).