



April 5, 2013

**Comments of Coalition for Patent Fairness on  
DOJ/FTC Workshop on Patent Assertion Entity Activities**

The Coalition for Patent Fairness (“CPF”) welcomes the initiative taken by the Department of Justice and the Federal Trade Commission in convening their joint Workshop on Patent Assertion Entity (“PAE”) Activities, and respectfully submits the following comments.

**I. Interest of Commenter**

CPF is a diverse group of companies<sup>1</sup> dedicated to enhancing U.S. innovation, job creation, and competitiveness by strengthening our nation’s patent system. CPF has spent the past seven years working to modernize and improve the U.S. patent system through legislative, administrative and judicial reforms.

CPF’s member companies are among the most innovative companies in the United States. Collectively, they hold tens of thousands of patents and support a strong patent system to reward and encourage innovation. But notwithstanding several improvements achieved by the America Invents Act, the U.S. patent system presents grave obstacles to innovation and competitiveness. In many cases, patents are too easy to obtain and too vague or ambiguous in scope. Damage demands are often disconnected to the contribution (if any) of the patented innovation over other alternatives. And patent litigation procedures are skewed in ways that tend to force defendants to settle rather than contest patent claims that may be meritless or inflated. As a result, unnecessary costs are imposed, and legitimate innovation is unnecessarily taxed and stifled. This harms U.S. competitiveness.

The largest and fastest growing area of patent abuse is by PAEs – patent assertion entities. PAEs impose enormous costs on U.S. innovators, manufacturers, and service providers, and a multi-faceted legal and policy response is needed from the federal Government to combat the harm done by PAEs’ manipulation of the U.S. patent system.

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<sup>1</sup> CPF’s members include Adobe, Blackberry, Cisco, Dell, Google, Intel, Intuit, Oracle, Rackspace, SAP, and Verizon.

## II. The PAE Business Model<sup>2</sup>

PAEs are not traditional commercial innovators, like CPF's members. PAEs do not make up-front investments in research and development; they do not supply products and services to consumers or other businesses; and they do not engage in pro-competitive cross-licensing of technology to create new products using complementary technologies. Because they produce nothing, they cannot be cross-sued for infringing the defendant's patents. Moreover, PAEs issue their threats and pursue their litigation strategies free of the reputational concerns that constrain productive, consumer-facing companies.<sup>3</sup> PAEs are not traditional inventors; they generally buy pre-existing patents, rather than inventing new technologies. They tax (at the highest rate possible) productive and innovative firms, using the threat of litigation. PAEs produce neither goods nor services; they simply threaten and implement costly litigation.

Traditional inventors have an incentive to be transparent and to sue early in the life of their patents if they detect infringements, in order to recoup their R&D costs and to prevent loss of market share to free-riders. Full disclosures and early warnings or suits protect the patent holder's legitimate interest in exclusivity while giving the alleged infringer the chance to take any steps necessary to avoid infringement. PAEs, however, typically sue late – both long after the patent has been granted and long after the alleged infringement has occurred. Their goal is to maximize potential settlement value or damages, so PAEs typically threaten or file suit after the defendant has generated a significant revenue stream and after the defendant is locked in to the allegedly infringing products and technologies. As Professor Chien documented at the Workshop, PAEs have an extraordinarily high ratio of demand letters to suits; PAE litigation is characterized by an extraordinarily high ratio of legal costs (borne mainly by defendants)<sup>4</sup> to settlement values (with the former exceeding the latter in 90% of cases); and PAEs lose an extraordinarily high proportion of litigated cases (over 90% of software patent cases). In other words, PAE litigation is enormously costly for defendants and largely non-merits-based.

PAEs also rely heavily on secrecy and avoiding accountability. They employ complex ownership structures to disguise the real party in interest. They sometimes refuse to even

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<sup>2</sup> We refer here specifically to PAEs – for-profit entities whose primary business consists of acquiring patents from others and asserting them via litigation and threat of litigation. PAEs may be considered a subset of NPEs, or non-practicing entities. The concerns raised in these comments regarding PAEs do not apply to traditional NPEs, such as universities, that engage in or fund research and/or make their innovations available on a consensual basis. Of course, some entities have a mixture of characteristics.

<sup>3</sup> PAEs are subject to the same antitrust laws as productive companies, and CPF encourages the antitrust agencies to enforce the law vigorously against abuses by PAEs, whether they involve acquisition of substitute technologies to accumulate market power, hybrid PAEs combining with product market competitors to raise rivals' costs, use of patent litigation and threats thereof to deter innovation by rivals, cheap exclusion by threats and sham litigation, or other abuses. PAEs may benefit from de facto antitrust loopholes, however, insofar as the technology/patent markets in which they exercise power are difficult to define and assess, both because there is no market share data in the traditional sense and because of PAEs' success in obscuring both the real party in interest and the competitive significance of their assets. Given these difficulties, and the general lack of pro-competitive benefit inherent in the PAE business model, antitrust enforcement should take a particularly aggressive approach towards PAEs.

<sup>4</sup> While PAEs impose high legal costs on defendants, PAEs' legal costs are generally low. PAEs generally produce little in discovery, because they acquire patents without acquiring the history of development that led to the patent.

disclose the patent portfolio they are offering, with threat of litigation, to license. They transfer patents in an attempt to avoid FRAND licensing or other pricing commitments.

Fifteen years ago, PAEs were almost nonexistent. Even in 2005, PAEs represented less than 19% of patent infringement suits. But by 2012, they were responsible for over 60% of patent infringement suits. In those seven years, total patent litigation has increased by over 20%.

Moreover, PAEs have now adapted their business model to target small to medium-sized innovators, retailers and end-users in a wide variety of industries,<sup>5</sup> including local governments and charitable organizations – those entities least able to defend themselves effectively. Two-thirds of PAE suits are brought against small to medium-sized firms (firms with less than \$100 million in revenue). PAEs increasingly demand nuisance value settlements from multiple parties, exploiting an imbalanced damages methodology that assesses damages based on the value of the whole accused product, rather than the value of the allegedly patented component. Yet another adaptation of the PAE is increased use of the International Trade Commission (“ITC”) to use the threat of an exclusion order as leverage for larger money settlements.<sup>6</sup>

In sum, PAEs are now the main source of patent litigation, and the main cause of the growing and evolving problem of patent abuse.

### **III. The Alleged Benefit of the PAE Business Model**

The only potential social benefit of PAEs is to create a market for patented inventions to reward inventors. CPF’s members believe that it is vitally important that innovators be rewarded. However, PAEs are by no means the only mechanism for doing so.

CPF’s members and other companies reward in-house inventors with jobs and bonuses, and outside inventors with prizes, contracts, and license or acquisition fees. The acquisition of valuable technology in the form of patents or patent licenses is a critical competitive differentiator in technology-intensive industries, and the substantial patent portfolios held by, and licensing fees paid by, CPF’s members and their competitors demonstrate that there is a vibrant market to reward innovation. There is also, of course, a legal system, with thousands of competent lawyers competing for business and generous remedies available under the patent laws to reward innovators.

PAEs may pay a higher price for some patents, but such prices reflect the fact that PAE litigation often results in overcompensation for dubious patents or for patents on inconsequential technologies. PAEs have mastered the arts of patent aggregation, of threats without litigation, of forum-shopping, of avoiding counter-suits, and of exploiting asymmetries relating to litigation costs, reputational risks and discovery. Even insofar as PAEs pass some of the profits from their non-merits-based patent assertion strategies on to inventors, they may reward inventors on a basis divorced from the merit of their inventions. Whereas traditionally productive firms acquire

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<sup>5</sup> See *Abusive Patent Litigation: The Impact on American Innovation & Jobs, and Potential Solutions*, Hearing before the House Subcommittee on Courts, Intellectual Property and the Internet, 113<sup>th</sup> Cong. (prepared statement of Janet L. Dhillon, JCPenny) (Mar. 14, 2013).

<sup>6</sup> *Abusive Patent Litigation: The Impact on American Innovation & Jobs, and Potential Solutions*, Hearing before the House Subcommittee on Courts, Intellectual Property and the Internet, 113<sup>th</sup> Cong. (prepared statement of Mark Chandler, Cisco Systems Inc.) (Mar. 14, 2013).

patents or patent licenses because they embody technology that is useful for producing valuable goods and services, PAEs select patents that look useful for litigation, often because they are very ambiguous or vague in scope and can potentially be stretched to cover a wide range of commercially successful products. That is, at best, a questionable benefit for the public.

#### **IV. The Harms Caused by the PAE Business Model**

In contrast, the harms caused by the PAE model are clear and enormous. The 2012 Bessen-Meurer study estimated the annual cost to the U.S. economy caused by PAEs at \$29 billion in 2011.<sup>7</sup> As that was based on 1509 PAE suits in 2011, and Bessen and Meurer counted 2544 suits in 2012, the 2012 figure may be closer to \$50 billion. Moreover, Bessen and Meurer counted only direct costs, and ignored indirect costs of lost innovation. Every hour that a scientist, engineer or software developer spends reviewing and producing documents for litigation, or preparing for or participating in a deposition, or helping lawyers figure out how to defend or whether to settle a PAE suit, is an hour that could have been spent inventing a better product. Every dollar spent on attorney fees or settlements is a dollar that could have been spent on research and development. And every dollar spent trying to identify and anticipate potential claims from thousands of technology patents held by obscure companies that do not even participate in a relevant product market, and every dollar spent avoiding a potential patent claim, is a dollar that could have been spent on inventing something better. A PAE-dominated patent system entails a disproportionate amount of investment and energy being allocated to rent-seeking, and to defending against rent-seeking behavior, to the exclusion of innovative and productive efforts.

PAE litigation penalizes innovation and success, and thrives on imposing unnecessary costs and inefficiency. PAEs target innovative products after they have succeeded in the marketplace; the most innovative firms, such as CPF's members, are among the most frequent targets of PAEs precisely because they are successful in delivering products and services that consumers want.

#### **V. What Can Be Done**

CPF encourages the FTC to take a closer look at the opaque business practices of PAEs by conducting a section 6(b) study that would bring clarity to the debate, and result in a better informed understanding of the negative impacts of PAEs on the economy. DOJ and the FTC should also be vigilant for antitrust violations by PAEs, which such a study may reveal. For example, some patent acquisitions may violate section 7 of the Clayton Act by creating market power in a technology market, and some arrangements between PAEs and other firms, or attempts by PAEs to evade FRAND commitments made by a patent's prior owner, may raise Sherman Act issues.

The antitrust agencies have a broader role to play, however, in deploying their economic expertise and investigatory power in their traditional competition advocacy role to help legislators, the PTO and the courts reform the patent system. Reform should be guided by the principle that the patent system is intended to reward innovation. But, in the hands of PAEs, it is

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<sup>7</sup> James E. Bessen & Michael J. Meurer, *The Direct Costs from NPE Disputes*, Boston U. Sch. of Law Law & Econ. Research Paper No. 12-34 (June 28, 2012), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2091210](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2091210).

attacking firms that bring innovative products and services to market, and rewarding rent-seeking by PAEs that have no involvement in the development of those innovative products and services but then demand an extortionate share of the revenue they generate. The patent system is also meant to embody a social contract: Congress grants lucrative rights of exclusion to inventors in exchange for their both investing in research and development and publishing an invention that can be put into practice to benefit the public. But instead of making clear and beneficial public disclosures, PAEs hide in a thicket of broad, vague and overlapping patents, owned by obscure networks of subsidiaries and related companies, and then ambush productive entrepreneurs who have already brought innovation to the marketplace.

The patent system now needs some targeted reforms to cope with the challenge posed by PAEs. First, the balance of patent litigation should be re-set. Litigation costs, rather than the merits, have become the key driver in many – especially PAE – patent settlement calculi, so the current litigation system, which imposes huge litigation costs on defendants and minimal costs on plaintiffs, ensures unbalanced settlements that harm the U.S. economy. Patent plaintiffs, especially PAEs (which lack the reputational and countersuit risks of traditional firms and typically have little information to provide in discovery), have almost a free roll of the dice. For an insignificant filing fee, they can file bare-bones complaints alleging infringement, provide no upfront information about how they construe the patent claims or how the accused product allegedly infringes, impose significant legal costs on the defendant, and walk away, without significant cost or penalty for themselves, if they lose. CPF supports legislative efforts like the bipartisan SHIELD (Saving High-tech Innovators from Egregious Legal Disputes) Act that was recently re-introduced in Congress to address this aspect of the problem. While it is early in its legislative evolution, we believe in the essence of this legislative idea: innovation and the patent system are best served by disincentivizing unnecessary and abusive litigation.

In addition, specific litigation abuses such as selective targeting of small innovative defendants and abuse of the ITC process should be addressed, as Congress and the courts have addressed litigation abuses in other contexts. To discourage abuse of the ITC, a respondent should be allowed to stay an ITC proceeding in favor of parallel district court litigation and an exclusion order should only be allowed to issue if it is in accordance with the equitable factors set forth in the Supreme Court’s *eBay* decision.<sup>8</sup> In addition, Section 337 of the Tariff Act should be amended to clarify that complainants in the ITC cannot rely on “revenue driven licensing” to satisfy the ITC’s requirement for establishing that there is a domestic industry entitled to protection. Instead, if licensing activity is to be relied upon to establish a domestic industry, it must be of the type that promotes adoption and use of the patented technology and must have preceded such adoption and use. When PAEs attack an innovative new industry or market, the job-creating participants in that industry should have a full and fair opportunity to defend themselves, whether individually or collectively. A system that requires innovative and productive firms to spend millions in legal costs to establish their innocence, but permits PAEs to

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<sup>8</sup> See generally *eBay Inc. v. MercExchange, L.L.C.*, 547 U.S. 388, 391 (2006) (“A plaintiff must demonstrate: (1) that it has suffered an irreparable injury; (2) that remedies available at law, such as monetary damages, are inadequate to compensate for that injury; (3) that, considering the balance of hardships between the plaintiff and defendant, a remedy in equity is warranted; and (4) that the public interest would not be disserved by a permanent injunction.”).

bring baseless and exaggerated claims with impunity, is unfair and harmful to U.S. competitiveness.

Second, Congress made improvements to the patent system in the America Invents Act (AIA). But the efficacy of the AIA is threatened by an acknowledged technical error. With respect to the estoppel threshold for the AIA’s new post-grant procedure, corrective action by Congress is needed to restore the intent of the AIA – by changing “raised or reasonably could have raised” to “actually raised.”<sup>9</sup> If left uncorrected, potential challengers of a patent will be discouraged by the estoppel risks and the availability of this new procedure will be greatly limited.<sup>10</sup>

Third, both in order to ensure that real innovators benefit from the patent system, and to protect the investments of U.S. innovators in international markets, prior user rights need to be clarified and strengthened. Foreign competitors enjoy broad prior user rights in their home countries that extend to all kinds of inventions (not just manufacturing processes), expressly include substantial preparation for commercial use as protected subject matter, and apply to prior use at any time before the invention filing date.<sup>11</sup> In order to compete on a level playing field, American companies likewise need the protection afforded by broad prior user rights. Uncertainty exists about the availability and extent of prior user rights now that the United States has adopted the first to file system. Until prior user rights are assured, that uncertainty will continue to create a disincentive to investment in and commercialization of new technologies, and will continue to place U.S. firms at a competitive disadvantage.

Fourth, consistent with the economic principle that reducing information costs facilitates efficient voluntary exchanges, strong real-party-in-interest disclosure requirements should attach on a continuing basis to all patents and patent applications. This reform would help combat the PAEs’ strategy of secrecy and unaccountability. It would enable firms threatened with patent litigation to at least identify the portfolio of patents at issue; and it would also facilitate meaningful antitrust review. CPF addressed this issue in detail in comments to the PTO in January.<sup>12</sup>

Further investigation of PAEs, their business model, and the costs it imposes is likely to suggest further avenues for reform. CPF welcomes the attention these issues have begun to

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<sup>9</sup> “Reasonably Could Have Raised” Estoppel, The Coalition for 21st Century Patent Reform, available at <http://www.patentsmatter.com/issue/pdfs/RCHR%20Estoppel%20Paper%2012-30-2012.pdf>.

<sup>10</sup> A “Reasonably Could Have Raised” Estoppel in Litigation Following Post-Grant Review Will Prevent the Envisioned Benefits of the New Procedure From Being Achieved, The Coalition for 21st Century Patent Reform, available at <http://www.patentsmatter.com/issue/pdfs/Why%20RCHR%20Estoppel%20Should%20Not%20Apply%20to%20PGR.pdf>.

<sup>11</sup> See Prior User Rights, Hearing before the House Subcommittee on Intellectual Property, Competition and the Internet, 112<sup>th</sup> Cong. 2-6 (2012) (prepared statement of Dan Lang, Cisco Systems Inc.).

<sup>12</sup> Comments of the Coalition for Patent Fairness and the Internet Association in response to USPTO, Notice of Roundtable on Proposed Requirements for Recordation of Real-Party-in-Interest Information Throughout Pendency of Patent Term, Docket No. PTO-P-2012-0047 (Jan. 25, 2013), available at [http://www.uspto.gov/patents/law/comments/rpii-e\\_cpf-ia\\_130125.pdf](http://www.uspto.gov/patents/law/comments/rpii-e_cpf-ia_130125.pdf).

receive from the President, Congress, the Department of Justice, the Federal Trade Commission, and the U.S. Patent and Trademark Office, and it encourages all parties to work together on a continuing basis to achieve a fuller understanding of the PAE problem and to implement strong and effective reforms.

Respectfully submitted,

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