{ Application Developers Alliance }

**U.S. DEPARTMENT OF JUSTICE/FEDERAL TRADE COMMISSION
WORKSHOP AND COMMENT PROCEEDING ON PATENT ASSERTION ENTITIES**

COMMENTS OF THE APPLICATION DEVELOPERS ALLIANCE

The Application Developers Alliance ("Alliance")[1] welcomes the Department of Justice (DOJ) and the Federal Trade Commission's (FTC) Workshop on Patent Assertion Entities (PAEs), and respectfully submits the following comments.

PAE Leeches Impose a Tax on Genuine Innovation, and Patent System Reform Is Urgently Needed

As we elaborate below, the U.S. patent system is seriously flawed, and over the past few years PAEs have become enormously successful in exploiting its flaws:

- PAEs now dominate patent assertion and litigation, especially with regard to software/smartphone/mobile device patents.[2]

- PAEs acquire huge portfolios, which often consist largely of dubious and overbroad patents. They routinely assert these patents in shotgun fashion against app developers and other successful innovators.

- PAEs are secretive and unaccountable, their litigation costs are low, and they can afford to lose cases. Their victims, however, are accountable to consumers and investors, and patent litigation is often a "bet the firm" risk. The result is inflated settlements bearing little relation to the merits (if any) of the PAEs' claims, or to the value of the contribution (if any) of the PAEs' patents in the innovators' products.

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[1] The Alliance is a non-profit professional and industry organization dedicated to advancing the interests of app developers and publishers, and promoting the growth of the app economy generally. We have over 20,000 individual members and over 100 corporate members.

Our mission is to support the conditions in which the app economy grows and brings consumers the diverse, innovative products that they want. App developers flourish in conditions of competition, transparency, and open standards, and when genuine valuable innovation – but not rent-seeking – is incentivized by efficient, fair and merits-based intellectual property protection.

[2] PAEs now file more than 60% of U.S. patent suits, and the overall frequency of patent suits has grown rapidly in the past few years due to the rise of PAEs. PAEs are even more dominant in the software/mobile technology area. Moreover, lawsuits are just the tip of the iceberg; because litigation costs are very high, most cases settle before suit is filed.

The settlements and litigation costs imposed by PAEs are a huge tax on true innovators who bring apps and other products to consumers. PAEs are the principal threat to the continuing growth and success of the app economy.

To combat this threat, a strong legal and public policy response is needed. DOJ and the FTC can play a valuable role, using enforcement, investigative and advocacy powers. In particular, the FTC could conduct an informational investigation (using subpoena power) directed at PAEs, to provide transparency and inform Congress and enforcement agencies about the economic harms created by PAEs. Ultimately, however, Congress, the PTO, and the courts must reform a patent system that now hurts genuine innovators and rewards rent-seeking free-riding PAEs.

The App Developer's Experience and the Harm Caused by PAEs

App developers are innovators. They make substantial upfront investments in research, development and software coding to create new products that consumers value and trust. They fund those investments with their own money, or with loans or outside investment, but their funding and incentives ultimately depend on revenues derived from consumer purchases or consumer use of the app. When PAEs use threats and lawsuits to impose an extortionate tax on those revenues, the app developer's business model collapses.

App developers routinely face PAE litigation threats after their apps succeed in the marketplace. PAEs do not provide notice of potential patent claims, and do not threaten suit, when an app is at an early stage. Doing so would protect the PAE's patent rights, while enabling the app developer to develop its app in a manner that avoids patent claims. But that is not the PAE's objective; PAEs seek money. PAEs lie in ambush, waiting for the app developer's innovation and marketing to generate a revenue stream they can tap. Then, when the app developer has sunk its development and marketing costs, when the public has embraced the app, and when the developer is at a critical stage in the recoupment of its investment, the PAE letters arrive, threatening suit and demanding royalty payments.

The PAE letter identifies the patent(s) at issue, but they are typically patents that purportedly cover extraordinarily broad technology, or just basic ideas, that could relate to almost any app, website, or software. Moreover, a huge and mysterious PAE patent portfolio is often waiting in the wings,[3] with the implicit threat that if the app developer does not pay up, more threats and litigation may follow. The PAE letter does not explain how the app is alleged to have infringed the patent, so the app developer calls the PAE for an explanation. The response is often chilling: that information will only be shared in the litigation discovery process.

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[3] The major PAEs have thousands of patents, often housed in hundreds of affiliates, so evaluating the overall threat posed by a PAE's patent portfolio is not practically possible.

At this point, the app developer must choose between paying the PAE or litigating. If it pays:

- the developer's revenues will be taxed heavily based on patent claims that are probably invalid or overbroad, infringement claims that are undisclosed and dubious, and/or patented innovations that play a trivial role in the value of the app;

- the developer will have to negotiate without the benefit of important information, because PAEs use non-disclosure agreements to hide prior settlements, and complex networks of affiliates to obscure their portfolios;

- the developer may not know whether it is dealing with a "hybrid" PAE, which may be coordinating with a competitor of the developer to raise the developer's costs; and

- more threats based on different patents, from the same and other PAEs, may follow.

If the developer chooses to fight:

- it will incur high litigation costs, typically far exceeding the amount plausibly at issue on the merits, in an inconvenient forum selected by the PAE;

- it will be distracted from its innovative and productive efforts by the litigation process, including burdensome discovery;

- its reputation and its app's reputation may be harmed by the fact of the litigation, regardless of the merits, deterring consumers and investors at a critical time;

- it will risk losing its entire business if it loses and has to pay damages and both sides' legal fees, and damages assessment is often highly uncertain because assessing the contribution of the patented innovation to the app is difficult;

- under the current asymmetric rules of patent litigation, it will have no prospect of reimbursement for its legal fees if it prevails; and

- regardless of the result, there will always be the prospect of more threats and suits.

In contrast, the PAE bears little burden and little risk:

- PAEs' litigation costs are typically low (and commonly financed on a contingency basis), in part because, as acquirers of patents after the alleged invention and patent prosecution process is complete, they have little to provide in discovery;

- for PAEs, rent-seeking litigation is not a distraction from productive endeavors; it is the core of their business;

- PAEs are not publicly traded and they do not sell to consumers, so they have no accountability and no reputational concerns; and

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- PAEs can readily afford to lose cases – and indeed, do lose the vast majority of cases that do not settle – because they are repeat players in the litigation game with huge patent portfolios.

The inevitable result is that most app developers are coerced into making payments that far exceed anything justifiable based on the legal merits (if any) of the case. A few choose to fight. For example, one entrepreneur with a wife, three children and 25 employees chose to pay $30,000 to lawyers instead of paying a $2,000 royalty to a PAE. When an app developer contests a dubious patent or patent infringement claim, app developers and the public benefit: if a patent is invalidated or an overbroad claim is narrowed, the public domain is restored. But for the typical app developer – a small business at a critical stage of growth starting to recoup upfront development costs – contesting the merits is not economically viable.

Above, we have outlined the realities faced by app developers when sued directly by PAEs. But they are also victimized indirectly when PAEs attack the devices and software platforms for which app developers produce apps. When, for example, PAEs use the International Trade Commission (ITC) process to threaten or secure exclusion orders against a mobile device, an app developer's investment dedicated to that platform is jeopardized, even though there is no patent infringement case against the app developer and the patent at issue may be dubious and at best insignificant to the real value of the device.

The end result of these direct and indirect PAE threats is a non-merits-based tax on app development (and other innovation), which thwarts and deters app developers and the investors who support them, and slows down the delivery of innovative new products to consumers. A recent survey estimated that PAEs cost the U.S. economy $29 billion in 2011. PAE litigation has grown substantially, so that number will have grown substantially, since then. Moreover, that number does not take into account the huge opportunity costs caused by diverting developers' efforts from innovative and productive work and into litigation avoidance and response. Nor does it measure the suppression of entrepreneurs, startups and investment that result when people are dissuaded from writing code, creating a company, or investing in a start-up.

What Can Be Done

PAEs have four major advantages that enable them to extort non-merits-based settlements while harming real innovators:

- dubious and overbroad patents, especially in the software area;

- aggregation by acquisition of large patent portfolios;

- secrecy, lack of transparency, and lack of reputational concerns/accountability; and

- a patent litigation system in which they benefit from asymmetries in litigation cost, discovery burden and risk, and uncertain and sometimes excessive remedies.

A strong and multi-faceted public policy response is necessary to restore the patent system to an even-handed, merits-based system that rewards innovation rather than rent-seeking.

DOJ and the FTC have valuable roles to play, particularly in their traditional competition advocacy function, but reforms by Congress, the PTO, and the courts are essential.

First, the FTC should use its subpoena powers to conduct an informational investigation of the major PAEs. Secrecy and unaccountability are important components of the PAE problem. The patent system is meant to be transparent – patents are a reward for disclosure – and transparency is good for competition and for sound public policy. PAEs should be required to open themselves up for scrutiny. Policymakers and antitrust enforcers need to know in detail how PAEs work in order to formulate appropriate responses to the new reality of patent litigation.

DOJ and the FTC should then take appropriate action based on the information generated. This might include antitrust enforcement (*e.g.,* against (1) PAE patent acquisitions that tend to monopolize a technology market, (2) productive companies that create or work with PAEs to harm competition, or (3) anticompetitive sham litigation and patent assertion), and should include advocacy before Congress, the PTO and courts in favor of competition, genuine innovation, and transparency.

Second, a critical reform that would improve transparency and accountability is real-party-in-interest disclosure requirements. The Alliance strongly supports reforms, such as those under consideration at the PTO, that would require continuous disclosure of the real party in interest behind patent applications, patent grants and transfers, and patent suits. Settlement negotiations are more likely to be fair and efficient when the defendant knows with whom it is dealing. Moreover, antitrust enforcers, policymakers and the general public need to know whether the real party behind a patent suit is (1) a well-known public company that is hiding extortionate patent assertion tactics from scrutiny; (2) a rival of the defendant that is trying to harm competition; (3) a PAE that has made inconsistent or overlapping patent claims based on other patents in its portfolio, or (4) a firm that has committed to FRAND or other licensing practices but is using the PAE to evade that commitment.

Third, the problem of bad and overbroad patents is fundamental. The PTO should be encouraged to review software patent applications rigorously, using software experts, and Congress should provide the necessary funding. The PTO should deny applications that are obvious, or for general ideas, or that are not described in plain language and with sufficient detail that the average coder could duplicate the patented software simply by reading the patent application and conscientiously following its instructions. Arguably, software patent applicants should be required to submit actual code that effectively achieves the claimed advance. The PTO should limit patent claims strictly to the publicly available description of the invention, and the courts should strictly enforce such limitations.[4]

Finally, patent litigation reform is essential. Reforms are needed to combat PAEs' litigation-by-ambush strategy, and to make it less expensive to fight, and more expensive to pursue, meritless infringement claims. The SHIELD Act currently pending in Congress, which would allow patent infringement defendants to recover attorneys fees in some cases, represents a

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[4] *See generally* Remarks of Jonathan Potter, President, Application Developers Alliance, at USPTO Software Patent Roundtable (Stanford, CA, Feb. 12, 2012), *available at* http://devsbuild.it/files/Jon%20Potter%20Remarks%20at%20USPTO%20Roundtable%202-12-13.pdf.

constructive idea, but possible *ex post* fees recovery is not enough. Reforms are needed to change the fundamental reality that it is cheap and easy to bring a patent suit, regardless of the merit, but prohibitively expensive and burdensome to defend one. Moreover, courts and the ITC should be pressed to limit the availability of exclusion orders and injunctions, and the amount of damages, so that infringement remedies are proportionate to the value of the patented invention.

The Alliance appreciates DOJ and the FTC's initiative in convening the Workshop. Reform is urgently needed to combat the harm increasingly being done to the app economy, and the broader innovation economy, by PAE abuses. The Alliance looks forward to continuing dialog with DOJ and the FTC, and with Congress, the PTO and the courts, with the goal of substantial reforms.

April 5, 2013   Respectfully submitted,

                                                     Jon Potter
                                                     President
                                                     APPLICATION DEVELOPERS ALLIANCE