

COMMENTS ON PAEs' ACTIVITIES
by
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Please note that the following comments are made in my personal capacity and do not necessarily correspond to the views of the WIPO Secretariat or Member States

1. NPEs and PAEs

The only difference between NPEs and PAEs is that the former hold one or more patents and keep them dormant whereas the latter do not manufacture the patented invention(s) directly, but do so indirectly, by means of licenses, or through enforcement against infringers. So, essentially, the similarity between the two categories is that neither NPEs nor PAEs manufacture the patented inventions. Their essential difference, on the other hand, is that patents owned by PAEs are worked, either indirectly (through licensees) or through infringement (allegedly or actually).

2. PAEs-licensors

PAEs that are licensors do not raise a particular problem. They put inventions to work in the same way as many patent owners do – by licensing rather than by manufacturing. Actually, most patent licensors are PAEs, especially when they engage in exclusive licensing agreements, by means of which they commit not to engage in manufacturing. Antitrust rules, therefore, do not have a special role to play as regards those PAEs. Because they do not engage in manufacturing (and in selling), PAEs are not real competitors of licensees or of any company for that matter – unless we take the market of the invented technology in isolation into consideration. Generally, that would not be a relevant market. But if it is, then it is a *Horton market* (a market the size of a speck of dust). In such a market – a market whose boundaries are confined to the invention covered by the patent and alternative technologies – no IP owner is obliged to license if its dominant position results from expertise, acumen or luck. In the absence of manufacturing and selling by the patent owner, it would not be possible to think of horizontal or vertical licensing. Moreover, because licensing by a PAE would be the only manner to bring the patented invention to the market, such manner of asserting the rights is generally seen as inherently positive and in compliance with the rationale of the patent system.

3. PAEs-enforcers

So, the problem – if there is a problem – occurs with those PAEs that only enforce their patent rights (but do not and/or refuse to license them). To a very minor extent, we could also include in this category those PAEs that handle patents as financial assets, with purely speculative purposes, as if they were shares or bonds. Their strategy is just buying and selling patents. When the purchasers are also PAEs, the sellers are not distinguishable from genuine NPEs, to the extent that the patented inventions are not placed in the market by the patent holders.

(a) *The PAEs-enforcers problem and the Foster solution*

(i) From a multilateral perspective, there is a clear divide between the law in the United States and in the vast majority of other countries as far as the NPEs/PAEs-enforcers problem is concerned. In the United States, patents are granted as tools of protecting private property rights. In the rest of the world patents are instruments of industrial policy. The two systems are still coincident in that a patent is granted as recognition of an invention made. But the systems divide in that, in the majority of countries, actual manufacturing is necessary to keep the patent. In the United States, courts have consistently held that there is nothing wrong in not exploiting industrially/commercially the patents. In other jurisdictions in general, the mere failure to exploit can be deemed as an abuse of patent rights (see Article 5(A)(2) of the Paris Convention), even if that requires an effort of the mind to understand how not to exploit can be an abuse if exploiting is not comprised in the bundle of rights that stem from a patent. Anyway, that is how traditionally most countries have seen the lack of exploitation – an abuse.

(ii) In other words, PAEs-enforcers are a problem, if they can be deemed so, in the United States only. In other jurisdictions, patent owners are under the obligation to exploit them within certain periods (as set in the Paris Convention), directly or indirectly, otherwise they will be subject to compulsory licenses and, if these are not enough to persuade the owners to bring the invention to the market, to forfeiture. This means that outside the United States to buy and hold patents with the mere purpose of enforcing them is not a financially wise decision.

(iii) It is worth noticing, however, that the solution in the United States is not necessarily *very* different. The solution to the NPEs conundrum was given by the Court of Appeals for the Second Circuit in *Foster v. American Machine & Foundry Co.*, 492 F.2d 1397 (2nd Cir. 1974). In *Foster* the plaintiff was a patent solicitor with almost 50 years of experience at the bar. The opinion does not say how it acquired the patent, but probably it bought the invention (and the associate right to apply for a patent) from a client who – as it is very common in that particular segment of business – had no resources to procure a patent. Foster sued the defendant alleging infringement. He sought an injunction and 52,000,000 US dollars in damages. The Court of Appeals confirmed the District Court's holding that the plaintiff was entitled to neither. Because he did not exploit the patent, an injunction would not benefit the plaintiff and would cause serious harm to the defendant. Besides, for the same reason, he could not be entitled to damages, because he had no losses. Instead, Foster was entitled to a compulsory license, with the corresponding reasonable royalties (344,000 US dollars).

The last paragraphs of the opinion are worth quoting:

“Appellant contends that the District Court erred in denying an injunction and adjudging, in lieu thereof, a compulsory licensing in favor of appellant at the royalty fixed by the Court.

“We do not find any difficulty in agreeing with Judge Palmieri that an injunction would be an inappropriate remedy in this case. An injunction

to protect a patent against infringement, like any other injunction, is an equitable remedy to be determined by the circumstances. ... It is not intended as a club to be wielded by a patentee to enhance his negotiating stance. [citation omitted] Here, as the District Court noted, the appellee manufactures a product; the appellant does not. In the assessment of relative equities, the court could properly conclude that to impose irreparable hardship on the infringer by injunction, without any concomitant benefit to the patentee, would be inequitable. [citation omitted]

“Instead, the District Court avoided ordering a cessation of business to the benefit of neither party by compensating appellant in the form of a compulsory license with royalties. This Court has approved such a ‘flexible approach’ in patent litigation. *Royal-McBee Corp. v. Smith-Corona Marchant, Inc.*, 295 F.2d 1, 6 (2 Cir. 1961). Here the compulsory license is a benefit to the patentee who has been unable to prevail in his quest for injunctive relief. To grant him a compulsory royalty is to give him half a loaf. In the circumstance of his utter failure to exploit the patent on his own, that seems fair.”

(iv) The *Foster* opinion does not challenge the well established view (in the United States), as noted above, that there is nothing wrong with a patent owner who does not exploit his/her patent (even though it results clearly from the opinion that the judges did not have any sympathy for the plaintiff). Lack of manufacture may be a matter of lack of market opportunity, or of demand, or simply of economic irrationality. Because patent rights are property rights, courts should not interfere with the manner patent owners administer their assets. However, when a patent owner enforces a dormant patent against an infringer, prohibiting the latter to continue exploiting – no longer as an infringer, but under court fiat – would not serve any public interest. An injunction in that case would have the only merit of foreclosing the market to an invented product, to the loss of consumers. It follows that the reasonable way of addressing both sides of the equation – the interest of consumers on the one hand, and the legitimate private property rights of patent owners, on the other – is to refuse the injunction and ordering the payment of a reasonable royalty (as opposed to damages). That is a solution in conformity with the principles of equity.

(v) In conclusion, the *Foster* opinion has solved the problem, if any, of NPEs and PAEs-enforcers.

(b) *Is there the need for a solution other than the Foster opinion?*

As said, outside the United States patent owners are generally treated by law in a stricter manner, for they are subject to the so-called “working requirement” (working meaning manufacturing and selling the patent product of the product manufactured with the patented process). In a significant number of countries, the working requirement is even harsher, because it means *local working requirement*. Importing the relevant product would not meet the requirement, and a compulsory license (and eventually forfeiture) could ensue, even if the patent owner imported the product and made it available to local consumers. The local working requirement is at odds with the rationale behind the GATT 1947 and Article 27.1 of the TRIPS Agreement.

Nevertheless many countries keep it in their national statutes as an affirmation of national industrial policies.

Besides the working requirement, other jurisdictions impose, as a general rule of enforcement of rights, the principle “the loser pays.” The US Patent Code endorses this rule, but only in “exceptional cases” (35 U.S.C. §285). As a matter of course, imposing the rule to all infringement suits would discourage PAEs from enforcing their patents without a reasonable certainty of winning. Likewise, patent solicitors would not be able to run schemes of contingency fees. Indeed, it seems that there are data indicating that PAEs lose many lawsuits because courts find that there is no infringement. The rule “the loser pays” would therefore immediately eliminate a significant number of lawsuits.

However, the adoption of this rule would go against the legal tradition of the United States as well as the vested interests of a large professional category of trial lawyers. It is not foreseeable that such a practice could be easily changed.

It should be noted that NPEs and PAEs-enforcers are not a new issue in the United States. PAEs thrived in the second half of the nineteenth century, in two areas of business – the railroad industry and farm tools manufacture. Abundant literature describes the pains of small farmers as well as of large railroad companies in defending against the attacks of PAEs. The circumstances of both industries were different: the railroad industry became a target of PAEs when it changed its way of managing technology: instead of using in-house invented technology, it moved to rely more on outside inventors (today we would call this “open innovation”). Thus, the industry was able to obtain significant technological contributions from outside inventors, but it also became vulnerable to the attacks by patent trolls. In the area of farming tools, patent owners based in large cities (mostly, patent attorneys) would organize “patent rings” to extract money from defenseless farmers – they would very frequently obtain invalid patents (the PTO was frequently accused – as it is today – of being very lenient in granting patents), and hire agents who would visit remote farmers threatening them of seizing their farming tools unless they paid a small lump sum for each allegedly infringed patent (which would correspond in practice to almost every single tool used in farms).

The harm of PAEs was significantly increased because of the application of the “savings doctrine”, which contributes to raise the amount of damages when the defendant is not directly involved with selling the infringing products, but rather with using them. The damages, therefore, are also accounted for the productivity gains of the patented product end user.

How did the PAEs problem disappear in the 19th century? Farmers and railroad companies gathered resources to defend against lawsuits. They lobbied Congress to change the patent statutes (at some point there were at least seven bills to amend the patent laws). But inventors would resist such attempts, and vigorously defended the patent system (Thomas Edison was among those). This means that, in the end, the threat of PAEs vanished not because of the actions of their victims, but because of the change in orientation by the Supreme Court, which, in *Atlantic Works v. Brady*, 107 U.S. 192 (1882), raised considerably the difficulties in obtaining a patent. Frivolous patents already issued, like those held by the patent rings, became

susceptible of invalidation. New patents like those became virtually impossible to obtain.

This brings me to the answer to the question above suggested: are PAEs a problem? I do not think so. I would say they are more a symptom of a problem – as they were in the nineteenth century. They are the expression of a very successful patent system – so successful that patents have become financial assets, as much as industrial assets. They may also be a symptom of an unbalanced patent procurement system, in which patents are very easy to obtain, with tolerance to very broad claims or, if narrow, very vaguely drafted claims, thus giving patent holders a profusion of hunting licenses.

One might expect that the recent opinion of the Supreme Court in *KSR Int'l Co. v. Teleflex Inc.*, 550 U.S. 398 (2007), would have the same consequence as *Atlantic Works*, but the adversaries of PAEs allege that it continues being very easy – too easy – to obtain patents in the United States.

However, it should be noted that the problem does not lie in the nature of the inventions claimed. Software patents are not a problem. Associating the PAEs issue with the abstract nature of claims in software patents is an expression of the bias in favor of manufactures against ideas. Such an association is conceptually dated and biased as far as it keeps the patent system tied to an industrial economy and fails to acknowledge the realities of the post-industrial economy – an economy of inventions in services, rather than of inventions in bricks and mortar. The problem of software patents is not a fatality. The problem may be the broadness and vagueness of their claims, if they are not properly drafted, not the claimed matter per se.

Would the United States need to adopt a working requirement similar to the one that prevails in most other jurisdictions? I do not think so. I believe that the *Foster* doctrine is enough, particularly having in view that it refuses the payment of damages, thereby putting aside the risks inherent to the savings doctrine that so much harm did to the railroad industry in the nineteenth century.

However, for the *Foster* doctrine to be a solution it must be actually applied, which does not seem to be the case.