



Consumer Electronics Association
1919 South Eads Street
Arlington, VA
22202 USA
(866) 858-1555 toll free
(703) 907-7600 main
(703) 907-7601 fax
www.CE.org

Federal Trade Commission
Antitrust Division, United States Department of Justice
Patent Assertion Entity Activities Workshop
Comments of the Consumer Electronics Association
April 5, 2013

The Consumer Electronics Association (“CEA”)¹ is pleased to submit these comments on the growing and alarming diversion of resources away from innovation as a result of frivolous lawsuits by so-called Patent Assertion Entities (PAEs or “patent trolls”). As discussed at the December 10, 2012 “Workshop” on Patent Assertion Entities, the harm to our economy that panel members attributed to Non-Practicing Entities (NPEs) is occurring most critically at the smaller firms that have been our most efficient and productive innovators and job creators. The workshop presentations and comments demonstrate that passage of the SHIELD (Saving High Tech Innovators From Egregious Legal Disputes) Act, H.R. 845, is an urgent and necessary step toward reversing this destructive trend.

U.S. patent law exists to promote – not tax or hinder – innovation. The presentations at the Workshop establish, however, that patent law is being misused to damage innovators and entrepreneurs at a rate that hurts innovators and jobs. Litigation and threats of litigation aimed at exploiting imperfections in the patent system are diverting resources and discouraging risk-taking.

Improving the patent review process and the patent system’s overall operation is an important long-term objective – but no presenter forecast that such reform could be sufficiently effective in the immediate future. What *can* be accomplished more urgently is passage of The SHIELD Act, a bill that requires “patent assertion” NPEs (“Patent Assertion Entities,” or “PAEs”) to pay all legal bills if they lose in court because the patent is found to be invalid or there is no infringement. By restoring marketplace balance to decisions about when to litigate patent claims, the SHIELD Act will force PAEs to take financial responsibility for their frivolous lawsuits.

¹ CEA is the principal U.S. trade association of the consumer electronics and information technologies industries, with more than 2,000 member companies. CEA’s International Consumer Electronics Show® (“CES”) is our leading annual showcase for technology innovation.

The problem of frivolous patent litigation brought by PAEs – companies that specialize not in inventing or producing things, but simply in the business of filing patent lawsuits – is growing. Alarmingly, patent trolls now account for a majority of all patent litigation brought in the United States.²

As the number of lawsuits rises, the penalty paid by innovators grows to enormous proportions. According to a recent Boston University study, in 2009 the aggregate annual direct costs attributed to NPEs was \$13.7 billion. By 2011, it had ballooned to \$29.2 billion.³

The study's more specific conclusions are even more alarming. Specifically, the study found that direct costs of dealing with NPE claims exceed 10 percent of total business spending on research and development. The study also concluded that the burden of defending these frivolous lawsuits falls most heavily on small and medium-sized companies. These companies, our most dynamic job creators, account for 90 percent of entities sued, further they pay a disproportionate share of non-litigated settlements – because they cannot afford the cost of defending against the lawsuit in court, which can frequently be in the millions.

As shocking as these numbers are, they are likely understated, since the study only measured direct costs to businesses from NPE lawsuits, without taking into consideration indirect costs such as diversion of resources, delays in new products, and implications for obtaining investor funding. A 2011 study that measured indirect penalties set overall costs from patent troll litigation at over \$80 billion per year.⁴

At the Workshop, innovators and entrepreneurs testified to the marketplace harms of these run-amok patent lawsuits. The panel presentations by Robin Feldman (Hastings College of the Law), Michael Meurer (Boston University School of Law), Thomas Ewing (Avancept LLC), and Brad Burnham (Union Square Ventures) laid out very clearly how PAEs take advantage of flaws in our patent system while hindering innovation. They noted that the targeting of a company by patent trolls is directly related to the company's success and perceived ability to pay, rather than to any relationship between its products and potential patent infringement. Panelists also detailed the tactic of going after end-users in order to force a settlement. A commonly-used patent troll strategy is to sue large customers of small firms, knowing that the small firm is not in a position to offer indemnification even with respect to very weak claims.

In his presentation, Iain Cockburn (Boston University) summarized the harm to the economy and consumers from these frivolous lawsuits. Litigation-generation misallocations of resources in product investment skew pricing decisions, raising prices for consumers and degrading market efficiency. Meanwhile, the time and focus

² Colleen V. Chien, "Startups and Patent Trolls," Santa Clara University Legal Studies Research Paper No. 09-12, September 28 2012.

³ James Bessen and Michael Meurer, "The Direct Costs from NPE Disputes," Boston University School of Law Working Paper No. 12-34, June 25 2012.

⁴ James Bessen, Jennifer Ford, Michael Meurer, "The Private and Social Costs of Patent Trolls," Boston University School of Law Working Paper 11-45, September 19 2011.

of the victim company's most valuable personnel are diverted to collecting unnecessary information instead of the more productive endeavors for which they were hired. Prof. Cockburn also notes how venture capitalists are frightened away from the riskiest and most potentially successful products because of threat of a lawsuit.

In reality, the results of the Workshop merely confirmed facts that were already well known in the marketplace. Gary Shapiro, CEA's President and CEO, summarized the impact of patent trolls in a *Forbes* article last year:

The patent laws are so unclear that a manufacturer never knows with total certainty whether he is inadvertently violating a patent. Even a successful defense of a patent lawsuit costs upwards of a million dollars, so cash settlements to avoid the nuisance factor are significant. Meanwhile, these lawsuits increase consumer costs for useful products and stifle the creation of any new innovation or product. How did it become a good thing for businesses to be created simply to file lawsuits?⁵

President Obama has shown a keen understanding of the issue. In a recent Google Hangout, he responded to a question about patent trolls by noting:

The folks you're talking about...don't actually produce anything themselves. They're just essentially trying to leverage and hijack somebody else's idea and see if they can extort some money out of them.

While there is no single remedy to the patent troll lawsuit explosion, Congressional passage of the SHIELD Act is a sensible place to start. According to the sponsors of The SHIELD Act:

The proposed SHIELD Act forces patent trolls to take financial responsibility for frivolous lawsuits. If a troll brings a patent lawsuit and loses, the SHIELD Act makes sure that the troll pays all costs and attorney's fees associated with the case. This increased risk will help to deter many trolls from bringing frivolous lawsuits in the first place.⁶

The December 10 panelists demonstrated that the informational and resource allocation harms of PAE litigation and threats were attributable in large part to marketplace and litigation asymmetries. Specifically, PAEs find it efficient to aggregate, threaten, and sue on masses of patents, without any potential responsibility for the defense costs that they engender.

⁵ Gary Shapiro, *Legal Slime Chokes Best Companies*, *Forbes*, August 1 2012, <http://www.forbes.com/sites/garyshapiro/2012/08/01/legal-slime-chokes-best-companies/>.

⁶ Press Release, Chaffetz, DeFazio Introduce Expanded SHIELD Act to Combat Patent Trolls, <http://chaffetz.house.gov/press-release/chaffetz-defazio-introduce-expanded-shield-act-combat-patent-trolls>.

The SHIELD Act addresses these distortions by raising the possibility that an unsuccessful PAE plaintiff may have to pay some of the resource allocation taxes that it seeks to impose. The prospect of cost-shifting should also allow smaller companies that are currently pressured into paying for invalid or non-infringed patents to mount defenses and for their venture investors and customers to stand by them when they do. In short, The SHIELD Act will move the market dynamics around PAE patent litigation and discourage frivolous and opportunistic claims.

The restoration of market dynamics encouraged by the SHIELD Act should also have a beneficial effect on the systemic flaws (as also discussed by panelists) that PAEs exacerbate and abuse. As panelists noted, the absence of adequate information about patents and claims is exploited and amplified by PAEs to produce the most egregious cases. Unless PAEs face at least some of the risks borne by practicing entities in collecting patents and threatening suit, their incentive, and the incentive of those who deal with them, will be to further cloud the information for all concerned, such as examiners, patent seekers, sellers, and aggregators, and potential inventors. Introducing potential litigation costs of the sort faced by other market participants should roll back PAE behavior to better approximate that of market risk-takers. In turn, this should increase, at every level, the incentives to seek and provide accurate information. In time, this pressure may contribute to better functioning of the system itself.

In addition to passage of the SHIELD Act, panelists acknowledged the need for reform of the patent process itself. In a recent article, Jon Potter suggested two core reforms to fix the information defects that PAEs regularly exploit:

First, the Patent Office should require software patent applications to be written in plain language, so they can be easily understood by coders and reasonably smart people. The public has the right to know precisely what is patented, so they know clearly what will be infringing. Patent examiners should be trained to reject applications that do not clearly describe the invention and precisely set out the limits of patent claims.

Additionally, the patent application must describe the invention with enough detail that a reader could actually make and use it. Without sufficient detail, neither an examiner nor the public can be sure that there is really an invention being patented, or whether it is only a non-patentable idea.

We don't patent ideas because that would leave no opportunity for next-generation innovators.⁷

⁷ Jon Potter, San Jose Mercury News, February 11 2013, *Jon Potter: Software patent trolls can be stopped by U.S. Patent Office and Congress*, http://www.mercurynews.com/opinion/ci_22565075/jon-potter-software-patent-trolls-can-be-stopped?fb_action_ids=10151411193764909&fb_action_types=og.recommends&fb_source=other_multiline&action_object_map={%2210151411193764909%22%3A309732665796920}&action_type_map={%2210151411193764909%22%3A%22og.recommends%22}&action_ref_map

If America is to continue to be an economic leader, we must protect innovators, and discourage those who exploit our patent system while creating nothing of value. We recognize that addressing patent abuse is a complex issue and offer our assistance in working with the FTC/DOJ on crafting appropriate and balanced solutions. Further, we believe Congress must move expeditiously to pass The SHIELD Act, the courts should insist that only truly novel and useful ideas receive protection, and the Patent and Trademark Office should strive for accurate and searchable information and definitions in its application process. The Joint Workshop brought attention and scholarship to this vital subject, and provides a well-considered basis for necessary action.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "M Petricone". The signature is fluid and cursive, with the first name "M" being a simple loop and "Petricone" written in a more complex, connected script.

Michael E. Petricone
Senior Vice President
Government Affairs

April 5, 2013