



Comments of Microsoft Corporation on the Impact of Patent Assertion Entity Activities on Innovation and Competition

Microsoft Corporation commends the Department of Justice and the Federal Trade Commission for having held a [joint workshop](#) in December 2012 to explore the impact of patent assertion entities (PAE) activities on innovation and competition and their implications for antitrust enforcement and policy. In response to the agencies' request for further input on the topics covered in the workshop, Microsoft is pleased to submit the following comments.

1. Introduction: PAE Litigation

In general, we agree with the assessment that former FTC Chairman Leibowitz offered in his opening remarks at the workshop:

Patent issues raise a minefield of problems. Poor patent quality tips the balance between exclusivity and competition. Unclear scope and poor notice hurts innovation. But there have been improvements.¹

As Chairman Leibowitz noted, there have been improvements on several fronts. The recently-enacted America Invents Act² (AIA) contains a number of reforms designed to increase patent quality and mandated new post-issuance review mechanisms intended to provide feasible, cost-effective alternatives to testing patent validity in litigation. Efforts undertaken by the U.S. Patent and Trademark Office have already been successful in improving patent quality. And the courts have actively sought to address these problems by, *inter alia*, strengthening the non-obviousness requirement,³ beginning to rationalize patent damages,⁴ and reducing the likelihood of patent hold-up through application of the standard balancing test for injunctions.⁵

Notwithstanding these and other advances, suits by PAEs continue to be a serious and growing problem for industry as demonstrated by an expanding docket of PAE cases in both District Courts and the International Trade Commission.⁶ This increase in PAE litigation presents significant challenges and

¹ <http://www.ftc.gov/speeches/leibowitz/121210paeworkshop.pdf>.

² Public Law No. 112-29, 125 Stat. 338 (2011).

³ *KSR v. Teleflex*, 550 U.S. 398, 415 (2007).

⁴ See, e.g., *Uniloc USA, Inc. v. Microsoft Corp.*, 632 F.3d 1291 (Fed. Cir. 2011); *Lucent Techs., Inc. v. Gateway, Inc.*, 580 F.3d 1301, 1324 (Fed.Cir.2009); *ResQNet.com Inc. v. Lansa, Inc.*, 594 F.3d 860, 869 (Fed.Cir.2010).

⁵ *eBay v. MercExchange*, 547 U.S. 388 (2006).

⁶ See James Bessen and Michael J. Meurer, *The Direct Costs from NPE Disputes* (Boston Univ. School of Law, Law and Economics Research Paper No. 12-34, 2012) (reporting substantial increases in PAE-generated costs since 2005); Sara Jeruss, Robin Cooper Feldman, and Joshua H. Walker, *The America Invents Act 500: Effects of Patent Monetization Entities on US Litigation* (UC

imposes significant costs on innovative companies like Microsoft. At any given time Microsoft has pending against us approximately 60 patent infringement suits brought by non-practicing entities, the bulk of which are PAEs, and we spend tens of millions of dollars annually on direct litigation costs (principally attorneys' fees) in defending against these suits. These direct costs represent only a fraction of the overall impact of PAE litigation, with the bulk of the costs being imposed in the form of outsized damages judgments and potential business disruption.

These problems are not unique to Microsoft, or indeed to large technology companies. As has been noted by several academics (including at least one presenter at the workshop), the costs of PAE litigation are spreading rapidly to start ups and retailers.⁷ In sum, despite recent efforts, PAE litigation is a growing problem for innovative companies of all sizes and in multiple industries.

2. Defining the Problem

Any effort to formulate policy in response to this development should begin with a careful analysis that defines the nature of the problem to be addressed. In this case, conducting such an inquiry is no easy task. Because the emergence of PAE business models (and the resulting growth of PAE litigation) is a recent development, companies, regulators, and academics have little experience to draw upon in assessing the full impact of PAE activities. And because the vast majority of patent assertions by PAEs are made (and resolved) privately, data regarding the full economic impact of PAE activities is woefully incomplete. Nor, as discussed more fully below, are all PAE activities detrimental, as PAEs and other patent aggregators help enable an efficient and vibrant secondary market for patents.

In our view, the limited evidence available suggests that the growth of PAE activity is merely a symptom of more general challenges relating to, *inter alia*, imperfect patent quality, high patent litigation costs, and systemic information and risk asymmetries. Accordingly, we generally agree with the assessment voiced by Professor Shapiro that the appropriate focus of further reforms should be focused improvements to the patent system, including patent litigation, rather than the PAE business model itself.⁸

In sum, the challenges posed by PAEs are not solely or primarily caused by their business model or by their acquisition and assertion of patents. Rather, the high cost and unpredictability of patent litigation and imperfect patent quality allow PAEs, in some cases, to extract rents that exceed the incremental value of the technology covered by their patents. Addressing these challenges through targeted reforms would reduce the economic incentives of PAEs to engage in gamesmanship and to lie in wait seeking to "hold up" companies, thereby helping to resolve the problem of PAE litigation. Accordingly, we believe that the most appropriate and effective policy response is not to regulate PAEs or their behavior directly, but rather to adopt more general reforms of the types discussed immediately below.

Hastings Research Paper No. 3, 2012) (reporting that proportion of patent suits brought by PAEs has nearly doubled in the past five years).

⁷ See, e.g., Presentation of Colleen Chien, available at <http://www.ftc.gov/opp/workshops/pae/docs/cchien.pdf>.

⁸ Presentation of Professor Carl Shapiro available at <http://www.ftc.gov/opp/workshops/pae/docs/cshapiro.pdf>.

3. Appropriate Reforms

Having just finished one of the most significant reform efforts in the history of U.S. patent law, we think that – in most areas – it would be prudent to give the changes made by the AIA a chance to work before advancing further reforms. However, we believe that further improvements are possible with respect to a handful of issues not fully addressed by the AIA, and that these reforms would have a beneficial effect in limiting PAE litigation. These include:

a. Transparency of Patent Ownership

Microsoft supports increasing transparency in IP ownership. As Professor Colleen Chien and others have recently emphasized, a well-functioning patent system should provide notice not only of what a patent covers, but also of who owns it.⁹ The availability of accurate, up-to-date ownership information is critically important to an efficient secondary market for patents and to potential infringers' ability to accurately assess liability and litigation risks and to ameliorate them through patent acquisition and licensing efforts.

Currently, information regarding the ownership of patents is often inaccurate or unavailable because there is no requirement that such information be publicly disclosed or recorded upon the transfer of a patent. It is not uncommon for PAEs and others to seek to exploit the lack of mandatory disclosure PAEs by hiding their ownership of patents through a web of subsidiaries and shell companies to conceal the real party in interest that owns those patents. As a result, despite their enormous value as strategic assets and the emergence of a substantial secondary-market enabling their transfer, lack of transparency has resulted in the market for patents being unnecessarily opaque.

Concealing patent ownership unnecessarily increases uncertainty and transaction costs without any countervailing benefit to the public interest or economic efficiency. For instance, if a potential licensee is unable to determine what patents are owned by a particular licensor's subsidiaries, its ability to conclude a more efficient or comprehensive patent licensing deal is negatively impacted as the licensor can negotiate a license to a narrow sliver of its portfolio while secretly holding back other patents for future assertion against the licensee. In addition, without transparency around patent ownership, it is virtually impossible to assess companies' compliance with patent encumbrances such as commitments to license standards-essential patents on reasonable and non-discriminatory terms or pledges not to assert patents against particular products or companies. Likewise, clarity about what patents a given company owns makes it easier to determine when it makes sense to proactively license that company's portfolio.

All of this flies in the face of the presumption of notice provided by the patent system. For this reason, Microsoft support reasonable regulatory measures by Congress and the USPTO to encourage disclosure of information relating to patent ownership. But even in the absence of regulation, companies that participate in the IP system have an obligation to act responsibly. Last week Microsoft launched our "Patent Tracker" tool. This is an online resource, accessible to the public, that provides a list of all the patents Microsoft owns. Microsoft has committed to update this information to reflect newly-issued and acquired patents on an ongoing basis. We hope that other companies will join us in voluntarily disclosing

⁹ See Comments of Professor Colleen Chien to the U.S. Patent and Trademark Office on Recordation of Real-Party-In-Interest Information http://www.uspto.gov/patents/law/comments/rpii-f_chien_130125.pdf.

patent ownership information relating to their own portfolios and in supporting further efforts by Congress and the USPTO to encourage such disclosure.

b. Patent Quality

The prevalence of low quality patents leads to inefficient litigation and is a significant contributor to the problems posed by PAE activities. While patent quality has increased significantly over the past decade, there continues to be significant room for improvement in all technology areas, including software. In our view, the most serious of the challenges in this area relate to the lack of clarity in claim scope and meaning that prevents potential infringers from being able to accurately determine whether a product or service infringes a particular patent. This ambiguity is too frequently exploited by some PAEs that allege infringement based on overly-broad (and highly questionable) interpretations of patent claims, knowing that even though their likelihood of prevailing in litigation is very low, even a small risk of a high damages award or injunction will often provide enough leverage to extract a small settlement from the targets of these spurious patent assertions.¹⁰

Microsoft commends the USPTO for its focus on this issue and for convening the recently-created “Software Partnership” to discuss how to drive increased quality in software patents. While the USPTO has already made great improvements in overall patent quality, we believe that more can and should be done. Two examples include:

- *Clearer claim terms.* Patents related to chemicals or pharmaceuticals generally are clear, because there is an established nomenclature for describing the molecule at issue. However, there is far less precision in describing computer-implemented inventions; as a result, the metes and bounds of such patents are frequently unclear. Development of standard terms to describe computer-implemented inventions would increase the likelihood that the claims will be interpreted to cover what the inventor invented, rather than stretched to cover products or features unanticipated at the time. In addition to encouraging use of standard claim terms, examiners should be encouraged to require applicants to provide a clear definition of non-standard terms in the specification
- *Written description and enablement.* A patent is required to describe what the invention is, and must do so in sufficient detail to enable someone skilled in the art to implement it. More rigorous standards for applying the written description and enablement requirements should be adopted by the USPTO and the courts (or, if necessary, mandated by Congress through legislation). With tougher standards, the boundaries of patents relating to young technologies such as software would be clearer, enabling companies to proactively manage litigation risk and preventing PAEs and others from exploiting the ambiguity of claims and uncertainties about claim construction in litigation.

¹⁰ See, e.g., John R. Allison, Mark A. Lemley, and Joshua Walker, *Patent Quality and Settlement Among Repeat Patent Litigants*, 99 GEO. L.J. 677, 694 (2011) (finding that – excluding default judgments – PAE plaintiffs win only 8% of cases that reach a judgment on the merits).

c. Patent Litigation Reform: Adopting a “Loser Pays” Rule for Patent Litigation

As discussed during the workshop, nuisance suits by PAEs are a significant problem. While such non-meritorious claims can – per the discussion above – be partially addressed by increasing patent clarity and quality, these steps alone are unlikely to fully resolve this problem. While claim clarity can certainly be improved, some level of ambiguity is inherent in human language and, therefore, in patent claims. Accordingly, if nuisance suits are to be effectively curtailed, it will be necessary to create a financial disincentive to bringing them.

Currently, PAEs face little economic risk in asserting a patent (due to contingency fee arrangements and other litigation financing options that shift the risk to third parties). PAEs face no risk from counterclaims because they do not make products or provide services that are susceptible to a claim of infringement. So long as some litigation uncertainty exists, nuisance suits will often be profitable and absent a countervailing financial incentive PAEs will continue to bring them.

In our view, the most effective way to provide the needed disincentive is through adoption of a “loser pays” rule. Requiring PAEs (or, preferably, all patent plaintiffs) to pay a prevailing defendant’s legal costs would create appropriate incentives to carefully assess the merits of a claim before engaging in litigation. While such a rule would not be universally efficacious (*e.g.*, because some plaintiffs are effectively judgment-proof), many of the most litigious PAEs are well-funded, making fee-shifting a real disincentive against bringing nuisance suits. In sum, adoption of a “loser pays” rule for patent litigation would be a significant step towards ensuring that only meritorious cases make it to court.

4. Importance of Retaining an Efficient and Vibrant Secondary Market for Patents

As discussed above, we believe that it is strongly preferable to address the challenges resulting from PAE activity by addressing challenges in the patent system and litigation process rather than by targeting the PAE business model or by seeking to restrict PAEs’ ability to acquire and assert patents. In our view, the goal should be to ameliorate the undesirable effects of PAE activity without harming incentives to innovate by unduly restricting the ability of inventors to receive fair value for their patents. The secondary market remains a critically important mechanism that enables innovators to obtain compensation for the use of their inventions through the licensing or sale of patents. An efficient and vibrant secondary market is also an important means for operating companies to monetize unused assets or acquire the necessary rights to technologies they plan to incorporate in products and services.

For this reason, we believe that a key consideration in pursuing any reform in this area is the need to preserve a vibrant secondary market in patents, allowing companies to sell assets that are not core to their businesses and purchase technologies they need. This leads to a more efficient allocation of IP, enhances its exploitation, and ultimately results in a wider variety of products and services offering richer functionality for both consumers and businesses.

A well-functioning secondary market renders patent assets more liquid, creates efficiency and market clearing by matching buyers and sellers, and allows for risk transfer by patent holders. Despite the unique nature of patent assets, PAEs (and patent aggregators more generally) have made significant strides in adding liquidity, market clearing, and risk transfer mechanisms to the patent market. Their market

participation by serving as “ready and willing” buyers of patents helps manage the supply of patents and provides liquidity to the patent market. Patent intermediaries’ expertise in evaluating patent assets also leads to better information, more rational pricing, and lower transaction costs in the secondary market. Indeed patent intermediaries help make patents available to implementers at quite reasonable costs, particularly when compared to defending litigation.

Unlike PAEs, operating companies have little incentive to provide a market clearing function. Even if they did, it would be costly, time-consuming, and difficult for them to replicate the same level of expertise in valuing patent assets currently exhibited by the more sophisticated patent intermediaries. In short, the opaque and unique nature of patents requires organizations like PAEs with significant focus and resources to match buyers and sellers and form expertise necessary to value assets to provide a market clearing function.

In the absence of patent intermediaries, individual inventors and small companies would have limited avenues to monetize their patents given the disadvantages they often face as a result of information and resource asymmetries. Often small inventors and companies lack the time, expertise and money to market their patents to companies that may need them (or are already infringing), much less pursue litigation against existing infringers that are generally more sophisticated and better funded. Larger companies benefit as well, by being able to sell patents resulting from their history of innovation and – as recent transactions have shown – use the proceeds for valuable business purposes, such as paying down debt, funding employee health and pension obligations, or funding investment in new lines of business.

In sum, because PAEs increase both liquidity and efficiency in the secondary market, we believe that reforms should not seek to disadvantage or discriminate against PAEs, but rather should focus on removing existing incentives to engage in undesirable “hold up” behavior while preserving sufficient incentives for them to continue performing these valuable functions.

5. The Appropriate Role of Antitrust Policy in Addressing PAE Activities

For the reasons discussed above, we do not believe that antitrust policy is the most appropriate or effective tool for addressing most of the challenges posed by the emergence of and increased litigation activity by PAEs. As the antitrust agencies, economists, and the courts have concluded, mere ownership of a patent (or many patents) does not inevitably confer meaningful market power on the owner, making any presumption of power in a particular market based solely on IP holdings both factually and legally erroneous.¹¹

Patents are highly heterogeneous and each individual patent is unique.¹² Not only does the value and technological relevance of the claimed invention vary dramatically from patent to patent, but the validity, scope, and enforceability – each of which has enormous impact on whether and what impact ownership

¹¹ *Illinois Tool Works, Inc. v. Independent Ink, Inc.*, 547 U.S. 28, 43 (2006) (holding that a finding of market power for antitrust purposes “must be supported by proof of power in the relevant market rather than by a mere presumption” that intellectual property right affords market power).

¹² Patent law’s novelty requirement and prohibition against double patenting theoretically preclude the issuance of more than one patent on the same invention, which means that every valid patent by definition claims a distinct, unique invention.

a particular patent will have on its owners' bargaining position – are also widely divergent. In our experience, except in very rare cases – for example, where use of a particular technology is mandated by law or the patent is standards-essential – ownership of patents will rarely if ever confer significant market power. This is especially true in technology industries like software where there is a very high “patent density” (*i.e.*, a very high number of patents that cover an individual product) widely distributed. Thus, patent acquisitions typically have little potential impact on competition due to the sheer number of patents in the industry and the diffusion of patents on interrelated technologies among multiple entities throughout an industry. Additionally, software in general is highly malleable. Alternatives to a patented technology are generally available or can feasibly be developed for use by competitors, further reducing the potential for the control of narrow technologies through patent holdings to confer market power. For these reasons, we believe that the aggregation, acquisition, assertion, and licensing of patents will rarely warrant intervention by antitrust regulators outside of unique circumstances like the abuse of standards-essential patents (SEPs) – which by their very nature confer market power because standardization involves horizontal cooperation among competitors.

Consistent with our earlier comments, there remains an important role for antitrust to play in addressing PAE activities: antitrust law should be enforced as to PAEs just as it is enforced in other patent contexts. For example, the agencies' efforts to address abuses of SEPs is essential to deterring unfair and anticompetitive practices. Microsoft strongly supports these efforts and urges the DOJ and FTC to continue to be vigilant in this area and to intervene actively in situations where owners of SEPs abrogate their commitments to license their SEPs on reasonable and non-discriminatory (RAND) terms, whether this occurs through the transfer of SEPs to third parties, through deceptive practices during the standard-setting process, or through refusals to license or unreasonable royalty demands after a standard is adopted.

Conclusion

In closing, we would like to again commend the DOJ and FTC for their focus and thoughtful approach to the challenges presented by PAE activities and for the thoughtful and balanced way that these issues were examined in the joint workshop held last December. Microsoft is grateful for the opportunity to provide our views through these comments and looks forward to future opportunities to engage in the ongoing public dialogue about these important issues.

Respectfully submitted,

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