

**COMMENTS OF FOOD MARKETING INSTITUTE AND THE NATIONAL  
RESTAURANT ASSOCIATION TO THE FEDERAL TRADE COMMISSION AND U.S.  
DEPARTMENT OF JUSTICE**

on

**PATENT ASSERTION ENTITIES**

David A. Balto  
The Law Offices of David A. Balto  
1350 I Street N.W.  
Suite 850  
Washington, D.C. 20005

**DAVID A. BALTO**  
**ATTORNEY AT LAW**  
1350 I STREET, NW  
SUITE 850  
WASHINGTON, DC 20005

PHONE: (202) 789-5424  
Email: [david.balto@dcantitrustlaw.com](mailto:david.balto@dcantitrustlaw.com)

April 5, 2013

Donald Clark  
Secretary  
Federal Trade Commission  
600 Pennsylvania Avenue, NW  
Washington, DC 20580

Re: Public Comments on Patent Assertion Entities for Food Marketing Institute  
and the National Restaurant Association

Dear Secretary Clark,

We respectfully submit the following public comments to the Federal Trade Commission and the Department of Justice Antitrust Division on behalf of Food Marketing Institute (“FMI”) and the National Restaurant Association (“NRA”) for the request for comments on Patent Assertion Entities.

FMI represents 1,500 food retailers and wholesalers, composed of large multi-store chains, regional firms and independent supermarkets. FMI’s U.S. members operate more than 25,000 retail food stores and almost 22,000 pharmacies with a combined annual sales volume of nearly \$680 billion. As the largest trade association of its kind, FMI offers its members a diversity of services that range from helping the small independent operation remain competitive, to assisting wholesalers to develop the latest distribution systems, to identifying consumer attitudes toward food safety, solid waste, new products and the like.

The National Restaurant Association is the leading business association for the restaurant industry, which comprises 980,000 restaurant and foodservice outlets and a workforce of more than 13 million employees. In partnership with its state restaurant associations (SRA), NRA has more than 750 staffers working to represent and advocate for foodservice industry interests with state, local and national policymakers. NRA provides tools and systems that help members of all sizes get significantly better operating results. And NRA offers substantial networking, education and research resources to its membership base.

FMI and NRA applaud the agencies’ decision to hold a workshop and accept public comments regarding the impact of patent assertion entities (“PAE”) on the economy. Both FMI and NRA represent thousands of retailers which lack the expertise and resources to battle intellectual property disputes and patent litigation. Supermarkets and restaurants are in highly competitive markets in which our members’ resources are dedicated to providing the best goods

and services to the consumer at the lowest cost. PAEs have increasingly targeted retailers because they recognize how vulnerable they are to abusive litigation.

The demands and litigation brought by PAEs harm the retail markets and ultimately consumers. They drain necessary time and money from these retailers and ultimately those costs translate to higher costs for consumers. As egregious as the monetary costs, these demands also stifle the ability of retailers to utilize and consider new forms of technology consumers demand and deserve. Ultimately, the conduct of PAEs harms everyone in higher prices and less innovation.

The impact on innovation and small business is critical. Suppliers of new services who are threatened by these types of dubious litigation cannot shed the shadow of doubt cast upon their enterprise. This stifles the growth of enterprises that are trying to gain a foothold in the industry, and pushes the conservative (or fearful) retailer to only do business with those vendors who can display immunity because they have settled with the PAEs, often at a high cost. And in the worst case, retailers may completely abandon the adoption of new technology because of the threat of PAE litigation. All of this results in the stifling of profitability, ingenuity, and growth, three things that we desperately need in an economy that is straining to grow.

The attached comments are structured as follows:

- Section I highlights how conduct by PAEs is a significant threat to competition and properly-functioning markets. Retailers that traditionally play almost no role in patent litigation are becoming the new targets for PAEs. Based on our survey of members, we found that FMI and NRA retailers report that they face dramatically increasing numbers of demand letters and litigation. PAEs seem to be targeting small retailers in particular. Demand letters are often obscure and are based on outdated and broadly asserted patents. The demands seem to be tied more to the potential costs of litigation for the retailer rather than the value of the patent or the item alleged to infringe the patent. Defending these cases is difficult when a retailer cannot determine the real party in interest. This litigation is costly and time-consuming and retailers often have little choice but to settle.
- Section II discusses the factors that have led to the expansion of the PAE business model in moving beyond high-tech firms to targeting end-users and retailers. A flood of poor-quality patents, opacity in the ownership or real-party-in-interest of patents, and asymmetric litigation procedures make small market players like retailers perfect targets for exploitative lawsuits.
- Finally, in Section III we provide suggestions of how the FTC and DOJ can act to rectify the PAE problem, whether through traditional antitrust law, Section 5 of the FTC Act, and/or through changing standards for HSR reporting. We additionally urge the FTC to conduct a 6(b) study to bring to light that information which remains difficult to collect through public information, and to use the information from that study to report to Congress on the need for reform.

We applaud the FTC and DOJ efforts to address the PAE issue. The abusive litigation by PAEs is causing significant harm in retail markets that ultimately harms consumers. The FTC and DOJ should use all of their powers to combat these practices.

Date: April 5, 2013

Respectfully Submitted,

A handwritten signature in cursive script that reads "David A. Balto".

David A. Balto<sup>1</sup>  
The Law Offices of David A. Balto  
1350 I Street N.W.  
Suite 850  
Washington, D.C. 20005

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<sup>1</sup> We gratefully acknowledge the thoughtful work of Brendan Coffman, a former associate in the firm, in preparing these comments.

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I. Conduct by Patent Assertion Entities is a Significant Threat to Competition and Properly-Functioning Markets

A. Patent Assertion Entities Disrupt the IP Infrastructure and Harm Competition by Skewing Incentives Towards Litigation

Intrinsically, patents are neither a form of protection nor a reward for innovation. Instead, patents are one side's consideration in a social contract. The Patent Act<sup>2</sup> and subsequent amendments under Title 35 – as well as other laws that impact patent rights outside of Title 35 – stem from Congress' powers to grant “for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries.”<sup>3</sup> Congress has this power because the drafters of the Constitution determined that temporary exclusive rights are the best way to encourage and incentivize innovation. The Constitution articulates this rationale; Congress may grant a temporary exclusive right “To promote the Progress of Science and useful Arts.”<sup>4</sup> Thus, a patent is best understood as part of an exchange. Society gives up the right to practice on a patent without the patentee's blessing, and in exchange the patentee discloses the specific details of his innovation. Patents are not designed to be a bottleneck to innovation, or a club to deter new innovators from participating in the marketplace.

The Federal Trade Commission (“FTC”) acknowledged that patents are function-specific, commenting on the first page of its 2011 report The Evolving IP Marketplace “The goal of the patent system is to promote innovation in the face of that expense and risk...The patent system plays a critical role in promoting innovation across industries from biotechnology to nanotechnology, and by entities from large corporations to independent inventors.”<sup>5</sup> However, the FTC and the Antitrust Division also recognize that improper use of patents can cause the opposite result, and harm innovation without the intended incentivizing effect.<sup>6</sup>

Patent Assertion Entities (“PAE”) embody the counter-innovative threat discussed by the FTC in The Evolving IP Marketplace. PAEs do not manufacture, produce, collaborate, or facilitate the introduction of new products or services to the market in any way. Instead, PAEs aggregate patents and deploy them as a tax on innovation. PAEs exploit endemic flaws in the patent and litigation system. The United States Patent and Trademark Office (“USPTO”) grants too many patents with opaque, non-specific, and often obvious claims that purport to cover entire business models or abstract concepts.<sup>7</sup> This deluge of poor-quality patents renders the notice-function of patents inconsequential, and leads to a secondary patent market that is oversaturated and unregulated. The patent litigation framework leaves it far too easy for a holder of any patent to bring a lawsuit against entire industries, which can lead to crippling litigation costs to defend. The PAE faces little or no costs to litigation since it does not produce any products. Finally, it is often virtually impossible to determine the holder of a specific patent, and even more difficult to ascertain whether there are other real parties in interest (“RPI”). Patents are bought, sold, assigned, transferred, and pooled at a staggering pace, leaving putative defendants incapable of even identifying the party with whom they should negotiate. PAEs combine these systemic flaws with an endless supply of

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<sup>2</sup> 35 U.S.C. §271 et seq.

<sup>3</sup> U.S. CONST. art. I, § 8, cl. 8.

<sup>4</sup> Id.

<sup>5</sup> THE EVOLVING MARKETPLACE: ALIGNING PATENT NOTICE AND REMEDIES WITH COMPETITION, FED. TRADE COMM'n 8 (2011), available at <http://www.ftc.gov/os/2011/03/110307patentreport.pdf>.

<sup>6</sup> Id. at 50.

<sup>7</sup> For an in-depth discussion on the patent quality problem, see John R. Allison, Mark A. Lemley, & Joshua Walker, Patent Quality and Settlement Among Repeat Patent Litigants, 99 GEORGETOWN LAW J. 677 (2010); Peter Menell, It's Time to Make Software Patents More Clear, WIRED, Feb. 7, 2013, available at <http://www.wired.com/opinion/2013/02/its-time-to-make-vague-software-patents-more-clear/>.

patents and an untraceable network of shell corporations to create a perpetual motion machine of patent extortion.

It is important to distinguish PAE activity from traditional patent licensing. The purchase of a license from a patent holder should be analogous to the purchase of any other input in the supply chain. A manufacturing company will be able to identify a needed technology, and through a patent search will be able to identify the patent holder for that given technology or, in the case of substitute technologies, the patent holders. The manufacturing company then can reach out to the patent holders and negotiate a license, or determine if there is a method for working around the patented technology. The manufacturing company may even have a right to a license under existing agreements, or participation in standard setting organizations or patent pools. In any scenario, there are several commonalities among licensees including 1) opportunity to identify the patent holder through public information; 2) ex ante choice to obtain a license before committing to a certain technology; and 3) opportunities for either counterclaims or future business decisions if they feel they are unfairly being targeted with patent litigation. The PAE evades all of these commonalities that make the patent system function for competing manufacturing entities.

PAEs harm the innovation infrastructure. Firms that usually innovate must invest in protectionism. Firms that prefer to license their patents broadly may instead find themselves clinging to patents as a future bargaining chip. And nearly all firms find themselves straying from their preferred business model in order to address PAE litigation, such as stockpiling money for outside counsel, hiring additional in-house counsel, or foregoing new technology to avoid future litigation. As the public information highlighted in the next section makes clear, the PAE problem is both broad and profound.

Retailers and other end users are particularly vulnerable to the predatory conduct of PAEs. Retailers are not well-versed in the complex world of patent litigation. As entities that deal with millions of consumers and have large sales they appear to be particularly attractive “victims” in the eyes of PAEs. Colleen Chien recently published an article in which she concluded that PAEs now target more non-tech companies than tech companies.<sup>8</sup>

#### B. Scholars and Research Institutions Have Used Limited Publically Available Information to Begin to Demonstrate the Extent of the Harm

It has been difficult to assemble a complete profile of PAEs because of the limitations of the patent system and the sophistication of PAE efforts to keep their practices hidden. Notwithstanding this difficulty, several important pieces of research have begun to uncover the details of the business model and the impact on the economy.

For instance, the PricewaterhouseCoopers, 2011 Patent Litigation Study shows that PAEs are successful in just 23% of litigation, and even less successful in certain industries including business/consumer services, software, and telecommunications.<sup>9</sup> Sarah Jeruss, Robin Feldman, & Joshua Walker build on this research in The America Invents Act 500: Effects of Patent Monetization Entities on US Litigation,<sup>10</sup> in which they detail the meteoric rise in the propensity of PAE lawsuits, and show that the most litigious companies are in fact PAEs. James Bessen and Michael J. Meurer discuss the macroeconomic financial

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<sup>8</sup> Colleen Chien, Patent Trolls by the Numbers, Patently O, March 14, 2013, *available at* <http://www.patentlyo.com/patent/2013/03/chien-patent-trolls.html>.

<sup>9</sup> Chris Barry, Ted Martens, Larry Ranallo & Chel Tanger, 2011 Patent Litigation Study: Patent litigation trends as the “America Invents Act” becomes law, 2011 by PricewaterhouseCoopers, LLP, *available at* <http://www.pwc.com/us/en/forensic-services/publications/2011-patent-litigation-study.jhtml>.

<sup>10</sup> Jeruss, Sara, Feldman, Robin & Walker, Joshua H., The America Invents Act 500: Effects of Patent Monetization Entities on US Litigation 11 DUKE LAW & TECH. REV. 357, 2012, *available at* [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2158455](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2158455).

implications of PAE lawsuits in The Direct Costs from NPE Disputes,<sup>11</sup> where they conclude that PAE litigation has cost the country over \$29 billion.

Professor Colleen Chien of the University of Santa Clara has several studies out in which she highlights the impact of PAEs on startups and small tech companies, and in which she explains how the mechanisms of the patent system have led to the current PAE situation. In From Arms Race to Marketplace<sup>12</sup> Professor Chien describes the evolution of the current patent ecosystem, including the transition from defensive patenting to offensive patent assertion by high-technology companies, the birth of intermediaries in the patent arbitrage system, and the origin of asymmetric patent warfare. Then in Startups and Patent Trolls<sup>13</sup> she evaluates the precise impact PAEs have on the innovation economy, particularly in Silicon Valley and the high-technology community. This research looks at a comprehensive database of patent litigation and features interviews from 223 high-tech startups regarding their experiences with patent infringement lawsuits, demand letters, and licensing relationships with patent aggregators.

## II. Patent Assertion Entities No Longer Isolate Their Tactics to High-Tech Firms, and They Increasingly Harm End-users including Retailers

PAEs have been in existence for some time. One common belief is that the term “patent troll” was coined by a 1994 video called “The Patents Video” which was widely marketed to major companies and universities. By 1999, Intel General Counsel Peter Detkin popularized the term by calling the companies suing Intel patent trolls.<sup>14</sup> However, despite the modest press, patent trolls – or PAEs as we now know them – were considered an isolated problem for high-tech firms and telecommunications companies.

Today there can be no doubt that PAEs plague a wide range of industries and companies. The rest of this section discusses this transformation in three parts. First we detail some of the factors that have led to the expansion of the PAE business model. Second we provide an overview of Food Marketing Institute members’ experience, including select descriptions and data concerning PAE litigation. Finally, we provide first-hand accounts from FMI members concerning their interactions with PAEs.

### A. Factors That Have Led to the Expansion of the PAE Business Model

Although many factors likely have contributed to the explosion in patent litigation by firms that do not participate in the market, three stand out: 1) a flood of poor quality patents; 2) increased abuse of opacity concerning patent ownership and RPI information; and 3) asymmetry in patent litigation.

#### 1. Flood of poor-quality patents

The USPTO grants too many patents, and many of the patents that are granted – particularly those relating to software and/or the Internet – are of poor quality and ripe for exploitation.<sup>15</sup> In 2011 alone the USPTO

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<sup>11</sup> Bessen, James E. and Meurer, Michael J., The Direct Costs from NPE Disputes (June 28, 2012). Boston Univ. School of Law, Law and Economics Research Paper No. 12-34. Available at SSRN: <http://ssrn.com/abstract=2091210> or <http://dx.doi.org/10.2139/ssrn.2091210>.

<sup>12</sup> Colleen Chien, From Arms Race to Marketplace: The Complex Patent Ecosystem and Its Implications for the Patent System, 62 HASTINGS LAW J. 297 (2010), available at <http://digitalcommons.law.scu.edu/cgi/viewcontent.cgi?article=1119&context=facpubs>.

<sup>13</sup> Colleen Chien, Startups and Patent Trolls, (September 28, 2012). Santa Clara Univ. Legal Studies Research Paper No. 09-12, available at SSRN: <http://ssrn.com/abstract=2146251> or <http://dx.doi.org/10.2139/ssrn.2146251>.

<sup>14</sup> Brenda Sandburg, You May Not Have a Choice: Trolling for Dollars, Law.com, July 30, 2001.

<sup>15</sup> Peter Menell, It’s Time to Make Software Patents More Clear, WIRED, Feb. 7, 2013, available at <http://www.wired.com/opinion/2013/02/its-time-to-make-vague-software-patents-more-clear/>.

granted 382,679 patents, 57,692 of which were for a “700 class” subject matter ranging from data processing to digital processing systems.<sup>16</sup> This is a staggering number of patents, especially when each patent contains multiple claims and many include unclear methods of implementation. Indeed, the USPTO’s own data demonstrates that 90% of all patents reexamined suffer a substantial question of patentability, 89% of all patents challenged through inter partes reexamination and 78% of patents challenged through ex parte reexaminations are cancelled or changed.<sup>17</sup> The PAE business model capitalizes on this immense pool of low-quality patents, and is only successful because of the vast availability of exploitable intellectual property; if the USPTO practiced a greater degree of discretion and only issued high-quality patents, there would be significantly less ammunition for PAEs to wield against producing firms.<sup>18</sup> Unfortunately, USPTO is understaffed, and unable to perform substantive examinations of the thousands of applications they receive, which aren’t reviewed for an average of three years.<sup>19</sup> Thousands of patents are nonetheless issued each week, illustrating the magnitude of the constant flood of new intellectual property claims.<sup>20</sup>

The unending stream of low-quality patents and the PAE activity it enables has a depressive impact on innovation among new firms, particularly in the software industry. Because there is a great deal of overlap and conflict among the thousands of software patent applications approved each year, entrepreneurs are disincentivized from developing and marketing new software and other products for fear of legal action over the inclusion of common features.<sup>21</sup> While large, established technology firms can absorb such litigation as a cost of doing business, this obstacle represent a significant barrier to entry for smaller firms, who would as soon not invest in product development if the chances of facing patent litigation are too great.<sup>22</sup> The patent system thus runs the risk of crowding out legitimate innovation, and undermining its original purpose, while simultaneously arming PAEs with the weapons to exploit the very low-quality patents that perpetuate the problem.

## 2. Increased abuse of opacity concerning patent ownership and RPI information

PAEs routinely hide ownership and RPI information behind a network of shell companies, subsidiaries, and contractual relationships. Recordation of transfers in ownership, assignments, or contractual relationships is largely voluntary, and the USPTO provides no incentive for parties to make the recording (in fact they charge a fee, making it even less likely that the transfer would be recorded). In fact, the USPTO does not even require an assignee to demonstrate proof of its assignment to control the assertion of the patent.<sup>23</sup> Parties seeking information regarding existing patents have no way of tracking whether a

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<sup>16</sup> United States Patent and Trademark Office Patent Technology Monitoring Team, Patent Counts By Class By Year January 1977 – December 2011, *available at* <http://www.uspto.gov/web/offices/ac/ido/oeip/taf/cbcby.htm>.

<sup>17</sup> Inter Partes Reexamination Filing Data - June 30, 2012, USPTO, [http://www.uspto.gov/patents/stats/IP\\_quarterly\\_report\\_June\\_30\\_2012.pdf](http://www.uspto.gov/patents/stats/IP_quarterly_report_June_30_2012.pdf) (summary borrowed from the Amicus Brief of the Public Patent Foundation in *Federal Trade Commission v. Watson Pharmaceuticals, Inc.*, Supreme Court Docket No. 12-416, *available at* <http://www.scribd.com/doc/122850058/FTC-v-Watson-PUBPAT-Amicus-SCT-Merits-2013-01-29-pdf>).

<sup>18</sup> Timothy B. Lee, *Patent Trolls Are A Symptom of Deeper Problems*, Cato Institute, January 17, 2009, *available at* <http://www.cato.org/blog/patent-trolls-are-symptom-deeper-problems>.

<sup>19</sup> Richard Posner, *Why There Are Too Many Patents in America*, *The Atlantic*, July 12, 2012, *available at* <http://www.theatlantic.com/business/archive/2012/07/why-there-are-too-many-patents-in-america/259725/>.

<sup>20</sup> Christina Mulligan and Timothy B. Lee, *Scaling the Patent System*, N.Y.U. ANN. SURV. AM. L. (forthcoming), *available at* [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2016968](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2016968).

<sup>21</sup> Rhodri Marsden, *Are there now so many patents in Silicon Valley that it’s impossible to innovate?*, *The Independent*, August 12, 2011, *available at* <http://www.independent.co.uk/life-style/gadgets-and-tech/features/are-there-now-so-many-patents-in-silicon-valley-that-its-impossible-to-innovate-2336171.html>.

<sup>22</sup> Timothy B. Lee, *Software Patents and Barriers to Entry*, *Forbes Magazine*, December 22, 2011, *available at* <http://www.forbes.com/sites/timothylee/2011/12/22/software-patents-and-barriers-to-entry/>.

<sup>23</sup> 37 C.F.R. § 3.73 (2011).

particular patent is still controlled by its original inventor or assignee, or whether it is likely to be included in a lawsuit by a PAE. This practice is particularly pernicious against the backdrop of poor-quality patents. Since the public often cannot determine what a patent actually covers, they often look at which patents certain entities have asserted in litigation as a means of determining what technology the patent may cover. If the PAEs are able to re-obfuscate the scope of the patent by obfuscating the ownership, this effectively renders patents held by PAEs devoid of any notice function whatsoever. The USPTO itself has acknowledged this – former Under Secretary David J. Kappos commented “[a] root cause of problems with our current environment for software patents —and indeed all patents — is simply deciphering ownership. At the heart of a well-functioning innovation environment is accurate information about who owns what assets, so that license rights can be confirmed or sought, and unproductive effort simply avoided.”<sup>24</sup>

The USPTO recently held a public Roundtable on Proposed Requirements for Recordation of Real-Party-in-Interest Information Throughout Application Pendency and Patent Term<sup>25</sup> which included twenty-one presenters and for which the USPTO solicited public comments.<sup>26</sup> The majority of the participants applauded the proposed requirements, emphasizing that they will lead to increased transparency in the patent system and will ultimately facilitate open-market transactions. The DOJ and FTC filed joint comments detailing the benefits of greater transparency:

Overall, informational transparency will improve the efficiency of the IP marketplace. In an optimal marketplace for patents, competing technologies would be well known, claims would be well specified, and the applicability of claims would be clear. In addition, the patent rights holders would be easy to determine. As a consequence, firms developing products could weigh the relative merits, likelihood of licensing, and licensing costs of competing technologies and decide whether to license the patented technology, develop a non-infringing competing technology, or omit the covered feature. The current marketplace falls short of this ideal, and the PTO’s adoption of RPI rules could help address some of these shortcomings.<sup>27</sup>

It is clear that this is one area for reform that has been identified and targeted, and it is an important step in remedying anticompetitive harm from PAEs.

### 3. Asymmetry in Patent Litigation

Patent litigation is dramatically skewed in favor of the patent holder, and PAEs exploit this asymmetry to extreme degrees and use the asymmetry to secure unwarranted settlements. A PAE can file substantially the same complaint against nearly any plausible infringer. Under Professional Real Estate Investors v. Columbia Pictures<sup>28</sup> a patent holder is arguably protected through the Noerr-Pennington Doctrine unless 1) the litigation is objectively baseless or 2) it is an attempt to interfere with a competitor’s business through litigation. Since a PAE does not manufacture any product, it does not compete, and therefore litigation initiated by a PAE may only be improper if it is objectively baseless, which the Federal Circuit

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<sup>24</sup> David J. Kappos, Under Sec’y of Com. for Intellectual Prop. & Dir., U.S. Pat. & Trademark Office, An Examination of Software Patents, Keynote Address at the Center for American Progress (Nov. 20, 2012), *available at* [http://www.uspto.gov/news/speeches/2012/kappos\\_CAP.jsp](http://www.uspto.gov/news/speeches/2012/kappos_CAP.jsp).

<sup>25</sup> For more information on the RPI Roundtable, *see* Brendan Coffman, USPTO Real-Party-in-Interest Roundtable, Patent Progress, *available at* <http://www.patentprogress.org/2013/01/15/uspto-real-party-in-interest-roundtable/>.

<sup>26</sup> For access to all public comments, *see* [http://www.uspto.gov/patents/law/comments/rpi\\_information.jsp](http://www.uspto.gov/patents/law/comments/rpi_information.jsp).

<sup>27</sup> *In the Matter of* Notice of Roundtable on Proposed Requirements for Recordation of Real-Party-in-Interest Information Throughout Application Pendency and Patent Term Comments of the Antitrust Division of the United States Department of Justice And the United States Federal Trade Commission, February 1, 2013, *available at* [http://www.uspto.gov/patents/law/comments/rpii-b\\_dojatr-ftc\\_130201.pdf](http://www.uspto.gov/patents/law/comments/rpii-b_dojatr-ftc_130201.pdf).

<sup>28</sup> 508 U.S. 49 (1993).

has described as “Unless an argument or claim asserted in the course of litigation is ‘so unreasonable that no reasonable litigant could believe it would succeed,’ it cannot be deemed objectively baseless...”<sup>29</sup>

The alleged infringer bears the burden of proving that it is highly probable that a patent’s claims are invalid.<sup>30</sup> The patent infringement defendant also carries the burdens of proof to show enablement, prior art, and obviousness. These are all extremely costly endeavors in patent litigation. As a practical matter the mere filing of a patent infringement complaint commits the defendant to thousands – if not hundreds of thousands – of dollars in litigation expenses if it chooses not to settle. And the PAE faces few of these costs. John Boswell, the Senior Vice President and General Counsel of SAS, described the real world litigation costs for companies facing PAE lawsuits: “In short, there is an asymmetry in the patent troll context. Patent trolls can and do pursue litigation strategies that make the litigation as expensive as possible because that same tactic cannot be used against them. With no documents to produce and no witnesses to depose, they have very little cost associated with their obligation to respond to discovery requests. It is this asymmetry that the trolls are using as a primary tactical weapon against those they have chosen to pursue in their quest to extort money.”<sup>31</sup>

Finally, as evidenced by the PriceWaterhouseCoopers study described in Section I.B of these comments, PAE patent litigation leads to disproportionate results. Across all industries, the median damages awarded for a non-practicing entity prevailing in litigation was more than double the median damage awarded for a prevailing practicing entity from 2006-2010 (\$6.9 million vs. \$3.4 million).<sup>32</sup> And this is despite the fact that “PAE litigation appears to yield a substantially higher fraction of non-infringement findings than does litigation by practicing firms.”<sup>33</sup>

#### B. Harm from PAEs Extends Well Beyond High-Tech Industries and Harms End-Users Such as Retailers

In his presentation at the PAE hearing Carl Shapiro explained that “PAEs appear to target small companies more than practicing entities” and “PAEs typically initiate litigation after [the] target has incorporated the patented technology in its products.”<sup>34</sup> This is only part of the story. The truth is that PAEs are not only targeting smaller companies, but are also targeting companies far removed from the

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<sup>29</sup> Old Reliable Wholesale, Inc. v. Cornell Corp., 635 F. 3d 539 (quoting iLor, LLC v. Google, Inc. 631 F.3d 1372, 1378 (2011) (Fed. Cir. 2011).

<sup>30</sup> Model Patent Jury Instructions, prepared by The National Jury Instruction Project, May 2009, *available at* <http://www.nationaljuryinstructions.org/documents/NationalPatentJuryInstructions.pdf>; *see also* Microsoft Corp. v. i4i Limited Partnership, 131 S. Ct. 2238 (2011) (affirming Radio Corp. of America v. Radio Engineering Laboratories, Inc., 293 U.S. 1 (1934) and quoting the RCA court in holding that “an infringer who assails the validity of a patent fair upon its face bears a heavy burden of persuasion, and fails unless his evidence has more than a dubious preponderance.” RCA at 8).

<sup>31</sup> Statement of John Boswell, Senior Vice President and General Counsel, SAS Before the House Judiciary Subcommittee on Courts, Intellectual Property and the Internet “Abusive Patent Litigation: The Impact on American Innovation & Jobs, And Potential Solutions,” March 7, 2013, *available at* <http://docs.house.gov/meetings/JU/JU03/20130307/100399/HHRG-113-JU03-Wstate-BoswellJ-20130307.pdf>.

<sup>32</sup> Chris Barry, Ted Martens, Larry Ranallo & Chel Tanger, 2011 Patent Litigation Study: Patent Litigation Trends as the “America Invents Act” becomes Law at 9.

<sup>33</sup> Professor and former Deputy Assistant Attorney General for Economics Carl Shapiro, Patent Assertion Entities: Effective Monetizers, Tax on Innovation, or Both?, presentation to the PAE Workshop, *available at* <http://www.ftc.gov/opp/workshops/pae/docs/cshapiro.pdf>.

<sup>34</sup> Professor and former Deputy Assistant Attorney General for Economics Carl Shapiro, Patent Assertion Entities: Effective Monetizers, Tax on Innovation, or Both?, presentation to the PAE Workshop, *available at* <http://www.ftc.gov/opp/workshops/pae/docs/cshapiro.pdf>.

traditional patent litigation ecosystem such as retailers, restaurants, and non-technical Internet-based services.<sup>35</sup>

Here is one example. In testimony before the House Judiciary Committee Subcommittee on Courts, Intellectual Property and the Internet, Executive Vice President and General Counsel Janet Dhillon of jcpenny explained that four years ago jcpenny had no patent litigation whatsoever. Since then, jcpenny has had to “defend or settle over two-dozen patent infringement lawsuits that have nothing to do with the products jcpenny actually sells.”<sup>36</sup> These lawsuits have been for products such as drop-down menus on websites, activating gift cards, browsing a web site on a mobile device, and electronic shopping carts. jcpenny is not unique in this circumstance – these are the types of lawsuits many retailers across the country are facing, many even further removed from high-tech products than jcpenny.

The effect of PAE conduct on retailers is threefold. First, as explained above, litigation and unwarranted cease and desist letters drive up costs for these businesses. There is not only the cost of litigation and settlement, but also the time and effort by the retailer’s staff. Second, this litigation threatens to drive up costs for the legitimate provider of products or services that are subject to the infringement claim. For instance, many retailers have been sued for providing WiFi in their stores, which they usually do with a valid license from a WiFi manufacturer. In exchange, the manufacturer traditionally offers indemnification against patent infringement lawsuits. Having to fight a PAE for every customer threatens to make providing this indemnification either cripplingly expensive or completely impossible. In fact, a recent article highlights that PAE practices cost advertising agencies over \$10M per year because of indemnification agreements in their contracts.<sup>37</sup> Finally, PAE tactics disincentivize future investment in technology, meaning that today’s innovators will not have as robust a customer base as they should. Consumers benefit from continued investment in new technologies and new services, and offering these services allows firms in industries such as retail to compete in ways beyond traditional price and marketing.

### C. First-Hand Accounts from FMI and NRA Members

We surveyed our member retail institutions to better understand the nature and impact of PAE practices. Respondents ranged from large national corporations to small regional and local retailers. Here are some observations from the survey:

- Hundreds of Retailers Have Faced Increasing Threats of Litigation PAEs – Notwithstanding the broad range of respondent size, hundreds of retailers have faced the threats of litigation from at least one PAE. Many members report a dramatic increase in the number of demand letters and cases filed in the past four years. One supermarket alone has had eight PAEs file suit since 2011.
- Demand Letters are Often Vague, Uninformative and Lack Sufficient Information for Retailers to Determine Potential Liability. Retailers report numerous egregious practices involving the demand letters from PAEs. They are frequently amorphous and make broad claims without providing an adequate basis to assess those claims. They demand broad licenses while refusing

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<sup>35</sup> See, e.g., *Personal Audio, LLC v. Ace Broadcasting Network, LLC*, Civil Action No. 2:13-cv-00014, Eastern District of Texas.

<sup>36</sup> Testimony of Executive Vice President and General Counsel Janet Dhillon before the United States House of Representatives Committee on the Judiciary Subcommittee on Courts, Intellectual Property and the Internet, March 14, 2013, available at [http://judiciary.house.gov/hearings/113th/03142013\\_2/Dhillon%2003142013.pdf](http://judiciary.house.gov/hearings/113th/03142013_2/Dhillon%2003142013.pdf).

<sup>37</sup> Nancy Hill, Patent Trolls Are a Big Headache for Ad Agencies, Too, Ad Age Digital, March 14, 2013, available at <http://adage.com/article/digital/threat-patent-troll-litigation-looms-large-agencies/240313/>.

to disclose what patents are involved and what patents are infringed. This puts retailers in a very difficult position to determine liability or respond to the claims.

- Boilerplate Nature of Demand Letters is Alarming – Several retailers commented on the boilerplate nature of the demand letter, with one commenting the letters “contain a specific demand dollar number, or a detailed ‘matrix’ to calculate the licensing demand” and another respondent explaining that the demands are “Never presented as negotiable [and are] always strongly presented as better sign the license now as ‘cost is only going to go up substantially.’”
- PAEs Appear to Base the Licensing Demands more on the Potential Cost of the Litigation Rather than the Value of the Intellectual Property or the Product. PAEs seem to assess damages based on what they can effectively extort from a defendant. Thus, the demands appear to be based more on litigation costs and the ability of the defendant to pursue litigation, rather than the value of the intellectual property.
- The Costs of Defense are Very Substantial and Increasing. Few if any retailers have in-house intellectual property counsel. Even if they do, they must retain outside counsel to respond to demand letters or litigation. Even for relatively simple matters, outside counsel fees can quickly mount up to \$250,000-500,000. Besides the out-of-pocket legal costs, there are substantial costs of the time and attention that retailer management has to spend to defend the case.
- Cases are Frequently Filed In Venues where the Retailer does not do Business.
- It is often Difficult to Determine the Real Party in Interest, Making Defense Difficult.
- All Respondents Report Difficulty Quantifying the Cost of PAE Demands – Many factors contribute to this difficulty, including the vagueness and complexity of the demand letters, the age of the patents, the difficulty of researching validity, and the complexity of the technology.

The responses from these retailers confirm that they are particularly vulnerable to PAE conduct. Retailers lack experience with patent litigation and sophistication in negotiations. They typically do not have in house IP counsel and lack the expertise to challenge the claims of the PAEs.

### III. The Department of Justice Antitrust Division and the Federal Trade Commission are Uniquely Positioned to Police Anticompetitive Conduct by Patent Assertion Entities

#### A. Antitrust Law May Provide Some Tools to Regulate the Misconduct of PAEs

There are several avenues the FTC and DOJ may consider utilizing under existing antitrust law to rein in PAE activity.<sup>38</sup> PAEs that wield large patent portfolios may violate Section 1 of the Sherman Act if they coerce licensees to pay for licenses on patents in which they do not infringe, or to the extent that a PAE assembles a portfolio containing patents covering many substitutive or competing technologies it may be illegally monopolizing a technology in violation of Section 2 of the Sherman Act. Similarly, if the agencies can demonstrate that a PAE is pursuing licenses from entities that are likely not infringing its patents, a patent misuse case may be available. Alternatively, if a PAE can be linked back to an operating entity, and it can be shown that an operating entity is guiding or directing a PAE’s licensing decisions, this may be an instance of raising rivals’ costs in violation of Section 2 of the Sherman Act.

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<sup>38</sup> See generally Michael A. Carrier, Patent Assertion Entities: Six Actions the Antitrust Agencies Can Take, CPI Antitrust Chronicle, Jan. 2013; Logan M. Breed, DOJ and FTC Consider NPE Antitrust Issues, Oct. 12, 2012, available at <http://ehoganlovells.com/cv/11ff3f03de63c2f1d35c4d19144090c8e7ac5902>.

Furthermore, the FTC may have the ability to challenge PAE conduct under Section 5 of the FTC Act. As preeminent antitrust scholars Areeda and Turner explain, “Congress expected the Commission to build up its own administrative law of unfair trade practices and not be limited rigidly to what had been already held to be unfair trade practices at common law.”<sup>39</sup> The FTC has recently exercised its authority to bring an action alleging “unfair methods of competition” in cases involving patents in the Google/MMI investigation.<sup>40</sup> As the American Antitrust Institute has explained, conduct by a PAE can be challenged as an “unfair act or practice.”<sup>41</sup> And as one commentator explained, former FTC Chairman Jon Leibowitz implied that PAEs’ “refusal to disclose meaningful ownership information could amount to an “unfair” or “deceptive” act or practice under Section 5 of the FTC Act.”<sup>42</sup> Thus, it is conceivable that either the unfair methods of competition or unfair acts and practices prong of Section 5 of the FTC Act may provide an avenue for enforcement.

#### B. The Merger Review Procedure Provides an Opportunity to Prevent Patent Assertion Entities from Arming Themselves

The FTC and DOJ may consider supporting a change to reporting requirements under the Hart-Scott-Rodino Act (“HSR”).<sup>43</sup> While most patent transfers may not be valued at the necessary threshold level, it is apparent that the impact on commerce is well above the threshold. The government could tailor such a rule specifically to PAEs or make it broader for all patent holding entities. This would allow the government to probe the likely effects of the transaction, and even review the business materials created in anticipation of the acquisition. If a PAE truly does benefit licensees by creating an efficient market for obtaining many licenses, the HSR review should be innocuous.

However, if it becomes clear that a PAE has the clear intention of acquiring or enhancing its ability to charge supracompetitive prices, or it is attempting to circumvent an existing licensing agreement by hiding patents in a shell corporation, the regulators would be able to identify the harm quickly and react accordingly. In August of 2012 the FTC issued a Notice of Proposed Rulemaking to change the HSR notification rules with respect to transfers of exclusive licenses and “all commercially significant rights” by pharmaceutical companies.<sup>44</sup> The Notice acknowledges the following problems pertaining to exclusive licenses in the pharmaceutical industry:

Determining whether the transfer of rights to a patent is an asset acquisition, and thus potentially reportable, is usually a more challenging analysis...Under the current [FTC] approach, these exclusive licenses are not reportable since, without the right to manufacture, they are viewed as distribution agreements rather than asset acquisitions.

The Notice goes on to explain that a limitation to the pharmaceutical industry is appropriate because the FTC staff has “extensive experience” with these arrangements. A similar argument can be made for a

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<sup>39</sup> AREEDA & TURNER, ANTITRUST LAW 11 (§ 305) (1978).

<sup>40</sup> *In the Matter of* Motorola Mobility LLC and Google, Inc., File No.121-0120.

<sup>41</sup> For example, the American Antitrust Institute outlined the scope of potential claims under Section 5 in their petition asking for an investigation of the PAE Rembrandt. They specifically focused on both an unfair method of competition and unfair act or practice claim. AAI, “Request for Investigation of Rembrandt, Inc.” at 21-23, *Available at*

[http://www.antitrustinstitute.org/files/AAI%20FTC%20Petition%20Rembrandt%203.26.08\\_040120081130.pdf](http://www.antitrustinstitute.org/files/AAI%20FTC%20Petition%20Rembrandt%203.26.08_040120081130.pdf).

<sup>42</sup> Robert A. Skitol, FTC-DOJ Workshop on Patent Assertion Entity Activities: Fresh Thinking on Potential Antitrust Responses to Abusive Patent Troll Enforcement Practices, Drinker Biddle & Reath LLP (Dec. 14, 2012), *available at* <http://www.drinkerbiddle.com/resources/publications/2012/ftc-doj-patents-workshop>.

<sup>43</sup> 15 U.S.C. § 18a et seq.

<sup>44</sup> *Available at* <http://www.ftc.gov/os/2012/08/120813hsr-ipnprm.pdf>.

specialized set of rules pertaining to PAEs. A change in the rules such as this does not ban potentially efficient and welfare-enhancing business models; it merely would require the transacting companies to permit the agencies the opportunity to conduct an analysis before clearing the deal.

C. The Federal Trade Commission Should Use its 6(b) Power to Gather Information to Better Inform the Agencies, Congress, the Public, and Policy-Makers

The FTC has a unique weapon in its arsenal to bring to light the facts about PAEs, their business methods, and their impact on competition. Unlike other agencies, the FTC has the power to use subpoenas to secure information from companies to conduct studies.<sup>45</sup> As the FTC Office of General Counsel explains, “Section 6(b) [of the FTC Act] empowers the Commission to require the filing of ‘annual or special \* \* \* [sic] reports or answers in writing to specific questions’ for the purpose of obtaining information about ‘the organization, business, conduct, practices, management, and relation to other corporations, partnerships, and individuals.’”<sup>46</sup> Congress gave the FTC this power 98 years ago because it hoped the FTC would serve as a key investigator to illuminate potentially anticompetitive practices. The question of PAEs is the perfect scenario to exercise this authority.

Although there have been some studies of the PAE issue those are necessarily very limited. They are restricted to only public information. In addition, they focus only on litigation and not demand letters, but much of the harm from PAE conduct arises from demand letters.

Through a 6(b) study, the FTC can not only unveil the business practices and negotiating techniques of PAEs, but the FTC can subpoena and analyze the data necessary to determine – once and for all – whether PAEs do in fact provide an efficient market function as many of them contend.<sup>47</sup> Indeed, much of the concern over PAEs in these comments and others focuses on the lack of transparency into their businesses. The FTC can remedy lack of information with an independent, unbiased study.

We have provided a proposed 6(b) study in Appendix B. A 6(b) study can focus on the following issues, among others:

- Determining the full ownership interest of PAEs and a list of all subsidiaries and affiliates;
- What are the relations between PAEs and the owners of the patents and how do the owners benefit from patent enforcement;
- What are the type and scope of demand letters used by PAEs;
- How often is litigation by PAEs successful; at what stage is litigation typically resolved;
- How are patents acquired by PAEs and from whom; what is the purpose of these transactions; and
- How does the PAE determine which patents to acquire.

The FTC’s 6(b) power is an important and potent tool, and historically has been used as a launching point to draft legislation curbing industry abuse. A 6(b) study led to the Packers and Stockyards Act of 1921<sup>48</sup>

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<sup>45</sup> The FTC most recently exercised this power to initiate a study into the business practices of the data broker industry. *See* <http://www.ftc.gov/opa/2012/12/databrokers.shtm>.

<sup>46</sup> Federal Trade Commission Office of the General Counsel, A Brief Overview of the Federal Trade Commission’s Investigative and Law Enforcement Authority, *available at* <http://www.ftc.gov/ogc/brfvrwv.shtm>.

<sup>47</sup> For a discussion of possible PAE efficiencies, *see* Timothy Simcoe, Patent Assertion Entities: Potential Efficiencies, presentation at the FTC/DOJ PAE Workshop, *available at* <http://www.ftc.gov/opp/workshops/pae/docs/tsimcoe.pdf>.

<sup>48</sup> 7 U.S.C. §§ 181-229b.

and, more recently, to the Medicare Modernization Act of 2003.<sup>49</sup> A similar study into PAEs may very well lead to meaningful reform in this industry as well.

Finally, the FTC should use the 6(b) study to provide a comprehensive report to Congress suggesting reforms to address the PAE issue.

#### D. Private Actions Short of Full-Blown Patent Litigation Have Proven Incapable of Defeating Patent Assertion Entities

Finally, it is worth pointing out that attempts to combat PAEs without resorting to full-blown patent litigation have not been fruitful. Cisco Systems, Netgear, and Motorola filed a complaint against notorious PAE Innovatio IP Ventures after Innovatio began contacting Cisco customers seeking royalties for using WiFi. Cisco's complaint contained a bevy of causes of action, most notably an allegation of illegal racketeering under the RICO statute. The court ultimately dismissed the RICO claim and many others on the grounds of Noerr-Pennington protection. As discussed above, the court held that only an objectively basis claim could overcome the right to petition the court, and this standard is so high that it is virtually insurmountable.<sup>50</sup>

In July 2012 Silicon Valley startup Hipmunk, Inc. filed a complaint seeking declaratory judgment against PAE I2Z Technology, Inc.<sup>51</sup> Hipmunk noticed that I2Z was suing many companies similar to Hipmunk, and decided to confront the problem head-on by asking a court to declare that Hipmunk does not infringe I2Z's patents. Hipmunk's suit was a creative attempt to beat the PAE at its own game. However, the parties settled just five months later, leaving other potential targets unsure whether declaratory judgment will provide adequate relief.

Finally, in March of last year noted PAE Cascades Computer Innovation filed an antitrust lawsuit against five Android manufacturers who rejected an offer to license 38 patents for \$5 million.<sup>52</sup> The manufacturers are all members of RPX, a joint-defense and licensee negotiating service. The PAE alleged that the Android manufacturers were conspiring to boycott Cascades' patents in violation of Section 1 of the Sherman Act. The judge ruled that Cascades failed to allege a sufficient factual basis to survive dismissal under the rule of reason, but will allow Cascades to amend its complaint. Furthermore, the court did not dismiss the *per se* allegation. While it is unlikely Cascades will prevail under either antitrust theory, the fact remains that even market-based solutions such as joint defense groups are difficult to utilize against PAEs.

These examples serve to demonstrate that the inflexibility of patent litigation makes it very difficult for the targets of PAE activities to defend themselves without committing to huge legal expenditures or purchasing a license they do not need.

## **Conclusion**

PAEs are a blight on the innovation economy and a tax on every part of the supply chain, from innovation to design, from manufacturing to distribution, and at the retail level. Their assertions that they provide efficient market-clearing services for companies needing licenses are not borne out by the facts. Instead,

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<sup>49</sup> Public Law 108-173—DEC. 8, 2003.

<sup>50</sup> For more information on the Cisco's RICO case, see Joe Mullin, Wi-Fi Patent Troll Hit with Racketeering Suit Emerges Unscathed, ARS TECHNICA, Feb. 13, 2013, available at <http://arstechnica.com/tech-policy/2013/02/wi-fi-patent-troll-hit-with-novel-anti-racketeering-charges-emerges-unscathed/>.

<sup>51</sup> Hipmunk, Inc. v. I2Z Technology, Inc., Civ. Dock. 4:12-cv-03409 (N.D.C.A.).

<sup>52</sup> Cascades Computer Innovation, LLC v. RPX Corp., et al., Civ. Dock. 12-CV-01143 (N.D.C.A.).

it is clear that PAEs use patents to accomplish the antithesis of their purpose – to inhibit innovation, deter investment in new technologies, and tilt incentives away from creativity and towards litigation. Retailers provide a unique perspective for understanding the competitive effects of PAE extortion and litigation tactics. Furthermore, unlike traditional patent litigation in which a competitor is trying to stop another competitor from capitalizing on its innovation, retailers do not compete with PAEs or any other entity in the high-tech innovation space. As a result PAE litigation is nothing but a drain on resources and an unexpected cost of operation. To the extent that the agencies are able to identify harmful practices, it is imperative that they use all of the tools in their toolkit to combat PAEs. Alternatively, if the agencies believe there is not yet enough information to warrant an enforcement action, then the agencies should seek to gather the information they need to either combat the business practice, or explain why it is permissible when so many participants in the modern economy find PAEs to be nothing but an increasing cost of doing business.

## Appendix A – Summary of Important Research into PAEs

We highlight and summarize some of the best research on PAEs below:

- PricewaterhouseCoopers, 2011 Patent Litigation Study<sup>53</sup> – PricewaterhouseCoopers (“PwC”) maintains a database of patent litigation damages awards from 1980. PwC tracks the litigation by industry, practicing vs. non-practicing entity, judicial forum, and case disposition (summary judgment, bench decision, or trial award by jury). Although PwC does segment non-practicing entities into three groups (company, university/research institution, and individual) the report does not account specifically for PAEs in the sense that it tracks companies with a deliberate business model of acquiring and asserting patents. PwC also does not account for non-litigation settlements, cases decided before summary judgment, or cases occurring outside of United States district courts. PwC’s data and analysis unveil several important trends that provide a useful backdrop against which to assess the impact of PAEs, including the following conclusions:
  - “Reasonable royalties” far exceeds other forms of damages such as price erosion or lost profits across all patent holders. PwC suggests that complexity and evidentiary burden of demonstrating price erosion or lost profits helps account for this drastic difference, but also acknowledges that non-practicing entities would not be entitled to either of these damages, leaving “reasonable royalties” as the only basis for liability.<sup>54</sup>
  - Non-practicing entities are successful in just 23% of litigation, largely because more courts are dismissing infringement claims at the summary judgment stage. Notwithstanding this fact, non-practicing entities prevail just as frequently as practicing entities if they make it to a trial with about 66% success rate.<sup>55</sup>
  - While non-practicing entities enjoy a 23% success rate across all industries, this success rate is much lower in certain industries including business/consumer services, software, and telecommunications.<sup>56</sup>
- Colleen Chien, From Arms Race to Marketplace<sup>57</sup> and Startups and Patent Trolls<sup>58</sup> – Ms. Chien’s scholarship focuses on the hazards of the patent system, including the burgeoning problem of PAEs, and provides an informative narrative for understanding the complexity of the patent landscape.
  - In From Arms Race to Marketplace Ms. Chien describes the evolution of the current patent ecosystem, including the transition from defensive patenting to offensive patent assertion by high-technology companies, the birth of intermediaries in the patent arbitrage system, and the origin of asymmetric patent warfare. She then explains the roles of non-practicing entities and PAEs, and suggests that the existence of PAEs in particular prevents large corporations engaged in patent warfare from reaching a mutually beneficial patent peace.

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<sup>53</sup> Chris Barry, Ted Martens, Larry Ranallo & Chel Tanger, 2011 Patent Litigation Study: Patent litigation trends as the “America Invents Act” becomes law, 2011 by PricewaterhouseCoopers, LLP, *available at* <http://www.pwc.com/us/en/forensic-services/publications/2011-patent-litigation-study.jhtml>.

<sup>54</sup> *Id.* at 15.

<sup>55</sup> *Id.* at 18.

<sup>56</sup> *Id.* at 24.

<sup>57</sup> Colleen Chien, From Arms Race to Marketplace: The Complex Patent Ecosystem and Its Implications for the Patent System, 62 HASTINGS LAW J. 297 (2010), *available at* <http://digitalcommons.law.scu.edu/cgi/viewcontent.cgi?article=1119&context=facpubs>.

<sup>58</sup> Colleen Chien, Startups and Patent Trolls, (September 28, 2012). Santa Clara Univ. Legal Studies Research Paper No. 09-12, *available at* SSRN: <http://ssrn.com/abstract=2146251> or <http://dx.doi.org/10.2139/ssrn.2146251>.

- Ms. Chien builds on her previous research in Startups and Patent Trolls by evaluating the precise impact PAEs have on the innovation economy, particularly in Silicon Valley and the high-technology community. This research looks at a comprehensive database of patent litigation and features interviews from 223 high-tech startups regarding their experiences with patent infringement lawsuits, demand letters, and licensing relationships with patent aggregators. The research unveils that in litigation initiated by PAEs 66% of unique defendants have less than \$100 million annual revenue, and 55% of unique defendants have less than \$10 million annual revenue. This contrasts to operating companies, who sue companies with less than \$10 million in revenue just 15% of the time. Ms. Chien concludes that startups in particular are excellent targets for PAEs because they often use technology nominally covered by PAE patents and they have enough money to warrant a demand, but often lack the legal sophistication or financial resources to combat a PAE infringement accusation head-on.
- Sarah Jeruss, Robin Feldman, & Joshua Walker, The America Invents Act 500: Effects of Patent Monetization Entities on US Litigation<sup>59</sup> – Jeruss, Walker, and Feldman executed this study at the request of the Government Accountability Office, pursuant to the America Invents Act, (Pub. L. No. 112-29, 125 Stat. 284 (2011)). Using data from Lex Machina, an intellectual property litigation database hosted by Stanford University, they surveyed patent litigation over a five year period, collecting a random sample of 100 cases from each of the years 2007-2011. Each case was coded based on the entities involved, the type of plaintiff (following a scheme designed by the authors), the venue, the defendant’s primary industry, and the outcome. The authors also introduced a new term, “patent monetization entities,” (alternatively “patent monetizers,”) defined as “entities whose core activity is creation of an income stream from the patent market itself,” that they feel better describes the firms in question. Their specific findings include:
  - In the first year surveyed (2007), 22 percent of all patent lawsuits were filed by patent monetization entities; this percentage increased to 40 percent of all suits in the last year surveyed (2011). At the same time, the total number of suits filed by patent monetizers increased, while the number filed by operating companies (the opposite of monetizers) decreased.
  - Of the five most litigious patent holders in the sample, four were patent monetizers, and only one was an operating company. Universities accounted for only 0.2 percent of the first-named plaintiffs in the sampled litigation.
- James Bessen and Michael J. Meurer, The Direct Costs from NPE Disputes<sup>60</sup> – Bessen and Meurer analyzed the direct costs of patent assertion suits by non-practicing entities (“NPEs”) defined as “individuals and firms who own patents but do not directly use their patented technology to produce goods or services, instead [asserting] them against companies that do produce goods and services.” (Page 3). The study’s goal was to determine the costs NPEs impose on targeted firms (including license fees), and what types of firms are typically targeted. The survey covered 82 firms, including small and large private companies, who conducted a total of 1,184 defenses against NPE litigation. Their findings included:
  - Aggregate direct costs of NPE patent assertions grew from \$7 billion in 2005 to \$29 billion in 2011, representing a massive increase parallel to the growth of the number of NPE lawsuits. During this period, 12 selected NPE firms

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<sup>59</sup> Jeruss, Sara, Feldman, Robin & Walker, Joshua H., The America Invents Act 500: Effects of Patent Monetization Entities on US Litigation 11 DUKE LAW & TECH. REV. 357, 2012, *available at* [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2158455](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2158455).

<sup>60</sup> Bessen, James E. and Meurer, Michael J., The Direct Costs from NPE Disputes (June 28, 2012). Boston Univ. School of Law, Law and Economics Research Paper No. 12-34. Available at SSRN: <http://ssrn.com/abstract=2091210> or <http://dx.doi.org/10.2139/ssrn.2091210>.

cumulatively earned \$5.8 billion in revenue. While median total costs per defense litigation were about \$500,000 (somewhat proportional to the size of the targeted firm), mean total costs were nearly \$8 million in the survey sample.

- Mean legal costs per defense ranged from \$420,000 for smaller companies, to \$1.52 million for large companies. Mean settlement costs ranged from \$1.33 million for small/medium companies and \$7.27 million for large companies, producing mean total litigation costs of \$1.75 million for the former category and \$8.79 million for the latter. The proportions of these sums indicate that smaller companies pay significantly more in NPE litigation costs relative to their size, demonstrating the major impact such infringement suits have on smaller firms.
- John R. Allison, Mark A. Lemley, & Joshua Walker, Patent Quality and Settlement Among Repeat Patent Litigants<sup>61</sup> – The authors reviewed the approximately one hundred patents subject to eight or more infringement suits between 2000 and August 2009, with the hypothesis that because of the asymmetric consequences of asserting a patent (a finding of invalidity is permanent, while validity is only case-specific), patent holders are reducing their risk by filing single suits against multiple entities, and only litigating the strongest patents, least susceptible to invalidation. A group of 343 patents only litigated once composed a control set. The study in fact found the reverse of the main hypothesis:
  - Entities asserting the most-litigated patents won only 10.7 percent of their cases, compared to the control set of patents, which were successful in 47.3 percent of cases. This strongly suggests that the most-litigated patents are in fact some of the weakest, rather than the strongest. However, the holders of frequently litigated patents were more likely to settle rather than advance litigation, settling 90.5 percent of the time, compared to patents litigated once, illustrating a greater risk aversion among the frequent litigation group.

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<sup>61</sup> John R. Allison, Mark A. Lemley, & Joshua Walker, Patent Quality and Settlement Among Repeat Patent Litigants, 99 GEORGETOWN LAW J. 677 (2010).

## **Appendix B – Proposal for FTC 6(b) Study**

### **Suggestions for an FTC 6(b) Study on Patent Assertion Entities**

We provide some suggestions on questions the FTC might consider including in a 6(b) study on PAEs. These questions are designed to provide answers that will move the analysis forward into a comprehensive understanding of the PAE business model and its impact on competition. There are three categories of questions. First, there are questions for stand-alone PAEs. Second, there are additional questions for hybrid PAEs that have a relationship with established operating companies. Finally, there are questions concerning procompetitive efficiencies claimed by PAEs.

These questions are designed to solicit information to provide statistical evidence for or against what are believed to be common business practices in the industry. For example, many commentators portray PAEs as acquiring patents late in their life cycle; using a complex network of subsidiaries and shells to obscure patent ownership; and aggressively pursuing licenses from any conceivable infringer without performing due diligence on the technology in question or the likelihood of infringement.

The questions:

#### **Information about PAE structure**

- List any current or former corporate parent.
- List all entities in which Company has an ownership interest. For each entity Company has an ownership interest in, provide the full name, address, state of incorporation (if applicable), and nature of ownership interest. Ownership interest includes any business association, subsidiary, sole proprietorship, or shell organization.
- List all entities in which Company has a financial interest and/or relationship. Interest and/or relationship in an entity is defined as ownership, assignment interest, and any financial or commercial benefit stemming from a contractual arrangement relating to a patent.
- If Company has a board of directors or similar governing body, list all other business associations (companies, subsidiaries, partnerships, etc.) in which these individuals have a role with a fiduciary responsibility.

#### **Information about interest in Company's patents**

- List all patents in which Company has a current ownership interest, including options, or has had such an interest within the past five years. For all patents listed describe the nature of acquisition (original patentee, assignment, purchase, etc).
- List all patents Company has transferred to another entity within the last five years and indicate Company's interest in or relationship to that entity. State the nature of the interest and the responsibilities of each party.

#### **Information about Company's licensing and litigation practices**

- Provide a comprehensive list of all entities, including individuals:
  - To whom Company has sent an invitation, notice, or demand letter in the past five years;
  - With whom Company has been involved in a lawsuit;

- From whom Company currently collects royalties
- For each licensing agreement made in the past five years by Company, provide the agreement and any correspondence prior to the agreement.
- Describe the process through which Company learns of potential licensees.
- Describe the process through which Company identifies and selects invitation/notice/demand letter recipients.
- Describe the process through which Company prices its patent licenses.
- Describe how Company determines whether a potential licensee already has a license to the technology in question and whether the potential licensee has any indemnification against patent infringement.

#### Information on strength of patents in which Company has an interest

- For each patent purchased in the past five years
  - provide any information received on the patent prior to purchase.
  - state the age of the patent at the time of purchase.
  - identify whether the patent had been licensed, was the subject of litigation, or was embodied in a product prior to the date of purchase.
- Describe the process through which Company selects patents to purchase.

#### **Hybrid PAEs (including “privateers”)**

As explained above, hybrid PAEs are those that are aligned with an established operating entity. Typically hybrid PAEs enter into a contractual relationship in which the operating entity either sells patents or assigns enforcement rights to the PAE, who in turn targets likely infringers.

#### Information about hybrid PAE relationship (questions in addition to those above)

- For each patent purchased from or assigned by an Operating Company to the patent Company in the past five years, provide the agreement and information on any continuing responsibilities of either party.
- Provide or describe any agreement, including any payment schedule, requiring patent Company to share royalties with an Operating Company.
- Provide or describe any agreement between patent Company and an Operating Company that restricts the parties that the patent Company can seek licenses from or lists companies that already a license.
- Provide or describe any agreement between patent Company and an Operating Company that specifies or targets other Operating Companies.

#### Procompetitive Efficiencies

Describe the actions, if any, Company is taking to bring the patented technologies to market. Include

efforts to educate operating entities on the patented technologies to encourage the adoption of the patented innovation.

- Identify any patents Company owns where the inventor uses the patented innovation in a product on the market or is in the process of bringing a product to the market using the patented innovation.
- Identify any licensees or potential licensees that proactively sought out a license from Company.
- Provide any evidence that Company's licensing practices have benefitted licensees other than limiting liability.

This information will help determine if PAEs are providing any benefits to innovation. Many PAEs claim they are an important step in transferring technology from inventors who have no interest in forming operating companies, and the companies that successfully bring products to market. Many others disagree with this claim, but antitrust law requires a balancing of the procompetitive benefits against the harm to competition.

Ultimately the information secured from this 6(b) study can better inform the debate before Congress and the regulators on the impact of PAE business practices.