

PAE Reports: Paperwork Comment; Project No. P131203

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I applaud the FTC's efforts to prevent business practices that are anticompetitive or deceptive or unfair to consumers. Unfortunately, the information requests to PAEs suggested by the FTC are asking the wrong questions. The questions that should be asked are those that determine whether the cases (or assertions for demand letters) have merit. Since over 90% of the cases settle and an even larger absolute number of demand letters are settled without a case being filed and since the settlement agreements are typically under NDA and other relevant information from the Courts is kept under seal, there is virtually no visibility regarding merit (i.e. patent validity and accused instrumentality infringement) for most cases.

Without visibility into the actual merit of cases and assertions, legal arguments can be made that there is no proven problem and the results of your information requests will not have practical utility except for academics making theoretical arguments. The questions you should be asking are those that let you determine whether the patents are actually valid and the defendants actually infringing. In other words, you need to determine the degree of litigation abuse.

FTC Comment Invitation Topics

The FTC in the Federal Register¹ specifically invited comments on particular topic areas. These are addressed below in turn.

(1) Whether the proposed collection of information is necessary for the proper performance of the functions of the FTC, including whether the information will have practical utility

In order to respond to this topic, one needs to review relevant aspects of the FTC mission, vision and strategic goals.² Two such strategic goals are relevant for this discussion.

¹ Federal Register / Vol. 78, No. 192 / Thursday, October 3, 2013 / Notices. p. 61357.

http://www.ftc.gov/sites/default/files/documents/federal_register_notices/2013/10/131003paereportsfrn.pdf

² See "About the FTC" on the FTC website. <http://www.ftc.gov/about-ftc>

Protect Consumers

One of the FTC's strategic goals is to protect consumers by preventing "fraud, deception, and unfair business practices in the marketplace". In general, PAEs do not sue consumers. Some PAEs have expanded their suits from manufacturers of products to end-users of products but such end-users are nearly always small businesses (hotels, smartphone application developers, etc.) and not consumers.

Nevertheless, consumers are indirectly impacted by the cost burden to small businesses and larger corporations. Costs of litigation, settlement, fees and fines, royalties, etc. are generally passed on to the consumer (on average) in the form of higher prices, especially when patent assertion is widespread with many businesses impacted. This represents a wealth transfer from consumers to the beneficiaries of patent assertion including lawyers and their firms, parent PAE employees, investors in PAEs, inventors, and even the Federal Court system itself that must size itself to accommodate the volume of cases.

Consumers are also indirectly impacted when manufacturers sue competitors for patent infringement. In this case, the wealth transfer may be from consumers to the company asserting patents if the competitor stays in business, but wealth transfer may also be from the competitor and that leads to another issue regarding competition.

Maintain Competition

A second FTC strategic goal is to maintain competition by preventing anticompetitive business practices in the marketplace. When one company asserts patents against a competitor, there is also a decrease in competition if the competitor is unable to remain in business or if their investment in product innovation or the rate of business expansion is reduced due to the higher costs.

When patent assertion is legitimate with reasonably strong patents (i.e. with validity) and cases (i.e. with infringement), then such wealth transfer and reduction in competition is justified by the Constitution securing the exclusive right to inventors to their discoveries. This is particularly true when the costs of discovery and invention are high, as with drug discovery, since such costs may not be recovered without the exclusive right given by patents. Without the prospect of cost recovery there is less incentive to invest and innovate. However, when weak patents (i.e. with invalidity) or weak cases (i.e. with non-infringement) are pursued then such cases without merit are a form of "legal extortion" and clearly cause harm to defendants and indirectly to consumers.

As to whether the information collected by the FTC will have practical utility, this depends on whether the right questions are being asked and what will be done subsequent to receiving the answers. I address this issue in my response to topic (3) below.

(2) The accuracy of the FTC's estimate of the burden of the proposed collection of information

I have no comments with regard to this topic.

(3) Ways to enhance the quality, utility, and clarity of the information to be collected

In the Information Requests, you are mostly asking the wrong questions. Though basic background information as in Request A and a small part of Request B are required of any information request, the rest of the questions are irrelevant if nearly all patents that are asserted are strong, valid, clearly-defined patents and if nearly all cases (or assertions, for demand letters) are strong with clearly identified infringement.

The question you should be asking is whether the patents are valid and the defendants infringing. Or course, if you ask the PAE plaintiffs this question, they will no doubt respond in the affirmative since there is no penalty for responding otherwise. If you ask defendants, they will likely respond in the negative. In fact, this gets to the core of the alleged “patent troll” problem. There is minimal penalty for pursuing weak patents or weak cases. As should be readily recognized, this problem has little to do with the nature of the plaintiff, but is a general problem of litigation abuse.

So how does one determine if a patent is valid or if there is infringement? For patent validity, it is a review of the patent in light of current standards for patent eligible subject matter, non-obviousness, no relevant prior art or invention, and other factors. Because a patent is presumed valid upon issuance from the USPTO, the hurdle is high to demonstrate invalidity by requiring “clear and convincing evidence”.³ In practical terms, it would be difficult for the FTC to determine patent validity unless the defendant in the case had already gathered strong evidence of invalidity or if the Court had ruled on patent validity.

Determining whether there is actual infringement of patent claims is done most easily by examination of the infringement claim chart that:

- identifies the claims being asserted,
- identifies specifically where each element of each asserted claim is found within the accused apparatus, product, device, process, method, act, or other instrumentality, and

³ See the Supreme Court opinion in *Microsoft v. 141 Limited Partnership* at <http://www.supremecourt.gov/opinions/10pdf/10-290.pdf>

- gives details as to the type of infringement (i.e. literal direct, doctrine of equivalents direct, inducing, or contributory).

These are generally requirements specified in local District Court patent rules.⁴ If there is no infringement claim chart, then the merit of the case should be questioned. If an infringement claim chart does not properly tie to the accused instrumentality, then the merit of the case should be questioned. Though many cases may be in a gray area with regard to merit, there may be many cases or accusations where the merit is reasonably clear one way or the other. Since the FTC is not adjudicating the case, you can assess merit through a consistent process for statistical purposes.

I will now turn to the specific question areas the FTC has proposed and will suggest questions to reflect the goal of ascertaining the merit of the case or accusation and of determining other areas of abuse.

A. Identification of Report Author

Clearly required.

B. Company Information

The structure of the entity will be interesting, but the relevant question is not the structure itself but *why* the structure is being used. You will likely find that some PAEs have wholly owned subsidiaries that have no assets beyond the patent(s) being asserted and have no revenues. The real question to ask is why. The PAE may not truthfully answer this question in a “the truth, the whole truth and nothing but the truth” sense, so better questions to ask are the following:

- Was any payment avoided due to the entity being unable to pay? This includes the inability to pay for fee shifting or sanctions.
- If yes, then how did the entity declare its inability to pay? Via a lack of assets? Declaration of bankruptcy? Termination/dissolution?
- Did any defendant fail to properly identify the true owner (assignee) of the patent due to lack of disclosure from the plaintiff? Did it lead to harm for the defendant in the case?
- Was the Court unable to apply joinder rules due to the PAE entity structure? Was it due to a lack of identification of the true interested party? Or was it due to jurisdictional issues (e.g. foreign subsidiary)?

C. Patent Information

The patent ownership will be interesting, but the relevant questions are the following for each patent:

⁴ See comparative local patent rules for infringement contentions at <http://www.localpatentrules.com/compare-rules/infringement-contentions/>

- Has the patent been asserted and if so, how (e.g. demand letter, filing a case) and against how many defendants?
- Detail the outcome/result of each assertion (see “F. Patent Assertion Information” for details)
- Has patent validity been reviewed in a Court or via USPTO re-examination and if so what was the result?
- Has patent infringement been decided in Court and if so what were the results (against each defendant)?

D. Patent Portfolio Information

I don't understand the distinction between the patent portfolio and the patent information request. A patent portfolio is a collection of patents so what relevance is there to which entities hold which groups of patents or how they are organized?

E. Patent Acquisition and Transfer Information

Though the details of patent acquisition will be interesting, the more relevant questions are about proper valuation and due diligence with regard to patent quality and fairness to the inventor or entity selling patent rights.

- What specific due diligence was performed on each acquired patent to ascertain patent validity and value?
- If purchasing a patent portfolio, what was the number of patents in the portfolio and what number of patents had significant due diligence and describe the due diligence performed?
- What is your process for valuing patents for acquisition?
- Were multiple PAEs or other entities competing for acquisition of the patent?

F. Patent Assertion Information

This is the most important category of information since it is where litigation abuse can occur. Many of the proposed questions are good, but some questions should be asked of defendants as well as plaintiffs. The most relevant questions are with regard to the following:

- What specific due diligence was performed prior to sending out a demand letter or to filing a patent infringement case? Was the instrumentality examined in detail for infringement?
- Provide copies of every demand letter.
- Provide copies of the infringement claim chart (or multiple charts, if more than one such as preliminary and final).
- Are attorneys or law firms hired on contingency? If so, provide details as to fee arrangements.
- What discovery requests were made in the case? Was a preliminary infringement claim chart provided prior to core discovery? Was core

discovery completed and a final infringement claim chart provided prior to non-core (e.g. E-mail) discovery?

- Provide a copy of the settlement agreement. Was the settlement a lump sum or did it include a future royalty stream of payments?
- Was an NDA part of the settlement agreement? If so, provide a copy.
- Was there a change in requested settlement price? If it changed during the case, why did it change? If demonstration of non-infringement or invalidity was shown, why was the case not dropped?
- (for the defendant) What was the cost of defense?
- (for the defendant) If the case was believed to be without merit, provide evidence of patent invalidity or non-infringement.
- (for the defendant) Was discovery delayed or inhibited? Were there sanctions or fee shifting from the Court against you?
- What was the result of the assertion? Were there any sanctions or fee shifting? Provide a timeline of events.

G. Aggregate Cost Information

This information is not particularly relevant except in determining costs that are contingent on receiving a settlement or winning a case. Details of such contingency fee arrangements with lawyers or law firms (or others) should be provided.

H. Aggregate Revenue Information

Most of this information is not particularly relevant except for determining revenues that are shared with the previous patent owners (i.e. revenue sharing arrangements). Revenue sharing with parent entities or investors would also be useful to know.

(4) Ways to minimize the burden of collecting information

The best way to minimize the burden of collecting information is to **request the smallest possible set of information necessary** to achieve the goals of the information collection activities. To that end, the proposed Information Requests A-H of nearly 3-1/3 pages in the Federal Register⁵ is excessive. As I explained in response to the previous topic regarding the quality of the information collected, you are mostly asking the wrong questions.

APPENDIX

This Appendix contains background information that does not directly address the comment topics requested by the FTC, but nevertheless is relevant information in

⁵ Federal Register / Vol. 78, No. 192 / Thursday, October 3, 2013 / Notices. pp. 61354-61357.

http://www.ftc.gov/sites/default/files/documents/federal_register_notices/2013/10/131003paereportsfrn.pdf

understanding the possible nature of the alleged patent assertion abuse problem and gives guidance towards potential solutions.

Weak Patents

Patent quality varies a lot and it is largely due to variability of quality of patent examinations in the different patent units.^{6,7} Though improvements at the USPTO would help, there are many patents already issued so some sort of faster and less expensive review process would be beneficial.

There is a very good film about patent history, with interviews during the Supreme Court review of *in re Bilski*.⁸ This not only discusses the kind of patent broadening that occurred, but why it occurred both from the legal rulings and the nature of district judges and those composing the CAFC.

Weak Cases

There is a representative case from 2009 that showed the typical unwillingness of courts to impose sanctions for cases without merit where, after nearly a year, the plaintiff could not produce a Preliminary Infringement Chart that identified "how each accused product's functionality contributes to infringement" and yet sanctions were denied though "it is a close call".⁹

You can get a glimpse into the contents of settlement agreements by seeing what happened after the case above where settlement agreements may contain a license of existing patent portfolios with a covenant not to sue.¹⁰ This poor company was sued again by another shell company subsidiary of the same plaintiff PAE (they ultimately settled again in 2012).

⁶ See "Patent Reforms Must Focus on the U.S. Patent Office" by Ron Katznelson at <http://works.bepress.com/cgi/viewcontent.cgi?article=1062&context=rkatznelson>

⁷ Patent quality comments to David Kappos from Ron Katznelson: <http://works.bepress.com/cgi/viewcontent.cgi?article=1061&context=rkatznelson>

⁸ See <http://patentabsurdity.com>

To view the film, you may need to download a VNC player, but it's worth it. There's one short stretch in the film that bogs down, but most of it is excellent and well worth viewing even though it is biased in that it is presenting the view that most software should probably not be patentable.

⁹ See *Diagnostic Systems v. Symantec* at <http://sites.google.com/site/271patentblog/Home/DiagnosticSystemsvSymantec.pdf>

¹⁰ See the first paragraph of section "(b) Litigation" in the following section of the Microstrategy 10-K: <http://www.sec.gov/Archives/edgar/data/1050446/000119312512067605/R15.htm>

Penalties and sanctions have generally only been given for serious misconduct such as destruction of documents (evidence). Simply pursuing a weak case has not resulted in sanctions or fee shifting until very recently. This situation started to change with *Eon-Net* in 2011.¹¹ In this case there were sanctions, but the behavior included **destruction of documents**, so simply having a weak case was not clear if that was sufficient for sanctions.

Then things started to turn more substantially with *Marctec* on 1/3/12¹² where the claim construction ignored the specification and prosecution history and 35 U.S.C. § 285 attorney fees were upheld. However, in this case **the plaintiff claimed that spraying a substance at the speed of sound was equivalent to bonding with heat!**

Then came *Highmark* on 8/7/12¹³ where again § 285 attorney fees were upheld (in part, reversed in part) because the preamble to the asserted claim was limiting, but ignored in the claim construction. This case is headed on appeal to the Supreme Court.

And more recently we have *Raylon* on 12/7/12¹⁴ where the appellate court sent back to the circuit court which originally did not sanction using Rule 11 and where not only that is now to be done but § 285 is to be considered as well. In this case, the claim language was being twisted beyond reason where **a user being able to physically move a solid device base with a fixed display on top was claimed to be equivalent to a pivotable display!**

Unfortunately, none of these recent decisions are about weak (incomplete) claim constructions (as with the *Diagnostic Systems* case) and are instead about pursuing unusually weak arguments.

Focus on Behavior, Not the Actor

I postulate that your information collection will discover that there are three broad categories of PAE:

- Those that perform significant due diligence and mostly have strong valid patents with strong cases demonstrating infringement,
- Those that are indiscriminate by hiring lawyers or law firms on contingency so pursue both weak and strong patents and cases, and

¹¹ See *Eon-Net v. Flagstar Bancorp* at

<http://www.cafc.uscourts.gov/images/stories/opinions-orders/09-1308.pdf>

¹² See *Marctec v. Johnson and Johnson and Cordis* at

<http://www.cafc.uscourts.gov/images/stories/opinions-orders/10-1285.pdf>

¹³ See *Highmark v. AllCare Health Management Systems* at

<http://www.cafc.uscourts.gov/images/stories/opinions-orders/11-1219.pdf>

¹⁴ See *Raylon v. Complus Data Innovations* at

<http://www.cafc.uscourts.gov/images/stories/opinions-orders/11-1355.pdf>

- Those who mostly have weak patents or cases and often send out mass demand letters.

It should also be noted that some companies perform litigation abuse as well, especially in discovery.¹⁵ **What should be examined and regulated is litigation abuse, regardless of the actor.** Some companies have also not acted in good faith with individual inventors and some people say that the current situation with PAEs is the companies getting their just deserts. However, two wrongs do not make a right and any litigation abuse or bad faith dealings from any party should be penalized.

Fee Shifting May Not Work

Fee shifting may be completely pointless against patent assertion entity (PAE) plaintiffs who have set up shell companies with no assets (beyond the patent being asserted) nor revenues from which to pay fees or penalties. Unfortunately, we only have anecdotal reports about this and I could find no statistics showing that shifted fees were never able to be collected. This is why your information collection is so important.

These plaintiffs have few or no assets other than the patents themselves, the out-of-pocket expenses of litigation being fronted by the lawyers, and the lawyer's fees being entirely contingent upon settlement payments. In other words, NPEs are designed to be, and typically are, judgment-proof. For this crucial reason, the traditional fee-shifting mechanism in the Patent Act, 35 U.S.C. Sec. 285, is not an effective deterrent to truly unwarranted patent infringement allegations. Only in rare situations are the litigation attorneys held jointly and severally liable for Sec. 285 attorney's fees awards. While Rule 11, Fed. R. Civ. P., always exists to deter the very worst offenses, Rule 11 awards against signing attorneys are even rarer in patent infringement cases than Sec. 285 awards.¹⁶

Also, the "interested parties" provisions in proposed legislation¹⁷ may be pointless because the PAEs will simply set up foreign subsidiaries owning the domestic shell companies thereby creating a jurisdictional corporate veil. There will be the excuse that they cannot find the true party of interest because the domestic shell company plaintiff does not know nor control its foreign parent and the Court will have no jurisdiction to demand information from the foreign entity.

¹⁵ See *Alexsam v. IDT* at <http://www.cafc.uscourts.gov/images/stories/opinions-orders/12-1063.Opinion.5-16-2013.1.PDF>

¹⁶ This quote is from <http://www.patentlyo.com/patent/2013/03/guest-editorial-throwing-trolls-off-the-bridge.html>

¹⁷ See "Joinder of Interested Parties" and "Transparency of Patent Ownership" in H.R. 3309 "Innovation Act" of 2013 at <https://www.govtrack.us/congress/bills/113/hr3309/text>

Sanctions are Rare

The reason why sanctions against attorneys are rare is disclosed in a recent speech from a CAFC Judge three months ago:

With respect to the Rule 11 proposals and the asserted desire for more sanctions, I believe what you really want is not more sanctions, but more fee shifting. Having been a district judge, I know that, while sometimes you must do it, it is difficult to sanction lawyers. Most of us that have been on the district bench were also practicing lawyers, and we know that people make mistakes, we know that lawyers can be pushed in certain directions by their clients, and we know that they do not usually intend to step over the line. And we know that a sanction can destroy a lawyer's career.¹⁸

Cost of Litigation Drives Settlements

A 2008 survey of trial lawyers was summarized by the task force Chairman who stated that "the costs and burdens of discovery are driving litigation away from the court system and forcing settlements based on the costs, as opposed to the merits."¹⁹

One can look at case statistics for 2012²⁰ where if one assumes that "No Court Action" and "Before Pretrial" are settlements (or dropped cases), then this comes to 81.9% while with "During or After Pretrial" this would be 96.6% so the question is how many cases in between were dismissed with Summary Judgment. I looked at patstats data for 2012²¹ and teased out case statistics from the claim statistics and came to 4.2% of cases filed resulting in summary judgment. So $96.6 - 4.2 = 92.4\%$ of **cases settled (or were dropped)**. Note that these are not PAE statistics and represent all patent infringement cases.

Of course, there are many more settlements that are made from demand letters without a case being filed, but there are no hard statistics on this. This is again why your information collection is so important.

¹⁸ See the Intellectual Property Owners (IPO) 41st Annual Meeting keynote address by Hon. Kathleen O'Malley USCAFC at <http://www.ipo.org/wp-content/uploads/2013/02/IPO-Annual-Meeting-Keynote-Speech-09-17-13.pdf>

¹⁹ See the press release from the American College of Trial Lawyers (ACTL) at http://www.abajournal.com/files/Survey_Press_Release_Final.pdf

²⁰ See <http://www.uscourts.gov/uscourts/Statistics/JudicialBusiness/2012/appendices/C04Sep12.pdf>

²¹ See http://www.patstats.org/2012_full_year_w_breakdown.html

Fighting Back is Futile

If a plaintiff with a weak case does come across a defendant willing to fight to the end to prove their case in court, risking a finding of patent invalidity, the plaintiff can simply drop the case as has occurred twice against Kaspersky Labs^{22,23}

In that first case, it cost Kaspersky Labs 3-1/2 years of distraction and \$2.5 million in legal fees being the only one of 35 companies who refused to settle while in the second case it cost them 2-1/2 years of distraction and an undisclosed amount in legal fees (probably at least \$1.5 million) being the only one of 55 companies who refused to settle and in neither case were there any fee shifting nor sanctions. This is why many companies settle -- it's simply not worth fighting weak cases when it costs so much compared to the price of settlement. Such settlements are almost always private with NDAs preventing anyone (other than the parties to the case) seeing the terms. By dropping the case, Lodsys is able to continue to sue other companies as its patent has not been seen by a Court to determine validity.

But that is not the end of the story. On 10/18/13, Kaspersky Labs filed a lawsuit for declaratory judgment against Device Security who had sent them a demand letter dated 9/18/13. Also on 10/18/13, Kaspersky Labs was sued by Uniloc. So now they have two active lawsuits from patent assertion entities. Other companies who have a policy of always fighting back weak cases, such as Twitter and Newegg, have not stemmed the tide of patent assertion entity lawsuits against them (as shown by a Pacer search and correlation of cases against known patent assertion entities).

Civil Litigation Abuse Not Limited to Patent Infringement

Medical malpractice insurance rates skyrocketed in Texas in part due to too many weak cases resulting in settlements to avoid large jury awards. Doctors went on strike in 2002 and legislation was passed in 2003 to cap pain and suffering awards in medical malpractice cases to \$250,000 (actual damage awards were not capped). As a result, medical malpractice filings dropped by 90%, but many Personal Injury (PI) attorneys found themselves without sufficient work and many moved to Intellectual Property (IP).^{24,25,26}

If one does not address the core of litigation abuse and only changes the specific laws for specific types of litigation, then one ends up with a situation similar to the

²² See the case with IPAT at <http://en.ria.ru/business/20120626/174253507.html>

²³ See the case with Lodsys at <http://eugene.kaspersky.com/2013/10/02/the-patent-trolls-can-be-defeated-just-never-give-up/>

²⁴ See "Texas Doctors Strike To Protest Malpractice Insurance Rates" at <http://www.kaiserhealthnews.org/Daily-Reports/2002/April/09/dr00010523.aspx>

²⁵ See "From PI To IP" at http://mcsmith.blogs.com/eastern_district_of_texas/files/IP.pdf

²⁶ See "From PI to IP: Yet Another Unexpected Effect of Tort Reform" at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1878966

game of **Whac-A-Mole®**. Securities class action was another area of significant abuse and even with the legislative changes, it was until recently the #2 legal cost for large public companies, especially in tech, right after patent infringement litigation. The Private Securities Litigation Reform Act of 1995 (PSLRA) significantly cut down the abuse, but it is still an active area about to be reviewed by the Supreme Court.^{27,28}

Patent marking was another area of abuse where attorneys even needed to solicit plaintiffs to drum up business. After a while the courts started to increase pleading standards but the abuse didn't get significantly cut back until AIA legislation in 2012.^{29,30}

I could go on with the civil litigation abuse especially in California with ADA, Proposition 65, and Section 17200, but you get the point.

The Missing Doctrine

Courts generally only see one case at a time from a plaintiff and their attorneys so the line for punishing abusive behavior is set rather high so as not to “chill” the legitimate pursuit of cases that may become stronger and to encourage what is stated in the ABA Preamble to the Model Rules of Professional Conduct: “As advocate, a lawyer **zealously** asserts the client's position under the rules of the adversary system.” The problem is that **there is no doctrine of cumulative repetitive harm**. If such a doctrine existed, then the Court would not view behavior as being isolated to a single case, but would consider the effect on the Courts and on society if *every* case had similar conduct because if the behavior is not punished it will usually become more prevalent.

Possible Solutions

First and foremost is to demonstrate that there is a real problem. Otherwise, there will be those who argue that nearly all of the settled cases have merit. The FTC should do whatever it takes within its power to determine the merits of cases currently hidden behind confidential settlements and some sealed case documents. Only then can we talk about real solutions.

²⁷ See 15 USC § 78u-4 “Private Securities Litigation” at <http://www.law.cornell.edu/uscode/text/15/78u-4>

²⁸ See “Supreme Court Poised to Decide Future of Securities Class Actions” at <http://www.insurancejournal.com/news/national/2013/11/18/311504.htm>

²⁹ See “Expired Patent could make manufacturer liable for Big Fines (Attorneys False Marking Claims)” at <http://www.kirksanderslaw.com/blog/expired-patent-could-make-manufacturer-liable-big-fines-attorney>

³⁰ See “AMERICA INVENTS ACT IMPACTS PATENT MARKING REQUIREMENT” at <http://www.hblaw.com/alerts/America-Invents-Act-Impacts-Patent-Marking-Requirement-08-29-2012>