December 16, 2013

Federal Trade Commission
Office of the Secretary
Room H–113 (Annex J)
600 Pennsylvania Avenue NW
Washington, DC 20580

Re: PAE Reports: Paperwork Comment; Project No. P131203

To Whom It May Concern:

The United States Telecom Association (USTelecom)[1] is pleased to submit its comments to the Federal Trade Commission (FTC) in the above referenced proceeding (Notice).[2] USTelecom's membership ranges from large publicly traded companies that serve the national market to small rural providers. All of these companies are adversely impacted by the practices of patent assertion entities (PAEs) addressed in the Notice.

The FTC's proposed information collection will provide a better understanding of the substantial and detrimental costs associated with PAE activity. While numerous studies and reports have discussed the broad and growing role of PAE activities, USTelecom agrees that there is a lack of empirical data in this area.[3]

I. The FTC's Proposed Information Collection is Appropriate and Necessary.

As FTC Chairwoman Edith Ramirez noted in a recent speech regarding PAEs, the issues associated with their activity are not new to the agency and others.[4] The FTC first reported in detail on PAE activity in its March 2011 Report on the Evolving IP Marketplace.[5] Last year, it

[1] USTelecom is the premier trade association representing service providers and suppliers of the telecommunications industry. USTelecom members provide a full array of services, including broadband, voice, data and video over wireline and wireless networks.

[2] Public Notice, 78 Fed. Reg. 61352, *Agency Information Collection Activities; Proposed Collection; Comment Request*, October 3, 2013 (*Notice*).

[3] *Notice*, p. 61353.

[4] *See*, Opening Remarks of Chairwoman Edith Ramirez, p. 1, *Competition Law & Patent Assertion Entities: What Antitrust Enforcers Can Do*, Computer & Communications Industry Association and American Antitrust Institute Program, Washington, DC, June 20, 2013 (available at: http://www.ftc.gov/speeches/ramirez/130620paespeech.pdf) (visited December 11, 2013) (*Ramirez Remarks*).

[5] FTC Report, *The Evolving IP Marketplace: Aligning Patent Notice and Remedies With Competition*, 2011 (available at: http://www.ftc.gov/os/2011/03/110307patentreport.pdf) (visited December 11, 2013) (*2011 FTC PAE Report*).

held a workshop with the Department of Justice (DOJ) to further explore PAE activity.[6] The issue even prompted the President to issue a report[7] and new directives to target PAE abuse,[8] and several bills have been introduced in Congress.[9] Finally, a growing body of academic literature has evaluated the broad scope and adverse impact of PAEs.[10]

While each of these efforts has been informative, the very nature of PAE activity shields a great deal of information from scrutiny. As one witness recently explained in testimony before the House Energy and Commerce Committee, much of the behavior by PAEs is "shrouded in nondisclosure agreements and hidden behind layers of shell companies. This makes it difficult for regulators to see when bad behavior is occurring. It is also difficult to hold anyone accountable, because the shells may have no meaningful assets."[11]

Thanks in large part to the FTC's efforts, various stakeholders and policymakers have begun to recognize the need to address the adverse impact of PAE activities on the broader patent system. PAEs introduce unnecessary costs and chill innovation. Even absent an adverse ruling against a defendant in a patent related lawsuit, the mere presence of patent litigation can adversely impact marketplace sectors. For example, one study found that during the years they were being sued for patent infringement by a PAE, health information technology companies

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[6] *See*, FTC website, *Patent Assertion Entity Activities Workshop* (available at: http://www.ftc.gov/opp/workshops/pae/) (visited December 11, 2013).

[7] *See*, Report, Executive Office of the President, *Patent Assertion And U.S. Innovation*, June, 2013 (available at: http://www.whitehouse.gov/sites/default/files/docs/patent_report.pdf) (visited December 11, 2013) (*White House Report*).

[8] *See*, White House Fact Sheet, *White House Task Force on High-Tech Patent Issues, Legislative Priorities & Executive Actions*, June 4, 2013 (available at: http://www.whitehouse.gov/the-press-office/2013/06/04/fact-sheet-white-house-task-force-high-tech-patent-issues) (visited December 11, 2013).

[9] *See e.g.*, Innovation Act, H.R. 3309, 113th Cong. (2013); *see also*, Saving High-Tech Innovators from Egregious Legal Disputes Act of 2013, H.R. 845, 113th Cong. (2013); *see also*, Patent Abuse Reduction Act of 2013, S. 1013, 113th Cong. (2013).

[10] *See e.g.*, Tucker, Catherine, *Patent Trolls and Technology Diffusion*, March 26, 2013 (available at: http://ssrn.com/abstract=1976593) (visited December 16, 2013); James Bessen, Michael J. Meurer, Boston University School of Law, *The Direct Costs from NPE Disputes*, Boston University School of Law Working Paper No. 12-34 (June 25, 2012) (*Bessen Meurer Paper*).

[11] See, Summary of Testimony, *The Impact of Patent Assertion Entities on Innovation and the Economy, Professor Robin Feldman*, Before the House Committee on Energy & Commerce, Subcommittee on Oversight & Investigations, p. 3, November 14, 2013 (available at: http://energycommerce.house.gov/hearing/impact-patent-assertion-entities-innovation-and-economy) (visited December 11, 2013).

ceased all innovation in that technology, causing sales to fall by one-third compared to the same firms' sales of similar products not subject to the PAE-owned patent.[12]

The opaque nature of the PAE business model makes the FTC's inquiry into their activities both timely and imperative. USTelecom therefore strongly agrees with Chairwoman Ramirez's recent remark that the FTC has an important role to play "in advancing a greater understanding of the impact of PAE activity and using [the FTC's] enforcement authority where appropriate to curb anticompetitive and deceptive conduct."[13]

II. The Adverse Effects of PAE Activity are Significant, and are Felt by a Broad Range of Stakeholders.

Despite the lack of transparency into certain of their activities, there is already ample evidence regarding the destructive impact of PAEs in today's marketplace. As Gene Sperling, Assistant to the President for Economic Policy and Director of the National Economic Council, observed upon the release of the White House report on PAEs, "[b]usinesses of any size are vulnerable to these tactics, whether you're a software giant designing complex applications or a mom-and-pop store using a technology product you purchased over the counter."[14] PAE activities generally include the sending of patent demand letters to businesses of all sizes, as well as initiating litigation against certain targets.

A. The Widespread Abuse of Patent Demand Letters Impacts a Broad Range of Companies

The abuse of patent demand letters by PAEs is an issue that has been gaining increased attention by government and industry stakeholders. The White House report suggested that PAEs may have threatened over 100,000 companies with patent infringement last year alone.[15]

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[12] *See generally*, Catherine Tucker, *Patent Trolls and Technology Diffusion*, Massachusetts Institute of Technology - Management Science, March 23, 2013 (available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2136955##) (visited December 11, 2013) (noting that "No new variations of existing products or new models of imaging software were released by the a affected vendors during the period of litigation. An explanation for this lack of innovation is that the vendors did not want to run the risk of being found guilty of 'wilful infringement' in the patent suit and being liable for treble damages. Therefore, one explanation of the slow-down in sales is that the product release and attendant sales cycle was halted as a result of litigation. This emphasizes that even if [PAEs] do not prevail in the courtroom, their actions can have significantly negative consequences for incremental innovation while litigation is ongoing." *Id.*, p. 29).

[13] *Ramirez Remarks*, p. 2.

[14] White House Blog, *Taking on Patent Trolls to Protect American Innovation*, June 4, 2013 (available at: http://www.whitehouse.gov/blog/2013/06/04/taking-patent-trolls-protect-american-innovation) (visited December 11, 2013).

[15] *White House Report*, p. 1.

A single PAE reportedly sent 14,000 demand letters to small businesses, cafes, bakeries, inns and hotels, and a children's health clinic based on their alleged use of consumer Wi-Fi technology.[16]

In recent testimony regarding the abuse of patent demand letters by PAEs, several witnesses noted that demand letters are often "vague" and "uninformative", and that some "contain plain falsehoods and deceptions, intended only to stoke fear where there is no legitimate claim."[17] Mark Chandler, Cisco System's Senior Vice President and General Counsel, extensively detailed the misinformation contained in just one PAE's patent demand letter activities which targeted small businesses utilizing off-the-shelf WiFi technology.

The company behind the demand letters, Innovatio, was seeking exorbitant licensing fees for use of the products containing WiFi technology. Chandler noted that, contrary to the statements contained in the demand letter, a "huge proportion" of the devices at issue were already licensed; that any resulting license had to be on "fair and non-discriminatory terms;" and that the manufacturers of the products, including Cisco, were suing Innovatio to defend their customers.[18]

The Nebraska Attorney General, who testified at the same Senate hearing, stated that PAE demand letters are "typically designed to ultimately achieve a single aim: the extraction of as big a payment as possible from the targeted entity."[19] He emphasized that most targeted entities "have neither the time, resources, nor inclination to engage in a pitched legal battle to defend a patent," since the average cost of a full-scale patent defense "ranges from $350,000 to $3 million."[20] Faced with this stark economic choice, targeted companies frequently opt to pay the demanded license fee rather than defend the charges in a lawsuit, in order to avoid the expense of litigation that could dwarf the amount of the demanded license fee. PAEs will then use the license fees collected from smaller entities to fund litigation against larger alleged

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[16] Testimony, *Demand Letters and Consumer Protection: Examining Deceptive Practices by Patent Assertion Entities*, Mr. Mark Chandler, Senior Vice President, General Counsel, and Chief Compliance Officer, Cisco Systems, Inc., Before the Senate Subcommittee on Consumer Protection, Product Safety, and Insurance, November 7, 2013, p. 3 (*Chandler Testimony*).

[17] Testimony, *The Impact of Patent Assertion Entities on Innovation and the Economy, Charles Duan*, Before the House Committee on Energy & Commerce, Subcommittee on Oversight & Investigations, p. 4, November 14, 2013 (available at: http://energycommerce.house.gov/hearing/impact-patent-assertion-entities-innovation-and-economy) (visited December 11, 2013).

[18] *Chandler Testimony*, pp. 4 – 5.

[19] Testimony, *Demand Letters and Consumer Protection: Examining Deceptive Practices by Patent Assertion Entities*, The Honorable Jon Bruning, Attorney General, State of Nebraska, Before the Senate Subcommittee on Consumer Protection, Product Safety, and Insurance, November 7, 2013, p. 5 (*Bruning Testimony*).

[20] *Id*.

infringers.[21] Given that the median revenue of USTelecom's small, rural telecom company members is approximately $3.5 million, a full-scale patent defense in a single case could prove disastrous.

More recently, many of USTelecom's member companies using DSL equipment to provide Internet service have been targeted by PAE demand letters. At least one PAE has reportedly contacted several ISPs alleging patent infringement for the use of such technology, and has sued over 39 different service providers.[22] Some PAEs may target small ISPs in hopes of extracting a quick settlement that can then be used a benchmark royalty rate against larger companies.

B. There has Been a Significant Increase in Patent Litigation, the Substantial Costs of Which are Borne Almost Exclusively by the Defendant Targets of PAEs.

The direct costs imposed on businesses of all sizes are particularly concerning given the significant increase in PAE litigation activity. According to one measure, there were fewer than 600 defendants sued annually by PAEs in 2001 – but by 2010, there were more than 5,000 such defendants. A recent Congressional report found that PAEs created $29 billion in direct costs from defendants and licensees in 2011, a 400 percent increase over $7 billion in 2005.

In a report released earlier this year, the White House found that suits brought by PAEs have jumped by nearly 250 percent in just the last two years, rising from 29 percent of all infringement suits to 62 percent of all infringement suits.[23] In 2012, PAEs brought over 2,500 lawsuits, compared to 1,500 in 2011 (45% of all cases,), and 731 in 2010 (accounting for 29% of all cases).[24] Other studies have identified a similar increase in PAE activity.[25]

The receipt of a demand letter by a targeted company often marks the beginning of a long and costly litigation proceeding. According to one study, the mean legal costs per defense range from $420,000 for small/medium sized companies to $1.52 million for large companies.[26] To the extent parties agree to settle a case, the mean settlement costs for small/medium companies are $1.33 million and for large companies, $7.27 million.[27] The same study showed that the

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[21] New Hampshire Bar Journal, *Patent Trolls: Who, What, Where & How To Defend Against Them, Autumn*, 2011, p. 40 (available at: http://www.nhbar.org/uploads/pdf/BJ-Autumn2011-Vol52-No3-Pg40.pdf) (visited December 11, 2013).

[22] New Edge Blog entry, *Patent Trolls on a Suing Spree*, January 7, 2013 (available at: http://www.ntca.org/new-edge/data/patent-trolls-on-a-suing-spree) (visited December 11, 2013).

[23] *White House Report*, p. 1.

[24] *Id.*, p. 5.

[25] *See e.g.*, *Bessen Meurer Paper*, p. 4 (noting that while non-practicing entities have "been around for a long time, over the last few years, NPE litigation has reached a wholly unprecedented scale and scope.").

[26] *Id.*, p. 12.

[27] *Id.*, pp. 12 – 13.

mean total litigation costs for these companies (*i.e.*, legal costs plus settlement costs), is $1.75 million and $8.79 million, respectively.

For USTelecom's members, however, a separate study released earlier this year found the median damages resulting from a jury award substantially exceed those of other industries. That study found that the median damages awarded with respect to technology associated with the telecommunications industry was "significantly higher" than in other industries.[28] Whereas the overall median damage award for all industries was approximately $5 million, the median damage awards for the telecommunications industry were in excess of $30 million.[29]

PAEs are all too aware of the exorbitant legal costs borne by their targets. The costs associated with the accelerating volume of patent litigation are borne almost exclusively by the numerous targets of PAEs. Because they generally face lower litigation costs than those they are accusing of infringement, NPEs often use the mere threat of imposing these costs as leverage in seeking infringement compensation.[30] Discovery costs in complex patent infringement litigation can run into the millions of dollars. Since NPEs do not make products, and therefore will have less information to disclose, they will ultimately have far lower discovery costs than their intended targets. Moreover, since they do not make products, they cannot be countersued by the target for patent infringement. This asymmetry in litigation costs gives NPEs significant leverage when seeking financial settlements from the companies they are targeting. And the non-disclosure agreements that many PAEs require prevent companies from comparing notes with their suppliers who may already have licensed the technology; this may result in inappropriate multiple recoveries by PAEs.

Finally, USTelecom's member companies are also adversely affected when patent holders try to extract the hold-up value of their patents. Earlier this year, USTelecom and Verizon filed joint comments with the FTC and the Department of Justice (DOJ) discussing this issue, and recommended that the DOJ and FTC encourage courts to take steps discouraging such activity, especially on RAND-encumbered patents.[31]

As the FTC is aware, "[t]he business model of PAEs focuses on purchasing and asserting patents against manufacturers already using the technology" at issue.[32] By doing so, PAEs put

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[28] PWC Study, 2013 Patent Litigation Study, *Big Cases Make Headlines, While Patent Cases Proliferate*, 2013, p. 15.

[29] *Id.*, p. 15.

[30] United States Government Accountability Office, Report to Congressional Committees, *Intellectual Property, Assessing Factors That Affect Patent Infringement Litigation Could Help Improve Patent Quality*, GAO 13-465, p. 3, August 2013.

[31] *See*, Comments of USTelecom and Verizon, *Public Comments Regarding Patent Assertion Entity Activities*, Federal Trade Commission, April 5, 2013.

[32] FTC Report, *The Evolving IP Marketplace, Aligning Patent Notice and Remedies with Competition*, p. 8 (2011) (available at: http://www.ftc.gov/os/2011/03/110307patentreport.pdf) (visited December 11, 2013) (*2011 IP Report*).

themselves in a position to obtain a payment from the defendant greater than the value of the patented technology over alternatives at the time of design. "At the time a manufacturer faces an infringement allegation, switching to an alternative technology may be very expensive if it has sunk costs in production using the patented technology. That may be true even if choosing the alternative earlier would have entailed little additional cost."[33]

Under these circumstances, the PAE might threaten an exclusion order to obtain royalties reflecting the hold-up value of the patent – that is, the costs that the defendant would incur if it were enjoined and had to switch away from using the PAE's patented technology.[34] And when the asserted patent is standard-essential, the PAE can exploit that fact to seek an even higher royalty from the defendant as there may be no other means than the PAE's technology for practicing the standard.[35] Particularly in the context of multi-feature, multi-component products, a PAE's control over a standard-essential patent may give it leverage to extract value properly attributable to features and controls having nothing to do with the PAE's patent.

USTelecom appreciates the FTC's efforts in the current proceeding to more fully explore the adverse impact of PAE activities. The effects of PAE activities are felt by businesses of all sizes across a broad range of industries. USTelecom looks forward to working with FTC staff in fully examining these issues.

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[33] *Id.* at p. 5.

[34] *See* Keynote Address by Commissioner Edith Ramirez, Competition Policy for the IP Marketplace, 29th Annual Antitrust, Consumer Protection and Unfair Business Practices Seminar and Annual Meeting, Washington Bar Association 2 (Nov. 8, 2012) ("switching costs give the patent holder the leverage to demand licensing terms that reflect the device maker's own investment, rather than the competitive value of the patent technology"); Edith Ramirez & Lisa Kimmel, *A Competition Policy Perspective on Patent Law: The Federal Trade Commission's Report on the Evolving IP Marketplace*, The Antitrust Source, August 2011 pp. 1, 5 ("[r]emedies that permit a patentee to capture the hold-up value of the patent do nothing to improve the alignment between economic value and reward in these situations because the hold-up value of the patent has nothing to do with the economic contribution of the patented technology and everything to do with the sunk costs of the infringer").

[35] *See* DOJ and FTC Report, *Antitrust Enforcement and Intellectual Property Rights: Promoting Innovation and Competition*, 37-38 (2007); Letter from Thomas O. Barnett, Assistant Attorney General, Department of Justice, Antitrust Division (Oct. 3, 2006), (available at: http://www.justice.gov/atr/public/busreview/219380.htm) ("Once a particular technology is chosen and the standard is developed . . . it can be extremely expensive or even impossible to substitute one technology for another. In most cases, the entire standard-setting process would have to be repeated to develop an alternative standard around a different technology."); *see also* Joseph Farrell, et al., *Standard Setting, Patents, and Hold-Up*, 74 Antitrust L.J. 603 (2007); Mark A. Lemley & Carl Shapiro, *Patent Holdup and Royalty Stacking*, 85 Tex. L. Rev. 1991 (2007).

Sincerely,

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