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PUBLIC COMMENT ON THE COMMISSION'S SECTION 6(b) REPORT ON PATENT ASSERTION ENTITIES: How the Commission Can Most Effectively Use Its Authority To Protect Both Consumers and Competition

To:

Federal Trade Commission
The Hon. Edith Ramirez, Chairwoman
The Hon. Julie Brill, Commissioner
The Hon. Maureen K. Ohlhausen, Commissioner
The Hon. Joshua D. Wright, Commissioner
The Hon. Donald S. Clark, Secretary

U.S. Department of Justice, Antitrust Division
The Hon. William J. Baer, Assistant Attorney General

Office of Management and Budget, Office of Information and Regulatory Affairs
The Hon. Howard A. Shelanski, Administrator

We write to commend the Federal Trade Commission (FTC or Commission), its staff, and its Commissioners for their continuing and bipartisan commitment to address risks posed to consumers and competition by patent assertion entities (PAEs, referred to by some as "patent trolls"). We believe this is an issue worthy of the Commission's attention and considerable resources. The rent-seeking—and sometimes potentially unlawful—conduct of PAEs can act as a tax on innovation and may harm American businesses and consumers.

Throughout the past century, the Commission has used Section 6(b) of the Federal Trade Commission Act (FTC Act)[1] to understand and make recommendations to address distortions in the marketplace—at times to historic effect, as in the passage of the Public Utility Holding Company Act of 1935.[2] Still, we recognize that the Commission's resources are precious, and we thank you for directing such resources to an issue of great importance to consumers and the businesses that serve them. Beginning with the Commission's joint workshop with the U.S. Department of Justice on PAEs in December 2012, and continuing now with the Commission's study brought under Section 6(b), the Commission has demonstrated clear leadership in analyzing a business practice which, we believe, reduces consumer welfare and distorts an open and competitive marketplace. Your work will provide an essential complement to the related efforts undertaken by the White House, the Government Accountability Office, and the bipartisan legislation in Congress introduced by Chairman Leahy (with Senators Lee and Whitehouse), Chairman Goodlatte, and others to understand and address the failures of our patent system.[3]

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[1] 15 U.S.C. § 46(b).

[2] In the past, the Commission has used its powers under Section 6 to "[lead] to major regulatory reforms such as the Packers and Stockyards Act (1921), the Securities Act of 1933, the [Securities] Exchange Act of 1934 and the Public Utility Holding Act of 1935." David Balto, *FTC to shine a light on patent troll practices*, The Hill, Sept. 30, 2013, *available at* http://thehill.com/blogs/congress-blog/judicial/325523-ftc-to-shine-a-light-on-patent-troll-practices; *see also* Hon. Richard D. Cudahy & William D. Henderson, *From Insull to Enron: Corporate (Re)regulation After the Rise and Fall of Two Energy Icons*, 26 Energy Law J. 35, 61 (2005) (noting that the FTC's conclusions in a Congressionally mandated study "served as the factual basis for dismantling the giant holding companies"). Also, in 2002, the Commission issued Section 6(b) orders to brand-name and generic drugmakers to gather information on "pay for delay" settlements and recommended legislative changes to the Hatch-Waxman Act based on such information, such as disclosure to the FTC of certain agreements between brand drugmakers and first generic applicants. Fed. Trade Comm'n, *Generic Drug Entry Prior to Patent Expiration: An FTC Study*, July 2002, *available at* http://www.ftc.gov/reports/generic-drug-entry-prior-patent-expiration-ftc-study. Subsequently, a new regulation promulgated in 2003 implemented an FTC recommendation regarding limiting the application of certain stays in order to speed up the availability of generic drugs. *See* Statement of Daniel E. Troy before the Senate Committee on the Judiciary, "Drug Price Competition and Patent Term Restoration Act of 1984 (Hatch-Waxman Amendments)," Aug. 1, 2003, *available at* http://www.fda.gov/newsevents/testimony/ucm115033.htm. Furthermore, the FTC's use of its Section 6(b) authority in the early 2000s to acquire information from hospitals and insurers led the FTC to change its strategy in hospital merger cases, resulting in a string of litigation victories and abandoned deals perceived as anticompetitive. "Retrospectives at the FTC: Promoting an Antitrust Agenda," Remarks of Chairwoman Edith Ramirez, ABA Retrospective Analysis of Agency Determinations in Merger Transactions Symposium, George Washington University Law School, June 28, 2013, *available at* http://www.ftc.gov/sites/default/files/documents/public_statements/retrospectives-ftc-promoting-antitrust-agenda/130628aba-antitrust.pdf.

[3] Patent Transparency and Improvements Act of 2013 (S. 1720), *available at* https://www.govtrack.us/congress/bills/113/s1720; Innovation Act (H.R. 3309), *available at* http://judiciary.house.gov/news/2013/10232013%20%20Innovation%20Act.pdf.

To that end, we are grateful for the opportunity to respond to the Commission's request for public comment on its study and aid in the Commission's efforts.

I. Background on PAEs

As the Commission is aware, a PAE acquires or aggregates patents in order to extract value from them, specifically by asserting them against operating companies already using the technology purportedly covered by such patents.[4] PAEs typically do not develop or commercialize the patents they assert.[5]

Instead, PAEs' primary business lies in using litigation—or the threat of it—to assert patent infringement against companies ranging from technology producers to end users, such as retailers and small businesses.[6] Frequently, targets of PAEs have already invested resources into creating products before PAEs make infringement claims relating to the technologies or methods for creating those products.[7] PAEs may also undertake opaque and questionable practices, such as not revealing their identities,[8] dispersing their patent portfolios among a network of shell entities,[9] and sending demand letters to a wide array of targets.[10] When PAEs make infringement claims, the targets or defendants may pay license fees or settle in amounts that reflect not the value of the patents asserted, but rather the costs of potential business disruption and expensive litigation.[11]

Statistical analyses indicate that PAE enforcement is expensive for defendants even though PAEs very rarely prevail on their infringement claims in court. According to the primary source of data to date—that is, data provided by RPX Corporation that formed the basis of many recent reports and studies[12]—PAEs launched 62% of all patent suits, or 2,500 cases, in 2012, representing an increase of about 67% over 2011, when there were 1,500 PAE suits.[13] According to one analysis, defendants and licensees paid PAEs $29 billion in 2011, even though less than 25% of this amount accrued to inventors (only about $6 billion), and another study

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[4] Fed. Trade Comm'n, *The Evolving IP Marketplace: Aligning Patent Notice and Remedies with Competition*, Mar. 2011 [FTC 2011 Report], at 60-63, *available at* http://www.ftc.gov/os/2011/03/110307patentreport.pdf.

[5] Executive Office of the President, *Patent Assertion and U.S. Innovation*, June 2013 [White House 2013 Report], at 4; FTC 2011 Report at 63.

[6] White House 2013 Report at 1, 4.

[7] *Id.* at 4.

[8] *Id.*

[9] *See*, *e.g.*, Tom Ewing & Robin Feldman, *The Giants Among Us*, 2012 Stanford Tech. L. Rev. 1, 4.

[10] White House 2013 Report at 6.

[11] *Id.* at 6-7.

[12] *See*, *e.g.*, White House 2013 Report; Fiona M. Scott Morton and Carl Shapiro, *Strategic Patent Acquisitions*, July 2, 2013, *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2288911; James Bessen & Michael J. Meurer, *The Direct Costs from NPE Disputes*, B.U. Law Working Paper No. 12-34 (June 28, 2012), *available at* http://www.bu.edu/law/faculty/scholarship/workingpapers/documents/BessenJ_MeurerM062512rev062812.pdf. *But see* Pricewaterhouse Coopers, *2012 Patent Litigation Study*, *available at* http://www.pwc.com/us/en/forensic-services/publications/2012-patent-litigation-study.jhtml (using PWC-collected data); John R. Allison, Mark A. Lemley & Joshua Walker, *Patent Quality and Settlement Among Repeat Patent Litigants*, 99 Geo. L.J. 677 (2011) (using Stanford IP Litigation Clearinghouse).

[13] White House 2013 Report at 5.

found that legal defense costs were greater than settlement or judgment amounts in more than half of PAE cases.[14] These costs are all the more significant in light of the fact that, when their infringement claims go to judgment or trial, PAEs have lost over 90% of the time, well above the 60% failure rate for infringement claims by non-PAEs.[15]

But such figures and statistics are only a start. RPX, a defensive patent aggregator, compiled these data on PAE litigation from public court records. More sources of data to be obtained by this Section 6(b) study, including nonpublic information, are necessary to provide a more complete picture of the PAE industry and the costs it imposes upon businesses and their customers.

II. Procedural Considerations

While the Commission has a long tradition of issuing reports pursuant to Section 6(b), the Commission on occasion has not been able to complete such studies quickly. As we know you will agree, any delay here would run counter to the public interest that the Commission safeguards. Below, we outline some ways the Commission could streamline its procedures in order to make findings of value to businesses and consumers as quickly as possible.

Allocate sufficient resources to the study. *First*, the Commission must allocate sufficient resources to the Section 6(b) study at all levels, ensuring that the staff within the Commission's bureaus has the focus and time necessary to contribute to the public debate in Congress, in the White House, and at executive agencies in a timely manner.

Issue an interim report to Congress. *Second*, the Commission need not wait until it has completed its final study to brief Congress about the findings it is making regarding the ways that PAEs affect consumers and competition. Most recently, the Commission issued an interim report to Congress during its study of authorized generic drugs in 2009, although it did not issue its final report until 2011.[16] The interim report provided a period of two years in which Congress and the public were able to engage in a dialogue with the Commission and to consider how to respond to preliminary findings. During that period, the interim report, which noted pro-competitive benefits from authorized generics, helped members of the U.S. Senate determine not to move forward with legislation to restrict these products. In the spirit of transparency to

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[14] White House 2013 Report at 9 (citing James Bessen and Michael Meurer's 2012 working paper and Colleen Chien's presentation to the DOJ/FTC hearing on PAEs in Dec. 10, 2012).

[15] Brian T. Yeh, *An Overview of the "Patent Trolls" Debate*, Congressional Research Service, Apr. 16, 2013, at 5 (citing John R. Allison, Mark A. Lemley & Joshua Walker, *Patent Quality and Settlement Among Repeat Patent Litigants*, 99 Geo. L.J. 677 (2011) (examining patent litigation from 2000 to 2009)). *But see* Pricewaterhouse Coopers, *2012 Patent Litigation Study* (examining patent litigation from 1995 to 2011).

[16] Fed. Trade Comm'n, *Authorized Generics: An Interim Report*, June 24, 2009, *available at* http://www.ftc.gov/os/2009/06/P062105authorizedgenericsreport.pdf; "Statement of Chairman Jon Leibowitz on the Release of the Commission's Interim Report on Authorized Generics," June 2009, *available at* http://www.ftc.gov/os/2009/06/P062105authgenstatementLeibowitz.pdf ("Although [the interim report's] analyses and facts do not answer every question about long-term and overall effects on competition from the use of AGs [authorized generic drugs], they offer new insights and understandings of AG competition that Congress may find useful in its deliberations on this issue."); Fed. Trade Comm'n, Press Release, *FTC Report Examines How Authorized Generics Affect the Pharmaceutical Market*, Aug. 31, 2011, *available at* http://www.ftc.gov/news-events/press-releases/2011/08/ftc-report-examines-how-authorized-generics-affect-pharmaceutical.

Congress and responding quickly to a serious public policy problem, we urge the Commission to issue an interim report here, as well.

Commit PAE executives to testimony. *Third*, we urge the Commission to supplement its document requests with depositions and/or sworn interrogatories of PAE executives in order to release information to Congress and the public regarding entities that are believed to take steps to insulate themselves from scrutiny.[17] Depositions and/or interrogatories will speed up the fact-finding process and afford PAE executives the opportunity to provide a high-level explanation of their activities, which would otherwise take more time and effort for the Commission staff to gather if done only through a document collection.

Expand the scope of the subpoenas to PAEs. *Fourth*, we respectfully submit that the draft information requests published in the Federal Register may constrain the Commission's ability to conduct its study in the most useful and effective manner:

1. For example, the definition of "Firm" in the draft information requests[18] could be too narrow, because it applies traditional ownership rights among businesses to a sector that is known for its novel and opaque business arrangements. We urge you to expand this definition to include any entity that holds a legal interest in a patent in which the Person or entity served with the information request holds an Economic Interest, as the draft information requests define these terms. Such a definition more closely reflects the flexible legal structures of PAEs acknowledged in Information Requests C(1)(m) and (n), which require identification of entities with "any legal rights" or "an Economic Interest" in the patents at issue, while also recognizing that a PAE may have an interest in patents that it does not hold directly and that are not held by its legal subsidiaries or affiliates. In addition, it reflects the Commission's recent rulemaking with regard to the transfer of pharmaceutical patent rights, in which it imposed rules beyond exclusive ownership rights to apply to "all commercially significant rights."[19] By expanding the definition of "Firm" accordingly, the Commission can quickly gain more clarity into PAE conduct, while minimizing the number of follow-on requests sent to entities.

2. In that connection, Information Request B(2), which demands disclosures regarding PAEs' corporate structures, should also include a request for all Persons or entities that hold a legal interest in a patent in which the Firm holds an Economic Interest.

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[17] The FTC Act extends to the Commission broad authority to solicit sworn testimony from PAE executives, whether done in written interrogatory form, *see* 15 U.S.C. § 46(b) (providing for "answers in writing to specific questions . . . made under oath"), or as oral depositions, *see* 15 U.S.C. § 49 ("The Commission may order testimony to be taken by deposition in *any proceeding or investigation pending under this subchapter at any stage of such proceeding or investigation.*" (emphasis added)) and 15 U.S.C. § 57b-1(c) (providing for oral testimony from any recipient of a civil investigative demand). Both powers would be useful here.

[18] In the current form of its information requests, the Commission defines "Firm" as "the Person or entity served with the information requests described in this notice and also includes all domestic and foreign parents, predecessors, divisions, subsidiaries, affiliates, partnerships and joint ventures, directors, officers, employees, agents, representatives, and all other persons acting or purporting to act on its behalf, regardless of how it is legally organized and established." *See* 78 Fed. Reg. 61,353 (Oct. 3, 2013). This definition covers the entity with an ownership interest in the patent and entities purporting to act on its behalf, but it does not cover, e.g., entities that can assert an interest in the patent or its proceeds but that have transferred ownership to avoid disclosure.

[19] 16 C.F.R. §§ 801.1(o)-(q); 16 C.F.R. § 801.2(g); 78 Fed. Reg. 68705 (Nov. 15, 2013).

3. Additionally, while it is clear that the Commission is focused on the acquisition of patents and the valuation of such patents, the Commission does not require entities to state whether they notified the acquisitions under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (HSR Act).[20] The Commission can and should compare the financial terms on which entities acquired the patents and monetize them (Information Requests E-F) with the entities' obligations to comply with the HSR Act.

4. We also respectfully suggest that Information Request F(2) include a request for information on the number of documents produced by the Firm and by opposing parties in each patent infringement litigation to gain more clarity into the asymmetry of discovery burdens in cases involving PAEs. These data are important for the Commission to assess costs imposed by PAEs on otherwise efficient businesses and also for Congress as it considers whether and how to adjust statutes governing PAEs' litigation behavior.

5. Finally, there is no reason why the Commission should constrain itself from being able to use the information gathered pursuant to the subpoenas issued in the Section 6(b) study to bring enforcement actions against PAEs, if and when the Commission discovers violations of the law. To the contrary, if the Commission finds evidence of a PAE engaging in an unfair or deceptive act or practice or an unfair method of competition, it should take action to safeguard competition and consumers. Recent reporting on the Section 6(b) study has noted that the Commission's subpoenas are likely to preclude investigations into specific abuses,[21] because the agency has drafted its subpoenas only for information-gathering purposes. But under the Commission's own rules, it has the ability to define the purpose of the subpoenas sent to PAEs, and there is no legal constraint preventing the Commission from retaining the right to bring an enforcement action where a violation has occurred.[22] In fact, the Commission has previously conducted a Section 6(b) study in which it has explicitly reserved the right to bring an enforcement action.[23] We believe that not to do so unnecessarily ties the Commission's hands should it discover conduct that violates its own consumer protection and competition mandates, to the potential detriment of consumers and small businesses.

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[20] Pub. L. No. 94-435.

[21] Policy and Regulatory Report (PaRR), *FTC at odds on effect patent troll study may have on subsequent investigations*, Oct. 24, 2013.

[22] *See* 16 C.F.R. § 2.6 ("Any person, partnership, or corporation under investigation compelled or requested to furnish information or documentary material shall be advised of the purpose and scope of the investigation, the nature of the acts or practices under investigation, and the applicable provisions of law."); *see also* Practising Law Institute (PLI) Course Handbook, *Understanding the Intellectual Property License*, 2013 ("An FTC 6(b) investigation can entail broad subpoenas to market participants, follow-up hearings, and even using the process to develop targets for law enforcement actions.").

[23] *See, e.g.*, Fed. Trade Comm'n, *Pharmacy Benefit Manager Conflict of Interest Study Public Notice*, Mar. 26, 2004 ("Although law enforcement is not the primary purpose of the information and data collection, the information collected could merit law enforcement action."). The Commission also used information gleaned from its 2002 study engaging in a retrospective of hospital mergers to bring a post-consummation challenge against the merger of two hospitals in Chicago: Evanston Northwestern and Highland Park Hospital. Deborah Haas Wilson and Christopher Garmon, *Two Hospital Mergers on Chicago's North Shore: A Retrospective Study*, Working Paper No. 294, Jan. 2009, *available at* http://www.ftc.gov/be/workpapers/wp294.pdf; Fed. Trade Comm'n, *FTC Issues Final Opinion and Order to Restore the Competition Lost in Evanston Northwestern Healthcare Corporation[']s Acquisition of Highland Park Hospital*, Apr. 28, 2008, *available at* http://www.ftc.gov/opa/2008/04/evanston.shtm.

Consider enforcement actions. *Fifth*, and relatedly, we urge the Commission to assess, as a legal matter, how PAE conduct may be enforceable within the jurisdiction of both the Commission and the Antitrust Division of the U.S. Department of Justice. Below, we outline a series of enforcement theories firmly within the Commission's existing consumer protection and competition jurisdiction.

III. Analytical Considerations

A. Acquisitions That "Substantially [ ] Lessen Competition" under Clayton Act § 7

Perhaps the most immediate way to address harms to competition posed by PAEs is at the stage at which PAEs acquire and aggregate patents.

Under the HSR Act, parties generally must notify the government of the proposed acquisition of an asset whose value meets or exceeds a certain threshold (for 2013, $70.9 million), subject to certain exceptions and exemptions.[24] (This figure is not necessarily the purchase price; it is the fair market value (or a good-faith estimate of such value)—an important distinction with respect to PAEs.) The HSR Act imposes a waiting period on transactions during which the parties must wait to close the acquisition while the FTC or the DOJ reviews the acquisition under Section 7 of the Clayton Act, which prohibits an acquisition whose effect "may be substantially to lessen competition."[25] All acquisitions, whether reportable under the HSR Act or not, are subject to Section 7 of the Clayton Act.

We urge the Commission to use its existing authority to determine whether PAEs are acting in good faith in complying with their HSR reporting obligations. If any PAEs are evading HSR requirements by understating the value of acquired patents in bad faith, the Commission should consider enforcement of the HSR Act and the Commission's regulations. Learning of those acquisitions before they are consummated would also give the Commission and the Antitrust Division the ability to scrutinize PAEs' acquisitions of substitute or rival technologies for anticompetitive impact:

1. The Commission now has an ideal opportunity to determine whether, as a procedural matter, PAEs have been making HSR filings as required and undertaking appropriate valuations of their acquired patents. As you know, fees collected during premerger notification bear upon the source of the Commission's own federal funding. Failure to meet HSR requirements harms taxpayers by obliging Congress to provide more funding to the Commission from the federal budget than would otherwise be required were the Commission to collect fees from entities failing to meet their HSR obligations.[26]

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[24] Pub. L. No. 94-435, § 201, 90 Stat. 1390 (codified as amended at 15 U.S.C. § 18a), amending the Clayton Antitrust Act of 1914, Pub. L. No. 63-212, 38 Stat. 730; Revised Jurisdictional Thresholds for Section 7A of the Clayton Act, 78 Fed. Reg. 2406-07 (Jan. 11, 2013).

[25] 15 U.S.C. § 18.

[26] *See, e.g.*, Administrative Conference of the United States, *The Budget For Fiscal Year 2013* at 774, 1349, *available at* http://www.gpo.gov/fdsys/pkg/BUDGET-2013-APP/pdf/BUDGET-2013-APP-1-15.pdf and http://www.gpo.gov/fdsys/pkg/BUDGET-2013-APP/pdf/BUDGET-2013-APP-1-31.pdf (stating that, with regard to both DOJ and FTC, allocated funds will remain available, provided that "fees collected for premerger notification

The HSR rules provide that an acquiring party must value an acquired patent based on fair market value or, if determined prior to closing and greater, the acquisition price. Such fair market value is determined by the ultimate parent entity of the acquiror "in good faith."[27] We respectfully submit that there are questions as to whether a PAE should have notified a transaction under the HSR Act if the PAE asserts in demand letters or in court that an acquired patent or portfolio of patents is worth more than $70.9 million (as adjusted) or attempts to collect more than $70.9 million in licensing fees and settlements from alleged infringers regarding such patent(s). This study positions the Commission to determine whether PAEs are extracting more value from their patents above the HSR threshold in a way that may call into doubt whether they are working in good faith to meet their HSR obligations. For example, deposing PAEs' chief executives would serve as an avenue to glean what the patents were thought to be worth at the time of acquisition and whether PAEs violated the HSR Act by acting in bad faith in valuing a patent or patents below the applicable HSR threshold (contrary to the requirements of Rule 801.10(c)(3)).

Moreover, as you know, failure to comply with HSR requirements can trigger fines of up to $16,000 per violation per day.[28] If the Commission discovers that PAEs have acted in bad faith to evade their HSR requirements, we urge the Commission to use its fining authority to send a message that it will not tolerate such conduct.

2. Furthermore, both in the Section 6(b) study and as a general matter, we encourage the Commission and the Antitrust Division to undertake rigorous substantive review of PAEs' acquisitions of patents under Section 7 of the Clayton Act. For example, although ownership of a patent does not conclusively establish market power, if the Commission allowed a PAE to amass patents for rival or substitute technologies, that aggregation could provide the PAE with pricing power vis-à-vis prospective licensees. Operating companies would have little choice but to license from the PAE, even at supracompetitive rates. Therefore, potentially some PAE acquisitions may substantially lessen competition. The Section 6(b) study can elicit information as to whether PAEs are aggregating complementary or substitutable patents.

B. "Unfair or Deceptive Act or Practice" under FTC Act § 5

As you know, the Commission can proscribe PAE activities that harm consumer welfare under its consumer protection authority to proscribe any "unfair or deceptive act or practice" under Section 5 of the FTC Act.[29]

Under the terms provided by Congress, conduct that harms consumer welfare is actionable if it is either "unfair" or "deceptive." As to "unfairness," the Commission has clarified

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filings . . . shall be retained and used for necessary expenses in this appropriation" and that the sum allocated in the general fund shall be reduced by offsetting collections received during the fiscal year).

[27] 16 C.F.R. § 801.10(c)(3) ("The fair market value shall be determined in good faith by the board of directors of the ultimate parent entity included within the acquiring person, or, if unincorporated, by officials exercising similar functions; or by an entity delegated that function by such board or officials.").

[28] 74 Fed. Reg. 857 (Jan. 9, 2009).

[29] 15 U.S.C. § 45 (amended in 1938 to prohibit "unfair or deceptive acts or practices").

its jurisdiction as resting on three core principles, which in 1994, Congress codified into Section 5(n). That section provides that an act or practice is "unfair" if it poses consumer injury that is (1) substantial, (2) not outweighed by countervailing benefits to consumers or to competition, and (3) not reasonably avoidable by consumers, with established public policies to be considered within the totality of the evidence before the Commission.[30] An act, omission, or practice may be "deceptive" if it is likely to mislead reasonable consumers and is material, i.e., "likely to affect the consumer's conduct or decision with regard to a product or service."[31] The Commission has used its consumer protection authority under Section 5 against businesses engaging in unfair or deceptive acts or practices where there is harm to small businesses or even if the harm to consumers may be indirect.[32]

Congress' grant of authority in Section 5 provides the Commission with the ability to initiate enforcement proceedings against PAEs that use misrepresentations, omissions, and other unfair or deceptive acts or practices to coerce businesses into paying license fees, regardless of whether those businesses infringe on any claims of the patent(s) at issue. We urge the Commission to consider commencing proceedings immediately against any PAE that the Commission's staff discovers is, e.g.:

1. Issuing demand letters or alleging patent infringement without a reasonable and/or good-faith basis for believing that the patent at issue is both valid and infringed.

2. Entering into commitments with standard-setting organizations (SSOs) to license patents on fair, reasonable, and nondiscriminatory (FRAND) terms, and then conveying ownership or assertion rights to another entity to evade FRAND commitments and seek license fees in excess of FRAND fees.

3. Issuing demand letters or initiating infringement proceedings against defendants using legal theories of infringement that have already been rejected by courts. In this sense, a consumer protection action by the Commission would effectively serve as a form of offensive, nonmutual collateral estoppel without requiring the businesses targeted by PAEs to bear the costs of individually litigating actions, which are frequently cheaper to settle than to litigate.[33]

4. Issuing demand letters or initiating infringement proceedings against defendants over the same patents already alleged by the PAE's other related entities to be infringed (e.g., "double-dipping" by using one PAE to elicit license fees from alleged infringers and then

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[30] *Id.* at § 45(n), *added by* The Fed. Trade Comm'n Act Amendments of 1994, Pub. L. No. 103-312 (codifying the unfairness standards set forth in the FTC Policy Statement on Unfairness, Dec. 17, 1980, *available at* http://www.ftc.gov/ftc-policy-statement-on-unfairness).

[31] Fed. Trade Comm'n, *FTC Policy Statement on Deception*, Oct. 14, 1983, *available at* http://www.ftc.gov/ftc-policy-statement-on-deception.

[32] Fed. Trade Comm'n, Complaint, In the Matter of Take-Two Interactive Software, Inc. and Rockstar Games, Inc., Docket No. C-4162 (alleging that makers of the *Grand Theft Auto: San Andreas* video game failed to disclose to the industry's ratings board that the game contained sexual content that could be viewed by downloading a patch that would reveal this content).

[33] *See, e.g.*, Brian T. Yeh, *An Overview of the "Patent Trolls" Debate*, Congressional Research Service, Apr. 16, 2013, at 12-14.

using another PAE to assert infringement against the same licensees over related patents).[34]

C. "Unfair Methods of Competition" under FTC Act § 5

The Commission also has the authority under Section 5 of the FTC Act to prohibit "unfair methods of competition in or affecting commerce."[35]

The Commission has stated that "[a]s a general proposition, practices that constitute unfair methods of competition include at least practices that violate the Sherman Act and the Clayton Act."[36] The Commission has also noted in prior statements that the legislative record for the creation of the Commission provides some color on the types of conduct Congress intended for the Commission to target, such as "unjust, inequitable or dishonest competition."[37]

We encourage the Commission to evaluate whether certain PAE practices constitute "unfair methods of competition" in violation of Section 5. Such PAE activities allow for the potential disregard of encumbrances of standard-essential patents (SEPs), i.e., patents covering technologies selected by SSOs as common standards in the industry.

First, as noted above, PAEs may serve as a mechanism by which patent owners that committed to licensing SEPs on FRAND terms can shed such commitments. There are precedents of transferees of SEPs claiming not to be subject to FRAND commitments, despite Commission pronouncements to the contrary.[38]

Second, the Commission should be attentive to the possibility of a more indirect evasion of FRAND obligations. Aggregating PAEs often bundle a large number of patents together to seek higher licensing fees from targets. If SEPs are bundled with non-SEPs for a single licensing fee, it can be difficult for the prospective licensee to tell whether the SEPs are being charged at FRAND rates. If the SEPs were transferred from a patent owner at a price that suggested that the SEPs would be unencumbered by FRAND obligations in the hands of the transferee, or if benefits from licensing of SEPs on non-FRAND terms flow back to the transferors because of any proceeds-sharing arrangements, then the Commission should

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[34] *See, e.g.* David Segal, *Has Patent, Will Sue: An Alert to Corporate America*, The New York Times, July 13, 2013 (citing Taurus IP, LLC v. DaimlerChrysler Corp., 559 F. Supp. 2d 947 (W.D. Wisc. 2008)).

[35] 15 U.S.C. § 45.

[36] Fed. Trade Comm'n, *Strategic Plan Fiscal Years 2000–2005*, *available at* http://www.ftc.gov/sites/default/files/documents/reports_annual/strategic-plan/spfy00fy05.pdf.

[37] Fed. Trade Comm'n, Statement, In the Matter of Negotiated Data Solutions LLC, Docket No. C-4234, *available at* http://www.ftc.gov/sites/default/files/documents/cases/2008/01/080122statement.pdf. The Supreme Court has confirmed that the "unfairness" standard characterizes conduct that the Commission determines is "against public policy," whether due to violation of antitrust laws or "for other reasons." F.T.C. v. Ind. Fed'n of Dentists, 476 U.S. 447, 454 (1986); *see also* F.T.C. v. Sperry & Hutchinson Co., 405 U.S. 233, 244-45 (1972).

[38] Prepared Statement of The Federal Trade Commission Before the United States Senate Committee on the Judiciary Subcommittee on Antitrust, Competition Policy and Consumer Rights Concerning "Standard Essential Patent Disputes and Antitrust Law," July 30, 2013, at 11-12, *available at* http://www.ftc.gov/sites/default/files/documents/public_statements/prepared-statement-federal-trade-commission-concerning-standard-essential-patent-disputes-and/130730standardessentialpatents.pdf.

consider whether transferors employed unfair methods of competition against other patent holders in the standard-setting process.[39]

Overall, the Commission need not seek expanded enforcement powers in order to bring an enforcement action against PAEs. To the contrary, as stated in the above sections, we believe that the enforcement theories against PAEs fit squarely within traditional causes of action within consumer protection and competition law.

IV. Policy Recommendations

Numerous public policy assumptions concerning the manner in which the marketplace rewards and protects innovation underlie the current patent system. The Section 6(b) study presents an opportunity for the Commission to test these assumptions, in light of the ability to collect previously unavailable data and determine whether these assumptions are, in fact, accurate. Moreover, the study will enable the Commission to develop policy recommendations for a multilateral and bipartisan approach to PAEs that is informed by the facts in the marketplace, rather than assumptions about how the patent system should operate in theory or allegations and justifications made by PAEs themselves—an approach that can inform the courts, other administrative departments and agencies, and, most importantly, Congress.

There are reasons to examine each of the three primary assumptions of our patent system with a critical eye:

- The first assumption is that the patent system rewards individual investment in new technologies and protects that investment against free riders.[40] However, the publicly available evidence suggests that PAEs may do little to further this goal, as it can be questioned whether they return enough revenue to the inventors of the patents they assert.[41]

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[39] *See, e.g.*, Fed. Trade Comm'n, Statement, In the Matter of Negotiated Data Solutions LLC, Docket No. C-4234, *available at* http://www.ftc.gov/sites/default/files/documents/cases/2008/01/080122statement.pdf (finding that defendant's reneging on licensing commitment made to a standard-setting body was an unfair method of competition). Such evasion of FRAND commitments may also raise Section 2 concerns under the Sherman Act.

[40] *See, e.g.*, Ron Epstein, *Debunking the "Patent Troll" Myth*, Bloomberg Businessweek, Feb. 1, 2010, *available at* http://www.businessweek.com/stories/2010-02-01/debunking-the-patent-troll-mythbusinessweek-business-news-stock-market-and-financial-advice; Erin Fuchs, *In Defense of the Dreaded "Patent Troll,"* Business Insider, Nov. 27, 2012 (quoting Acacia CEO Paul Ryan as stating "[u]ntil we came along, most small entities were really frozen out of the market," and explaining that Acacia helps small-time investors get paid for their creations), *available at* http://www.businessinsider.com/in-defense-of-the-dreaded-patent-troll-2012-11; Nathan Myrhvold, *The Big Idea: Funding Eureka!*, Harv. Bus. Rev., Mar. 2010, at 40, 48.

[41] *See, e.g.,* Fed. Trade Comm'n, *The Evolving IP Marketplace: Aligning Patent Notice and Remedies with Competition* 70, Mar. 2011 ("amount PAEs paid to inventors was too small to provide a significant incentive to invent or funding for future work"); *see also* James Bessen & Michael Meurer, *Patent Trolls in Public*, Patent Law Blog (Patently-O) (Mar. 19, 2013), http://www.patentlyo.com/patent/2013/03/patent-trolls-in-public.html (for ten publicly listed PAEs during the period 2005 to 2010, "[o]f the total licensing revenues earned, only 7% flowed to third party inventors"); James Bessen & Michael J. Meurer, *The Direct Costs from NPE Disputes* at 22, B.U. Law Working Paper No. 12-34 (June 28, 2012), *available at* http://www.bu.edu/law/faculty/scholarship/workingpapers/documents/BessenJ_MeurerM062512rev062812.pdf (stating percentage of costs from NPE suits flowing to small investors no more than 21%); Andrei Hagiu & David B. Yoffie, *The New Patent Intermediaries: Platforms,*

- The second assumption is that the system promotes the adoption of technology through disclosure and licensing.[42] Yet the vast majority of PAE licensing activity appears to be *ex post*—that is, PAEs generally approach companies that have already developed and marketed the products or services that allegedly incorporate the patented technology.[43]

- Finally, the third assumption is that the system operates to spur further innovation by permitting the public to learn from a patent, develop a better solution, and design around it. But if the system provides too much protection to the holder of the first patent, then the incentive to improve upon it is diminished.

Operating companies that have regularly been the targets of PAE patent assertions know the disruption PAEs cause to their businesses. Nevertheless, it has been difficult for Congress, the courts, and market participants to test these assumptions against the realities of the market in a systematic fashion, because of the lack of publicly available data. Accordingly, we urge the Commission to take full advantage of the information that it receives through the Section 6(b) study to bring clarity to these issues and promote a better understanding of the ways in which the patent system operates in practice.

In addition, we urge the Commission to consider issuing policy recommendations based on its findings. Congress is currently engaged in a bipartisan effort to address PAE litigation, and we generally support the legislative proposals put forth by Rep. Goodlatte, Sen. Leahy, and others, including:

- Awarding fees and expenses to the prevailing party in patent litigation;

- Increasing the disclosure required when filing a complaint for patent infringement, including disclosure of the ultimate parent entity and all parties with a financial interest in any asserted patent;

- Heightening initial pleading requirements;

- Limiting discovery until after the terms of a claim are construed;

- Changing joinder and intervention rules to ensure that appropriate parties are in a suit;

- Limiting the number of continuation claims that may be filed off a single application and the time in which they may be filed, in order to prevent abuse;

Defensive Aggregators, and Super-Aggregators, 27 J. Econ. Persp. 45, 52 (2013) ("back-of-the-envelope calculation" showing patent settlements are expected to exceed ten times the cost to the PAE of the patents).

[42] *See, e.g.,* Chief Judge Randall R. Rader, "Patent Law and Litigation Abuse," Keynote Speech at the Eastern District of Texas Bench and Bar Conference, Nov. 1, 2013, at 4-5, *available at* http://www.fedcirbar.org/olc/filelib/LVFC/cpages/9008/Library/Rader%202013%20ED%20Tex%20BB%20Speech.pdf (emphasizing disclosure benefits of patents in driving innovation); James F. McDonough III, *The Myth of the Patent Troll: An Alternative View of the Function of Patent Dealers in an Idea Economy*, 56 Emory L.J. 189, 223 (2006).

[43] White House 2013 Report at 4.

- Staying cases against end users in certain circumstances while infringement claims against manufacturers are being litigated; and

- Clarifying that the widespread sending of demand letters without a reasonable basis in fact or law or that are materially misleading is an unfair or deceptive act or practice under Section 5 of the FTC Act.

The Commission should join in endorsing Congressional action, and the bipartisan legislative efforts can proceed expeditiously alongside the Commission's conduct of its Section 6(b) study.[44] We also urge the Commission to use the findings of the Section 6(b) study as a basis on which to make its own specific legislative recommendations, as it did in its 2012 report on privacy and its 2002 report on authorized generics.[45] The Commission's unique ability to collect previously unavailable information concerning PAEs and use that information to examine the fundamental features of our patent system puts it in an ideal position to make meaningful recommendations again on this issue.

* * *

Thank you for considering our suggestions. We applaud the Commission's efforts in this area and await the findings of this potentially historic study.

Davis Polk & Wardwell LLP

[44] In addition to the points enumerated here, the Commission also has rulemaking authority under FTC Act § 6(g) and in accordance with the provisions of the Administrative Procedure Act. 15 U.S.C. §§ 46(g), 553; Fed. Trade Comm'n, Operating Manual, Chapter 7: Rulemaking, §§ 7.2, 7.4, *available at* http://www.ftc.gov/sites/default/files/attachments/ftc-administrative-staff-manuals/ch07rulemaking.pdf. There is a range of potential rules for which the Commission might consider using this authority, such as clarifying the appropriate circumstances under which acquisitions of patents trigger HSR reporting obligations or outlining which PAE activities qualify as "unfair methods of competition" in violation of Section 5.

[45] *See* Fed. Trade Comm'n, *Protecting Consumer Privacy in an Era of Rapid Change*, Mar. 2012, *available at* http://www.ftc.gov/os/2012/03/120326privacyreport.pdf; Fed. Trade Comm'n, Press Release, *FTC Report Examines How Authorized Generics Affect the Pharmaceutical Market*, Aug. 31, 2011, *available at* http://www.ftc.gov/news-events/press-releases/2011/08/ftc-report-examines-how-authorized-generics-affect-pharmaceutical. For example, the Commission could evaluate whether to recommend the legislative enactment of an antitrust exemption for affected companies to work together strictly for the purpose of alleviating the negative impact of PAE activities on competition, consumers, and innovation. *Cf.* Television Program Improvement Act of 1990, 47 U.S.C. § 303c ("The antitrust laws shall not apply to any joint discussion, consideration, review, action, or agreement by or among persons in the television industry for the purpose of, and limited to, developing and disseminating voluntary guidelines designed to alleviate the negative impact of violence in telecast material.").

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