Project No. P131203

COMMENTS

of

THE WASHINGTON LEGAL FOUNDATION

to the

FEDERAL TRADE COMMISSION

Concerning

FTC'S PROPOSED INFORMATION REQUESTS TO PATENT ASSERTION ENTITIES AND OTHER ENTITIES ASSERTING PATENTS IN THE WIRELESS COMMUNICATIONS SECTOR

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Federal Trade Commission
Office of the Secretary
Room H-113 (Annex J)
600 Pennsylvania Avenue, N.W.
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Re: PAE Reports: Paperwork Comment; Project No. P131203; Request for Comments on Proposed Information Requests to Patent Assertion Entities and Others Asserting Patents in the Wireless Communications Sector; 78 Fed. Reg. 61352 (October 3, 2013)

Dear Commissioners:

The Washington Legal Foundation (WLF) appreciates this opportunity to submit these comments to the Federal Trade Commission (FTC) in connection with the FTC's proposed information requests to Patent Assertion Entities (PAEs) and other entities asserting patents in the wireless communications sector. WLF applauds the FTC's decision to go forward with its investigation of PAEs and concludes that the proposed information requests are consistent with the requirements of the Paperwork Reduction Act, 44 U.S.C. §§ 3501 *et seq.*

Interests of WLF. WLF is a non-profit public interest law and policy center based in Washington, D.C. with supporters nationwide. WLF promotes free-market policies through litigation, administrative proceedings, publications, and advocacy before state and federal government agencies, including the FTC. To that end, WLF regularly appears before the U.S. Supreme Court and the U.S. Court of Appeals for the Federal Circuit in cases raising important

patent law issues, particularly those cases in which enforcement of broad or ambiguous patent claims might serve to inhibit innovation. *See, e.g., Hyundai Motor America, Inc. v. Clear with Computers, LLC*, 496 Fed. Appx. 88 (Fed. Cir. 2013), *cert. denied*, ___ S. Ct. ___, 2013 WL 4776515 (Nov. 12, 2013); *i4i Limited P'ship v. Microsoft Corp.*, 598 F.3d 831 (Fed. Cir. 2010), *aff'd*, 131 S. Ct. 2238 (2011); *Ariad Pharms., Inc. v. Eli Lilly & Co.*, 598 F.3d 1336 (Fed. Cir. 2010). On April 4, 2013, WLF filed comments with the FTC in response to the Commission's November 19, 2012 invitation for public comments on the impact of PAE activities on innovation and competition.

FTC's Proposal for a Section 6(b) Study. A universal theme among panelists and commentators at the FTC's December 12, 2012 workshop—conducted for purposes of exploring the impact of PAE activity on innovation and competition—was the lack of empirical data in this area. Numerous commentators have recommended that the Commission remedy that deficiency by using its authority under Section 6(b) of the Federal Trade Commission Act, 15 U.S.C. § 46(b), to collect information on PAE acquisition, litigation, and licensing practices. WLF agrees with those recommendations and, accordingly, wholeheartedly supports the FTC's decision to go forward with a § 6(b) information request. In particular, WLF believes that the information that the FTC is proposing to request is appropriate in scope and fully complies with the requirements of the PRA.

WLF Responses to FTC's Four Questions. In its notice announcing that it planned to proceed with a § 6(b) information request, the FTC invited comments on four specific topics to

which it plans to give additional consideration before seeking OMB approval for its information request. WLF provides the following specific comments regarding those topics:

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

Federal law authorizes the FTC to prevent businesses and individuals (with certain limited exceptions) from "using unfair methods of competition in or affecting commerce and unfair or deceptive acts or practices in or affecting commerce." 15 U.S.C. § 45(a)(2). The FTC has authority to declare an act or practice unfair if it is "likely to cause substantial injury to consumers," and the injury "is not reasonably avoidable by consumers themselves and not outweighed by countervailing benefits to consumers or to competition." 15 U.S.C. § 45(n). It is empowered to issue cease-and-desist orders, ordering individuals and entities not to engage in acts or practices it determines to be in violation of the FTC Act. 15 U.S.C. § 45(b).

WLF is a strong supporter of the patent system and believes that patents can provide strong incentives for innovation. We recognize that the creation of entities that purchase patents for the sole purpose of extracting licensing fees from operating entities, without any intent of ever practicing the patent, can have positive effects; such entities help create a vibrant secondary market for patents and thus allow innovators who lack access to capital to nonetheless profit from their inventions.

The activities of PAEs nonetheless have the potential to interfere significantly with competition and to harm consumers. Given the tremendous growth of PAE activity in recent

years, the FTC would be derelict in its duty if it did not look closely at the growing number of complaints that PAEs are engaging in unfair methods of competition and unfair practices. WLF believes that the FTC's proposed information requests are appropriate in scope, are necessary for the proper performance of the Commission's functions, and will have significant practical utility.

As the FTC has noted, there was consensus agreement at the FTC's December 10, 2012 workshop on PAE activity that little reliable empirical data exist regarding such activities. In the pages that follow, WLF outlines some of its concerns regarding PAE activity and why it believes that the proposed information requests will assist in determining whether those concerns are sufficient to warrant FTC enforcement action.

A. Outsourcing of Patents to PAEs by Operating Companies

In fields such as the wireless communications sectors, firms have long recognized that both they and all of their competitors hold significant numbers of important and often overlapping patents. While one firm may suspect that a rival's product may infringe one of its products, it may be reluctant to file a patent infringement suit for fear that doing so will induce the rival to file a patent countersuit. This mutual fear of countersuits generally promotes patent "peace," a development that is undoubted good for innovation, competition, and consumer welfare.

However, critics allege that PAEs often purchase their patents from operating entities that, in effect are "outsourcing" their patent infringement claims. By allowing a PAE to serve as its proxy for asserting infringement claims, an operating entity can often avoid a patent

counterclaim and can structure the patent sale in a manner designed to inflict the maximum harm on competitors. By disassociating itself from the infringement suit, it can also avoid the damage to corporate goodwill that can arise from becoming known as an overly litigious defender of patent rights.

The § 6(b) information requests appear to be well designed to uncover information regarding the extent of such outsourcing and the terms under which PAEs acquire such patents. WLF is primarily concerned by acquisition agreements under which the operating entity retains an interest in the patent. For example, if the agreement provides that the seller is to recover a percentage of any royalties collected under the patent, or that the patent will revert to the seller if royalty collections are insufficiently large, the threat to competition is readily apparent. Indeed, if the current rapid expansion of PAEs continues, one can reasonably expect that the "patent peace" that usually arises from the fear of counterclaims will be totally eliminated, and firms may routinely enter into patent outsourcing agreements explicitly designed to harm their competitors. By requesting detailed "Patent Acquisition and Transfer Information" from major PAEs, the FTC will be able to determine the extent to which firms are using outsourcing of their patents as a means of gaining unfair competitive advantage over their rivals.

B. Transparency of Patent Ownership

A well-functioning patent system should provide notice not only of what a patent covers, but also of who owns it. In the absence of such information, potential infringers cannot accurately assess liability and litigation risks and ameliorate them through patent acquisition and

licensing efforts. Unfortunately, many PAEs have taken steps to obscure patent ownership, thereby unnecessarily increasing uncertainty and transaction costs without any countervailing benefit to the public interest or economic inefficiency. Many PAEs hide their ownership of patents through a web of subsidiaries and shell companies.

WLF supports the adoption of mandatory disclosure rules for patent ownership. Until such measures are fully adopted, the FTC has an important role to play in ascertaining whether PAEs are, as some critics allege, taking advantage of their secrecy to engage in unfair methods of competition. For example, if PAEs do not disclose what patents are contained in their portfolios, potentially licensees will have difficulty negotiating an equitable licensing agreement. They may end up negotiating a license for what turns out to be only a portion of the entire portfolio, while the PAE secretly holds back other patents for future assertion against the licensee. Moreover, the licensee likely will be unable to demonstrate that the PAE has engaged in such practices, because the PAE can transfer the withheld patents to other subsidiaries, which in turn can press the new licensing demands. By demanding that a firm purchase a license for an entire patent portfolio yet failing to disclose what patents are within it, PAEs make it impossible for firms to negotiate for licenses to individual patents they deem necessary; the tying together of patents in that manner raises serious antitrust concerns.

The lack of transparency in patent ownership also facilitates potential evasion of prior commitments to comply with patent encumbrances—such as commitments to license standards-essential patents on FRAND ("fair, reasonable, and non-discriminatory") terms and pledges not

to assert patents against particular products or companies, or not to "stack" royalties in a manner that results in royalty payments above a previously-specified level.

The extent to which PAEs engage in such conduct is not publicly known. The § 6(b) investigation is well-designed to uncover this highly necessary information. In particular, responses to Request F, entitled "Patent Assertion Information," should enable the FTC to determine whether PAEs have been improperly exploiting their lack of transparency to engage in unfair methods of competition and unfair practices. Section F is necessary to ascertain the extent of demands asserted, litigation initiated, and licenses entered into by PAEs, and whether PAEs had an adequate legal basis for such actions

C. The Net Economic Effect of PAE Activities

As noted earlier, PAEs have the potential to spur innovation, by promoting the creation of a secondary market for patents that promises potential rewards for would-be inventors who lack the ability to market their inventions. But the large number of PAE critics, including President Obama, contend that many PAEs are a net drain on innovation and merely assert tolls that firms must pay to continue marketing products that have been marketed for years and that owe none of their success to alleged innovations contained in the patents held by the PAE. The FTC can perform an invaluable public service by attempting to quantify the effects of PAEs on innovation in this county. The proposed § 6(b) information requests should provide the FTC with information vital to engaging in that quantification effort.

One study has found that PAW public companies have incurred $500 billion in costs

between 1990 and 2011 as a result of PAE activities, with total costs of more than $83 billion per year over each of the last four years. *See* James E. Bessen, et al., *The Private and Social Costs of Patent Trolls*, at 4, Working Paper, SSRN-id 1957325 (September 19, 2011). The costs of defending patent litigation are staggering; to avoid those costs, firms will often pay PAEs large royalties without regard to the merits of the royalty demand, in order to avoid incurring those litigation costs. Yet it is highly questionable that more than a small percentage of costs of PAE is channeled toward increased innovation; many of the costs are consumed by legal fees or the cost of raising capital to finance PAEs. Some studies suggest that as little as 2% of PAE costs flows through to innovators.

PAEs assert, of course, that they contribute to innovation. By collecting the data outlined in its proposed information requests, the FTC will be able to provide far more detailed answers to these disputed questions than have heretofore been available. The fundamental goal of the patent system is to "Promote the Progress of Science and the Useful Arts." U.S. Const., Art. I, § 8, cl. 8. Only by obtaining the detailed information sought by the § 6(b) information requests can the FTC hope to ascertain whether the activities of PAEs are promoting that fundamental goal or whether they are, to the contrary, undermining innovation and competition. In particular, the detailed information sought by Request G (Aggregate Cost Information) and Request H (Aggregate Revenue Information) is essential to answering those questions.

2. The Accuracy of the FTC's Estimate of the Burden of the Proposed Collection of Information

WLF has no direct information regarding the accuracy of the FTC's estimate of the burden imposed on those entities that will be required to respond to the information requests. We can say, however, that the type of information that the FTC seeks is the sort of information to which PAEs could be expected to have ready access. For example, they undoubted have ready access to lists of all litigation in which they have engaged, all licenses agreements they have entered into, and all income and expenditures attributable to each.

3. Ways to Enhance the Quality, Utility, and Clarity of the Information to Be Collected

One remarkable statistic regarding PAE patent litigation is that PAEs reportedly lose 92% of the time when cases are actually litigated. *See* Remarks of Jon Leibowitz, Chairman of FTC, Patent Assertion Entities Workshop Opening Remarks (Dec. 10, 2012), at 3. If so, that would suggest that many PAEs are asserting insubstantial patent claims. To assist the FTC in assessing whether many PAEs are, in fact, asserting insubstantial patent claims, WLF recommends that Request F.2 ("Litigation Information") be amended to request more specific information regarding the PAEs' rates of success in litigation. In particular, each PAE should be asked to state how many of its lawsuits were decided on their merits, the percentage of such lawsuits in which it was successful, the number of unsuccessful lawsuits in which the defendant requested an award of sanctions or attorney fees, and the number of instances in which a court granted such a request in whole or in part.

4. Ways of Minimizing the Burden of Collecting Information.

WLF has no direct information on ways in which collection burdens can be minimized. It does not oppose any reasonable efforts to minimize those burdens. However, it views the FTC's collection effort to be of the highest importance and would oppose any effort to water down the information requests in the name of decreased burdensomeness, if doing so would result in the FTC not obtaining all of the information currently contemplated by this investigation.

CONCLUSION

WLF strongly supports the FTC's decision to go forward with its investigation of PAEs and concludes that the proposed information requests are consistent with the requirements of the Paperwork Reduction Act.

Sincerely,

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