United States

Pressure increases on patent assertion entities

On 4 June, the White House announced several initiatives aimed at curbing the perceived drag on innovation that is said to result from increased patent infringement litigation by patent assertion entities. **Koren Wong-Ervin**, a consultant in the Office of International Affairs at the US Federal Trade Commission and **Brinkley Tappan**, counsel at Crowell & Moring, explore the issues

Koren Wong-Ervin

Brinkley Tappan

In a recent report, the White House defines a patent assertion entity (PAE) as a company that buys patents but does not manufacture products, and engages in aggressive enforcement litigation by, for example, threatening to sue thousands of companies at once without specific evidence of infringement against those companies; creating shell companies that make it difficult for defendants to know who is suing them; and asserting that their patents cover inventions that were not in existence at the time the patents were granted.

The report concludes that costs imposed by PAEs are best addressed not by regulating the entities themselves, but by changing the legal rules that enable these firms to capture a significant share of returns on investment in innovation. To that end, the White House announced five executive actions intended to increase transparency in the patent system, and to level the playing field for innovators. Specifically, the administration:

- directed the US Patent and Trademark Office (PTO) to require patent applicants and owners to identify themselves and their ultimate parents;
- directed the PTO to train examiners on functional claiming in order to improve patent quality, particularly in software;
- directed the PTO to publish information to assist small businesses that become targets of demand letters or infringement suits;
- announced a plan to increase outreach and study through workshops and enhanced PTO scholarship; and
- directed the ITC and Customs and Border Protection (CBP) to conduct an inter-agency review to ensure that exclusion order enforcement procedures are transparent, effective and efficient.

The White House also made several legislative recommendations, including advocating for measures that would allow district courts to award attorneys' fees to prevailing parties in infringement litigation, and rules that would permit users of technology to stay litigation where manufacturers of the products at issue are already defending infringement suits regarding the same patents.

The White House action is the latest headline in a long series of efforts to address PAEs and their perceived effect on innovation. Indeed, various agencies, legislative bodies and private parties have also recently attempted to assess the impact of PAEs, and to determine whether and how to address it.

In December 2012, the antitrust division of the US Department of Justice (DoJ) and the Federal Trade Commission (FTC) hosted a workshop on the subject. The workshop included speeches and presentations by regulators, economists and high-tech industry participants, and fostered discussion and debate about the effect of PAEs and whether the antitrust laws should be brought to bear in regulating PAE activity. In his opening remarks, then-FTC chairman Jon Leibowitz presented various statistics to illustrate the increase in litigation by patent assertion entities. He noted that 40 per cent of infringement actions are now brought by PAEs and cited a study estimating that PAE activity imposed $29 billion in costs in 2011. He emphasised that of these costs, economists have calculated that no more than 25 per cent flows back to innovation. (The White House report cites similar statistics.)

Although many participants at the workshop were critical of PAEs and their effect on competition and innovation, some economists and other proponents of the business model acknowledged that PAEs offer a path to commercialisation for individual inventors, which can actually spur innovation. Furthermore, many panellists stated that any regulatory measures should focus on the conduct of PAEs and not the business model. There was lively debate about the positive and negative effects of PAEs, but many workshop participants agreed that a bottom-line assessment is difficult because of the lack of reliable data regarding the amount of PAE litigation and the outcome of those cases. Speakers at the workshop blamed the scarcity of data on several factors, including the fact that the lack of transparency regarding patent ownership makes it difficult to track litigation, and the fact that confidentiality provisions in licensing agreements obscure the outcome of demand letters and settlement negotiations.

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Of course, a primary focus of the DoJ-FTC workshop was whether and how the antitrust laws should apply to conduct by PAEs. To spur discussion, the agencies posed three hypothetical scenarios. The most straightforward scenario involved a PAE purchasing patents from an operating company with the intent to commercialise more aggressively than the operating company in the absence of an operating company's reputational (or business relationship) constraints or need for cross-licences. Although many panellists had reasons why such a transaction could raise costs for consumers – for example, by disaggregating the operating company's portfolio and creating a royalty stack for downstream manufacturers – they recognised that it was difficult to see how the antitrust laws would operate to prohibit acquisition and aggressive enforcement by a "pure" PAE. As a transaction between an operating company and a non-practising entity, the panellists opined that this type of acquisition would be unlikely to inspire scrutiny under section 7 of the Clayton Act; there was also consensus that asserting patents in good faith cannot be a violation of the antitrust laws, not least because of Noerr-Pennington protection, which shields from liability parties who petition the government for the redress of grievances (including through litigation).

A second hypothetical situation involved a "hybrid" PAE – that is, a PAE with a relationship to an operating company. In this scenario, the agencies posited that the PAE would purchase a portfolio from an operating company under terms that would align the PAE's interests with the operating company's, such that the PAE would selectively enforce the patents against the operating company's rivals, thus raising the rivals' costs. In this case, many of the panellists agreed that the transaction itself might be scrutinised under section 7 and blocked (assuming it was reportable).

The third hypothetical posed by the agencies posited that two operating companies would jointly create a PAE with interests aligned with those of the operating companies. There seemed to be general agreement that this arrangement would be the most likely to attract antitrust scrutiny. In addition to raising similar issues to those raised by the prior (second) hypothetical, panellists pointed out that this scenario might also allow two competing operating companies to conspire to shield weak patents, thus attracting scrutiny under section 1 of the Sherman Act.

Outside of the agencies' hypotheticals, there was discussion of certain "plus factors" that might give rise to antitrust liability, even in a pure PAE situation. For example, if a patent assertion entity were to acquire a massive portfolio and require targets to take a licence to the entire portfolio, this could raise antitrust issues. If a pure PAE were to acquire standard-essential patents and then renege on the original owner's FRAND licensing commitment, this would also raise flags.

Although the workshop participants did not reach any firm conclusions regarding the application of the antitrust laws to PAE activity, there seemed to be general agreement that non-antitrust-specific measures might also go some distance towards addressing PAE conduct. Specifically, panellists advocated for improvements to patent quality and clarity, and for judicial reforms such as fee-shifting and limitations on injunctions and exclusion orders.

In the wake of the workshop, the antitrust agencies accepted dozens of comments on the issue of PAEs, and those are currently being evaluated.

In addition to agency efforts to study the effects of PAEs, there has been legislative activity as well. Both state and federal legislatures recently put forward various bills aimed at reducing abusive litigation tactics by both PAEs and operating companies. For the most part, the legislation focuses on PAE behaviour and not on the business model itself.

For example, on 22 May, Vermont enacted the nation's first PAE law prohibiting bad-faith assertions of patent infringement (by both PAEs and operating companies). The law allows courts to take into consideration factors such as whether the claim was brought by the inventor or an institution of higher learning (as opposed to a PAE) and whether the demand letter contains sufficient information to allow targets to evaluate the claim. The law also requires claimants to post a bond if the court finds a reasonable likelihood that the claim was made in bad faith.

Legislation has also been introduced in Congress aimed at addressing frivolous patent suits (by both PAEs and operating companies). Most recently, on 17 May, the End Anonymous Patents Act was introduced with the intention of bringing transparency to the patent system. The bill would require parties to file a disclosure with the PTO regarding the owner of the patent and any real party in interest, as well as file a disclosure whenever a patent or patent application interest is sold. Also in May, the House and Senate Judiciary Committee chairmen proposed comprehensive legislation aimed at reducing abusive litigation tactics (by both PAEs and operating companies). Among other things, the Judiciary Committee bill would:

- require the offeree of a settlement to pay the offeror's costs and expenses if the judgment is not more favourable than the settlement offer;
- require entities that send 20 or more demand letters or file a patent infringement suit to disclose patent ownership information (including identification of each licensee);
- require entities to disclose RAND commitments;
- limit discovery; and
- allow manufacturers of allegedly infringing products to intervene when their customers are sued, and allow customers to stay the action on their own behalf.

In late February, the SHIELD Act was introduced; in contrast to the measures outlined above, it would apply only to PAEs. The act would require courts to award the recovery of full costs (including attorneys' fees) to any prevailing party asserting invalidity or non-infringement against a PAE, and allow the accused infringer to file a motion at any time requiring the PAE to post a bond to cover the recovery of full costs. Several members of Congress have advocated postponing legislation until the Government Accountability Office releases its congressionally-mandated report on the role and impact of non-practising entities (NPEs) and PAEs on the United States economy.

Private litigants have also attempted to address PAE conduct using various legal theories. For example, in conjunction with the introduction of the PAE legislation in Vermont, the state attorney general there filed suit in May against a PAE called MPHJ Technology Investments, alleging that it engaged in unfair and deceptive trade practices in violation of the Vermont

Consumer Protection Act by sending a series of demand letters to businesses and non-profit organisations in Vermont, threatening patent litigation if the businesses did not pay licensing fees. According to the complaint, MPHJ Technology operates in Vermont through multiple wholly-owned shell subsidiary companies, and has sent hundreds or thousands of similar demand letters to businesses outside Vermont. The Vermont attorney general alleged that MPHJ Technology targeted small businesses in commercial fields that were probably unrelated to patent law, including, for example, several non-profit disabled services organisations. The initial demand letters sent by MPHJ Technology allegedly required recipients to complete a questionnaire and produce voluminous documentation to prove that they were not infringing, and subsequent letters assumed infringement. According to the complaint, the actual average licensing fee paid by companies that ultimately settled was less than $900.

In addition to state consumer protection laws, litigants have also attempted to use RICO to curb threats from PAEs. In *In re Innovatio IP Ventures, LLC Patent Litigation*, a case in the Northern District of Illinois, several WLAN product manufacturers brought a RICO claim against Innovatio IP Ventures, a PAE. The manufacturers claimed that Innovatio engaged in a pattern of unlawful racketeering activity through a scheme to deceive and defraud end-users of Wi-Fi internet in an effort to obtain licensing fees.

Specifically, the complaint alleged that Innovatio violated RICO by sending thousands of licensing demand letters to businesses around the country – including retirement homes, restaurants and convenience stores – claiming that their use of Wi-Fi infringed multiple Innovatio patents. The WLAN manufacturers alleged that Innovatio's letters demanded exorbitant royalties for the patents, threatened protracted negotiations for those who refused to pay and offered discounts to those businesses that agreed to pay promptly. The letters allegedly contained other misrepresentations and omissions, including an omission of the fact that some of the patents had expired or were subject to existing licences.

Ultimately, the RICO claim was dismissed on the basis that infringement claims and demand letters – even those that contain misrepresentations about the success of the PAE's licensing campaign – are protected under the Noerr-Pennington doctrine. Nonetheless, the decision did not foreclose the possibility that PAE conduct could run afoul of RICO where the conduct satisfies the sham exception to Noerr-Pennington protection.

While discussions of PAE behaviour have mostly been confined to the US, the European Union recently announced that it has invited outside consultants to prepare a report on how PAEs are affecting electronic-chip makers.

Although the end of the story on PAE regulation remains unwritten, the flurry of activity by regulators and private litigants is ratcheting up the pressure on PAEs, and may signal a shift in the conditions in which PAEs currently operate.

The views expressed here are Koren Wong-Ervin's alone and do not necessarily represent the views of the United States.