Protecting Small Business Innovation

December 16, 2013

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PAE Reports: Paperwork Comment; Project No. P131203

On behalf of the Association for Competitive Technology (ACT), I write to submit comments on the FTC's proposed information requests to Patent Assertion Entities (PAEs) and other entities asserting patents in the wireless communications sector.

ACT's membership includes more than 5,000 small and medium sized software and "mobile app" companies, including more than 4,000 based in the United States. The app industry, which did not exist six years ago, has grown exponentially. In 2010, total app industry revenues were $3.8 billion and expected to rise to $8.3 billion by 2014. However, by the end of last year we already reached $20 billion and are now projected to reach $140 billion by 2016. In 2013 alone, over 70 billion mobile apps were downloaded.[1]

The growth of the app economy has resulted in significant job growth. A 2011 ACT's study estimated that the app economy created, saved, or supplemented more than 600,000 jobs nationwide across iOS, Android, Windows Phone 7, and Blackberry platforms.[2] In July of 2013, those numbers had risen to 750,000.[3] These job numbers will continue to grow, with 65% of the most successful app companies are now hiring.[4] The growth is not limited to the US; a study from ACT last month showed that the apps economy has created over 800,000

[1] John Koetsier, "We will download 70 billion mobile apps in 2013 (50% Android, 41% iOS)" Venture Beat (March 4, 2013), *available at* http://venturebeat.com/2013/03/04/we-will-download-70-billion-mobile-apps-in-2013-50-android-41-ios/#ZUwlLXO8MzmgF0Pk.02.

[2] "Testimony of Morgan Reed before the House Committee on Energy and Commerce Subcommittee on Commerce, Manufacturing and Trade." (Oct. 5, 2011) *available at* http://democrats.energycommerce.house.gov/sites/default/files/image_uploads/Testimony_10.05.11_CMT_Reed.pdf.

[3] Michael Mandel, "752,000 App Economy jobs on the 5th anniversary of the App Store," Progressive Policy Institute (July 8, 2013), *available at* http://www.progressivepolicy.org/2013/07/752000-app-economy-jobs-on-the-5th-anniversary-ofthe-app-store/.

[4] "The App Store After Five Years: What the Most Successful Apps Reveal about the Mobile Economy," ACT (July 19, 2013), *available at* http://www.act4apps.org/wp-content/uploads/2013/07/The-App-Store-After-Five-Years-FINAL.pdf.

jobs in Europe.[5] Unfortunately, the tremendous success of app developers has made them a target for PAEs.

PAEs that are bad actors send vague and intentionally confusing demand letters alleging patent infringement. These letters do not allow recipients to clearly understand the real party at interest or how the recipient's product is infringing on the patent. The licensing fees offered in the demand letter are often set at an amount just below the cost of litigation, thus ensuring settlement instead of litigation. Moreover, demand letters have even threatened higher licensing costs if the recipient engages in "early motion practice" – the patent equivalent of "don't go to the cops if you want to see your family again."

Most app developers are small businesses (73% of apps ranked top ten in their category are made by small companies) with little to no patent experience. These confusing and intimidating demand letters force developers to choose between expensive litigation or licensing a patent they may or may not be reading on.

ACT is not arguing for the abandonment of the secondary market for patents and PAEs in general. Small and large businesses alike depend on patents to protect the investment they make in innovation. Resources spent on innovation can be recouped through productions, licensing, or selling the patent. The secondary market is vital for businesses that do not have the capital or desire to produce a product around their invention or handle licensing. The secondary market helps ensure the pace of innovation by adding financial incentives for investors.

A large part of the problem is patent quality. We believe that many of the efforts undertaken by the USPTO in recent years will help reduce the number of poor quality patents that make it into the world. However, we know of existing patents that should have failed tests for novelty or were overly broad in their claims are allowing certain unscrupulous firms to run roughshod over our IP system. The USPTO must continue to implement internal reforms and to improve prior art searches, training examiners to more fully understand the art, and to increase outreach to industry to educate inventors.

The other problem, which the proposed questions address, is when a party has acquired poor-quality patents with the intent to use them in an unfair or deceptive manner. For example, the acquisition of a patent whose scope is so ill-defined that theoretically every product in an entire sector will read on the patent. The PAE then sends a demand letter merely outlining the expansiveness of the patent and the successful forced licensees it has received so far as a method of extracting licensing fees from small businesses. Former USPTO Director Kappos sums this situation up well when he said, "If you've got a patent

[5] "The European App Economy" ACT (September 2013) *available at* http://www.act4apps.org/appeconomy/europe/.

and sue 50 to 100 manufacturers all at once, what you're really saying is that your patent covers the problem, not the particular solution."

The actions of bad actors are often opaque and confusion works to the disadvantage of small businesses. We appreciate that the FTC is using its authority to investigate this issue and bring transparency to the demand letter process. However, we have some concerns regarding the impact of this request for information on small business:

Clarify Definition of PAE

PAE (also called patent troll or non-practicing entity (NPE)) has many different definitions. In the FTC's notice, PAE is defined as a firm "with a business model based primarily on purchasing patents and then attempting to generate revenue by asserting the intellectual property against persons who are already practicing the patented technology." The SHIELD Act (HR 845) defines a PAE as not the original inventor, an exploiter of the patent through sale of an item covered by the patent, or a university or technology transfer organization. The "Patent Assertion and U.S. Innovation" report from the Executive Office of the President has yet another definition, stating PAEs are entities that own patents but "focus on aggressive litigation."

The problem for app developers is not the PAE business model but rather how that model is used. When run well, a PAE legitimately manages an IP portfolio and the bar to sending out demand letters for these PAEs is extremely high. They do not go after companies without knowing there has been a specific violation. However, bad actors run the PAE business model to maximize revenue by sending out blanket demand letters to companies that might have a slight suspicion of having technology related to the patent. Bad PAEs count on the fact that settling the issue by paying the license fee is cheaper than litigation and knowing many small businesses do not have the resources to fight back.

With the current broad definition of PAE, the information gathering the FTC proposes will pose a financial burden on small businesses that engage in the secondary patent market as "good" PAEs.

The problem for app developers is not PAEs but the bad use of the PAE business model. We encourage the FTC to focus the information collection at those who would use the secondary patent market in a way it was never intended to work.

Burden of Information Collection Falling on Small Businesses

The proposed information request requires the collection of a significant amount of information. While such information is important to allow the FTC a clear picture, we are concerned such information gathering could be burdensome on app developers and other innovators who have sold their patents to PAEs. As you know, many of the patents owned by PAEs are developed by individual inventors or small businesses.

The proposed questions require the submission of all documents relating to the firm's acquisition including but not limited to market analyses, financial analyses, business plans, statements to investors and potential investor, and disclosures required by the Securities and Exchange Commission and any other person. This arduous request will likely be passed down to the small businesses and innovators that initially drafted theses documents when they sold their patents to a PAE. While the inventor may have hard copies of such documents stored, some of these documents will require updates and create an unnecessary and expensive burden on small business developers.

We suggest that the FTC add a clarification that entities asked these questions answer them using information in their own records. Additional information which would be available from third parties can be noted in the entity's response. The FTC could then determine whether such information would materially help their investigation before asking a small business to send it.

Publication of Private Information

The questions proposed by the FTC are probing and contain a significant amount of sensitive information. While such information will be important in order to allow the FTC to investigate the impact of demand letters, it is also information which should not be released to the public. Information such as names and addresses, business practices, patent claims asserted, and settlement information all contain information which has an effect beyond the scope of the PAE being questioned. While such information is not sensitive to the PAE, it can be to the small businesses to which it relates.

We believe the FTC should establish clear guidelines for how such information will be protected and redacted in the publically available data. While the FTC has protected similar data in previous investigations, the notice in the federal register does not clarify that process. Without such clarification, small businesses will be discouraged from participation and contributing additional information to the investigation.

Necessary Questions

We commend the FTC on including many important questions that will help discover the financial burden PAE suits have on small businesses and the economy. Questions such as a list of any subsidiary, divisions, affiliates, branches, joint ventures, franchise, operations under assumed names, Websites, or entities over which it exercises supervision or control help identify demand letters issued by PAEs. Since it is a common practice to use multiple subsidiaries to issue these letters, a full evaluation of PAE demand letters must also look at those subsidiaries.

Conclusion

Abuse of demand letters can have a negative impact on the app industry, the tech industry, and the economy as a whole. We thank the FTC for taking up this important issue and for using its authority to measure the affect this behavior has on industry and innovation. Transparency on this problem is critical to solving the problem of bad PAEs.

ACT, as the leading trade association for app developers, is ready and willing to provide the FTC with any assistance it may require in the course of this information collection.

Respectfully Submitted by:

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ACT