Response of Adobe Systems, Inc., Canon U.S.A., Inc., Cisco Systems, Inc., Dell Inc., Ford Motor Company, Google, Inc., Hewlett-Packard Company, Limelight Networks, Inc., Rackspace US, Inc., and SAP Americas, Inc.

to the

Federal Trade Commission's Proposed Section 6(b) Information Requests to Patent Assertion Entities and Other Entities Asserting Patents

December 16, 2013

The FTC requested public comments on its proposed Section 6(b) information requests relating to patent assertion. The FTC asked for comments on (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; (2) the accuracy of the FTC's estimate of the burden of the proposed collection of information; (3) ways to enhance the quality, utility, and clarity of the information to be collected; and (4) ways to minimize the burden of collecting information. Federal Trade Commission, Notice and Request for Public Comment, 78 Fed. Reg. 61,352, 61,357 (Oct. 3, 2013).

The FTC's information requests are necessary to elicit information on the growing problem of abusive patent assertion. The information sought will shed light on claims that patent assertion entities (PAEs) play a useful role in the innovation economy and will document the ways that PAEs harm competition and consumers by inflicting heavy costs on start-ups and other operating companies that have to do with the costs of litigation, not the quality of patents. The information sought also is calculated to uncover and confirm unlawful conduct, to the extent it exists, and lead to enforcement activity.

The cost to the PAEs of complying with the information requests is small compared to the burden PAEs impose on the economy. In 2012, PAEs filed 2,921 of the 4,701 new patent cases filed in federal court, a record 62% of all patent cases. For each of the past three years, well over half the defendants in federal court patent cases were sued by PAEs. This is a radical increase from just a few years earlier.[1] Initial estimates, to be confirmed by the FTC's study, are that PAE activity costs industry tens of billions of dollars per year.

[1] In 2006, PAEs represented less than one-fifth of patent infringement cases. By 2012, the total number of cases had doubled and PAEs were responsible for more than three-fifths of the cases. *See* Comments of Dell, Hewlett-Packard, and Adobe, Patent Assertion Entities Workshop (PAEW) No. 65, at 2 (Apr. 5, 2013), *available at*http://www.justice.gov/atr/public/workshops/pae/comments/paew-0066.pdf; Comments of Coalition for Patent Fairness, PAEW No. 55, at 3 (Apr. 5, 2013), *available at* http://www.justice.gov/atr/public/workshops/pae/comments/paew-0055.pdf; Comments of Electronic Frontier Foundation, PAEW No. 64, at 2 (Mar. 10, 2013), *available at* http://www.justice.gov/atr/public/workshops/pae/comments/paew-0064.pdf.

There are several respects in which the Commission's proposed information requests may be clarified in order to produce uniform and useful answers. Those clarifications are discussed below. The Commission may also further minimize the burden of collecting the information by setting up-front ground rules for dealing with PAE assertions of confidentiality.

I. Substantial Cost and Harm Caused by PAE Activity Warrants the Full Scope of the FTC's Proposed Investigation.

Section 6(b) of the FTC Act grants the Commission power to require "answers in writing to specific questions, furnishing to the Commission such information as it may require as to the organization, business, conduct, practices, management, and relation to other corporations" or entities. 15 U.S.C. § 46(b). The FTC may use Section 6(b) information requests "to satisfy [itself] that corporate behavior is consistent with the law and public interest." *United States v. Morton Salt Co.*, 338 U.S. 632, 652 (1950).[2] The FTC does not need to establish a violation before using its 6(b) powers. It "can investigate merely on suspicion that the law is being violated, or even just because it wants assurance that it is not." 338 U.S. at 642-43. "[I]t is sufficient if the inquiry is within the authority of the agency, the demand is not too indefinite and the information sought is reasonably relevant." *Id*. at 652.[3] Each of those prerequisites is satisfied by the proposed information requests.

The FTC has subject matter authority to investigate and to pursue enforcement against conduct that harms competition in any market, including harms to innovation. 15 U.S.C. § 45. The information being sought is reasonably relevant to harms to competition and innovation, as demonstrated by the extensive comments submitted to the FTC and the Department of Justice following last year's standing-room-only workshop on PAE activity. Over eighty companies and individuals filed 68 comments totaling more than 600 pages, describing (or, alternatively, trying to defend) the cost and harms imposed by PAE activity.

In addition to the record before the Commission, other agencies, Congress, and the Administration have documented serious concerns. In 2012 and 2013, Congress alone will have held seven PAE-focused hearings, with 33 witnesses producing approximately 1,000 pages of hearing records.[4] Testimony before the House Judiciary Committee "established that misuse of

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[2] Paul Rand Dixon, *The Federal Trade Commission: Its Fact-Finding Responsibilities and Powers*, 46 Marq. L. Rev. 17, 17-19 (1962).

[3] *See FTC v. Texaco, Inc*., 555 F.2d 862, 874 (D.C. Cir. 1977) (en banc) (striking down limits on FTC subpoena because, "in the pre-complaint stage, an investigating agency is under no obligation to propound a narrowly focused theory of a possible future case. Accordingly, the relevance of the agency's subpoena requests may be measured only against the general purposes of its investigation.").

[4] *See Fostering the U.S. Competitive Edge: Examining the Effect of Federal Policies on Competition, Innovation, and Job Growth: Hearing Before the Subcomm. on Technology and Innovation of the H. Comm. on Science, Space, and Technology*, 112th Cong. (Mar. 27, 2012) (four witnesses, hearing record of 102 pages), *available at* http://www.gpo.gov/fdsys/pkg/CHRG-112hhrg73604/pdf/CHRG-112hhrg73604.pdf; *Oversight of the Impact on Competition of Exclusion Orders to Enforce Standard-Essential Patents: Hearing Before the S. Comm. on the Judiciary*, 112th Cong. (July 11, 2012) (one witness, hearing record of 103 pages), *available at* http://www.gpo.gov/fdsys/pkg/CHRG-112shrg76072/pdf/CHRG-112shrg76072.pdf; *International Trade Commission and Patent Disputes: Hearing Before the Subcomm. on Intellectual Property, Competition, and the Internet of the H. Comm. on the Judiciary*, 112th Cong. (July 18, 2012) (five witnesses, hearing record of 256 pages), *available at* http://www.gpo.gov/fdsys/pkg/CHRG-112hhrg75152/pdf/CHRG-112hhrg75152.pdf; *Abusive*

various patent-enforcement mechanisms is a serious problem—and one that has grown worse in recent years."[5] The White House identified similar problems: "[I]nnovators continue to face challenges from Patent Assertion Entities (PAEs), companies that, in the President's words 'don't actually produce anything themselves,' and instead develop a business model 'to essentially leverage and hijack somebody else's idea and see if they can extort some money out of them.'"[6] PAE activity is a "drain on the American economy."[7] The Congressional Research Service prepared a report for members of Congress that describes how the supposed benefits of PAE activity "are significantly outweighed by the costs."[8] And the GAO conducted a study pursuant to the America Invents Act that found PAE activity increased the amount of patent litigation "significantly" and caused "significant operational impacts."[9]

The full impact of PAE activity on competition and innovation is largely hidden because it is within the exclusive knowledge of disparate PAEs, veiled behind the protections of non-disclosure agreements, or conducted through anonymous shell companies or indirectly through third parties.[10] Litigation statistics are only "the tip of the iceberg" because much PAE activity

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Patent Litigation: The Impact on American Innovation and Jobs, and Potential Solutions: Hearing Before the Subcomm. on Courts, Intellectual Property, and the Internet of the H. Comm. on the Judiciary, 113th Cong. (Mar. 14, 2013) (six witnesses, hearing record of 260 pages), *available at* http://www.gpo.gov/fdsys/pkg/CHRG-113hhrg79880/pdf/CHRG-113hhrg79880.pdf; *Abusive Patent Litigation: The Issues Impacting American Competitiveness and Job Creation at the International Trade Commission and Beyond: Hearing Before the Subcomm. on Courts, Intellectual Property, and the Internet of the H. Comm. on the Judiciary*, 113th Cong. (Apr., 16, 2013) (six witnesses, hearing record of 139 pages), *available at* http://www.gpo.gov/fdsys/pkg/CHRG-113hhrg80459/pdf/CHRG-113hhrg80459.pdf; *Innovation as a Catalyst for New Jobs: Hearing Before the Subcomm. on Economic Growth, Tax, and Capital Access of the H. Comm. on Small Business*, 113th Cong. (Apr. 18, 2013) (four witnesses, hearing record of 87 pages), *available at* http://www.gpo.gov/fdsys/pkg/CHRG-113hhrg80821/pdf/CHRG-113hhrg80821.pdf. The seventh hearing is scheduled for December 17, 2013, in the Senate Judiciary Committee. *See Protecting Small Businesses and Promoting Innovation by Limiting Patent Troll Abuse: Hearing Before the S. Comm. on the Judiciary*, 113th Cong. (Dec. 17, 2013) (seven witnesses), *available at* http://www.judiciary.senate.gov/hearings/hearing.cfm?id=32caee8082f9297f0e7df6280b03ff1f.

[5] H.R. Rep. No. 113-279, at 18-20, 26-28 (Dec. 2, 2013) (quoting witnesses from Adobe Systems, Cisco Systems, Inc., JCPenney, Johnson & Johnson, SAS, and Yahoo! Inc., and statements by the National Retail Federation, the Food Marketing Institute, the National Association of Realtors, and the American Bankers Association).

[6] White House Press Release, *FACT SHEET: White House Task Force on High-Tech Patent Issues* (June 4, 2013) (quoting President Obama), *available at* http://www.whitehouse.gov/the-press-office/2013/06/04/fact-sheet-white-house-task-force-high-tech-patent-issues.

[7] *Id*.

[8] Congressional Research Service, *An Overview of the "Patent Trolls" Debate* at 2 (Apr. 16, 2013), *available at* http://www.fas.org/sgp/crs/misc/R42668.pdf.

[9] GAO, *Intellectual Property: Assessing Factors that Affect Patent Infringement Litigation Could Help Improve Patent Quality*, GAO-13-465, at 14, 26 (Aug. 2013), *available at* http://www.gao.gov/assets/660/657103.pdf.

[10] *See* Comments of Robin Feldman, PAEW No. 35, at 31-35 (Mar. 27, 2013) (describing patent holders demanding confidentiality "for what one claims is the territory covered by one's patent," hiding patent holdings in anonymous shell companies, using third-party monetization entities, and noting: "Cloaking one's actions in non-disclosure agreements makes it more difficult for public and private antitrust actors to make the necessary connections between different transactions that could reveal a pattern of anticompetitive conduct. . . . This could be particularly problematic if the full picture of a scheme can only emerge across different transactions involving different parties. Under those circumstances, swearing each party to silence makes it very difficult for anyone to see the full picture."), *available at* http://www.justice.gov/atr/public/workshops/pae/comments/paew-0035.pdf; Comments of Microsoft, PAEW No. 46, at 2, *available at* http://www.justice.gov/atr/public/workshops/pae/comments/paew-0042.pdf ("[B]ecause the vast majority of patent assertions by PAEs are made (and resolved) privately, data regarding the full economic impact of PAE activities is woefully incomplete."); Fiona Scott Morton & Carl Shapiro,

occurs outside the court room.[11] Chairwoman Ramirez correctly described that, although currently there is enough known information to be concerned, much is still unknown:

> These are troubling stories. But they don't tell us that much about the competitive costs and benefits of PAE activity. As a competition agency with a long history of policy work on the patent system, that's the broad question we are interested in addressing at the FTC. But the information necessary to tackle this broader question is limited. So, for example, how common are mass demand letter campaigns, and what's the typical payoff to the sender? What's inside these mass portfolios, and what are the strategies that drive aggregation? What kind of costs do PAEs incur and how much revenue flows back to inventors? If we want to understand the competitive implications of PAE activity, these are the kinds of questions we need to answer.
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> Of course, litigation is only a part of the picture. Understanding what happens outside the courtroom, and inside PAEs, would add substantially to the empirical picture.[12]

The FTC has unique power under Section 6(b) "to get information from those who best can give it and who are most interested in not doing so."[13] The proposed study would add significantly to the existing evidence on PAE behavior. Because the scope and variety of PAE activity are large, PAE behaviors evolve rapidly, PAEs may resist disclosure of their activity, and the FTC is examining only a sample of the PAEs currently in operation, the initial study may fail to capture the problem fully and it may be necessary for the FTC to do additional investigation.

On December 5, 2013, the House passed a bill designed to curb litigation abuse based on a finding that there is a "huge" PAE problem demonstrated by the fact that PAEs file over 50%

Strategic Patent Acquisitions, Haas School of Business, University of California at Berkley Working Paper at 4 (July 2, 2013), *available at* http://ssrn.com/abstract=2288911.

[11] Comments of Application Developers Alliance, PAEW No. 54, at 1 n.2 (Apr. 5, 2013), *available at* http://www.justice.gov/atr/public/workshops/pae/comments/paew-0050.pdf ("lawsuits are just the tip of the iceberg"). *See* Staff of H. Comm. on the Judiciary, 119th Cong., Patent Quality Improvement (Comm. Print 2005) (Apple's Chip Lutton testified that he received 25 letters insinuating infringement for every suit that Apple was a named defendant); Comments of American Association of Advertising Agencies, PAEW No. 35, at 4 (Mar. 28, 2013), *available at* http://www.justice.gov/atr/public/workshops/pae/comments/paew-0030.pdf; Comments of SAS Institute et al., PAEW No. 37, at 2 (Apr. 3, 2013), *available at* http://www.justice.gov/atr/public/workshops/pae/comments/paew-0037.pdf; Morton & Shapiro at 4.

[12] Remarks of Chairwoman Edith Ramirez, ABA Antitrust Section's Intellectual Property Committee at 1-2, 3 (Nov. 12, 2013), *available at* http://www.ftc.gov/sites/default/files/documents/public_statements/remarks-chairwoman-edith-ramirez-fall-networking-event-aba-antitrust-sections-intellectual-property/131112er-ip-committee.pdf. The GAO likewise noted that: "We were not able to determine litigation cost information from our sample data, and we found very little information on the costs of patent infringement lawsuits in court records. . . . In addition to lawsuits, patent assertion occurs without firms ever filing lawsuits, but the extent of this practice is unclear because we were not able to find reliable data on patent assertion outside of the court system." GAO-13-465, at 25-26.

[13] *Morton Salt*, 338 U.S. at 642.

of all patent cases.[14] The House bill takes steps toward adjusting the asymmetries of cost and risk between PAEs and their operating company targets that underlie many abusive litigation strategies by making litigation more efficient and less costly, and by leveling the field through increased fee shifting. The record before Congress makes clear the immediate need for legislation to address the problem of abusive litigation as quickly as possible.

Recognizing the need to curb abusive patent litigation is so clear, Chairwoman Ramirez "emphasize[d]" that the FTC's Section 6(b) study should not hold up patent reform.[15] By the same token, the Commission should not see congressional action as preempting the need for this study. The House bill does not purport to address all the concerns about PAE conduct that have been identified in the record before the FTC.[16] If the House bill or a variant following Senate consideration is eventually enacted, it will leave several important problems unaddressed. Even for the clearly demonstrated problems that the House bill (as well as proposed bills in the Senate) seeks to solve, the FTC's study will capture critical baseline information about PAE activity from which to begin measuring progress.

The remainder of this section describes, by category, some of the principal concerns and questions about PAE activity, and shows that the FTC's proposed collection of information is not only "reasonably relevant" (*see Morton Salt*, 338 U.S. at 652) but practically useful and indeed necessary to understanding the concerns. For the convenience of the Commission staff, attached to these comments is a separate table that (in the reverse direction) maps the proposed information requests onto the concerns. The table shows that there are no superfluous information requests; each request is necessary and practically useful.

a. The FTC's Proposed Information Requests Are Necessary and Useful To Determine Whether PAE Activity Hinders or Promotes Innovation.

There is substantial evidence that the principal "innovation" that PAE activity rewards is lawyering and that PAE activity is inefficient as a mechanism for providing rewards for development of new and useful technology, with no more than about 15% of the costs to licensing targets (perhaps as little as 5% to 10% of the costs) being paid to patentees.[17] PAE

[14] 159 Cong. Rec. H7511-12 (daily ed. Dec. 5, 2013) (statement of Rep. Goodlatte).

[15] Remarks of Chairwoman Edith Ramirez at 5 (Nov. 12, 2013) ("I want to emphasize that Commission activity, on both the policy and enforcement side, should be part of a much broader response to flaws in the patent system that fuel inefficient behavior by PAEs and other firms. Reforms that improve patent quality, and reduce the costs of challenging weak IP and defending against frivolous lawsuits, are crucial to providing an environment that fosters innovation and promotes consumer welfare. Understanding more about the PAE business model will inform the policy dialogue. But it will not change the pressing need for additional progress on patent reform. I urge continued effort on that front."), *available at* http://www.ftc.gov/sites/default/files/documents/public_statements/remarks-chairwoman-edith-ramirez-fall-networking-event-aba-antitrust-sections-intellectual-property/131112er-ip-committee.pdf.

[16] *E.g.*, 159 Cong. Rec. H7517-18 (daily ed. Dec. 5, 2013) (colloquy between Reps. Chaffetz and Terry on need for continuing work by FTC regarding PAE demand letters sent to small businesses demanding unwarranted license fees).

[17] *See, e.g.*, Dell et al. at 3-6. The term "patentee" is used in these comments to refer to the original entity or person that developed the patented technology. When a technology is developed within an operating company (*i.e.*, the company paid the salaries of the inventors, provided the research environment and tools, conducted testing of prototypes, etc.) and the resulting patent is initially assigned to that company, that company would be the "patentee."

activity taxes innovation by imposing excessive payments beyond the value of the patents asserted on companies that have deployed independently developed technology.[18] Such activity does not increase the development or use of technology but instead imposes immense costs that subtract from R&D and potentially hinder adoption of new technologies.[19] The results are reduced innovation and higher costs to consumers.[20]

Nonetheless, proponents of PAE activity argue that PAEs facilitate "an efficient and vibrant secondary market for patents" that enables "operating companies to monetize unused assets or acquire necessary rights to technologies they plan to incorporate," leading to more efficient allocation and enhanced exploitation of patents.[21] IPNav, a PAE, asserts it and others "play an essential role in providing inventors a mechanism to receive compensation for their inventions" by working with legitimate inventors to make assertions only against those companies that are actually infringing a valid patent.[22] IPNav blames certain "black hat" patent monetizers—those that "use spam-type assertions to seek enforcement of weak patents where there is dubious infringement" and obtain "nuisance value" settlements—for sullying PAEs' reputation as promoters of innovation.[23]

The FTC's information requests are necessary to determine the net effect of PAE activity on innovation. The information requests focus on three areas: whether PAE activity rewards patentees, the costs of PAE activity and the effect of such costs on an operating company's ability to innovate, and whether PAE activity is injurious to small, innovative companies and start-ups.

i. The Extent PAE Activity Rewards Patentees.

First, commentators disagree about whether or not PAE activity rewards patentees. Several commentators argue that PAEs reward speculators and lawyers instead, citing data that 80% to 95% of the costs inflicted on targets goes to lawyers and investors in litigation and patent enforcement.[24] To the extent that PAEs reward patentees at all, the record is clear that PAEs'

[18] *See, e.g.*, Comments of Rackspace, PAEW No. 56, at 3-4 (Apr. 5, 2013), *available at* http://www.justice.gov/atr/public/workshops/pae/comments/paew-0054.pdf.
[19] Niels J. Melius, *Trolling for Standards: How Courts and the Administrative State Can Help Deter Patent Holdup and Patent Innovation*, 15 Vand. J. Ent. & Tech. L. 161, 164 (2012), *available at* http://www.justice.gov/atr/public/workshops/pae/comments/paew-0054.pdf. *See also* Dell et al. at 18; Comments of the Food Marketing Institute and National Restaurant Association, PAEW No. 67, at ii (Apr. 5, 2013), *available at* http://www.justice.gov/atr/public/workshops/pae/comments/paew-0068.pdf.
[20] *See* Comments of National Retail Federation, PAEW No. 57, at 1-2 (Apr. 1, 2013), *available at* http://www.justice.gov/atr/public/workshops/pae/comments/paew-0057.pdf.
[21] Microsoft at 3, 5.
[22] *See* Comments of IPNav, PAEW No. 10, at 1-5, *available at* http://www.justice.gov/atr/public/workshops/pae/comments/paew-0010.pdf; Microsoft at 2; *see also* Comments of World Intellectual Property Organization (WIPO), PAEW No. 7, at 1, *available at* http://www.justice.gov/atr/public/workshops/pae/comments/paew-0007.pdf.
[23] IPNav at 1-5; *see also* Comments of Michael Risch, PAEW No. 15, at 1 (Mar. 9, 2013) ("labels . . . suffer from the risk of overinclusiveness"), *available at* http://www.justice.gov/atr/public/workshops/pae/comments/paew-0015.pdf.
[24] *See, e.g.*, Comments of Barnes & Noble, PAEW No. 12, at 10 (Mar. 1, 2013), *available at* http://www.justice.gov/atr/public/workshops/pae/comments/paew-0012.pdf; Dell et al. at 3-4; Electronic Frontier Foundation at 5; Comments of Google et al., PAEW No. 47, at 10 (Apr. 5, 2013) *available at*

use of weak and low-value patents (which cost less as an input to the PAE business model) accentuates the disjunction between rewards to patentees and value of the patents.[25] PAEs and their supporters argue, however, that PAEs provide "a valuable service to inventors" by providing a mechanism to receive compensation for their inventions.[26] The proposed information request will allow the FTC to review systematically the PAEs' costs and revenues (Information Requests B.2-3, C.1.l, C.1.n, E.1.a(4)(c), E.1.b(5)(c), E.2.c(3), E.4-6, F.2.c, G.1-2, H.1-2) to determine more precisely what portion of revenues collected are paid to patentees and which entities actually benefit from PAE activity.

To provide further insight into what role inventors play in assertions of their patents, the FTC should consider requesting, as part of Information Request F.2, whether any original inventor is a party to any disclosed litigation and whether any benefit the original inventor receives is dependent on or related to litigation of the inventor's patent.

The Commission's proposed study of manufacturing firms (particularly Information Requests E, F, G, and H) will provide a potentially useful benchmark for evaluating whether PAEs are an efficient means of rewarding patentees. The FTC should clarify, for all recipients of the information requests (not only the manufacturing firms), that the terms "Acquire" and "Acquisition" include obtaining legal rights in a patent by any means, such as from other entities, from a company's own employee-inventors, or by other internal development of technology. Being inclusive will avoid inconsistencies and omissions in the answers to the information requests.[27]

ii. The Costs PAE Activity Inflicts on Operating Companies.

Second, while many commentators agree that PAEs impose substantial costs on operating companies, one commentator disagreed. Several commentators argue that the costs imposed by PAEs are significant and divert valuable resources away from productive activities, citing, for example, a study that PAE activity cost defendants and licensees $29 billion in direct costs in 2011 alone.[28] Innovation Alliance, however, disputes the study as "performed for the express

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http://www.justice.gov/atr/public/workshops/pae/comments/paew-0049.pdf; Morton & Shapiro at 6; Comments of RPX, PAEW No. 60, at 3 (Apr. 5, 2013) *available at* http://www.justice.gov/atr/public/workshops/pae/comments/paew-0061.pdf (reporting that a PAE advertised that it would bring in $40 million of revenue, of which $8 million would go to the patent owner and estimating the cost to operating companies would be another $40 million, so that the patent owner only received 10% of all costs imposed on the operating company licensing targets).

[25] *See* GAO-13-465, at 10, 28 (describing problems of broad patents and asymmetrical discovery); Coalition for Patent Fairness at 3-4; Morton & Shapiro at 12 (describing transfer of revenues to patentees as a "leaky bucket").

[26] Comments of Innovation Alliance, PAEW No. 52, Att. A at 24-26 (Apr. 12, 2012), *available at* http://www.justice.gov/atr/public/workshops/pae/comments/paew-0052a.pdf; IPNav at 1; *see* Microsoft at 5; Comments of MOSAID Technologies Inc., PAEW No. 44, at 2 (Apr. 5, 2013), *available at* http://www.justice.gov/atr/public/workshops/pae/comments/paew-0044.pdf.

[27] For example, when an operating company sends its technical personnel to an "invention session" at the offices of a PAE and retains legal or economic rights in the resulting patents, that activity should be counted as "acquiring" rights in a patent by both the operating company and the PAE. If the definitions of "Acquire" and "Acquisition" were limited to transfers of all rights between two separate entities, then situations when the rights were split from the outset might be identified by neither the operating company or the PAE.

[28] *See*, *e.g.*, Comments of the American Intellectual Property Law Association (AIPLA), PAEW No. 50, at 5 (Apr. 5, 2013), *available at* http://www.justice.gov/atr/public/workshops/pae/comments/paew-0046.pdf; Comments of

purpose of garnering . . . publicity" and claims that its methodology is flawed.[29] The proposed information requests will allow the FTC to confirm and quantify some of the licensing costs incurred by operating firms (Information Requests F.1.a(c)-(d), F.2.a-c, F.2.c, F.3-6, G.1.b, G.2). The FTC should clarify that not only the amounts but also the structure of payments or other compensation should be specified in the answers to the information requests. *See* Definition of Economic Interest ("whether … lump sum payments, royalty streams, or access to other Patents as part of a cross-licensing agreement"). To the extent that the recipients of payments or other compensation are not shown in the documents to be produced under Information Requests F.2.a(8) and F.4, the FTC should require PAEs to identify all such recipients.

The Commission's proposed study of manufacturing firms (particularly Information Requests F.2-3, G, and H) will provide a potentially useful benchmark for evaluating whether PAE activity imposes excessive costs on operating companies.

iii. Whether PAE Activity Particularly Targets Small Business and Start-Ups.

Third, commentators disagree about whether PAEs target small, innovative businesses and start-ups.[30] Commentators cite a recent study showing that at least 66% of all defendants

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American Antitrust Institute (AAI), PAEW No. 11, at 3 (Feb. 21, 2013), *available at* http://www.justice.gov/atr/public/workshops/pae/comments/paew-0011.pdf ; Application Developers Alliance at 4; Barnes & Noble at 3; Comments of Carbonite, Inc., PAEW No. 59, at 2 (Apr. 6, 2013), *available at* http://www.justice.gov/atr/public/workshops/pae/comments/paew-0060.pdf ; Comments of Michael A. Carrier, PAEW No. 33, at 2, 9 (Jan. 2013), *available at* http://www.justice.gov/atr/public/workshops/pae/comments/paew-0002.pdf; Coalition for Patent Fairness at 2, 4; Comments of Consumer Electronics Association, PAEW No. 40, at 2 (Apr. 5, 2013), *available at* http://www.justice.gov/atr/public/workshops/pae/comments/paew-0039.pdf; Dell et al. at 8-9; Electronic Frontier Foundation at 4; Google et al. at 9; Comments of Korea Semiconductor Industry Association, PAEW No. 41, at 7 (Apr. 5, 2013), *available at* http://www.justice.gov/atr/public/workshops/pae/comments/paew-0059.pdf; Comments of MetroPCS, PAEW No. 62, at 1 (Apr. 5, 2013), *available at* http://www.justice.gov/atr/public/workshops/pae/comments/paew-0063.pdf; Melius, 15 Vand. J. Ent. & Tech. L. at 170; Microsoft at 2; Morton & Shapiro at 13; Comments of Newegg, PAEW No. 4, at 2 (Dec. 8, 2012), *available at* http://www.justice.gov/atr/public/workshops/pae/comments/paew-0004.pdf; RPX at 4; Comments of Software & Information Industry Association (SIIA), PAEW No. 42, at 2 (Apr. 5, 2013), *available at* http://www.justice.gov/atr/public/workshops/pae/comments/paew-0058.pdf; Comments of Verizon and USTelecom, PAEW No. 43, at 11 (Apr. 5, 2013), *available at* http://www.justice.gov/atr/public/workshops/pae/comments/paew-0043.pdf.

[29] Innovation Alliance at Att. B.

[30] *See, e.g.*, AAI at 5-6; Application Developers Alliance at 2; Comments of Artsnapper, PAEW No. 17, at 1 (Mar. 15, 2013), *available at* http://www.justice.gov/atr/public/workshops/pae/comments/paew-0017.pdf; Coalition for Patent Fairness at 3;Comments of Computer & Communications Industry Association, PAEW No. 64, at 2 (Apr. 5, 2013), *available at* http://www.justice.gov/atr/public/workshops/pae/comments/paew-0065.pdf; Comments of Creative Fuel, PAEW No. 23, at 1 (Mar. 18, 2013), *available at* http://www.justice.gov/atr/public/workshops/pae/comments/paew-0023.pdf; Dell et al. at 8-9; Comments of Downtown Brooklyn Partnership, PAEW No. 18, at 1 (Mar. 15, 2013), *available at* http://www.justice.gov/atr/public/workshops/pae/comments/paew-0018.pdf ; Electronic Frontier Foundation at 5; Comments of Engine, PAEW No. 49, at 1 (Apr. 5, 2013), *available at* http://www.justice.gov/atr/public/workshops/pae/comments/paew-0047.pdf; Comments of Entrepreneurial Development Center (EDC), PAEW No. 13, at 1 (Mar. 4, 2013), *available at* http://www.justice.gov/atr/public/workshops/pae/comments/paew-0013.pdf; Google et al. at 18; Comments of Halcyon Innovation, PAEW No. 30, at 1 (Mar. 11, 2013), *available at* http://www.justice.gov/atr/public/workshops/pae/comments/paew-0033.pdf; Comments of James Roberts Creative, PAEW No. 32, at 1 (Mar. 28, 2013), *available at* http://www.justice.gov/atr/public/workshops/pae/comments/paew-

named in PAE suits are small companies and start-ups that make less than $100 million, and 55% of these defendants make $10 million or less per year.[31] Carbonite, a small, innovative company explained that it was targeted by a PAE and, although it successfully defended its conduct, the fight caused significant harm to its R&D budget, stock price, and ability to introduce new products and create new jobs.[32] Innovation Alliance claims that the PAEs themselves should be understood as innovative start-ups and argues that "most patent cases are not against 'small companies.' "[33] It alleges "virtually all of the negative commentary on trolls, NPEs, and PAEs is based on anecdote or recent studies with a clear ideological and political agenda."[34] The proposed information requests will allow the FTC to determine how often PAEs target small businesses, users of technology that did not themselves develop the accused technology, and start-ups (Information Requests F.1.a-f, F.2.a-c).

Commentators noted that PAEs often target start-up companies as soon as they attract significant investments needed to expand their businesses, *e.g.*, after large venture capital investments or initial public offerings. To the extent not clear from the documents to be provided under Information Requests F.1.e and F.4, the FTC should require PAEs to indicate if the target of the demand letter or the licensee is a start-up company that had raised investment or debt financing.

b. The FTC's Proposed Information Requests Are Necessary and Useful To Determine Whether PAE Activity Promotes Technology Adoption.

There is a (rare) consensus in the comments that, when licensing promotes adoption of patented technology, the license is more socially useful. For example, licensing may provide know-how, enable the licensee to avoid the costs and time of independent development, speed entry of products into the market, and allow the licensee to offer a lower-priced product to consumers. PAE proponents claim that PAE activity provides this benefit.[35] Many commentators dispute whether PAEs engage in such *ex ante* licensing; there is substantial evidence that in fact the PAE business model is predominantly or entirely focused on *ex post* assertion against companies that have already invested and implemented the technology

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0032.pdf; Comments of Nevada Judiciary Committee, PAEW No. 21, at 1 (Mar. 12, 2013), *available at* http://www.justice.gov/atr/public/workshops/pae/comments/paew-0021.pdf; Comments of No Sweat Co., PAEW No. 19, at 1 (Mar. 13, 2013), *available at* http://www.justice.gov/atr/public/workshops/pae/comments/paew-0019.pdf; RPX at 3; Comments of Startupcity, PAEW No. 14, at 1 (Mar. 5, 2013), *available at* http://www.justice.gov/atr/public/workshops/pae/comments/paew-0014.pdf; Comments of St. Cloud Chamber of Commerce, PAEW No. 20, at 1 (Mar. 14, 2013), *available at* http://www.justice.gov/atr/public/workshops/pae/comments/paew-0020.pdf.

[31] Colleen Chien, *Startups and Patent Trolls*, Santa Clara Univ. School of Law, Accepted Paper No. 09-12 (Sept. 28, 2012) (cited by, *e.g.*, Dell et al. at 8-9; Electronic Frontier Foundation at 5).

[32] Carbonite at 1-2. *See also* Downtown Brooklyn Partnership (commenting that the 27 new start-ups in Brooklyn "are being stymied by superficial lawsuits engineered by patent trolls" and need protection); Engine at 1-2. Other commentators suggest potential new entrants in markets are unable to pursue start-ups because they are unable to find investors and take on risks of PAE suits. *See* AAI at 5-6.

[33] Innovation Alliance, Att. B at 4.

[34] *Id.*, Att. A at 5-6.

[35] *See id.*, Att. A at 26-27; Microsoft at 5; MOSAID at 2.

allegedly underlying the patents.[36] Commentators point to PAEs' assertion of patents late in the patent term, whereas licensors that practice their own patents or that license patents in order to promote technology adoption more often assert or license the patents shortly after issuance.[37] *Ex post* assertion provides no know-how, diverts resources from research and development, impedes product availability on the market place, and imposes a tax on consumers. Such activity needs a strong justification—is it really driving innovation, or merely using the costs of litigation and risk avoidance to drive outsized returns for weak patents?

The FTC's requests will identify whether PAE activity promotes the adoption of technology by gathering information regarding how long after issuance the PAEs assert each patent (Information Requests C.1.a, F.1-3), the context of licensing negotiations with manufacturing companies (Information Request F.4), and the underlying rationales for PAEs' assertions (Information Request F.5). To better enable the FTC to evaluate this concern, it should clarify Information Request F.1.a(a) so that, for each recipient of a demand letter, the PAE must specify whether the demand letter recipient had merely announced that it was developing an allegedly infringing product, was already manufacturing an allegedly infringing product, or was a mere end user of an allegedly infringing technology created by someone else. Similar information should be provided with regard to licensees in response to Information Request F.3.a(3). The FTC could also ensure that, to the extent not clear from documents provided under Information Request F.4, PAEs must indicate which specific entity—the PAE or the prospective licensee—initiated licensing negotiations. Finally, to the extent that PAEs are engaged in licensing that promotes technology transfer, their licensing practices may focus on exclusive, rather than non-exclusive, licenses; PAEs should specify whether each license was or was not exclusive in response to Information Request F.3.

The Commission's proposed study of manufacturing firms (particularly Information Request F) will provide a potentially useful benchmark for evaluating when licensing involves technology transfer. Some commentators note that, while the PAE business model necessitates solely *ex post* licensing, operating companies have an interest in *ex ante* licensing—both in granting such licenses as a means to be compensated for their investment and assumption of risk[38] and in obtaining such licenses during product development to avoid research expenses and expedite product launch.[39]

c. The FTC's Proposed Information Requests Are Necessary and Useful To Determine the Scope of PAE Activity.

As noted above, much PAE activity is non-public and PAEs have sought to prevent disclosure of their activity. The small portion of the activity that is visible appears to be increasing dramatically.[40] PAEs, by contrast, insist that they account for a relatively small (and

[36] AAI at 3-4; Coalition for Patent Fairness at 2; Electronic Frontier Foundation at 5; Dell et al. at 6-8; Google et al. at 4-5; Newegg at 3, 7-8.
[37] *See* Carrier at 9.
[38] *See* Morton & Shapiro at 5, 13.
[39] *See id.*; Coalition for Patent Fairness at 2, 4; Dell et al. at 6.
[40] *See*, *e.g.*, AAI at 2; Consumer Electronics Association at 2; Dell et al. at 2; Electronic Frontier Foundation at 2; Food Marketing Institute and National Restaurant Association at 7; Google et al. at 5-6; Comments of Internet

not increasing) fraction of patent infringement cases but concede that "there is insufficient empirical data to address these issues accurately and thoroughly."[41] MOSAID, a PAE that has acquired more than 5,000 patents over the last several years, acknowledges that the vast majority of its licensing occurs without litigation, but has not provided any data showing the scope of the unobservable licensing activity.[42] The FTC's requests will generate the empirical data necessary to quantify PAE activity with respect to patent assertions (Information Requests F.1.a-e, F.5-6), litigation (Information Request F.2.a), licensing (Information Requests F.3.a, F.4), and revenues (Information Requests H.1.a-b, H.2), and will identify trends since 2008.

The FTC should consider clarifying the temporal scope of the study to ensure it obtains consistent responses to the information requests. It is *not* correct to read the information requests as not requiring any discovery predating 2008. *See, e.g.*, Information Requests C.1 (requiring information and documents respecting "*each* Patent held … since January 1, 2008"), D.1 (requiring information and documents for "*all* Patent Portfolios held … since January 1, 2008"). If a PAE held a patent on or after January 1, 2008, it is required to provide information and documents, including information prior to 2008, relating to that patent. *See also* Information Request F.2.a (requiring information and documents for "*all* Litigation(s) pending since January 1, 2008").

d. The FTC's Proposed Information Requests Are Necessary and Useful To Assess How PAE Activity Exploits Low-Value (Weak, Overbroad, Vague, Likely Invalid) Patents.

There is widespread consensus that PAEs purposely acquire and assert overly broad and potentially invalid patents, which they can purchase at low prices and in large quantities.[43] Low prices paid for patents sold in the open market suggest low-quality patents, but PAEs are often attracted to low-priced patents in order to minimize their costs and because PAEs are less concerned with the actual merit of their case than the threat the case presents that may lead to settlement. Commentators explain that aggregating weak patents shifts the focus of a licensing negotiation from patent quality to patent quantity, essentially boosting the hold-up value of weak patents.[44] Even if a defendant could ultimately prove non-infringement or invalidity as to any

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Retailers, PAEW No. 48, at 4 (Apr. 5, 2013) *available at* http://www.justice.gov/atr/public/workshops/pae/comments/paew-0048.pdf; Korea Semiconductor Industry Association at 6; Microsoft at 1-2; RPX at 2; SAS Institute et al. at 1; SIIA at 3. Others point out that reliable data are not available, particularly with respect to patent assertion activity that may not be litigated. *See, e.g.*, Feldman at 80-81.

[41] *See* Innovation Alliance, Att. A at 13, 16, Att. B at 1; *see also* Feldman at 80-81.

[42] MOSAID at 1. MOSAID is changing its name to Conversant Intellectual Property Management Inc. effective January, 1 2014. *See* http://www.conversantip.com/about/.

[43] *See, e.g.*, Application Developers Alliance at 1; AIPLA at 5; Feldman at 16; Comments of The Internet Association, PAEW No. 51, at 3 (Apr. 5, 2013), *available at* http://www.justice.gov/atr/public/workshops/pae/comments/paew-0045.pdf; Internet Retailers at 3, 6; Korea Semiconductor Industry Association at 6; MetroPCS at 2; Microsoft at 4; Newegg at 6; Rackspace at 3; SIIA at 3.

[44] Dell et al. at 35; SIIA at 3 ("One way PAEs abuse the system is by purchasing multiple weak, vague and/or older patents . . . . As a PAE adds more and more patents to its portfolio, the incentive for their victims to defend themselves in litigation diminishes to a point where the only rational response is to capitulate to the PAE's demands.").

particular patent, the costs of litigation and risks of outsized jury awards create leverage for PAEs to extract settlements outsized and unrelated to the true value of the underlying inventions.[45] The GAO has confirmed that overly broad patents are a core problem, and some PAEs even accuse *other* PAEs of asserting low-value patents en masse to extract settlements leveraged by the threat of litigation.[46] The FTC's requests will address this issue by obtaining relevant information regarding each patent (Information Request C.1), the success rate of asserting PAE patents, including whether the patent was invalidated (Information Requests C.2.c(1), F.1.a(d), F.2.a), acquisition sources (Information Request E.1), acquisition costs (Information Request E.2.c), and methods and rationales for organizing patent portfolios (Information Request D).

e. The FTC's Proposed Information Requests Are Necessary and Useful To Examine Concerns Regarding PAE Aggregation of Patents.

Many commentators have expressed particular concern regarding PAEs that aggregate patents in massive portfolios.[47] Commentators expressed concern that aggregators use secrecy and the size of their portfolios to threaten prospective licensees, forcing them to accept licenses for portfolios containing predominantly weak or unneeded patents, including patents the aggregator does not even disclose to the licensee at the time of the transaction.[48] The aggregators may increase their hold-up leverage by indiscriminately or intentionally including in their portfolios substitute patents covering competing or potentially competing technologies, thereby eliminating alternatives for operating companies.[49] Some commentators also assert that aggregators can leverage their bargaining power by collecting patents that read on the same product—they can threaten to separately sue for infringement of each patent to obtain a license to a single portfolio containing these patents or divide the patents among separate portfolios and even transfer them to shell corporations to file suit, creating a royalty stacking problem.[50] PAE

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[45] AIPLA at 5; Barnes & Noble at 4; Electronic Frontier Foundation at 4 (complaining that software patents "fuzzy boundaries" directly feed the PAEs assertion business model); Internet Retailers at 6; Newegg at 6; Microsoft at 4; Rackspace at 3.

[46] *See* GAO-13-465, at 28 ("stakeholders we spoke with, including representatives from PMEs [patent monetization entities] . . . , said that many recent patent infringement lawsuits are related to the prevalence of low-quality patents; that is, patents with unclear property rights, overly broad claims, or both"); IPNav at 4 ("[I]n the patent monetization business, there are companies that do 'black hat' patent monetization. They buy up hundreds of patents, send thousands of threatening letters, sometimes to companies that are not infringing even a weak patent, and offer to settle for a royalty for lower than the costs of defending a patent lawsuit. They are scam artists trying to make a buck off the 'nuisance value' that companies would rather pay a relatively small amount to make them go away than go to the expense of going to court.").

[47] Application Developers Alliance at 4; Dell et al. at 19-25; *see also* Morton & Shapiro at 15-16.

[48] *See* Dell et al. at 19, 41; MetroPCS at 4; Morton & Shapiro at 8; AAI at 7-8; Carrier at 2-3.

[49] *See* Dell et al. at 25; Morton & Shapiro at 16-17.

[50] *See* Morton & Shapiro at 9 (explaining this as occurring when a PAE creates a stacking problem by dispersing portfolios that all read on the same product amongst spawned PAEs); *id.* at 15 (describing how a portfolio containing multiple patents reading on a targeted product can cause economic harm); *see, e.g.*, AAI at 7-8; Carrier at 10; Computer and Communications Industry Association at 7; Dell et al. at 14, 23; Google et al. at 14-16, 17; Retail Industry Leaders Association, PAEW No. 51, at 3 (Apr. 5, 2013), *available at* http://www.justice.gov/atr/public/workshops/pae/comments/paew-0051.pdf; Robert A. Skitol, *FTC-DOJ Workshop on Patent Assertion Entity Activity: Fresh Thinking on Potential Antitrust Responses to Abusive Patent Troll Enforcement Activities* at 3 (Dec. 14, 2012).

proponents argue that portfolio licensing is efficient because it enables the parties to "see the forest through the trees," and decreases transaction costs by resolving 1,000 disputed patents in a single license, even if many of the patents in the portfolio are invalid or non-infringed.[51]

The information requests will enable the FTC to identify PAE aggregators by obtaining information regarding the quantity and nature of patents each Firm owns (Information Request C) and whether and how each Firm organizes patents into portfolios (Information Request D). The requests will collect relevant information concerning the harms of aggregation, including PAE portfolio strategy (Information Requests D.1-D.2), acquisition and transfer history (Information Requests E.1-E.6), and assertion, litigation, and licensing activity (Information Requests F.1-F.6). To understand concerns relating to how aggregators hide patents from and threaten prospective licensees, the Commission should insist on full compliance with Information Requests F.1.a, F.1.d, and F.1.e, in order to determine whether the PAEs disclosed the patents being offered for license, whether PAEs threatened to file multiple lawsuits until the licensee capitulated, and whether the PAEs foreclosed competing alternative technologies. The Commission should also clarify that Information Request D.2 requires disclosure of whether the PAE markets bundles of patents that are comprised of patents that the PAE has determined the prospective licensee needs (such as standard-essential patents) with other patents where the PAE has not determined whether there is a basis to believe the prospective licensee currently uses or plans to use the technology.

f. The FTC's Proposed Information Requests Are Necessary and Useful To Examine Whether PAEs Evade F/RAND Obligations.

Commentators express concern that PAEs exploit patents that read on standards notwithstanding F/RAND commitments made by the original patentees. For example, PAEs may bundle patents that are subject to F/RAND obligations with other, non-F/RAND-encumbered patents, effectively charging a higher license price than had been committed to the standard-setting organization for the standard-essential patent.[52] PAEs respond that they are less likely to abuse F/RAND-encumbered patents because, unlike operating companies that might seek and enforce an injunction based on F/RAND-encumbered patents for the competitive benefit of excluding rivals, PAEs are interested only in money.[53]

The information requests will determine the extent to which PAEs own patents subject to commitments to standard-setting organizations (Information Request C.1.o), whether obligations continue to encumber these patents pursuant to transfers (Information Request C.2), and whether and how these patents have been asserted in demands (Information Requests C.1.p, F.1.a-f), litigation (Information Requests C.1.q, F.2.a-c), or licensing negotiations (Information Requests C.1.r, F.1.f, F.3.a, F.4, F.5, F.6). In order to address concerns regarding bundling of patents to

[51] *See* Risch at 1-3.
[52] *See, e.g.*, AAI at 6; Carrier at 5; Coalition for Patent Fairness at 4; Dell et al. at 22-23; Feldman at 38; Microsoft at 7; Melius, 15 Vand. J. Ent. & Tech. L. at 170; Microsoft at 3 (raising concerns when F/RAND patents are concealed in portfolio licensings); Verizon et al. at 4-7; Comments of Richard Wolfram, PAEW No. 66, at 5, 9 (Apr. 5, 2013), *available at* http://www.justice.gov/atr/public/workshops/pae/comments/paew-0067.pdf.
[53] *See* IPNav at 5 (when a PAE asserts a standard-essential patent, "it's looking to get paid").

evade F/RAND limits, the FTC should clarify that Information Request D (which requires PAEs to "describe … how the Firm organizes the Patent Portfolio(s)" and "submit all documents Relating to the Firm's reasons or business strategy for organizing the Patent(s) into Portfolio(s)") requires PAEs to identify whether any portfolios contain F/RAND-encumbered patents, what impact inclusion of these patents has on portfolio pricing, and whether the firm permits companies to separately license any F/RAND-encumbered patents contained in the portfolio. Similarly, the FTC should clarify (under Information Requests C, D, and F) or alternatively require that, if a PAE offered any F/RAND-encumbered patents only in bundles with other patents, the PAE should explain how it priced the portfolio to ensure compliance with F/RAND obligations.

g. The FTC's Proposed Information Requests Are Necessary and Useful To Determine Whether PAEs Are Exploiting Injunctive Relief To Facilitate Hold-Up.

Commentators express concern that PAEs use the threat of exclusion orders or injunctions to impose hold-up costs in excess of the value of the patent.[54] While the Supreme Court's decision in *eBay Inc. v. MercExchange, L.L.C.*, 547 U.S. 388 (2006), limits PAEs' ability to obtain injunctions in district courts, PAEs increasingly file litigation at the ITC, which does not follow *eBay*.[55] The Innovation Alliance notes that it is more difficult for PAEs to leverage threats of injunctive relief in light of *eBay*, although it concedes that *eBay* may be one reason for the increasing number of PAE complaints at the ITC.[56] Innovation Alliance disputes the accuracy of studies and allegations that PAEs are flocking to the ITC only to take advantage of exclusions orders rather than because of recent shifts of manufacturing abroad.[57] The proposed information request will allow the FTC to review litigation efforts and subsequent licenses at district courts and the ITC (Information Requests F.1.a(d)-(e), F.1.f, F.2.a-b, F.3.a(4), F.3.a(7), F.4) to evaluate the extent to which PAEs may obtain larger settlements as a result of their seeking exclusion orders, injunctive relief, or enhanced damages.

h. The FTC's Proposed Information Requests Are Necessary and Useful To Examine Concerns Regarding Non-Transparency of PAE Patent Ownership.

Commentators disagree about where PAE activities lie on the spectrum between secrecy and transparency. Several commentators argue that "PAEs routinely hide ownership and Real-Party-in-Interest information behind a network of shell companies, subsidiaries, and contractual relationships," and that "[r]ecordation of transfers in ownership, assignments, or contractual relationships is largely voluntary."[58] The lack of transparency puts potential targets at a

[54] Dell et al. at 7; Morton & Shapiro at 5; *see also* AIPLA at 13; AAI at 7; Application Developers Alliance at 4; Barnes & Noble at 8; The Internet Association at 4; Melius, 15 Vand. J. Ent. & Tech. L. at 170-71; Verizon et al. at 2-3.
[55] AIPLA at 13; Application Developers Alliance at 4; Barnes & Noble at 8; Morton & Shapiro at 6-7.
[56] Innovation Alliance, Att. A at 19-21.
[57] *Id.* at 20-22.
[58] SIIA at 4. *See also* AIPLA at 10; AAI at 7, 11; American Association of Advertising Agencies at 6; Carrier at 11; Coalition for Patent Fairness at 5; Dell et al. at 19; Feldman at 81; Retail Industry Leaders Association at 3; The

disadvantage when engaging in licensing negotiations and makes litigation abuse more prevalent.[59] MOSAID claims it is "clear about [its] ownership records."[60] But another PAE reportedly "has used at least 1,276 shell companies to purchase and hold patents."[61] The proposed information request will allow the FTC to obtain a clear understanding of each PAE's structure (Information Requests B.1, B.2) and affiliated persons and entities with a financial interest (Information Requests B.3, C.1.n, E.1.a(4)(c), E.1.b(5)(c), E.2.c(3), E.4-6, F.2.c, G.1-2, H.1-2), as well as the patents and patent portfolios it holds or has transferred (Information Requests C.1.a-r, C.2.a-c, C.3, D.1.a-c, D.2, E.1.a-b, E.2.a-c, E.3-6), and its assertion, litigation, and licensing activity (Information Requests F.1-6).

One of the justifications asserted for PAEs keeping their business information and structure confidential is "for the same reason Warren Buffett keeps his information confidential. . . . . Warren Buffett doesn't tell people where he's investing until he's forced to when he's practically ready to take over a company. Disney doesn't tell people when it's buying swamp land in Florida that, hey, we're planning to put a theme part over there."[62] Some of the information requests to be answered by the manufacturing firms will allow the Commission to test this assertion. If revealing patent ownership forfeits a legitimate competitive advantage, operating companies presumably would make comparable efforts to conceal patent ownership.[63]

i. The FTC's Proposed Information Requests Are Necessary and Useful To Determine the Extent to Which PAEs Exploit Imbalances in Litigation Risk.

Most commentators agree that PAEs have an unfair advantage in litigation compared to operating companies, as has been confirmed by the GAO.[64] PAEs do not produce anything and cannot be countersued for infringing the defendant's patents.[65] PAEs can take extreme litigation positions as the patent holder because they are never faced with those positions being used against them as the accused infringer. Also, the current litigation system imposes huge litigation costs on defendants but minimal costs on PAE plaintiffs. For example, PAEs often serve broad discovery requests requiring defendants to review and produce vast quantities of documents, many of which are of questionable relevance and contain sensitive information. PAEs also typically request numerous depositions—imposing additional costs and burdens on defendants.[66] By contrast, PAEs have little documentation to produce and few witnesses and therefore do not incur heavy discovery burdens and, as discussed above, PAEs have little disincentive to ask for

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Internet Association at 4; Microsoft at 3; Comments of Alan Minsk, PAEW No. 5, at 1 (Dec. 12, 2012); *available at* http://www.justice.gov/atr/public/workshops/pae/comments/paew-0005.pdf; MetroPCS at 5.

[59] Carrier at 3; Electronic Frontier Foundation at 7-8; Microsoft at 3; Minsk at 1; Morton & Shapiro at 8.

[60] MOSAID at 2.

[61] Carrier at 3.

[62] Transcript of Patent Assertion Entities Activities Workshop at 63, hosted by the FTC and DOJ (Dec. 10, 2012), *available at* http://www.ftc.gov/opp/workshops/pae/transcript.pdf.

[63] *See* Carrier at 4.

[64] *See, e.g.*, Coalition for Patent Fairness at 2; GAO-13-465, at 10.

[65] *See, e.g.*, Coalition for Patent Fairness at 2; Electronic Frontier Foundation at 7; AAI at 4; Computer & Communications Industry Association at 7; Carrier at 7.

[66] AIPLA at 8-9; Barnes & Nobles at 7; SIIA at 4-5.

such broad discovery.[67] Moreover, while defendants incur attorneys' fees, PAEs frequently avoid doing so by employing counsel working for contingent fees. Commentators also suspect PAEs cover whatever costs they do incur by suing large numbers of defendants and using early settlements to finance ongoing litigation against the remaining defendants.[68] Some commentators have suggested that PAEs even create judgment-proof shell companies to insulate themselves against any litigation losses. Innovation Alliance, however, claims that PAEs have *less* leverage to encourage settlement over litigation because PAEs are more dependent on patent income and royalty-based licenses essential to their survival.[69] The proposed information requests will allow the FTC to review litigation and patent dynamics, assertion costs (Information Requests F.1.b(1)-(3), F.2), damages awarded (Information Requests F.2.a(6)-(7)) and licensing revenue (Information Requests F.3.a(5)-(7), F.4-6, H.1-2), and evaluate the ways in which PAEs are being financed (Information Requests B.2, B.3, C.1.n, E.1.a(4)(c), E.1.b(5)(c), E.2.c(3), E.4-6, F.2.c, G.1-2, H.1-2). The information requests will also disclose the timing and structure of settlements entered into by public PAEs. Unusual numbers and structures of settlements reached around the end of reporting periods for public PAEs would weaken the claim that settlements are based on the merits of patent claims.

The Commission's proposed study of manufacturing firms (particularly Information Requests F) will provide a potentially-useful benchmark for evaluating the extent to which PAE litigation exploits imbalances in litigation risks. Commentators have identified several considerations for owner-operators when considering bringing suit that are absent for PAEs, including the threat of countersuit, the potential for cross-licenses, and the reputational "blowback" within the industry.[70] Commentators predict these considerations result in a lower rate of litigation, assertion against a specific defendant, higher rate of cross-licensing resolutions, and relatively stronger patents being asserted.

j. The FTC's Proposed Information Requests Are Necessary and Useful To Examine Concerns About Privateering.

Commentators described concerns regarding "hybrid PAEs" or "privateers," which involve operating companies outsourcing patent enforcement to PAEs while retaining some rights or interests in the patents.[71] MOSAID, for example, in its comments, describes a relationship it has to enforce Nokia patents, which also involves Microsoft receiving revenue

[67] *See*, *e.g.*, AAI at 4; Coalition for Patent Fairness at 5; Carrier at 7; Dell et al. at 9; Engine at 2; Internet Retailers at 9.
[68] *See* Newegg at 5.
[69] Innovation Alliance, Att. A at 18. Other commentators respond that protracted litigation benefits PAEs, regardless of the result, because developing a litigious reputation is a component of the business model, whereas the publicity and reputational impact of litigation is deleterious for defendants, motivating them to settle, regardless of merits. *See* AAI at 4; Coalition for Patent Fairness at 3; Carrier at 7; Computer & Communications Industry Association at 7-8; Morton & Shapiro at 7, 10.
[70] *See* AAI at 4-5; Carrier at 7; Electronic Frontier Foundation at 7; Morton & Shapiro at 8, 17.
[71] AAI at 9-10; Computer & Communications Industry Association at 8; Carrier at 2, 9; Comments of Tom Ewing, PAEW No. 56, at 3-4 (Apr. 4, 2013), *available at* http://www.justice.gov/atr/public/workshops/pae/comments/paew-0056.pdf; Feldman at 34, 37; Google et al. at 2-3, 12, 17-18; The Internet Association at 4; MetroPCS at 4; Morton & Shapiro at 18-19.

from MOSAID's enforcement of the patents.[72] Such arrangements alter enforcement incentives, may provide mechanisms for operating companies to evade commitments to standard setting organizations, and enable operating companies to use PAEs as alter egos to raise rivals' costs.[73] The proposed information requests will provide relevant information regarding privateering relationships on both an entity level—requiring disclosure of all legal, contractual, economic or ownership interests in a PAE (Information Request B.2, B.3)—and on a patent-by-patent basis—requiring disclosure of any third-party economic or legal interests in each patent held by the PAE (Information Request C.1.m-n). In addition, information relating to transfer and acquisition of patents (Information Request E), whether those patents are subject to industry-wide commitments (Information Request C.1.o), and identification of investors (Information Request B.1) is relevant to whether companies participating in standard-setting bodies are using PAEs to evade FRAND commitments, either by transferring patent directly to PAEs or sharing information with PAEs to enable them to acquire patents reading on standards without being subject to commitments.[74]

The FTC should clarify that Information Request B requires PAEs to reveal all investors and the terms of their investments, including any rights associated with the transfer or license of PAEs' patents. The "legal rights" that must be disclosed under Information Request B.2 should include reversionary interests, termination rights, and any other rights that would allow investors to retain any degree of control over assertion or licensing of patents. To ensure that the FTC obtains information regarding all third-party rights in any PAE patents, the FTC may want to add a provision that requires PAEs to specifically identify, to the extent not covered by Information Requests C.1.m or C.1.n, any other rights or controls third parties have over each patent a PAE possesses, including the right to license the patent even if no other rights are owned. Additionally, the FTC should clarify that transfer information provided pursuant to Information Request E.1.a(1) should note whether the transferee was or is an investor in the PAE; the assignment history provided pursuant to request Information Request C.2 should also note whether the assignment to the PAE has been recorded with the Patent and Trademark Office.

II. The FTC Should Clarify That Particular Topics Are Included Within the Scope of the Investigation.

In addition to the suggestions for clarifying various information requests discussed above, there are a few areas where the Commission may consider enhancing the clarity of the information to be collected.

[72] MOSAID at 2 (explaining that MOSAID purchased Core Wireless, which holds Nokia patents, and is managing Core Wireless's licensing and enforcement efforts from which Nokia receives a substantial share of revenues). Microsoft's economic interest in the revenue generated from MOSAID's licensing is described by Microsoft's outside counsel. *See* Covington & Burling LLP Press Release, Covington Advises Microsoft In Standards Essential Wireless Patents Portfolio Transaction With Mosaid and Nokia (Sept. 2, 2011), *available at* http://www.cov.com/news/detail.aspx?news=1661. *See also* Carrier at 8.
[73] *See* Google et al. at 11-17; Minsk at 1; Morton & Shapiro at 18.
[74] *See* Dell et al. at 23-24.

a. Disclosure of Relations to Other Entities Should Be Comprehensive.

A report filed under Section 6(b) ordinarily requires the reporting firm to identify its "relation to other corporations, partnerships, and individuals." 15 U.S.C. § 46(b). Understanding these relations is particularly critical to this study because of the efforts by many PAEs to hide their relations, and Information Request B, which requires disclosure of "business or corporate structure, … the names of all parents, subsidiaries (whether wholly or partially owned), divisions (whether incorporated or not), affiliates, branches, joint ventures, franchises, operations under assumed names, websites, or entities over which the Firm exercises supervision or control, or any other Person(s) or entities with a contractual or other legal right to a share of revenues, profits, or other Economic Interest tied to profitability or financial performance of the Firm" is plainly meant to be comprehensive. For the benefit of the firms that will be providing the information, the Commission may want to enhance the clarity of Information Request B in two ways:

i. Persons or Entities that Supervise or Control PAEs, Including Advisors to Public PAEs.

Information Request B.2, looking downstream, requires identification of entities or persons over which the PAE exercises supervision or control. The mirror image Information Request B.3, looking upstream, requires identification of "each Person or entity having an ownership interest in the Firm, or other legal entitlement to share in the financial performance of the Firm." It is likely that some persons or entities may have important supervision or control rights in a PAE but might be unsure whether their rights amount to an "ownership interest" in or "share in the financial performance" of the PAE. The Commission should clarify that Information Request B.3 includes upstream persons or entities that exercise *any* supervision or control over the PAE.

Similarly, lawyers that act as licensing agents may exercise control over settlement and licensing decisions beyond merely litigating a case, and such control should also be disclosed, including if the lawyers helped set up a PAE or put a PAE owner in touch with investors.

Based on public reports filed by the public-traded PAEs, it appears that several hedge funds and patent monetization advisors have been involved as repeat players in setting up public PAEs. For example, among the six most recent public PAEs established through reverse merger IPOs, Hudson Bay Capital Management appears as a top-ten shareholder four times (Vringo, Finjan, Document Security Systems, and Spherix); members of the Honig family appear four times (Vringo, Marathon Patent Group, Document Security Systems, and Spherix); and Iroquois Capital appears three times (Vringo, Finjan, and Spherix). These public PAEs have also tended to share the same advisor, with IP Navigation Group serving in that role for three of the most recently formed public PAEs (Marathon Patent Group, Document Security Systems, and GlobalOptions). The FTC should clarify or require that such organizers or advisors that establish a PAE's business must be disclosed under B.3, whether or not they play an ongoing role supervising or controlling the PAE once established.

ii. Cost Sharing as a Means for Participating in the Profitability or Financial Performance of the PAE.

As noted, Information Request B.2 requires identification of "other Persons or entities with a contractual or other legal right to a share of revenues, profits, or other Economic Interest tied to profitability or financial performance of the Firm." "Economic Interest" is defined broadly to include "rights or claims to current or future revenues derived from a Patent, whether as lump sum payments, royalty streams, or access to other Patents." As defined, the request is plainly meant to and should capture all persons or entities that have an economic interest in the PAE's patent monetization, but it is likely that some persons or entities may have significant economic interest in patent monetization in the form of sharing common costs with the PAE or in the form of contracts to perform services for PAEs (where the service contracts involve the patent monetization function itself, e.g., contracts for licensing or performing patent-related services, which are often identified by a PAE as part of the total cost of ownership or maintenance or exploitation of the patent assets). Cost sharing—like revenue sharing—directly affects (and is a means for participating in) the profitability or financial performance of the PAE. The FTC should clarify or require that cost sharing arrangements and contracts to perform services for PAEs must be disclosed under Information Request B.2.

b. Unresearched Assertions, Particularly Against End Users.

Information Request F.1.a. requires identification of "all Demands sent by, or on behalf of the PAE since January 1, 2008." Commentators have highlighted unique concerns when demand letters are sent to end-user customers or small businesses that have inadequate experience or resources to investigate or defend against such assertions.[75] Some PAEs prey on this weakness to obtain numerous low value, low cost settlements. Some PAEs have further exploited end-users' general lack of knowledge by asserting patents for which licenses already exist that cover the accused product or where the patent term has expired.[76] Some commentators also indicate that demand letters often do not even disclose what patents are being asserted—the equivalent of naked threat letters.

Information Request F.1.a(c) requires the PAE to specify, for each Demand, "the total time spent and costs incurred by the Firm, or any Person working on behalf of the Firm, for any research Relating to the Demand, including but not limited to any attempt to compare the allegedly infringing product(s) or process(es) with the Asserted Patent claims." The FTC should clarify that the total time and costs of "research" should include specification of the time spent by the PAE in determining whether litigation and demand letter targets already have a license to the asserted patent. Commenters are aware of several instances of no diligence (or willful blindness) on this question. The FTC should also clarify that for Information Request F.1.a.(b),

[75] *See* AAI at 5; AIPLA at 12; Electronic Frontier Foundation at 8-9; Dell et al. at 12-14; Food Marketing Institute & National Restaurant Association at 6-8 (describing the demand letters retailer end-users received and survey conducted); Morton & Shapiro at 3; Retail Industry Leaders Association at 3; Rackspace at 5-6; SIIA at 5.
[76] *See, e.g.*, Am. Compl. ¶ 77, *In re Innovatio IP Ventures, LLC Patent Litig.*, No. 1:11-cv-09308 (N.D. Ill. filed Oct. 1, 2012) (alleging PAEs "unlawfully and intentionally seek to circumvent this [license] and other licenses, by hiding these licenses from targets of Innovatio's conduct, pursing licenses from end users, . . . even though the amounts sought by Defendants are not due or legally recoverable").

responses should include whether the patents relating to the demand are explicitly disclosed in the demand letters.[77]

c. Commitments on Patent Use

Information Request C.1.o focuses on whether any patent in possession of respondent Firms is subject to a commitment made to a Standard-Setting Organization. In addition, there are industry-wide commitments that occur outside of standard-setting organizations and are broader than F/RAND commitments, such as commitments to avoid royalty stacking and to set maximum royalties, and non-assertion promises for open source software.[78] The FTC should modify its inquiry under Information Request C.1.o to apply to all industry-wide commitments made on the patent including, but not limited to, standard setting organizations.

d. Scope of Investigation of Manufacturing Firms

A separate study of a group of "owner-operators" that license or practice wireless patents to compare to pure PAE activity (which may include but not be limited to wireless patents) may be relevant and useful as described above. And depending on the targets the Commission chooses, there may be an overlap between the studies when an owner-operator itself is contributing to PAE activity by engaging in privateering or directing the activities of independent PAEs. The Commission's study of manufacturing firms is important to understand both the impact of PAE activities on firms producing products and services as well as the impact of manufacturing firm contributions to PAE activities.

III. Costs of the Study Can Be Reduced If the FTC Provides Guidance To Avoid Unnecessary Disputes About Confidentiality of the Information.

The FTC's methodology for estimating the burden of *complying* with the information requests (multiplying the expected hours of data collection times hourly labor costs) is reasonable. Any objection to the study based on burden should be presented in these terms. But because patents are the primary assets of the PAEs, and the PAEs necessarily track their activities for internal and investor reporting already, much of the requested information should be readily available. As noted above the harms associated with abusive PAE activity more than justify the burden of complying with the requests. Some burden on parties receiving information requests is expected and necessary in furtherance of the agency's legitimate inquiry and the public interest. *FTC v. Texaco, Inc.*, 555 F.2d 862, 882 (D.C. Cir. 1977). The proposed information requests here are targeted and go to the heart of the inquiry into whether and how PAEs cause harm to competition and hinder innovation. In these circumstances, "[w]hen the degree of burdensomeness necessarily inherent in the preparation of a full response to the Order is considered in light of the pertinent responses the objected portions of the Order will produce,"

[77] Rackspace at 4 (explaining that IPNav has a practice of sending patent assertion letters without divulging patent numbers, inventors, or details of their infringement claims unless parties agree not to file a declaratory judgment claim).

[78] *See* American University, Washington College of Law, "Non-SDO Patent Statements and Commitments" (compiling all non-SSO public statements and commitments), *available at* http://www.pijip.org/non-sdo-patent-commitments/ (last visited Nov. 23, 2013); *see also* Google et al. at 14.

the burden of compliance is not unreasonable. *See Genuine Parts Co. v. FTC*, 445 F.2d 1382, 1391 (5th Cir. 1971).

Certain types of costs, moreover, should not be considered as costs of compliance. For example, PAEs may seek to resist the information gathering; costs of *resisting* the study should not be taken into account in deciding to proceed. Indeed the secrecy of abusive PAE activity makes the investigation more imperative.

The FTC may be able to reduce costs, both for the PAEs responding to the information requests and for the FTC itself in enforcing compliance with the information requests, by anticipating and providing advance guidance on confidentiality assertions. For example, PAEs should not be permitted to avoid or delay compliance with the information requests on the ground that they have entered into private agreements requiring confidentiality of the information. The FTC has standard procedures for protecting confidential information.[79]

Respectfully submitted,

/s/ John Thorne

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[79] Federal Trade Commission Operating Manual § 15.5.1 ("Submitters may request confidential treatment for compliance reports and other materials"). Pursuant to 15 U.S.C. § 46(f), the FTC is not permitted to disclose any confidential business or commercial information, including current contracts.

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