



December 16, 2013

Federal Trade Commission
Office of the Secretary
The Honorable Donald S. Clark
Room H-113 (Annex J)
600 Pennsylvania Avenue NW
Washington, DC 20580

Re: PAE Reports: Paperwork Comment; Project No. P131203

Dear Mr. Clark:

Apple Inc. ("Apple") submits this statement in response to the Federal Trade Commission's ("FTC" or "Commission") request for public comments concerning its proposed collection of information pertaining to Patent Assertion Entities ("PAEs"). FTC Proposed Collection and Solicitation of Public Comments, 78 Fed. Reg. 61352 (Oct. 3, 2013).

I. APPLE'S INTEREST

Apple is a leading innovator in the fields of wireless communication and mobile devices. Over the past decade, Apple products like the iPhone and iPad have revolutionized these industries. Innovating on this scale requires an extraordinary investment of energy and resources, and Apple relies in part upon a healthy patent system to protect this investment. It owns thousands of U.S. patents, and is licensed to use thousands more. And when disputes arise, Apple sometimes finds itself in court, whether to enforce its own rights, or to defend against allegations of infringement levied by another firm. Apple therefore has a keen interest in a patent system that encourages competition and innovation, and discourages hold-up and waste.

As the Commission knows, the patent world has struggled to adapt to the emergence of the patent assertion industry. That industry's primary model—acquiring patents and licensing their use to others—is a departure from the traditional model under which operating firms invent products and bring them to market. There are now more than 250 active PAEs. And although the Commission is correct that publicly available litigation data provides only a narrow window onto the PAE phenomenon, what is visible through that window is startling. PAE litigation has become the dominant feature of the patent landscape. In 2013, 43 percent of all patent infringement defendants were sued by PAEs.¹ And if litigation is just the tip of the

¹ This data is drawn from a study commissioned by Apple and produced by PatentFreedom, a third-party consultancy focused on advising clients on the costs and risks associated with patent assertions by non-practicing entities. The study defines PAE as a non-practicing entity whose patent portfolio consists of more than fifty

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iceberg—and most believe it is²—then what lies beneath the surface poses a daunting challenge for the patent system.

No firm has been targeted by PAEs more than Apple. Apple has litigated against PAEs 92 times in the past three years alone,³ and has received many more demands. Its experience confirms what many others have documented: although PAE activity is not necessarily harmful in theory, far too many PAEs exist only to extract undeserved royalties. As both a market leader and the PAEs' favorite target, Apple has a special interest in policies that discourage this behavior. Apple thanks the Commission for undertaking this important study, and respectfully submits these comments on the Commission's proposal.

II. COMMENTS ON THE SCOPE OF THE PROPOSED INFORMATION REQUESTS

The proposed data collection covers a broad swath of topics. All of this data could theoretically lend useful insight into PAE behavior. But the PAE industry and the environment in which it operates is rapidly changing. It may be useful to keep other ongoing attempts to address the PAE phenomenon in mind in framing the scope of this study. A narrower inquiry designed to illuminate a handful of the more salient issues might prove a more useful contribution to the ongoing discussion.

As the Commission is of course aware, the data it collects will become part of an already robust response to the PAE phenomenon. In September 2011, President Obama signed the Leahy-Smith American Invents Act ("AIA"), Pub. L. No. 112-29, 125 Stat. 284 (2011), into law. The AIA contained provisions directly related to patent assertion practices, most notably its change to joinder rules.⁴ Scholars, judges, and elected officials in both the legislative and executive branches continue to study the evolving challenges posed by the patent assertion industry, and many new solutions are under active consideration.

Eleven bills have been introduced so far this Congress that in some way address the PAE issue. The Innovation Act, sponsored by Rep. Bob Goodlatte (R-VA), would usher in sweeping changes to patent litigation, from pleading, to discovery, to attorney's fees.⁵ That bill passed the House of Representatives with broad bipartisan support on December 5. A companion bill, the Patent Transparency and Improvements Act, has been introduced in the Senate by Sen. Patrick Leahy (D-VT). That bill would also tackle the issue of demand letters, empowering the FTC to take action against PAEs that send them in bad faith.⁶ Meaningful legislation

percent acquired, as opposed to originally assigned, patents. This definition aligns closely with that adopted by the FTC in the proposed study.

² See, e.g., Colleen V. Chien, *Of Trolls, Davids, Goliaths, and Kings: Narratives and Evidence in the Litigation of High Tech Patents*, 87 N.C. L. Rev. 1571, 1579 (2009) ("For every defendant that is actually sued, many more demands are made."); President's Council of Econ. Advisors, Nat'l Econ. Council, Office of Sci. & Tech. Policy, Patent Assertion and U.S. Innovation 6 (2013), available at http://www.whitehouse.gov/sites/default/files/docs/patent_report.pdf ("Conservative estimates place the number of threats in the last year alone at a minimum of 60,000 and more likely at over 100,000.").

³ This statistic is drawn from internal Apple data, verified against data provided by PatentFreedom.

⁴ AIA, Pub. L. No. 112-29, § 19.

⁵ Innovation Act, H.R. 3309, 113th Cong. § 3 (2013).

⁶ Patent Transparency and Improvements Act, S. 1720, 113th Cong., § 5 (2013).

addressing the PAE phenomenon could be just around the corner. Change may also come through the courts. The Supreme Court of the United States is now considering two appeals in cases from the Federal Circuit—one of them a PAE case—concerning the Federal Circuit’s test for fee shifting under the current patent law.⁷

The Commission proposes to collect extensive information from PAEs on seven substantive topics, and to collect data from manufacturing firms on five of these topics. It seeks, for example, detailed data concerning the internal corporate structure of each PAE, information on every patent the PAE has owned or acquired since 2008, and the manner in which the PAE divides these patents into portfolios. Its fine-grained requests include any previous owners of each patent, any communications to investors concerning any patent, payment arrangements for each acquired patent, and the potential consideration of cross-licensing agreements. This information will likely take a long time to collect. It will take even longer to organize into a useful set of data from which the Commission can draw meaningful conclusions.

Again, all of the information the Commission proposes to collect could theoretically provide worthwhile insight into PAE behavior. But because the PAE phenomenon and the responses to it are evolving so quickly, there is some risk that the landscape will change before all of the important details can be sketched. A narrower focus might be of greater utility.

III. COMMENTS ON PARTICULAR AREAS OF FOCUS

PAEs are intermediaries. Because they do not invent, make, or sell any product, they profit only when they can turn a patent acquired at a certain price into a larger stream of royalties. In other words, returns from patent assertions must outstrip costs of patent acquisitions. And judging by the industry’s astronomical growth, many PAEs have figured out how to make this work.

As the Commission has noted, however, most of the empirical work to date has focused on litigation. This work has documented how PAEs use the cost of litigation to get their targets to accede to their demands. Patent valuation and acquisition are just as important. The Commission’s study could attempt a full accounting of the economics that motivate PAEs. Such a study would focus on four factors: (1) PAEs’ valuations of, and methods of valuing, patents at the time of acquisition; (2) PAEs’ royalty demands at the time of assertion; (3) PAEs’ costs of asserting their patents; and (4) defendants’ costs of defending against PAEs’ assertions.

There are likely some PAEs who value patents the same way, and for the same reasons, that manufacturing companies do. One example would be a PAE that identifies and buys patents whose current owners lack the expertise or resources to bring the underlying technology to market, and then licenses use of those patents to firms better positioned to commercialize the technology. Another would be a PAE that pays top dollar to build a strong portfolio of very valuable patents, licenses their use to operating companies, and then asserts them sparingly against infringers in order to protect its licensees’ investment. PAEs operating under these models would assign the highest values to strong patents on innovative technologies, just as the patent law wants.

⁷ See *Highmark Inc. v. Allcare Health Management Systems, Inc.*, 12-1163, and *Octane Fitness, LLC v. Icon Health & Fitness, Inc.*, 12-1184. Apple recently filed an amicus curiae brief in both of these cases.

But these models are not what have fueled the PAE boom. The dominant patent assertion strategy is to leverage certain features of the patent *system*—not the strength of the patent or quality of the technology—into royalties. The idea is to use notice failure, the threat of litigation costs, and the risks inherent in litigation to bargain for royalties that are disproportionate to the value of the licenses they transfer.⁸ The tools of this trade are the demand letters, nuisance suits, and hold-ups that have convinced many of the need to address the PAE phenomenon. And those that ply it appear to attach value to patents for very different reasons than do those PAEs discussed above, let alone those in the business of innovation.

The difference between a PAE's acquisition price and its demand amount at the time of assertion reveals this. Consider those PAEs known as "bottom-feeders."⁹ Bottom-feeders buy patents on the cheap—likely for \$100,000 or less—that no operating company could possibly need or want.¹⁰ They are cheap for a reason. Often the patents are vague, weak, or otherwise invalid. Sometimes the underlying technology is totally worthless. But the bottom-feeder will nevertheless assert its low-value patents against scores of mom-and-pop tech firms, demanding an amount just below the cost of litigation. All the small settlements add up. So the bottom-feeding PAE values for its *in terrorem* assertion value what is otherwise a worthless patent.

Other PAEs go a bit bigger. *Highmark Inc. v. Allcare Health Management Systems, Inc.*, a case currently pending before the Supreme Court, is an example. Allcare, a PAE, bought the "health management system" patent in that case for \$75,000. It then asserted it against Highmark, a health services provider, including in its demand letter the warning that another firm had already spent \$2 million defending against Allcare's infringement suit. Allcare's allegations turned out to be totally meritless—the patent was entirely worthless to Highmark. But Allcare tried to buy it for a song and leverage the cost of litigation into millions.

But never is the disparity between PAE valuations and traditional valuations more apparent than when PAEs hunt "big game."¹¹ PAEs have a reputation for surprising the largest and most profitable companies with infringement lawsuits just after the announcement of a new and important product. PAEs employing this tactic do tend to acquire a potentially strong patent on a potentially useful technology, often for between \$1 and \$5 million. But they do not seek to license it immediately. Instead, they wait until a major product, late in development, wanders near the patent's scope. Because products like smartphones tend to consist of thousands of potentially patented technologies, this is likely to happen sooner or later. Then comes the ambush: an infringement suit with demands as high as \$100 million or more. Here, as in the previous examples, the yawning gap between the PAE's purchase price and demand has nothing to do with the usefulness of the underlying technology. It is a

⁸ Robin C. Feldman, *Intellectual Property Wrongs*, 18 Stan. J.L. Bus. & Fin. 250, 253 (2013); Mark A. Lemley, *Are Universities Patent Trolls?*, 18 Fordham Intell. Prop. Media & Ent. L.J. 611, 613-14 (2008).

⁹ Colleen V. Chien, *Startups and Patent Trolls*, 2014 Stanford Tech. L. Rev. (forthcoming) (manuscript at 15), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2146251.

¹⁰ Andrei Hagiu & David B. Yoffie, *The New Patent Intermediaries: Platforms, Defensive Aggregators, and Super-Aggregators*, J. Econ. Persp., Winter 2013, 45, at 52.

¹¹ James Bessen & Michael J. Meurer, *The Direct Costs from NPE Disputes*, 99 Cornell L. Rev. (forthcoming 2014) (manuscript at 20), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2091210.

function of the research and development costs the operating company has sunk while the PAE laid in wait.

There is nothing inherently wrong, of course, with a secondary patent market in which participants value patents differently. Inevitably, some will be better at monetizing a given patent than others, and will therefore assign it a greater value. But this does not mean that the patent law should not favor some types of value over others. The purpose of the patent law is to promote progress in the useful arts. The gap between a PAE's acquisition price and its ultimate demand suggests that something other than the patent's contribution to innovation and progress is driving PAEs' patent valuation. And that something is almost certainly assertion value, which is in large part a function of the cost of mounting a defense.

Data quantifying this dynamic would represent an important contribution to the existing understanding. Although news of patent acquisition amounts sometimes becomes publicly available, comprehensive data is not part of the public record. The Commission's proposal to collect the information identified in Request E, "Patent Acquisition and Transfer Information," would fill this gap. This data could then be compared to PAE demand data obtained pursuant to Request F, "Patent Assertion Information," as well as cost-of-assertion and cost-of-defense data obtained pursuant to Request G, "Aggregate Cost Information." Data or documentation indicating the factors relied upon in assessing the value of a patent at the time of acquisition, in particular that collected pursuant to Requests C.1.I, E.5, and E.6, would further illuminate the issue. All of this information would assist the Commission and others in determining whether the incentives motivating PAEs' valuations of patents align with the objectives of the patent law.

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Apple is grateful to the Commission for focusing on this important area of patent law. If narrowed as suggested, the Commission's proposed information collection could represent an important contribution to the ongoing dialogue concerning PAEs.

Sincerely Yours,

Noreen Krall
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