February 5, 2009

Mr. Donald S. Clark
Secretary
Federal Trade Commission
600 Pennsylvania Avenue, N.W.
Room H-135 (Annex I)
Washington, D.C. 20580

Re: Evolving IP Marketplace - Comment, Project No. P093900

Dear Mr. Clark:

The Innovation Alliance is pleased to submit these comments to the Federal Trade Commission for consideration in connection with the Commission's public hearings on "The Evolving IP Marketplace." The Innovation Alliance is a coalition of companies seeking to enhance America's innovation environment by improving the quality of patents and protecting the integrity of the U.S. patent system.[1] We commend the Commission's efforts to explore and understand the effect, if any, that changes in business models and IP law may have had on competition law issues related to IP and innovation since the FTC IP Report[2] was published in 2003.

As discussed below, it is a fact that business models for the use and exploitation of IP have continued to evolve since 2003. Likewise, IP law has evolved during this time. Yet, there remain certain basic principles that should guide effective competition policy and antitrust law as they relate to IP-related conduct. *First,* as identified in the 2003 IP Report, competition and antitrust law and policy must be defined to accommodate the common purpose of both the antitrust laws and intellectual property laws, *i.e.,* to promote consumer welfare. This requires a strong IPR environment that fosters innovation and competitiveness. Moreover, competition and antitrust law should play a role only to address conduct that has a demonstrable anticompetitive effect based on empiric and objective criteria. Otherwise, the risk of over-deterrence and condemnation of potentially pro-competitive conduct will exist to the detriment of innovation, competition and consumers. *Second,* competition policy and antitrust law, especially when considered in relation to intellectual property, must recognize the varying legitimate interests that exist among different entities with different business models, *e.g.*, vertically integrated manufacturers and aggregators of IP developed by third-parties, small manufacturing entities, technology developers, software companies, universities, and others. Accordingly, enforcement and policy determinations should not be made based on the type of entity that seeks to enforce its

[1] To learn more, visit www.innovationalliance.net.

[2] Federal Trade Commission, *To Promote Innovation: The Proper Balance of Competition and Patent Law and Policy* (October 2003), *available at* http://www.ftc.gov/os/2003/10/innovationrpt.pdf.

IPR or realize the value of that IPR. Here, too, evaluation of specific conduct is required rather than the adoption of rules based on types of business entity or strategy. *Third*, consideration, and even deference, should be appropriately given to the evolution of legal principles in the patent context before antitrust and competition enforcement agencies consider addressing conduct that may be better addressed under non-competition law legal principles. Recent developments in patent law as exemplified by the *eBay*, *KSR* and other decisions confirm the appropriateness of such deference.

These points address a number of the Commission's questions in the Federal Register Notice, and we discuss each in greater detail below.

Competition Policy Must Support A Strong IPR Environment

As recognized in the 2003 IP Report, it remains that innovation and competitiveness require a strong IPR environment. Thus, in the 2007 2nd IP Report, the Commission, together with the Antitrust Division of the Department of Justice, explained:

> Intellectual property laws create exclusive rights that provide incentives for innovation by establishing enforceable property rights for the creators of new and useful products, more efficient processes, and original works of expression. These property rights promote innovation by allowing intellectual property owners to prevent others from appropriating much of the value derived from their inventions or original expressions. These rights also can facilitate the commercialization of these inventions or expressions and encourage public disclosure, thereby enabling others to learn from the protected property.[3]

More specifically, an environment that affords strong protection for IPR provides incentives for continued investment in research and development and, of equal importance, facilitates entry of competitors of products and services that embody the IPR. Indeed, even if there may be higher costs at the outset based upon the need to obtain a license to a patented technology, any competitive impact of such costs may be offset by a virtuous cycle of innovation that in the long term balances the initial cost for obtaining access to IPR with the competitive gains resulting from the introduction of new and innovative products and services. Nor can it be categorically concluded that costs for accessing patented technology will even result in initial higher costs. Downstream product companies can save the expense of developing their own technology, or reverse engineering the technical solutions required to compete in the market, which would more than offset the cost of obtaining licenses to a patented technology. Such

[3] U.S. Dep't of Justice & Fed. Trade Comm'n,, *Antitrust Enforcement and Intellectual Property Rights: Promoting Innovation and Competition* (April 2007) ("2nd IP Report") at 1, *available at* http://www.usdoj.gov/atr/public/hearings/ip/222655.pdf. *See also* James A. Lewis, Center for Strategic & International Studies, *Intellectual Property and Innovation Policy*, (December 2007), Executive Summary at 2-3 ("the most innovative economies are clearly those with strong IP protection. Economies with weak IP protection are less innovative and less competitive in the global economy . . . . Companies must spend an increasing amount on R&D to develop new products. IP protections play a part in a company's decision on whether or not to make that investment. If IP rights are weak, some investors will choose less-risky investments rather than spend on innovation").

companies might also be able to offer superior performing products or lower cost implementations based on the patented technology, and thereby save expenses that would otherwise be incurred by using inferior technologies that command lower consumer demand, and that may require higher implementation, maintenance and/or replacement costs. Access to IPR, including through licensing, to allow the broad availability of superior products, thus, also facilitates entry, including by smaller firms that might not otherwise have the wherewithal to compete against entrenched downstream companies.

For these reasons, competition and antitrust law and policy should not inhibit innovation by weakening the ability of IPR owners to realize the full extent of their rights under the IP laws. Rather, inventors must be allowed their statutory right to exclude others from using their patented inventions as they may determine. In addition, if a patent owner chooses instead to commercialize or license his invention, competition and antitrust law and policy must not limit the patent owner's unilateral ability to realize a return on his innovative investment to the full extent contemplated by applicable IP laws as limited only by market forces. Doing so would diminish the incentives for patent owners to continue to invest in the development and commercialization of new technologies. In particular, it is not the role of antitrust law to regulate the prices charged by patent owners in the form of royalties, or to regulate the varying business strategies firms may adopt for maximizing, in their view, the value of their patented technology through monetary or non-monetary means.[4]

Nor are these principles in tension with effective antitrust law or policy. As emphasized by the FTC in the 2nd IP Report, it is well-settled that although IP rights are exclusive, they "do not necessarily (*and indeed only rarely*) create monopolies" due to the ability of consumers to substitute other products or technologies for the patented products or technologies.[5] More specifically, patent laws promote competition by mandating public disclosure of inventions, resulting in the dissemination of ideas that might otherwise be kept secret and encouraging a ripple effect of new innovation. Thus,

> Antitrust and intellectual property are properly perceived as complementary bodies of law that work together to bring innovation to consumers; antitrust laws protect robust competition in the marketplace, while intellectual property protects the ability to earn a return on the investments necessary to innovate. Both spur competition among rivals to be the first to enter the marketplace with a desirable technology, product or service.

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[4] *See* Remarks of William Blumenthal, FTC General Counsel, *Government Policy for Fostering Innovation*, before the China Council for the Promotion of International Trade and U.S. Chamber of Commerce, Global Forum on Intellectual Property Rights Protection and Innovation (Beijing, China March 28, 2007) at 5, *available at* http://www.ftc.gov/speeches/blumenthal/070328CCPITFinal.pdf ("Blumenthal Remarks")(a patent owner monetizing his patent through royalty-bearing licensing should "be free unilaterally to set the license fee at whatever level he chooses," and a patent owner monetizing his patent through downstream product sales should "be free unilaterally to set the price [of the product] at whatever level he chooses"). *Accord* 2nd IP Report at 1 (it is "well understood" than an antitrust concern is not raised if an IP owner charges a "high" royalty).

[5] 2nd IP Report at 2 (emphasis added).

Id.

This position is consistent with established, and still applicable, U.S. Supreme Court precedent. In the *Simpson v. Union Oil* case the Court directly addressed the question of how the patent and antitrust laws interrelate, and held that "[t]he patent laws … are in *pari materia* with the antitrust laws and modify them *pro tanto*."[6] In other words, conduct that is permitted and protected under the patent laws will not violate the antitrust laws. And while it is true that the protections created by a patent may, by the very nature of the patent laws, afford the patent owner with exclusive rights that permit it to exclude others from using the invention, antitrust law does not consider such conduct unlawful unless the challenged conduct is beyond what is permitted under the patent laws, and the effect of such conduct is anticompetitive and not the result of the patent owner's exercise of its statutory rights.[7] Thus, the Federal Circuit has held that the assertion of IP rights triggers liability under antitrust law only in the "exceptional" circumstances involving "illegal tying, fraud in the USPTO, or sham litigation."[8]

These principles also do not require reconsideration in light of what some now argue is the overcompensation of patent owners through their ability to obtain "excessive" royalties, or because of what these same critics identify as a "royalty stacking" problem.[9] Even assuming the issue of whether royalties and license fees are excessive were the proper subject of antitrust law, which they are not, these views are far from established, and indeed have been expressly rebutted with analysis suggesting that patent owners may in fact be under-compensated for their inventive investment, and that a royalty stacking problem is, at best, more theoretical than real, and that even as a matter of theory is suspect.[10]

Thus, the fundamental principles recognized by the FTC in 2003 in the IP Report, and reaffirmed in 2007 in the 2nd IP Report, remain the same today. These principles point out that a strong IPR environment is entirely consistent with an effective and rigorous enforcement of antitrust and competition laws. Such enforcement, however, must be focused on assessing conduct for its effect on competition when viewed from the perspective of all market participants. This is especially important in connection with IP-related conduct and in industries that have many different types of firms that garner value from IP. Stated simply, and as described in more detail below, while some firms may benefit from short term gains resulting from lower IP input costs, overall consumer welfare may suffer if owners of the IP are unable to realize an adequate

[6] *Simpson v. Union Oil Co. of Cal.*, 377 U.S. 13, 24 (1964).

[7] *See In re Indep. Serv. Orgs. Antitrust Litig.*, 203 F.3d 1322, 1327-28 (Fed. Cir. 2000).

[8] *Id.*

[9] *See, e.g.*, Mark Lemley & Carl Shapiro, *Patent Holdup and Royalty Stacking*, 85 Texas L. Rev. 1991 (2007); Carl Shapiro, *Injunctions, Hold-Up, and Patent Royalties* (Aug. 2006), *available at* http://faculty, hass.berkeley.edu/Shapiro/royalties.pdf.

[10] *See, e.g.*, Einer Elhauge, *Do Patent Holdup and Royalty Stacking Lead to Systematically Excessive Royalties*, Journal of Competition Law & Economics, 4(3), 535-570 (2008); Damien Gerardin, Anne Layne-Farrar, and A. Jorge Padilla, *Royalty Stacking in High Tech Industries: Separating Myth from Reality*, (Dec. 2006), CEPR Discussion Paper No. DP6091.

return on their investments sufficient to create incentives for further and greater investment into new research and development efforts.

Such long term benefits - *i.e.*, dynamic efficiencies - have been recognized as a greater driver of consumer welfare than the short term gains that may result from increased static efficiencies,[11] and competition and antitrust law and policy must accommodate such gains. The way to do that is to ensure that competition and antitrust law enforcement efforts are directed to address conduct based on effects-based tests that seek objectively to determine the demonstrable effects that such conduct has had on competition. Such efforts should not be based on the application of unbounded rules and criteria, because if they were, such a rules-based approach - as distinct from effects-based enforcement efforts - will pose a threat to a robust IP environment by threatening IP-related conduct that in fact may lead to new innovation and enhance competitiveness. Imposing liability, or even subjecting such ambiguous conduct to review under competition and antitrust laws, based upon such uncertain and unbounded concepts, would have the negative impact of disincentivizing innovative investment and lessen the availability of new generations of products and services that advance consumer interests.

Competition Law And Policy Related To IPR Must Accommodate All Business Models

Intellectual property rights can play different competitive roles for different firms depending on their business models and their positions in the marketplace. Such differences are particularly pronounced in information and communication technology ("ICT") industries where entities possessing significant IPR have adopted various approaches for maximizing its value, where some entities are only involved in licensing IPR and others are only involved in using IPR to create products and services, and where still others fit into more than one model along the continuum. Effective competition policy and IP law, however, must accommodate all business models and strategies. Otherwise, here too, the risk of over-deterrence of pro-competitive IP-related conduct will have a negative effect on innovation and competitiveness.

The varied business models used in ICT industries illustrates this point. In such industries, for example, innovation firms and universities exist that develop and seek to commercialize patented inventions and may seek to recover their costs and compensate for their risks in making investments, including in research and development, through the collection of royalties. Such firms must be able to realize sufficient compensation so they retain the incentive to make further investments in research and development or in the acquisition of new technologies that would not otherwise be commercialized and used in new products and services.

There also exist technology product companies that may or may not have developed their own technology to use in the products they sell. Even if such companies have their own technology, given the nature of information and communications technologies, that is likely not to be sufficient to allow the marketing of their products. Rather, access to other essential technology may be required. These companies, therefore, if they do not have their own

[11] Remarks of Thomas O. Barnett, Ass't Att'y General, Antitrust Div., U.S. Dep't of Justice, *Interoperability Between Antitrust and Intellectual Property*, George Mason University School of Law Symposium, Managing Antitrust Issues in a Global Marketplace (Washington, D.C. Sept. 13, 2006) at pp. 1-5, *available at* http://www.usdoj.gov/atr/public/speeches/218316.pdf.

technology must obtain it from the technology owner. This may involve a cost in the form of a royalty or other licensing fee that the product company would like to minimize. But that may reflect nothing more than the fact that everyone wants to pay less, and have no competition or antitrust law implications. Even if the product company has its own technology, it might not seek to monetize its value through royalty-based licensing. It might, instead, use the technology as part of cross-licensing arrangements that allow it to obtain other essential IP, or it might make its technology available royalty free to expand the market through greater sales of product for which its technology is a component or is otherwise complementary (*e.g.*, computer printers and other accessories, software, and Bluetooth accessories for wireless devices).

Many such vertically integrated firms, which have both patented technology and products, in fact continuously evaluate how to refine their business models to maximize the value of *both* their IP and their product offerings, and their business models do not remain static. Rather, the evolution of business models for ICT firms, even within a single company, reflects the dynamism of the marketplace and of competition. This, alone, counsels for a very judicious approach by competition and antitrust enforcement agencies in assessing conduct that may rise to disputes reflecting nothing more than the natural tension that can exist among firms with different business models and business interests. Moreover, licensors and licensees, in particular in the ICT area, can be, and often are, large and powerful companies fully capable of representing themselves in commercial transactions (and commercial disputes), and there is no reason to assume that the effect and intent of transactions between such parties is to harm consumers, requiring enforcers to intervene on behalf of one side or the other. Thus, here too, consideration of the full competitive effects of conduct must be considered, and disputes that simply reflect business disagreements should not be the subject of antitrust scrutiny.

Such judiciousness should apply regardless of the nature of the firm involved in the conduct under question. This includes firms that have increasingly been labeled with the pejorative expression “patent troll.” According to some this would be any entity that does not manufacture or sell a product, and simply seeks to recover the value of IP through licensing or the threat of infringement suits. But many entities that fall within this definition may have significant pro-competitive impacts on their respective markets. For example, many universities are engaged in important research and development activities, as well as investment activities to sponsor R&D. Such efforts have led to breakthrough inventions that have now been commercialized and that benefit consumers. Moreover, small and medium-sized firms with the technical know-how but not the capital required to produce goods, may license innovative technology and contribute to the competitive landscape. In fact, many medical advances and alternative energy technologies are commercialized in accordance with this model.

But even firms that are not themselves engaged in research and development, nor in the manufacture and sale of products, may have a pro-competitive impact in facilitating the introduction of new technologies, which new products and services can incorporate and in turn be offered to consumers. As noted at the Commission’s December 5, 2008 hearing,[12] 60% of U.S. patents are granted to small inventors, yet less than 10% of U.S. patent revenues are

[12] Presentation of Peter N. Detkin, *To Promote the Progress . . . of Useful Arts: Investing in Invention*¸ FTC Hearings on the Evolving IP Marketplace (Dec. 5, 2008).

realized by small inventors.[13] This disproportionate distribution of revenues as compared to inventiveness may suggest the difficulties that small inventors have in commercializing their inventions and realizing an adequate return to continue engaging in further innovative efforts. Yet, their inventions may be of great competitive significance, and risk-taking investment to facilitate such inventive activities, if anything, should be encouraged - even if such investments are made by firms that thereafter seek to maximize the return on their investments by seeking licensing revenues. Assuming, as is typically the case, that such conduct reflects the lawful effort to enforce legitimately obtained IP, no competition or antitrust issue should be involved, particularly since technology transfer is a goal of the patent system. To the contrary, such conduct may facilitate and enhance innovation and competitiveness.[14]

Nor is a different conclusion warranted based on what some have criticized as the growth of patent litigation seeking to enforce weak or invalid patents. Patent quality is not an antitrust issue, and concerns about patent quality are not specific to any particular business model. Rather, improvements to patent quality call for continued steps to strengthen the ability of the USPTO to evaluate claimed inventions for patentability.

Moreover, recent decisions by the Supreme Court and Federal Circuit have lessened incentives to litigate weak patents. Among other changes, these decisions have made it more difficult for patent speculators to maintain venue in chosen jurisdictions, to defend the validity of disputed patents, and to obtain injunctive relief and treble damages.[15] When viewed as a whole, these judicial decisions have dramatically shifted the balance of power between patent plaintiffs and alleged infringers, particularly in cases involving non-practicing patent holders and business method patents.

Perhaps most significantly, however, even assuming that non-practicing patent holders have given rise to competition and antitrust issues simply because of their character, which they have not, has there been an increase in patent litigation sufficient to raise innovativeness and competitiveness concerns? Chief Judge Michel of the Federal Circuit, in his remarks at these hearings, suggests the answer is no. He is not convinced that there is an extraordinary number of cases brought in *toto*, and even fewer actually going to trial. Moreover, he points out that the high cost of patent litigation is not attributable to the fact that it is a patent case, but rather to the Federal Rules of Civil Procedure that create extraordinary costs for civil discovery for all cases.[16]

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[13] *Id*. at 3.

[14] Damien Gerardin, Anne Layne-Farrar, and A. Jorge Padilla, *Elves or Trolls? The Role of Non-Practicing Patent Owners in the Innovation Economy*(May 2008). TILEC Discussion Paper No. 2008-018.

[15] *See, e.g. eBay Inc. v. MercExchange LLC*, 547 U.S. 388 (2006); *KSR Int'l v. Teleflex, Inc.*, 127 S. Ct. 1727 (2007); *In re Seagate Technology LLC*, 497 F.3d 1360, 83 USPQ2d 1865 (Fed. Cir. 2007); *In re Bilski*, 545 F.3d 943, 88 USPQ2d 1385 (Fed. Cir. 2008); *In re TS Tech USA Corp. et al.*, Misc. Docket No. 888, 2008 U.S. App. LEXIS 26409 (Dec. 29, 2008).

[16] Address of Chief Judge Paul R. Michel, United States Court of Appeals for the Federal Circuit, *Where Are We Now on Patent System Improvements and How Can We Best Make Further Progress?* Prepared for delivery at the FTC Hearing on the Evolving IP Marketplace (Wash. D.C. Dec. 5, 2008) at 2-3.

Judge Michel's observations are borne out by patent litigation statistics. The Administrative Office of the U.S. Courts reported only modest increases in patent litigation over the past five years -- i.e., a 9 percent increase in patent cases filed between 2003 and 2008.[17] In short, there is no evidence of a patent litigation explosion, or of a dramatic increase in suits by non-practicing entities.

Complaints about frivolous patent litigation are hardly new. A Senate committee report from 1836 cited the prevalence of "worthless and void" patents and the resulting increase in "injurious" lawsuits as a reason for legislative amendments to the patent system. However, the resulting reforms rightly focused on pre-grant measures to improve patent quality, not on weakening patent enforceability or remedies. In fact, every technological revolution (whether fueled by the Internet or the steam engine) has led to an increase in patenting activity and concerns about patent quality and excessive litigation. Congress's consistent response has been to right the ship through measured reforms, not to sink it.[18]

Categorical Rules Disfavoring Injunctive Relief for "Competitive Reasons" Would Violate *eBay* and Harm Competition

The Supreme Court's *eBay* decision[19] rejected the Federal Circuit's "categorical rule" favoring a grant of permanent injunctive relief following a final verdict of infringement. However, the Court was equally hostile to categorical rules disfavoring injunctive relief based on broad classifications, including a patent holder's decision to license its patents. In all cases, the Court held, a court must retain equitable discretion over the decision to grant or deny injunctive relief.

Despite the clear admonition of the Supreme Court, *eBay* has been interpreted in a manner that arguably replaces a categorical favoring the grant of permanent injunctive relief against infringers, with one that has made it far more difficult for non-manufacturing patent holders to obtain injunctive relief of any nature. Such interpretations are clearly at odds with *eBay*'s holding that a court may not categorically deny injunctive relief simply because a patent holder licenses its invention or falls into any broad class. Thus, it would be indefensible to read *eBay* to mean that non-practicing entities should be denied injunctive relief for competitiveness reasons. Adopting such an interpretation would not only be contrary to the balancing test of equitable factors established by *eBay*, which may make injunctive relief available to non-practicing entities in specific cases depending on the circumstances of each. A restrictive reading of *eBay* would also raise the possibility of causing a decrease in competitiveness because it would favor one type of business model over another.

[17] See http://www.uscourts.gov/caseloadstatistics.html.

[18] *See* Senate Report Accompanying Senate Bill No. 239, 24th Cong., 1st Sess. (April 28, 1836).

[19] 547 U.S. 388 (2006).

Specifically, if injunctive relief were automatically unavailable to remedy infringement simply because of the nature of the firm asserting a valid patent consistent with its rights under the patent laws, the owners of such patents would be unable to be compensated adequately for those patents. In patent license agreements negotiated in the open market, included in the amount of consideration received by the patent owner (often in the form of a royalty) is compensation for the value to the licensee of eliminating the threat of being excluded from practicing the patents being licensed.[20] Stated differently, absent the threat of an injunction, the value of the consideration received by owners of patents will be unfairly depressed because infringers will always be assured of bringing infringing products to market and keeping infringing products on the market, and will therefore have no incentive to negotiate a license. In *Fromson v. Western Litho Plate & Supply Co.*,[21] the Federal Circuit recognized the problem that is created when injunctive relief is unavailable or routinely denied to a category of patent holders. The Court explained:

> Because courts routinely denied injunctions to such patentees, infringers could perceive nothing to fear but the possibility of a compulsory license at a reasonable royalty, resulting in some quarters in a lowered respect for the rights of such patentees and a failure to recognize the innovation-encouraging social purpose of the patent system.
>
> Thus a cold, "bottom line" logic would dictate to some a total disregard of [such a patentee's] patent because: (1) ill-financed, he probably would not sue; (2) cost of counsel's opinion could await suit; (3) the patent may well be held invalid on one of many possible bases; (4) infringement may not be proven; (5) if the case be lost [by the infringer], a license can be compelled, probably at the same royalty that would have been paid if the patentee's rights had been respected at the outset.[22]

The innovation-chilling scenario described in *Fromson* is exactly what would result if special injunction rules were adopted, including under the guise of competition or antitrust principles, that would eliminate the ability of any class of patent owners to seek injunctive relief under the standards established by *eBay*. Infringers would choose to operate without a license and even if sued - which may not be a certainty - face only the worst-case outcome of paying the same as it would have under a license, but only later, and in many cases without many of the

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[20] *See, e.g., Smith Int'l, Inc. v. Hughes Tool Co.*, 718 F.2d 1573, 1578 (Fed. Cir. 1983)("Without the right to obtain an injunction, the right to exclude granted to the patentee would have only a fraction of the value it was intended to have, and would not longer be as great an incentive to engage in the toils of scientific and technological research").

[21] 853 F.2d 1568 (Fed. Cir. 1988), overruled on other grounds by *Knorr-Bremse Systeme Fuer Nutzfahrzeuge GmbH v. Dana Corp.*, 383 F.3d 1337, 1343-44 (Fed. Cir. 2004).

[22] *Id.* at 1574.

other requirements and safeguards a patentee requires of its licensees, such as grant-back rights and indemnification. In fact, such a compulsory license may be more advantageous to the infringer than the license the patentee has negotiated and entered into with an infringer's competitors. In the meantime, the cost to the patent holder of realizing reasonable compensation for the use of its property would be significantly increased and the ability of the patent owner to continue in efforts to bring patented inventions to market and make them available through licensing activities, would be undermined. Patent holders will, undoubtedly, either seek to pass on such added costs or, if not possible, make the calculation that further investment in innovation should be limited. If anything, therefore, competition and antitrust law and policy should carefully scrutinize efforts to limit patent holders' rights to seek permissible remedies, including for injunctive relief, because of the negative competitive effects that might arise from such conduct.

Reasonable Royalty Rules Reflect Well-Established Principles of Compensatory Damages that Promote Investments in Innovation

Careful scrutiny is particularly important in the field of damages, where calls for sweeping reform appear to be based on nothing more than anecdote, theoretical harms and, for some, a desire to reduce the risks and costs of infringement. For many patent holders, particularly small innovative firms, compensatory damages remain the only viable remedy in the wake of *eBay*. For these and other patent holders to remain competitive, it is imperative that patent damages rules aim to achieve (as they currently do) the overarching goal of compensatory damages generally, namely to make the injured party whole. Any lesser measure of damages would devalue patents and deprive patent owners (and their investors) of the incentives needed to make risky bets on innovative technologies and products.

Advocates of sweeping damages amendments have yet to substantiate allegations of excessive royalties or unfair damages awards. To the contrary, patent litigation studies reveal that median damages awards have, year after year, remained fairly stable.[23] Although jury trials are more likely to result in large damage awards than bench trials, federal judges do not hesitate to overturn or reduce excessive jury verdicts. With few exceptions, the largest jury verdicts awarded each year are typically reduced or overturned upon appeal, as in the *Alcatel-Lucent* case.[24]

Moreover, it is a fallacy to suggest that a large damage award is inherently unfair or excessive. As Chief Judge Michel noted in his remarks at these hearings, even a 600 hundred million dollar settlement, which may seem staggering to the average observer, could, in reality, reflect a relatively modest royalty for an infringing product with billions of dollars in annual sales, particularly if the settlement includes both compensation for several years of infringement, as well as a license for future use of the invention.

[23] PriceWaterhouseCoopers, *2008 Patent Litigation Study*.

[24] Innovation Alliance, *Moving beyond the Rhetoric, Jury Damage Verdicts in Patent Infringement Cases (2005-2007)*.

Critics of *Georgia Pacific*[25] (the leading case on reasonable royalty damages) are fond of suggesting that a 40 year old judicial decision must be outdated given the tremendous changes in technology that have since occurred. In reality, however, *Georgia Pacific* simply restated the basic principles and methodology that have historically guided courts in matters of patent damages. In addition, the court enumerated the types of factors that may be relevant to a patent's market value when calculating damages, while emphasizing the non-exhaustive nature of the list and the need for judicial discretion in all cases.

At their core, the rules articulated in *Georgia Pacific* are rooted in well-established (and arguably incontrovertible) legal and economic principles of compensatory damages generally - i.e., the same principles that govern damages in other contexts. Foremost among these is to restore the injured party, as nearly as possible, to the position he would have been had it not been for the wrong of the other party. The injured party's ex ante position is measured in terms of "market value" - i.e., the established exchange value of the property or, if no established value exists, the amount that would have been negotiated by a willing buyer and seller immediately prior to the trespass.[26]

Consistent with basic tenets of compensatory damages and market valuation, the court in *Georgia Pacific* cited three cornerstones of patent damages law:

1. Damages must place the patent holder in at least the same pecuniary position as it would have been in had the patent not been infringed - i.e., the reasonable royalty that would have been paid for the use made of the invention;
2. To achieve that result, damages should reflect the royalty a willing licensor and licensee would have negotiated immediately prior to the commencement of the infringement, with both parties assuming the patent to be valid, enforceable and infringed absent a license (i.e., the "willing buyer/willing seller" paradigm used to assess the market value of any asset); and
3. Given the multiplicity of factors that may be relevant to a reasonable royalty, courts and juries must be given the discretion and flexibility to consider any and all evidentiary factors that would have been deemed relevant by the parties in a hypothetical negotiation and to determine the respective weight to be given each such factor.

When taken as a whole, these principles aim to uphold the property rights embodied in a patent and to ensure that reasonable royalty damages are sufficient to safeguard those rights. These rules are not, as some would suggest, unique to patent law or easily susceptible to radical change. Indeed, the tried and true principles that underlie *Georgia Pacific* and patent damages law generally are so firmly grounded in our legal system that it would be difficult to justify any significant departure without acknowledging an effort to transform patent rights into something far different, and far less valuable, than our forefathers intended.

[25] *Georgia-Pacific Corp. v. United States Plywood Corp.*, 318 F. Supp. 1116 (S.D.N.Y. 1970).

[26] *See, e.g., United States v. Hatahley,* 257 F.2d 920 (10th Cir. 1958), cert. denied, 358 U.S. 899 (1958).

This would unquestionably be the impact of so-called apportionment rules. Proposed amendments that would, in most cases, mandate "apportionment" of damages according to novel rules of prior art subtraction would alter the fundamental purpose of reasonable royalty damages and, in the process, lessen the value and pro-competitive effects of patent rights. The proposed apportionment test would assess damages according to the patent's incremental benefit to the user (as measured by the value of the patent's "specific contribution over the prior art" or "inventive feature"), as opposed to the market value of lost royalties that would have been paid to the patent holder had the infringement not incurred. Damages rules would no longer aim to make the patent holder whole or function as a means of compensation or deterrence. As a result, a patent would confer something less than a property right and cease to function as a meaningful incentive to invest in and commercialize disruptive technologies.

The distinction between our system of compensatory patent damages and the proposed apportionment rule is more than theoretical. As a historical matter, apportionment of profits was a form of equitable remedy that gained acceptance in the 19th century due to the then-existing division between courts at equity and law. The concept of mandatory apportionment was abandoned by Congress in 1946 because of the gross inefficiencies and inequities that it had caused. Were mandatory apportionment to be resurrected in the form proposed in previous patent bills, the impact on patent holders and the U.S. economy would be significant and indefensible. According to a recent study conducted by Dr. Scott Shane of Case Western Reserve University, the proposed apportionment amendment would reduce the value of U.S. patents by at least $34.4 billion (and potentially as much as $85.3 billion); reduce R&D expenditures by between $33.9 billion and $66 billion per year; and potentially cost the U.S. economy between 51,000 and 298,000 manufacturing jobs.[27] Beyond these effects, an apportionment-based damages regime would inject tremendous uncertainty and instability into our patent system, at a time when U.S. firms can ill afford further upheaval. Uncertainty and instability are forces that unquestionably discourage investments in the commercialization of new technologies, leading to reduced competition across new and old industries alike.

Claims that existing patent damages rules are forcing large manufacturers to submit to frivolous settlement demands of small non-practicing entities are implausible, given that these rules are based on the same principles that underlie compensatory damages generally. The claim becomes even less credible in the aftermath of *eBay*, *KSR*, *Seagate* and *Bilski*, to name just a few of the recent judicial decisions that have weakened the bargaining power of non-practicing entities and owners of business method patents generally. An alleged infringer may opt to settle a case in order to avoid the costs of litigation, but this same dynamic exists throughout our system of commercial litigation.

Furthermore, there is no evidence that juries routinely get it wrong in patent cases, despite the complexity of patent valuation and licensing issues. Damage awards typically reflect the expert testimony proffered by plaintiffs and defendants, and the weight assigned to that testimony. The same holds true for any complex commercial dispute. Patent defendants have no less an opportunity than plaintiffs to persuade the jury that a patent should be assigned a certain

[27] Scott Shane, *The Likely Adverse Effects of an Apportionment-Centric System of Patent Damages* (2009).

value. In fact, the patent defendants clamoring for damages reform typically have far greater financial resources to retain experts than their opponents.

Nevertheless, there may be situations where courts fail to provide juries with adequate guidance to apply damages rules to the facts of a particular case. If situations of this type represent a systemic problem (and, again, there is no empirical evidence or pattern of appeals to suggest that such a problem exists), they are best addressed through procedural improvements that reaffirm the court's role as "gatekeeper." Measures of this type could enhance the fairness and transparency of damages proceedings for all litigants, without radically altering the damages rules that sustain patent-based incentives.

Indeed, enforcement officials have made clear that the "antitrust laws do not serve their proper function" if they prevent or discourage the legitimate exercise of IP rights or "stifle the innovation that is encouraged by a strong intellectual property rights regime."[28] Similarly, care must be taken by enforcement officials to avoid actions that however well-meaning are ultimately harmful to consumer welfare. As former FTC General Counsel Blumenthal explains: "[t]oo often, well-meaning government officials seek to protect the public by imposing regulations that have the unintended effect of elevating cost, limiting entry, and depriving consumers of marketplace options."[29]

In sum, the evolution of new business models, especially in ICT industries for example, suggests robust competition and the efforts by firms to continuously seek to maximize their competitive positions and values of their companies through innovation and other legitimate means. Competition and antitrust policy should not inhibit such activities and competition and antitrust enforcement agencies should be particularly judicious in considering IP-related conduct that arises from tensions that may be inherent to the different business models and strategies of market participants. Such commercial disputes do not, and should not, implicate competition or antitrust issues. The importance for agencies such as the FTC to follow such an approach, and to make clear that it is doing so, is especially compelling now given the international use and application of technology and competition relating thereto. The actions of the Commission are influential, and it is important for it to take the lead among its global enforcement counterparts in making it clear that antitrust and competition laws and enforcement priorities have no place in connection with lawful and pro-competitive IP-related conduct, and that a judicious approach with respect to such conduct is appropriate to avoid the risk of undermining legitimate innovation and competition enhancing conduct.

Patent Law Developments Further Militate Against A Role For Antitrust

Recent developments in patent law confirm that there is no systemic competitive failure that has occurred or that is now occurring in connection with IP-related conduct. Some of these

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[28] Makan Delrahim, former Deputy Ass't Att'y Gen., Antitrust Div., U.S. Dep't of Justice, *Contemporary Issues at the Intersection of Intellectual Property and Antitrust*, The Fair Competition & Market Economy, 2004 Shanghai International Forum, 2 (Shanghai, China Nov. 10, 2004), *available at* http://www.usdoj.gov/atr/public/speeches/206607.pdf.

[29] Blumenthal Remarks at 9.

developments are discussed above, and show that much of the wind has been taken out of the sails of those suggesting that competition issues exist in relation to the enforcement of patents, and at least by implication, the continuation of a strong IPR environment. Such developments, as mentioned, include the ability to challenge patents more effectively in forums of one's own choice, and to more rigorously subject questionably valid patents to more rigorous tests through re-examination proceedings.

This is not to say that the situation cannot be made better. But the antitrust laws are not the avenue to achieve such a result. In the first instance, the evolution of patent law and procedures is certainly going to continue, and such an evolutionary process, while perhaps involving some speed bumps, is a far more certain way to balance the interests of all relevant interests than intervention by competition law enforcement agencies.

Second, there should be no doubt that efforts must continue to ensure that the U.S. and international patent systems are of the highest quality and operate in the most efficient manner. Patentability should be available for only those inventions that meet the qualitative requisites of novelty and inventiveness, and unnecessary barriers - whether economic or administrative - should not inhibit inventors from obtaining protection for such inventions. Likewise, clear and certain procedures and remedies must exist for the enforceability of legitimately obtained valid patents, and licensing opportunities must not be unduly constrained.

Achieving these results requires continuous attention and investment in the USPTO. In particular, the quality of patent examiners must be kept high, and the necessary financial support to maintain sufficient staffing and support for effective patent evaluations must be made. These investments are the cornerstone for effective evaluation and assessment of patent rights. Indeed, efforts to date along these lines may be paying dividends. As reported by the Intellectual Property Owners Association ("IPO"), from 2000-2007 there was a steep decline in the percentage of filed applications that resulted in issued patents - approximately 71% in 2000 to approximately 51% in 2007.[30] This decrease may be attributable to a number of factors, but it is likely that at least one important reason is the continuous focus that has been placed on elevating the standards for the review of patent applications and funding such efforts in the USPTO.

These efforts, which should be supported into the future, and what will no doubt be the continued evolution of patent law through court decisions, have and will continue to be the most effective way to maintain the proper scope and focus of the patent laws as competition and innovation enhancing, and to ensure that no imbalance occurs between those principles and the complementary principles of the antitrust laws.

Thus, consideration, and even deference, should be appropriately given to the evolution of legal principles in the patent context before antitrust and competition enforcement agencies consider addressing conduct that relates to the lawful exercise of IP rights.

[30] IPO *Annual U.S. IP Developments* (2008) at 22.

Conclusion

We again thank the FTC for the opportunity to share these comments and to participate in the important inquiry the Commission is making related to the evolving IP marketplace. Now more than ever, support for the competition enhancing qualities of innovative conduct must be supported, and all due care must be given to avoid what may be the unintended chilling of such conduct. Because of the complex relationship many firms have with each other and in relation to critical IP, the issues that now exist are themselves extremely complex. But, if anything this counsels for a very careful and judicious approach in evaluating IP-related conduct under competition and antitrust laws, and further counsels for an approach that will seek to challenge such conduct only if it is determined, based on objective evaluation and a full consideration of all competitive interests, that the conduct has or will likely cause anticompetitive effects.

Respectfully submitted,

The Innovation Alliance