Before the
Federal Trade Commission
and the
Department of Justice
Washington, DC

Patent Assertion Entity Activities Workshop

COMMENTS OF
COMPUTER & COMMUNICATIONS INDUSTRY ASSOCIATION

I. <u>Introduction</u>

Pursuant to the request for comments issued by the Federal Trade Commission (hereinafter 'FTC' or 'the Commission') and the Antitrust Division of the Department of Justice (hereinafter 'DOJ'), in conjunction with the joint FTC-DOJ December 10, 2012 Patent Assertion Entity Activities Workshop, the Computer & Communications Industry Association (CCIA)[1] submits the following comments.

CCIA appreciates the opportunity to comment on competition issues surrounding patent assertion entities (PAEs) and applauds both the FTC and the DOJ for investigating the growing problem of patent trolls.

Given the sheer volume of troll litigation, coupled with the fact that its prevalence and the costs associated with it are increasing, the problem demands attention.[2]

As an organization that has long championed innovation and competition in the high-tech marketplace, we are particularly concerned with the disproportionate effect that PAE activity has on startups and small innovators. Given that many of our largest members began in garages –

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[1] CCIA is an international nonprofit membership organization representing companies in the computer, Internet, information technology, and telecommunications industries. Together, CCIA's members employ nearly half a million workers and generate approximately a quarter of a trillion dollars in annual revenue. CCIA promotes open markets, open systems, open networks, and full, fair, and opencompetition in the computer, telecommunications, and Internet industries. A complete list of CCIA members is available at http://www.ccianet.org/members.

[2] The workshop – reflecting academic and industry literature generally – was replete with both aggregate and anecdotal reflections of this. The direct cost of trolls has been calculated at $29 billion annually or at imputed costs at $80 billion annually. (These figures do not include startups and other small companies where the costs are inherently difficult to measure.) Between 2005 and 2011 the number of defenses mounted against NPEs increased more than 400%. *See* James Bessen et al., *The Private and Social Cost of Patent Trolls*, BOSTON UNIV. SCHOOL OF LAW, Law and Economics Research Paper No. 11-45 (September 19, 2011); James Bessen & Michael Meurer, *The Direct Costs from NPE Disputes*, BOSTON UNIV. SCHOOL OF LAW, Law and Economics Research Paper No. 12-34 (June 28, 2012).

without patent lawyers – when patenting software was either unheard of or not prevalent, it is likely that more than a few of them would have been derailed by patent lawsuits before they got off the ground had their founders been born a decade or two later.

Now, because of their vulnerability, startups and small innovators are routinely targeted by PAEs – particularly those with the most suspect patents – who seek to exploit fissures in the underlying patent system. In fact, one prominent venture capitalist noted that over a third of his company's portfolio faced troll lawsuits.[3] A prominent academic found that 55% of unique defendents in PAE suits are companies with an annual revenue under $10 million a year.[4] These developments increase the risk and expense of starting high-tech businesses, constituting what some have described as a "tax on innovation."[5] Whatever you call it, patent trolls threaten the delicately balanced ecosystem that has made America the world's unquestioned leader in high-tech innovation.

Although we recognize that the antitrust agencies cannot solve all the problems with our nation's patent system, particularly issues of patent quality and patent volume, there are actions the DOJ and the FTC can take to minimize the consumer harm inflicted by PAEs gaming the deficiencies of the system.

First and foremost, both the FTC and DOJ should continue their important investigatory work in this field. They should consider revisiting growing questions about how well patents are working to promote innovation as they did in the series they held in 2002.[6] Much has changed in the past 11 years. PAEs – and companies that utilize them – are constantly evolving their business strategies and relationships, and have pushed further into the complex and murky intersection of IP and competition law. Furthermore, PAEs frequently use armadas of shell companies (some even use thousands)[7] to obscure their strategies, relationships and the true scope of their patent portfolios.

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[3] *See* Brad Burnham, *We need an independent invention defense to minimize the damage of aggressive patent trolls*, Union Square Ventures Blog (Jan. 11, 2010), *available at* http://www.usv.com/2010/01/we-need-an-independent-invention-defense-to-minimize-the-damage-of-aggressive-patent-trolls.php.

[4] *See* Colleen Chien*, Startups and Patent Trolls,* Santa Clara Univ. School of Law, Legal Studies Research Papers Series No. 09-12 (Sept. 2012), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2146251.

[5] *Id*.

[6] Federal Trade Commission, Hearings on Competition and Intellectual Property Law and Policy in the Knowledge-Based Economy (2002), *available at* http://www.ftc.gov/opp/intellect/index.shtm.

[7] *See* Tom Ewing & Robin Feldman, *The Giants Among Us*, 2012 STAN. TECH. L. REV. 1 (2011), *available at* http://stlr.stanford.edu/pdf/feldman-giants-among-us.pdf.

The patent system and antitrust jurisprudence have not historically contemplated markets where individual products read on hundreds of thousands of patents. These markets have become vast and complex, and PAEs have grown more sophisticated and creative in exploiting asymmetries of information, cost and risk. Both the DOJ and the FTC must stay on top of marketplace developments. They must also revisit the guidance they provide – such as the 1995 IP Licensing Guidelines – to reflect new realities.

Specifically, the FTC should use its 6(b) authority to compel information from PAEs and their associates about their business practices and relationships. Armed with this information, the Commission should produce a comprehensive report on how they operate and a realistic assessment of the burdens and uncertainties they impose on others, along with any demonstrated benefits. Given that the application of the antitrust law to this field remains unsettled, and that the internal practices and business relationships of PAEs remain largely hidden from sight, a comprehensive study would assist both the FTC and DOJ in evolving competition policy, updating their public guidance, and reworking their enforcement priorities. In establishing the FTC, Congress sought to create "a government agency adequately equipped to secure, evaluate and report facts which revealed the structure of our economy."[8] Consequently, a study along these lines would dovetail perfectly with the FTC's historical mission.

In addition to the study, the DOJ and the FTC can address problematic troll behavior by:

- Bringing actions against PAEs that revoke prior patent commitments (e.g. FRAND, royalty stacking, non-assert against open-source software, etc.) that induced marketplace reliance;
- Targeting trolls acting at the behest of operating companies – often through incentives included in the contractual provisions associated with the transfer of patent rights from operating company to troll – to raise rivals' costs. This is particularly problematic when competitors operate in concert to enable trolls to attack other market participants.

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[8] *See* Paul Rand Dixon, *The Federal Trade Commission: Its Fact Finding Responsibilities and Powers*, MARQUETTE L. REV. Vol. 26 (Summer 1962), *available at* http://scholarship.law.marquette.edu/cgi/viewcontent.cgi?article=2771&context=mulr.

The FTC and the DOJ must continue to examine the patent system with a competition advocate's lens. The comprehensive 2003 and 2011[9] studies broke new ground in their examination of patents and their effects on competition and innovation. That work should be continually updated. As problems with the patent system and its secondary markets come to light and as reforms are debated, it is essential for both the DOJ and the FTC to maintain their commitment to serving innovation and consumer welfare. This commitment should include injecting their unique legal and economic expertise into all foras where patent reform is being debated.

II. <u>The FTC Should Conduct a Section 6(b) Study to Better Understand PAE Business Practices and Relationships</u>

The incomplete picture painted by publicly available information hints at many potentially unsavory, unethical and illegal activities conducted by patent trolls. Trolls use shell companies, sometimes by the thousands, to obscure their intentions. Many go to great lengths to mislead or deceive the public about the nature and scope of their business operations or the makeup of their patent portfolios. Furthermore, evidence has surfaced that operating companies are transferring patents to trolls with provisions encouraging the trolls to target the original owner's rivals.

The legality of many of these practices is questionable, and they present obvious public policy concerns. Given that the patent troll problem is growing rapidly and Congress is interested in addressing it, a comprehensive 6(b) study is needed to ensure that there is a factual record. This will assist our nation's antitrust enforcers in assessing whether competition laws are violated and will provide valuable information for Congress to consider when fashioning legislative remedies. Such 6(b) studies have often been used as the launching point for major legislation curbing questionable and abusive industry behavior, such as the Packer and Stockyards Act of 1921 and, more recently, the Medicare Modernization Act of 2003.

In addition to uncovering information on questionable business relationships, a 6(b) study can examine the "black market" of patent assertion, the reportedly vast amount of pre-litigation activity that ranges from carefully worded invitations to consider licensing to threats to assert

[9] *See* Federal Trade Commission, *To Promote Innovation: The Proper Balance of Competition and Patent Law and Policy* (October 2003); Federal Trade Commission, *The Evolving IP Marketplace: Aligning Patent Notice and Remedies with Competition* (March 2011).

portfolios of unspecified patents. For example, Apple's Chip Lutton testified before Congress that he received 25 letters insinuating infringement for every court filing in which Apple was a patent defendant.[10] Although ample anecdotal evidence provides plenty of cause for concern, meaningful data is difficult to obtain due to the secrecy in which such activity is conducted and the nondisclosure agreements that paper the landscape.

The FTC could use the study to better understand how PAEs initiate assertions, and how successful they are in extracting fees without going to court. Since small companies may have difficulty in simply mounting a legal response to a patent complaint, they appear to be disproportionately vulnerable to pre-filing threats. Since small company targets are numerous, scattered, and muzzled by NDAs, only the PAEs themselves are likely to be ready sources of information on this kind of activity.

In the Appendix, we provide some suggestions on questions the FTC might consider including in a 6(b) questionaire to PAEs. The questions are designed to elicit responses to provide statistical evidence for or against what are commonly believed to be common industry practices. Furthermore, they would unveil any potentially problematic business relationships or practices that might set off antitrust or unfair competition alarm bells. We also include questions that would help assess any of the procompetitive efficiencies claimed by PAEs and their advocates.

III. <u>Make Clear that Commitments Travel with Patents</u>

Given that high-tech products and markets are highly interdependent and patents confer powerful rights to exclude, patent owners frequently give the greater technology community ex-ante assurances about how they intend to enforce their patent rights. This is critical to encouraging the adoption and use of new technologies and products and building confidence in new markets.

These patent commitments are increasingly important to the high-tech ecosystem. Although FRAND commitments are especially familiar given the attention they have received in the smartphone wars,[11] many other types of commitments exist:

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[10] STAFF OF H. COMM. ON THE JUDICIARY, 119TH CONG., PATENT QUALITY IMPROVEMENT (Comm. Print 2005), *available at* http://commdocs.house.gov/committees/judiciary/hju20709.000/hju20709_0.HTM.

[11] Prior CCIA's comments to the FTC discuss the danger of interpreting FRAND pledges more strictly than the terms agreed to by the standard-setting organizations. In the Matter of *Motorola Mobility LLC and Google Inc.*,

- Red Hat's commitment not to exercise its patent rights against open source software[12]
- Commitments of patents to defensive patent organizations such as the Open Invention Network[13]
- Twitter's pledge to only use employee-owned patents defensively[14]
- Google's recent pledge not to assert certain patents against open source software (subject to a defensive termination agreement)[15]
- Promises not to "stack royalties" (often part of FRAND commitments), where a company agrees not to charge more than a certain royalty percentage for all of its patents that apply to a particular product

If it is not clear that commitments travel with the patents, giving such commitments would be futile as the certainty the commitments are intended to convey would be non-existent. Even well intentioned companies cannot anticipate how patents might be assigned or transferred and what future owners might do. Bad actors would be able to use commitments made to induce the adoption and reliance of their technology. Once the patented technology is adopted, the original patent holders could transfer the patent(s) to a PAE who could revoke the commitment. The PAE could exploit the implementers' investment in building on the patented technology to extract rents greater than the value of the patent(s) itself. The mere possibility of this gaming creates uncertainty, as all commitments would come under suspicion and the market certainty they are designed to confer would be lost, regardless of the intent of the company making the original commitment.

Although the FTC has taken action against at least one patent troll for disclaiming an explicit licensing commitment,[16] antitrust authorities should issue more explicit guidance on how the many types of commitments in the marketplace will be deemed to travel with the patents.

Federal Trade Commission, Comments of the Computer & Communications Industry Association, File No. 121-0120, February 22, 2013, *available at* http://ftc.gov/os/comments/motorolagoogle/563708-00028-85597.pdf.

[12] Red Hat, Inc., Statement of Position and Our Promise on Software Patents, *available at* http://www.redhat.com/legal/patent_policy.html.

[13] Open Invention Network LLC, Patent License Agreement, *available at* http://www.openinventionnetwork.com/patents.php.

[14] Adam Messinger, *Introducing the Innovator's Patent Agreement*, Twitter Blog, April 17, 2012, *available at* http://blog.twitter.com/2012/04/introducing-innovators-patent-agreement.html.

[15] Duane Valz, *Taking a stand on open source and patents*, Google Open Source Blog, March 28, 2013, *available at* http://google-opensource.blogspot.co.uk/2013/03/taking-stand-on-open-source-and-patents.html.

For example, "royalty stacking" commitments have posed concerns because they are not tied to specific patents. Patent portfolios can be shed in stages so that multiple parties control patents that were subject to the original royalty stacking pledge. For example, if Company A makes a commitment to not charge more than a 3% total royalty for the 200 patents it owns that read on a particular device, and Company B obtains 50 of those patents on the secondary market after Company A dissolves, what licensing rates is Company B allowed to seek on those patents? If three other companies each acquire 50 of the original 200 patents, and each company then reads the original pledge to mean that they can charge 3%, the royalty for the original patents could quadruple long after the market participants are locked-in. Once again, if adequate guidance is not issued, incentives to game the system will persist. Patent holders in search of more revenue could evade royalty-stacking commitments by spinning off a portion of their portfolio to PAEs.

Although both the DOJ and FTC have taken proactive action supporting the concept that commitments travel with the patents,[17] greater clarity is needed. For example, the president of a large PAE, the Rockstar Consortium, is on record claiming that the prior commitments of both the original patent holder (Novell) and the commitments that Rockstar's creators made to the DOJ did not apply to Rockstar because it was a separate entity.[18] Ironically, the antitrust approval for the creation of Rockstar was conditional on the very same commitments to the DOJ that the Rockstar CEO publicly disclaimed.

IV. <u>PAEs Acting in the Strategic Interest of Operating Companies</u>

Straightforward patent sales to PAEs may not run afoul of antitrust law, but they can still greatly affect competition. Because PAEs don't make products, they are not bound by the same reputational concerns or the classic "mutually assured destruction" (MAD) scenario, where firms are incentivized not to sue lest they be sued back. Patent détentes based on MAD or direct cross-

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[16] Statement of the Federal Trade Commission, *In the Matter of Negotiated Data Solutions LLC,* File No. 0510094, *available at* http://www.ftc.gov/os/caselist/0510094/080122statement.pdf.

[17] Department of Justice, *CPTN Holdings LLC and Novell Inc. Change Deal in Order to Address Department of Justice's Open Source Concerns*, April 20, 2011, *available at* http://www.justice.gov/opa/pr/2011/April/11-at-491.html; Statement of the Federal Trade Commission, *In the Matter of Negotiated Data Solutions LLC,* File No. 0510094, *available at* http://www.ftc.gov/os/caselist/0510094/080122statement.pdf.

[18] Robert McMillan, *How Apple and Microsoft Armed 4,000 Patent Warheads*, WIRED, May 21, 2012, *available at* http://www.wired.com/wiredenterprise/2012/05/rockstar/.

licenses of portfolios are not an ideal solution because they still increase barriers to entry for new entrants. However, they often work to minimize the anticompetitive effects of a congested, high-volume patent system. They minimize the costs of licensing and litigation between large competitors, the costs of which are eventually borne by consumers in the form of higher prices – and less innovation as resources are diverted from R&D.

However, the relatively new phenomenon of "patent privateering," wherein operating companies enlist trolls to attack their rivals and raise their operating costs, presents real antitrust concerns.[19] While companies may disclaim control of their privateers, suspicions may create damaging positive feedback loops as targets deputize their own PAEs to go after the rivals suspected of attacking them. If the massive defensive portfolios accumulated by IT giants over the last 20 years are "weaponized" and turned over to trolls, the collateral damage to competition and innovation is likely to be severe.

Accordingly, antitrust authorities should be vigilant when patent transfers to trolls contain provisions that explicitly or implicitly align the troll's incentives with those of the transferor.[20]

When multiple competitors jointly control or contribute to the same PAE, the FTC and DOJ should closely monitor the contractual relationships and terms of the patent licenses to ensure that the PAEs are not being used to conceal what would otherwise be collusive activity that would run afoul of Section 1 of the Sherman Act.

In reference to the hypothetical examples used as reference points in the PAE workshop,[21] the FTC and the DOJ should be most concerned with Scenario B. Scenario A also potentially presents some antitrust concerns. As discussed above, Scenario C presents significant public policy concerns, but straightforward sales of patents to trolls are unlikely to violate antitrust law.

[19] *See* Ewing & Feldman, *The Giants Among Us*, *supra* note 7; Tom Ewing, *Practical Considerations in the Indirect Deployment of Intellectual Property Rights By Corporations and Investors*, 4 HASTINGS SCI. & TECH. L. J. 109 (2011), *available at* http://hstlj.org/wp-content/uploads/2011/12/7-Ewing-TWO-109-158.pdf.

[20] For a more in-depth discussion of problematic contractual provisions, *see* Michael Carrier, *Patent Assertion Entities: Six Actions Antitrust Agencies Can Take*, CPI Antitrust Chronicle, Winter 2013, Vol. 1 No. 2, *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2209521.

[21] Patent Assertion Entity Workshop, "Panel C: How Does Antitrust Apply to the Potential Efficiencies and Harms Generated by PAE Activity? Hypotheticals," *available at* http://www.ftc.gov/opp/workshops/pae/docs/hypotheticals.pdf.

V. Conclusion

PAEs exacerbate underlying problems in the patent system and impede innovation and competition. As the use of patent trolls increases, so too have the costs associated with them. New PAE business arrangements and practices, such as patent privateering, deserve close scrutiny from antitrust authorities. However, most PAE activity – particularly pre-litigation demand letters and threats – occurs in the shadows and is often protected by NDAs. As a result, the FTC is uniquely suited to conduct a 6(b) study to get more information on their operations, business relationships and the costs and efficiencies associated with them.

Respectfully submitted,

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Appendix – Potential Questions for 6(b) Questionnaire[22]

Information about PAE structure

- List any current or former corporate parent.
- List all entities in which Company has an ownership interest. For each entity Company has an ownership interest in, provide the full name, address, state of incorporation (if applicable), and nature of ownership interest. Ownership interest includes any business association, subsidiary, sole proprietorship, or shell organization.
- List all entities in which Company has a financial interest and/or relationship. Interest and/or relationship in an entity is defined as ownership, assignment interest, and any financial or commercial benefit stemming from a contractual arrangement relating to a patent.
- If Company has a board of directors or similar governing body, list all other business associations (companies, subsidiaries, partnerships, etc) in which these individuals have a role with a fiduciary responsibility.

Information about interest in Company's patents

- List all patents in which Company has a current ownership interest, including options, or has had such an interest within the past five years. For all patents listed describe the nature of acquisition (original patentee, assignment, purchase, etc).
- List all patents Company has transferred to another entity within the last five years and indicate Company's interest in or relationship to that entity. State the nature of the interest and the responsibilities of each party.

Information about Company's licensing and litigation practices

- Provide a comprehensive list of all entities, including individuals:
    - To whom Company has sent an invitation, notice, or demand letter in the past five years;
    - With whom Company has been involved in a lawsuit;
    - From whom Company currently collects royalties

[22] For more discussion and analysis of these questions refer to CCIA's Patent Progress Blog. Specifically, *see* Brendan Coffman, *Suggestions for an FTC 6(b) Study on Patent Assertion Entities*, Patent Progress, April 5, 2013, *available at* http://www.patentprogress.org/2013/04/05/suggestions-for-an-ftc-6b-study-on-patent-assertion-entities/.

- For each licensing agreement made in the past five years by Company, provide the agreement and any correspondence prior to the agreement.
- Describe the process through which Company learns of potential licensees.
- Describe the process through which Company identifies and selects invitation/notice/demand letter recipients.
- Describe the process through which Company prices its patent licenses.
- Describe how Company determines whether a potential licensee already has a license to the technology in question and whether the potential licensee has any indemnification against patent infringement.

<u>Information on strength of patents in which Company has an interest</u>

- For each patent purchased in the past five years
    - provide any information received on the patent prior to purchase.
    - state the age of the patent at the time of purchase.
    - identify whether the patent had been licensed, was the subject of litigation, or was embodied in a product prior to the date of purchase.
- Describe the process through which Company selects patents to purchase.

<u>Information about PAE relationships with operating companies</u>

- For each patent purchased from or assigned by an Operating Company to the patent Company in the past five years, provide the agreement and information on any continuing responsibilities of either party.
- Provide or describe any agreement, including any payment schedule, requiring patent Company to share royalties with an Operating Company.
- Provide or describe any agreement between patent Company and an Operating Company that restricts the parties that the patent Company can seek licenses from or lists companies that already a license.
- Provide or describe any agreement between patent Company and an Operating Company that specifies or targets other Operating Companies.

<u>Procompetitive Efficiencies</u>

- Describe the actions, if any, Company is taking to bring the patented technologies to market. Include efforts to educate operating entities on the patented technologies to encourage the adoption of the patented innovation.

- Identify any patents Company owns where the inventor uses the patented innovation in a product on the market or is in the process of bringing a product to the market using the patented innovation.
- Identify any licensees or potential licensees that proactively sought out a license from Company.
- Provide any evidence that Company's licensing practices have benefitted licensees other than limiting liability.