

## FTC/DOJ Workshop Shines Spotlight On Competitive Harms and Benefits of Patent Assertion Entities

On Monday, December 10, 2012, the Federal Trade Commission and the Antitrust Division of the Department of Justice held a joint workshop ([Agenda](#)) on the activities of patent assertion entities (“PAEs”). PAEs, sometimes referred to as “patent trolls,” do not produce or sell products rather they acquire and assert patents for profits. PAEs range from small firms seeking to monetize single patents to huge corporations holding portfolios containing tens of thousands of patents. As PAE enforcement activities increase, many have expressed concern that PAEs harm competition and innovation, views the FTC expressed in its 2011 report on [The Evolving IP Marketplace](#). Building on the 2011 report, the PAE workshop brought together industry participants, academics, and antitrust experts to explore the scope, potential benefits, and potential competitive harms of PAEs. Workshop participants expressed several notable themes:

### PAE Activity Is Increasing

Participants presented [statistics](#) describing the dramatic recent increase in PAE litigation. In 2012 alone, PAEs accounted for 61% of all patent lawsuits and targeted 1,788 unique defendants. This represented a 400% increase in the number of PAE suits and an 80% increase in unique defendants since 2006. Researchers also estimate that for every suit filed, PAEs send out anywhere from 25 to over 300 demand letters. One company, a cloud computing firm, claimed that defending against PAEs accounted for 90% of its defensive legal spend.

At the same time PAE activity is increasing, the relationship between operating companies and PAEs is evolving. Operating companies appear to be increasingly outsourcing enforcement to PAE proxies. Moreover, PAEs are expanding their enforcement efforts. Although many PAEs target large, profitable technology firms, others tend to target startups, brick and mortar retailers, and technology customers. Workshop participants suggested smaller targets may lack the resources to litigate against PAEs and thus may succumb more readily to PAEs seeking to hold up the firm with nuisance suits.

### PAEs: Effective Patent Monetization, Or A Tax On Innovation?

Workshop participants debated the potential benefits and harms of PAE activities. Supporters contended that PAEs benefit competition by providing enforcement expertise and by making the market for patent rights liquid. Both stimulate innovation, supporters argued, by providing innovators who might otherwise be unable to monetize their intellectual property with an incentive to invent. To support this position, PAE advocates noted that many PAEs acquire patents from independent inventors, universities, and small firms that could not otherwise obtain adequate licensing revenue. An operating company participating in the workshop similarly contended that transferring patents to PAEs facilitate recovery of returns on R&D efforts, and thereby stimulate innovation, because PAEs can effectively monetize patents that the operating company cannot efficiently manage.

By contrast, other participants contended that, rather than supporting innovation, PAEs tax innovation. PAEs exploit operating companies’ lack of notice of applicable patents and sink costs in existing designs in order to extract “hold up” value unrelated to the technological merits of the asserted patents. Moreover, the high costs of patent litigation, and the proliferation of patents (particularly in information technology industries), give PAEs incentives to seek to monetize patents that might not support recovery if a case proceeded to trial. For example, the managing partner of one company described how a PAE’s assertion of a weak patent against a portfolio company had a devastating impact by driving away customers. Other witnesses described how PAEs may seek to extract hold up value through bringing nuisance suits.

Against this backdrop, economists participating in the workshop questioned whether PAEs on balance help or hinder innovation. Even if PAEs stimulate certain forms of invention, PAEs also impose deadweight losses on society. According to one participant, PAEs imposed \$29 billion in direct costs to operating companies in 2011, and indirect costs annually of \$80 billion. Another source posited that only 10%-30% of PAE revenues flow to inventors. Yet another academic reported that half the total direct costs imposed by PAEs were legal defense costs rather than licensing revenues or damages awards. All agreed that much empirical work needed to be done to assess the likely overall costs and benefits of PAEs.

### Privateering, Strategic Outsourcing, and Royalty Stacking

The workshop also addressed how operating companies might employ PAE proxies to engage in potentially anticompetitive conduct. For example, according to some workshop participants, an operating company might transfer patents to a PAE and give the PAE an incentive to target the operating company's rivals. Such strategies might succeed in raising rivals' costs, because PAEs do not face the threat of patent counter-suits, which might have deterred the operating company from asserting its patents in the first place. Participants debated whether such "privateering" or "strategic outsourcing" to PAEs (which some referred to as "hybrid PAE" arrangements) reflects more efficient enforcement of patent rights or potentially anticompetitive conduct.

Participants also described potential harms from "unbundling" portfolios. The pooling of complementary patents can benefit competition by avoiding royalty stacking. Certain operating companies, however, may atomize portfolios of related patents – and foster royalty stacking – by transferring some (but not all) patents to PAEs. One academic participant showed how such a strategy could greatly increase costs and harm efficiency. Another participant explained how such strategies could evade F/RAND commitments. Yet others explained how Nokia's outsourcing of part of its standard-essential patent portfolio, in conjunction with Microsoft, to PAE MOSAID raised precisely this concern.

Many also noted that the opacity of many PAEs can make it difficult to assess the threat PAEs pose to competition. Some participants complained that PAEs often mask patent holdings through complex corporate structures or through failing to record patent transfers.

### The Role of Antitrust Enforcement

Workshop participants also discussed the role antitrust enforcement might play in addressing the harms PAEs inflict. The participants considered hypothetical patent transfers from operating companies to PAEs. Some of these examples involved cooperation among competing operating companies, while others involved transfers that altered enforcement incentives. Participants explained that, depending on the circumstances, such fact patterns could raise issues under the antitrust laws, most notably Section 7 of the Clayton Act or Section 2 of the Sherman Act. Such transfers might change enforcement incentives in a manner designed to raise rivals' costs or to serve as a device to evade preexisting F/RAND commitments. Moreover, participants suggested that the *Noerr-Pennington* doctrine likely would not stand as a bar to challenges to patent transfers.

### Next Steps

The FTC and the DOJ will accept public comments from interested parties on PAEs through March 10, 2013. It is possible that the agencies might further explore issues raised by PAEs through various investigative tools. In the meantime, regulators are considering other measures to reduce the costs of PAE activity. FTC Chairman Jon Leibowitz noted that the Commission could consider employing its rulemaking authority to require greater disclosures regarding patent ownership. Stuart Graham, Chief Economist at the

USPTO, commented that the Patent Office is working to increase patent ownership transparency by eliminating the fee for electronic assignment. The Patent Office is also holding a [roundtable](#) on January 11, 2013 on regulations regarding “real-party-in-interest” ownership information.

Whatever the outcome of these initiatives, we can expect antitrust enforcers and others to continue to shine a spotlight on PAE activities.

If you would like to discuss the foregoing or any other related matter, please contact your usual Ropes & Gray advisor.