Federal Trade Commission

What Role Should Antitrust Play in Regulating the Activities of Patent Assertion Entities?

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Good afternoon. I am delighted to be here today, and I'd like to thank Dechert LLP for inviting me to speak to with you.

I am going to share some thoughts with you regarding patent assertion entities, or PAEs, and their potential relevance for antitrust policy. The term PAE is relatively new and has been adopted by my agency, but you may be familiar with these firms by

* The views stated here are my own and do not necessarily reflect the views of the Commission or other Commissioners. I am grateful to my advisor, Joanna Tsai, and my intern, Ryan Maddock, for their invaluable assistance in preparing this speech.

their more common label: "patent trolls." There are many different definitions of a PAE,[1] but the one the FTC has adopted – and the one I will use today for ease of reference – is that these are "firms whose business model primarily focuses on purchasing and asserting patents."[2] In short, PAEs purchase patents – usually along a business model to monetize these assets through licensing and patent infringement suits against manufacturers.

But this is only half the story. Why do patent holders sell to PAEs? At least one reason is because they often lack the capabilities, financial or otherwise, to exploit the patented technology in the marketplace. Why do PAEs purchase these patents? There are of course many reasons, but one obvious one is that their business model is to monetize these intellectual property assets via licensing, and when infringers reject their license offers, such as manufacturers who are already using the patented technology, PAEs sue them for patent infringement. Clearly, PAEs generally do not conduct research, development, technology transfer, or engage in manufacturing activities; their competitive advantage is in commercial licensing and legal enforcement, not development.[3]

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[1] *See, e.g.*, *eBay Inc. v. MercExchange, L.L.C.*, 547 U.S. 388, 396 (2006) (Kennedy, Concurring) ("An industry has developed in which firms use patents not as a basis for producing and selling goods but, instead, primarily for obtaining licensing fees.").

[2] Fed. Trade Comm'n, The Evolving IP Marketplace: Aligning Patent Notice and Remedies with Competition 8 n.5 (Mar. 2011) [hereinafter IP Report], *available at* http://www.ftc.gov/os/2011/03/110307patentreport.pdf.

[3] *Id.* at 63.

Let me begin with an aside, and a bit of sympathy for the proverbial devil: after all, "patent troll" conjures up quite a few hostile implications, as every child who has read Harry Potter, Lord of the Rings, or the classic story of the billy goat trying to cross the bridge can attest to.

PAEs are one of a variety of non-practicing entities, or NPEs, who license but neither manufacture nor sell the patented inventions to consumers. In contrast, practicing entities manufacture and sell products that incorporate patented inventions to consumers. The entities qualifying as NPEs are wide-ranging and heterogeneous: they include all universities, which certainly do not manufacture or sell patented inventions, but also start-up companies, semiconductor design houses, and even some large, established commercial firms, like IBM. Thomas Edison would have been called an NPE, if that term existed 100 years ago, as he worked full time in his invention factory in Menlo Park and only licensed his inventions to the companies that manufactured and sold his patented inventions, although he loved to put his name on these companies as well. As is clear, IBM, Edison, and Harvard University have hardly invoked the ire that has been directed to PAEs. Yet all of them hold patents for the same commercial reasons: they transfer technology and its rights to other market actors, and in some cases, they also develop technology. So with that aside, I will focus on PAEs and their antitrust implications but leave a discussion of other noteworthy types of NPEs for another day.

Few regulatory debates arise against a blank slate; this is no exception. I begin with a little context. Just over two years ago, the FTC issued a report that identified several problems with the patent system at that time, and further suggested ways for the PTO and the courts to improve patent notice and patent remedies.[4] This 2011 report was the first time the FTC offered its views on PAEs and their activities. With respect to PAEs, the FTC observed that there had been a surge in both patent sales and patent litigation in the IT industry, that PAEs were responsible for most of this increase, and that PAEs likely were having a deleterious effect on innovation and competition.[5]

The FTC again noted the PAE business model this past December, when it joined with the DOJ in holding a public workshop to explore the effects of PAE activities on innovation and competition, as well as to discuss the possible implications for antitrust enforcement and policy.[6] The workshop drew upon, and solicited advice from, industry leaders, academics, economists, regulators, and over a dozen other organizations.[7]

Congress has also taken interest in PAEs. Representatives Peter DeFazio and Jason Chaffetz introduced (and re-introduced) the Saving High-tech Innovators from

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[4] *Id. passim.*

[5] *Id.* at 58-72.

[6] Information about the workshop, including the panelist presentations, is available at http://www.ftc.gov/opp/workshops/pae/.

[7] The workshop public comments are available at http://www.ftc.gov/os/comments/pae/index.shtm. The Agencies accepted public comments through April 5, 2013.

Egregious Legal Disputes Act, or SHIELD Act, singling out PAEs for a "loser pays" fee-shifting scheme. Even more recently, the House Judiciary Subcommittee on Courts, Intellectual Property, and the Internet held hearings to discuss what it described as "abusive" patent litigation and whether legislation like the SHIELD Act is needed to curb the activities of PAEs.[8]

The PAE debates have percolated for some time among patent policymakers, regulators, and businesses; significantly, at least from my perspective, these debates have now broken onto the public stage – and into antitrust. I want to spend some time talking to you about the types of antitrust concerns PAEs might give rise to, and what role antitrust law should have in regulating their activities.

PAEs and Patent Litigation

The PAE is a specialist in licensing and enforcing patent rights. Because many PAEs end up in court, patent litigation economics are a critical part of the PAE story. For PAEs as well as practicing entities, enforcing patent rights can be remarkably costly, including direct costs, such as legal fees. Practicing entities also incur indirect costs, such as IP counterclaims and business disruptions.[9] Other indirect costs, including reputational costs, follow: involvement in IP litigation can impair customer relations,

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[8] Hearing materials are available at http://judiciary.house.gov/hearings/113th/hear_03142013_2.html.

[9] Colleen Chien, Patent Assertion Entities 8 (Dec. 10, 2012), *available at* http://www.ftc.gov/opp/workshops/pae/docs/cchien.pdf ("Traditional patent litigation economics are stacked against enforcement").

participation in standards setting organizations, and the willingness of other firms to cross-license their IP. For most practicing entities, i.e. manufacturers, the symmetry of these risks with other manufacturers favors a strategy resembling mutually assured destruction, discourages aggressive assertion of IP rights, and encourages licensing agreements.

But PAEs do not manufacture products, and this is an important starting point for critiques of this business model. The PAE business model, critics argue, creates asymmetrical risks and greater incentives for patent enforcement in court. Because PAEs do not manufacture or sell products, they face little risk of countersuits for patent infringement and do not have to be concerned about disruptions to other businesses or customer relations from litigation. With respect to reputational costs – and unlike most firms – PAEs may well *benefit* from developing an aggressive reputation for litigation.

PAEs may also end up in court more often because they risk far less in the way of indirect costs, as mentioned; they also can afford greater relative direct costs – costs of litigation – relative to practicing entities. PAEs can reduce or structure legal fees through contingency fee arrangements, capture economies of scale through repeat assertion of the same or similar patents, and economize on discovery costs due to inherently fewer documents generated in the ordinary course of business. Consequentially, PAEs can profitably sue on marginal infringement claims that practicing entities would ordinarily disregard.

Some scholars claim that these facts explain why, over the last two years, the number of PAE suits as a share of all IP infringement suits has doubled,[10] and PAEs now account for the majority of new patent infringement suits in the United States.[11] Some panelists at the FTC workshop and at the House hearing on Abusive Patent Litigation described what they saw as the effects of PAE-driven litigation: companies running the gamut from Hewlett Packard to J.C. Penney reported dozens of lawsuits from PAEs, often for basic technologies such as drop-down menus and gift card activations. There is also some evidence that PAEs send a large number of demand letters to potential infringers compared to practicing entities. The FTC's 2011 IP Report stated that "most PAEs suits are against large companies,"[12] but more recent data suggest that the primary targets of PAE suits are now small companies and start-ups.[13]

Are PAEs Specialists, Trolls, or Both?

A patent licensing business model is not new—by the mid-nineteenth century, American inventors like Elias Howe and others were monetizing their patented inventions solely by licensing their patented technology[14] — but the PAE business

[10] *Id.* at 23-24.

[11] *Id.* (citing data from RPX Research and PACER).

[12] IP Report, *supra* note 2, at 61.

[13] Chien, *supra* note 9, at 39 ("Although suits against large tech companies get the most attention, defendants revenue/industry profiles vary widely"), 50 ("The majority of PAE defendants (at least 55%) have less than $10M in revenue").

[14] See Adam Mossoff, *The Rise and Fall of the First American Patent Thicket: The Sewing Machine War of the 1850s*, 53 Ariz. L. Rev. 165 (2011).

model of acquiring and aggregating patents en masse for licensing is new. As is so often the case with antitrust analysis of novel business practices, PAEs are subject to dueling theoretical interpretations: on the one hand, PAEs are efficiency-generating specialist patent owners who facilitate licensing and innovation. On the other hand, PAEs are rent-seeking "patent trolls" taxing innovation by imposing costs on manufacturers and other firms. As with most dueling theories, there is a bit more complexity to each side than the rival caricature allows, and my proposed solution to this conundrum should come as no surprise: we must listen carefully to what the data tell us in order to discriminate between these competing accounts.

First, let's talk about the procompetitive story. This is the story of PAEs as market specialists. PAEs can generate efficiencies in two different but interrelated markets: the market for patents and the market for ideas. PAEs have contributed to a more active secondary market for patents, increasing patent liquidity, allowing patent holders to dispose of portfolios they cannot or will not maintain, and permitting companies to recoup immediately some R&D costs – often extensive. Each of these functions in turn permits practicing entities to re-focus on invention, manufacture, and further research. This liquidity-enhancing function operates along several dimensions, from funding small entrants which notoriously struggle in interacting with established incumbents to salvaging patent rights from failed start-up companies, to providing a marketplace to companies wishing to diversify or refocus their patent holdings.

Additionally, manufacturing companies can more easily ascertain what patent rights they must procure to operate freely in a new product area. In short, PAEs hold themselves out as intermediaries between inventors who engender patents and technology-driven practicing entities.[15] The critical question is, of course, to what extent these benefits increase innovation or otherwise enhance consumer welfare.

Some evidence supports this procompetitive narrative. One IP lawyer at the FTC Workshop commented that some "companies out there refuse to talk to anyone unless they are sued."[16] One report documents that PAEs buy and litigate small-firm patents more often, and more aggressively, than those owned by their larger rivals.[17] This suggests that PAEs channel capital to small firms and investors, compensating – and therefore encouraging – innovation. One PAE claims that it has returned $1 billion to investors to date.[18] The broad recognition that PAEs have facilitated or conducted a sizeable percentage of patent transactions further bolsters the procompetitive liquidity narrative.[19] Of course, these explanations are only intermediate inquiries for antitrust: the key final question is the ultimate impact on consumers PAEs have wrought.

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[15] IP Report, *supra* note 2, at 68.

[16] Testimony of Graham Gerst, Global IP Law Group, at FTC/DOJ Workshop on Patent Assertion Entity Activities (Dec. 10, 2012), *available at* http://www.ftc.gov/opp/workshops/pae/.

[17] *See* Chien, *supra* note 9, at 47-48 (reporting that for Q4 2010 and Q1 2011, small companies represented 50% of NPE/PAE patents and inventors represented 28%).

[18] IP Report, *supra* note 2, at 65 ("Intellectual Ventures makes patent acquisitions through funds, which have reportedly raised $5 billion, and returned $1 billion to investors to date.").

[19] *See, e.g.*, Anne Kelley, *Practicing in the Patent Marketplace*, 78 U. Chi. L. Rev. 115, 117 (2011).

There is merit to the "patent troll" story as well. The primary competitive concern regarding PAEs is that the cost of defending against patent infringement lawsuits diverts resources from R&D efforts and increases the risks associated with introducing new products, both of which ultimately reduce innovation. Another concern is that patent litigations brought on by PAEs force asymmetric warfare upon practicing entities. Both practicing entities and PAEs face costly legal fees, however, practicing entities also incur significant indirect costs, such as IP counterclaims, costs tied to business disruptions and reputational costs. In addition, as PAEs' bargaining leverage increases as they acquire more and more patents that can be asserted against practicing entities, potentially resulting in royalty rates above the underlying value of the patents.

PAEs may well impose significant costs on practicing entities. Reviewing a license demand or infringement claim for a single patent can cost several hundred thousand dollars, while litigating an infringement case to final judgment can cost millions of dollars, according to workshop participants. In addition, some firms may feel the need to acquire otherwise unnecessary IP for the purely defensive reason of simply preventing the patents from falling into the hands of a PAE.[20] But one must tread somewhat carefully when shifting from a discussion of the distribution of costs

[20] Firms can do this through direct acquisition of patents or through investment in a defensive patent fund, such as RPX, OIN, or AST.

within a system to making inferences about what antitrust really cares about: impact upon consumers.

Thus far, there is precious little reliable empirical data on the costs PAEs impose upon practicing entities.[21] Representatives of practicing entities at the workshop consistently cited PAE litigation as a substantial and growing expense, however: Cisco's general counsel stated his company spends $50 million per year fighting PAE lawsuits and has "reduced funding for new patent applications in order to fund this litigation."[22] There is also some evidence that most infringement claims by PAEs are

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[21] Professors James Bessen and Michael Meurer estimate that the total direct costs incurred by defendants in response to NPE patent assertions amount to $29 billion in accrued cost in 2011. *See* James Bessen & Michael J. Meurer, *The Direct Costs from NPE Disputes* 18-19 (working paper June 28, 2012), *available at* http://www.bu.edu/law/faculty/scholarship/workingpapers/documents/BessenJ_MeurerM062512rev062812.pdf.

However, others have found this study to have several flaws. In particular, Professors David Schwartz and Jay Kesan found that the estimate is likely based on a sample of firms with higher litigation costs and liability exposure than the average firm, which would result in an overestimation of the total direct costs. *See* David L. Schwartz & Jay P. Kesan, *Analyzing the Role of Non-Practicing Entities in the Patent System* (July 25, 2012), *available at* http://ssrn.com/abstract=2117421. In addition, the estimate of direct costs mostly consists of license fees, which may be patent holders' rightful rewards for their innovation, rather than costs to society. The litigation component of the direct cost should also be balanced against the policy interest of rewarding inventors and deterring infringement, rather than simply regarded as welfare losses. Finally, Professors Schwartz and Kesan also point out that the study includes patent assertions that may not be meritless, including those made by individual inventors and universities, and likely underestimates the benefits that NPE assertions could bring to ensure rewards for innovators.

[22] Prepared Statement of Mark Chandler, Senior Vice President, General Counsel and Secretary, Cisco Systems, Inc. before the Committee on the Judiciary, U.S. House of Representatives 3 (Mar. 14, 2013), *available at* http://judiciary.house.gov/hearings/113th/03142013_2/Chandler%2003142013.pdf. *See also* Iain M. Cockburn, Licensing: A View from the Trenches at 7 (Apr. 17, 2009), *available at*

weak. One frequently-cited study found that PAE claims litigated to judgment are successful only 8% of the time as compared to 40% for other types of plaintiffs.[23]

How are we to interpret these stylized facts within antitrust analysis? It is not immediately obvious why business conduct that lowers costs in one part of the economic system would give rise to antitrust concerns merely because it increases the costs of other firms. It is also unclear what distinguishes this conduct from a simple redistribution of economic rents along the production chain. In cases where PAEs and practicing entities are competitors – because, for example, they have closely substitutable IPRs – suits brought by PAEs could be motivated by a desire to undermine competitors. However, antitrust's well-known mantra of protecting competition and not competitors – and its corresponding insistence upon evidence that the conduct at issue has harmed consumers – is one meaningful protection against misusing the antitrust laws to thwart innovation or to tilt the playing field in favor of certain firms or business models. This is not to say that any PAE behavior that increases the costs of practicing entities is or should be immune from antitrust scrutiny;

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http://www.ftc.gov/bc/workshops/ipmarketplace/apr17/docs/icockburn.pdf; Chien, *supra* note 9, at 53 (citing Colleen Chien, *Startups & Patent Trolls* (2012)).

[23] John R. Allison et al, *Patent Quality and Settlement Among Repeat Patent Litigants*, 99 Geo. L.J. 677, 693 tbl. 8 (2011) ("[N]o matter how the data are sliced, product-producing entities are far more likely to win their cases than NPEs"). However, a Price Waterhouse Coopers study found a much higher success rate for NPEs generally. *See* Price Waterhouse Coopers, 2012 Patent Litigation Study chart 5b, *available at* http://www.pwc.com/en_US/us/forensic-services/publications/assets/2012-patent-litigation-study.pdf (finding that the overall litigation success rate for NPEs as 24% versus 38% for practicing entities for the 2006-2011 period).

it is not and it should not be so. Conduct that raises rivals' costs and harms competition can certainly violate the antitrust laws, and PAE conduct fitting this description should be subject to appropriate levels of scrutiny. But as I'll discuss below, antitrust contains a battle-tested framework for evaluating the costs and benefits of challenged conduct in an uncertain and fact-dependent context and there does not appear to be any need to deviate from that established framework to address the activities of PAEs.

What Role Should Antitrust Play?

Let's begin with the low hanging fruit. There is widespread agreement that the acquisition of patents by a PAE from a practicing entity with the intent to more aggressively monetize the patents would not violate the antitrust laws.[24] This agreement is not surprising. Patent enforcement requires familiarity with diverse fields of knowledge – including technical specifications, underlying scientific and market developments, and various legal rules, both substantive and procedural – with little thematic relationship aside from, naturally, patent enforcement. It requires little economic intuition to postulate that a well-functioning market might generate a set of firms specializing in enforcing patent rights. It would be an odd stance indeed for a competition agency to condemn an efficient delegation of a good-faith assertion of one's

[24] *See, e.g.*, Carl Shapiro, Patent Assertion Entities: Effective Monetizers, Tax on Innovation, or Both? 22 (Dec. 10, 2012), *available at* http://www.ftc.gov/opp/workshops/pae/docs/cshapiro.pdf ("Hard to make mere assertion of patents an antitrust violation.").

property rights and the corresponding welfare gains from this specialization.[25] But if antitrust is inappropriate in the face of the mere assertion of patent rights, when might it prove constructive in the face of PAE-relevant challenges?

This raises a question about antitrust's comparative advantage. As Ronald Coase observed, when an economist finds a business practice he does not understand, he looks for a monopoly explanation due to the vast ignorance outsiders have in comprehending, as Coase put it, "ununderstandable practices."[26] The deeply limited knowledge that outsiders to an industry or business bring to bear in interpreting seemingly inexplicable business practices often leads to a hasty proliferation of anticompetitive explanations. Those explanations can in turn be used to create the temporary intellectual foundation for an unduly aggressive enforcement posture against novel business models and methods only to discover years or decades later that the complained-of conduct bore little or no real risk of competitive harm. Antitrust history is replete with examples providing the proof that this temptation can be strong.

We have other historical examples from within the IP licensing context, the infamous era of the so-called Nine No-No's – an era in which competition agencies took the position that virtually all non-standard licensing agreements violated the Sherman

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[25] The Noerr-Pennington doctrine would also provide a substantial hurdle for an antitrust claim predicated on the mere assertion of IP rights.

[26] Ronald H. Coase, *Industrial Organization: A Proposal for Research*, in POLICY ISSUES AND RESEARCH OPPORTUNITIES IN INDUSTRIAL ORGANIZATION 59, 67 (Victor R. Fuchs, ed., 1972).

Act – should be sufficient to remind agencies to not just look, but also to analyze before they leap. These historical examples are a stark reminder that antitrust's comparative advantage is in *analyzing* the competitive implications of specific practices rather than picking winners and losers in the competitive process based upon an evaluation of the relative social merits of general business models.

What about when antitrust analysis is more narrowly focused upon the specific activities of PAEs rather than the business model? There are two basic categories of activities that proponents of greater antitrust scrutiny of PAEs point to; though there are an infinite number of variations on these basic themes that may alter the underlying analysis. One is a PAE engaging in so-called patent holdup – typically in the form of reneging on RAND commitments formed during the standard setting process. The other is a PAE acquisition of patents from a practicing entity. Without providing a detailed analysis of the many possible variants within each of these categories, I want to offer some general comments and perhaps raise some questions about the appropriate role of competition policy with respect to each potential PAE activity.

One type of PAE activity that, as I've mentioned, has attracted scrutiny is refusal to adhere to commitments made by a prior IP owner to a standards setting organization. The assertion of patents unconstrained by prior licensing commitments, particularly when backed by the threat of an injunction or exclusion order, can result in a "holdup" of practicing entities that have made sunk investments into existing

products and technologies.[27] Holdup concerns animated two recent FTC enforcement actions outside the PAE context: one against Bosch and one against Google.[28]

I have previously expressed skepticism concerning application of the antitrust laws to regulate patent holdup. My skepticism arises from the combination of the blunt and inflexible nature of antitrust compared to the flexibility of contract law and the risk of false positives associated with the difficulty of distinguishing efficient breach or contractual modification from truly anticompetitive behavior.[29] Contract law and patent law each have an advantage over antitrust in identifying and deterring

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[27] Economists have long viewed the holdup problem and ex post opportunism as a contract problem rather than antitrust problem. *See, e.g.*, Benjamin Klein, *Market Power in Antitrust: Economic Analysis After* Kodak, 3 S. Ct. Econ. Rev. 43, 62-63 (1993) ("Antitrust law should not be used to prevent transactors from voluntarily making specific investments and writing contracts by which they knowingly put themselves in a position where they may face a 'hold-up' in the future . . . . [C]ontract law inherently recognizes the pervasiveness of transactor-specific investments and generally deals with 'hold-up' problems in a subtle way, not by attempting to eliminate every perceived 'hold-up' that may arise."); Benjamin Klein, Robert G. Crawford & Armen A. Alchian, *Vertical Integration, Appropriable Rents, and the Competitive Contracting Process*, 21 J. Law & Econ. 297, 302 (1978) ("The primary alternative to vertical integration as a solution to the general problem of opportunistic behavior is some form of economically enforceable long-term contract."); Oliver E. Williamson, *Markets and Hierarchies: Analysis and Antitrust Implications* 26-30 (1975) (to prevent opportunism, "an effort must be made to anticipate contingencies and spell out terms much more fully than would otherwise be necessary. . . . [In addition,] the agreement needs to be monitored."); *see also* Timothy J. Muris, *Opportunistic Behavior and the Law of Contracts*, 65 Minn. L. Rev. 521, 531 (1981) ("[T]he law of contracts affects people's ability to act opportunistically.").

[28] Materials related to the Bosch settlement are available at http://www.ftc.gov/os/caselist/1210081/index.shtm and materials related to the Google settlement are available at http://ftc.gov/os/caselist/1210120/index.shtm.

[29] Bruce H. Kobayashi & Joshua D. Wright, T*he Limits of Antitrust and Patent Holdup: A Reply to Cary et al.*, 78 Antitrust L.J. 505 (2012); Bruce H. Kobayashi & Joshua D. Wright, *Federalism, Substantive Preemption, and Limits on Antitrust: An Application to Patent Holdup*, 5 J. Competition L. & Econ. 469 (2009).

inefficient ex post contractual opportunism and other inequitable conduct. Several courts have held, for example, that failure to adhere to a RAND commitment made to a standards setting organization may constitute a breach of contract.[30] Moreover, PAE holdup does not necessarily have the same competitive implications as holdups by practicing entities because PAEs arguably do not compete with practicing entities that do not have substitutable patents.

Are contract remedies sufficient to provide optimal deterrence of patent holdup? From an economic perspective, the remedial relief required is a function of, among other things, the probability that the anticompetitive conduct is detected.[31] While this

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[30] *Apple, Inc. v. Motorola Mobility, Inc.*, 886 F. Supp. 2d 1061 (W.D. Wis. 2012) (holding that Motorola was a party to binding contracts as a result of its FRAND licensing commitments to two standard setting organizations and that Apple had the right to enforce those contracts as a third-party beneficiary); *Microsoft Corp. v. Motorola, Inc.*, 854 F. Supp. 2d 993, 999-1001 (W.D. Wash. Feb. 27, 2012) (holding that Motorola's commitments to two standard setting organizations created enforceable contracts to license its essential patents on RAND terms), *reaffirmed*, 864 F. Supp. 2d 1023, 1030-33 (W.D. Wash. 2012), *aff'd in relevant part*, 696 F.3d 872, 884 (9th Cir. 2012) (upholding "district court's conclusions that Motorola's RAND declarations to the ITU created a contract enforceable by Microsoft as a third-party beneficiary (which Motorola concedes)"); *see also* U.S. Dep't of Justice & U.S. Patent & Trademark Office, Policy Statement on Remedies for Standards-Essential Patents Subject to Voluntary F/RAND Commitments 7 n.14 (Jan. 8, 2013) ("As courts have found, when a holder of a standards-essential patent makes a commitment to an SDO to license such patents on F/RAND terms, it does so for the intended benefit of members of the SDO and third parties implementing the standard. These putative licensees are beneficiaries with rights to sue for breach of that commitment.").

[31] Gary S. Becker, *Crime and Punishment: An Economic Approach*, 76 J. Pol. Econ. 169 (1968); William M. Landes, *Optimal Sanctions for Antitrust Violations*, 50 Chi. L. Rev. 652 (1983); Jeremy Bentham, *Principles of Penal Law*, *in* THE WORKS OF JEREMY BENTHAM 401-02 (Russell & Russell, Inc. 1962); *see also* Douglas H. Ginsburg & Joshua D. Wright, *Antitrust Sanctions*, 6 Competition Pol'y Int'l J. 3 (2010) (contending that current antitrust sanctions for cartel activity do not provide adequate deterrence).

implies the necessity of multiple or supracompensatory damages in the case of furtive conduct such as price-fixing, the same well-accepted economic principles imply single damages are sufficient in the case of conduct certain to be detected and subject to enforcement.[32] The very nature of a "holdup," as the name not so subtly suggests, implies a high probability of detection as the patent holder informs others of his demands. With little social value from stacking antitrust remedies on top of those provided by other legal regimes, and the risk of false positives – especially in cases involving mere breach of a RAND commitment rather than deception, the marginal benefit of antitrust enforcement in this context is therefore likely to be small.[33]

Another reason antitrust enforcers should not seek to enforce RAND commitments is that the Supreme Court has held that the Sherman Act does not condemn, without more, the evasion of pricing constraints. A monopolist's pricing may face any number of constraints: competition, contracts, regulation, the mix of products it sells, reputational capital, and any number of other tradeoffs. It is clear not all attempts to evade these constraints violate the antitrust laws. To take one extreme example, in *NYNEX*, the Court concluded that a monopolist was not liable under the

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[32] Frank H. Easterbrook, *Detrebling Antitrust Damages*, 28 J. L. & Econ. 445, 458-59 (1985) (asserting that detrebling is appropriate where there is a "[h]igh probability that the offending acts will be detected and, if detected, prosecuted" and where alternative remedies exist).

[33] *See also* Bernhard Ganglmair, Luke M. Froeb & Gregory J. Werden, *Patent Hold Up and Antitrust: How a Well-Intentioned Rule Could Retard Innovation*, 60 J. Indus. Econ. 249 (2012) (demonstrating that the availability of an antitrust remedy for holdup could lead to overdeterrence and discourage innovation).

Sherman Act for engaging in deceptive conduct that allowed it to evade pricing constraints and injure consumers because the monopolist's behavior did not harm the competitive process and because the "consumer injury naturally flowed . . . from the exercise of market power that [was] *lawfully* in the hands of a monopolist."[34] More broadly, the *NYNEX* opinion and other recent court decisions are consistent with the view that the antitrust laws do not prohibit any changes in pricing incentives or any conduct by a monopolist that harms consumers.[35] Antitrust is not a form of comprehensive price regulation; rather, the antitrust laws are concerned with conduct that reduces competition. Changes in pricing incentives that do not arise from changes in competition are outside the appropriate scope of antitrust.

Those principles are relevant here because a PAE's refusal to follow a prior owner's RAND commitment (or a PAE's adopting a narrower construction of that commitment) evades a pricing constraint but has no effect on the IP holder's degree of market power. Although the precise meaning of a RAND commitment remains ambiguous, it clearly places some constraints on the IP holder's ability to fully monetize the IP. To put it another way, disregarding a RAND commitment permits the IP owner

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[34] *NYNEX Corp. v. Discon, Inc.*, 525 U.S. 128, 136 (1998) (emphasis in original).

[35] *Rambus, Inc. v. FTC*, 522 F.3d 456 (D.C. Cir. 2008); *Broadcom Corp. v. Qualcomm, Inc.*, 501 F.3d 297 (3d Cir. 2007); *see also* Joshua D. Wright, *Why the Supreme Court was Correct to Deny Certiorari in* FTC v. Rambus, Global Competition Policy, March 2009 . In contrast, the FTC has taken a contrary position in the Google, Bosch, N-Data, and Rambus cases that a evading a pricing constraint, such as disregarding a licensing commitment, is a violation of Section 2 or Section 5.

to exercise its pre-existing market power to a greater degree than it could previously, but does not increase or help maintain the holder's market power. If a PAE's mere failure to abide by a prior RAND commitment were considered actionable under the antitrust laws, then a wide range of ordinary business conduct would raise similar concerns under an "evading a pricing constraint" theory, including transferring assets to a firm with a different product mix, different reputation, or different advertising intensity, because in each case the new owner would have different pricing incentives. Such a construction would place antitrust firmly into the business of contract regulation and micro-managing the competitive process.

Let me turn now to the second type of PAE activity that has raised antitrust concerns: the transfer of IP from a practicing entity to a newly-formed PAE.[36] As a result of this acquisition, the direct and indirect assertion costs over the same set of patents will decline, which will create an incentive to engage in more licensing demands and litigation. The acquisition may also result in a greater incentive to engage in ex post holdup, which will result in higher royalties. Thus, the transfer would plausibly increase the incentives to engage in such inefficient conduct related to the holdup and redistribution of economic rents. However, the transaction does not fall within the scope of Section 7 of the Clayton Act, which only prohibits acquisitions that

[36] This concern applies as well to a PAE with existing IP acquiring non-substitutable IP from a practicing entity.

"substantially . . . lessen competition, or tend to create a monopoly." Neither prong of Section 7 is implicated by a transfer of a patent from a practicing entity to a newly-formed firm; indeed, the mere transfer of that patent to a PAE would have *no* effect on competition or market concentration.[37] As with the holdup example, the transfer of a patent from an practicing entity to a PAE may allow the exercise of pre-existing market power, but the Supreme Court has long held that the mere exercise of existing market power, whether through higher prices or otherwise, is permissible.

Before closing this discussion, I want to emphasize that I do not mean to suggest that all PAE activity is immune from the antitrust laws. Critics have charged that PAEs have engaged in a variety of other activities that may raise more serious antitrust concerns.[38] To determine whether these other activities violate the antitrust laws, one should look at the conduct under standard antitrust decision frameworks, rather than focusing on the nature of the actor.[39] In addition, we need to keep in mind that the

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[37] Again, this assumes that the PAE had no IP prior to the acquisition that was substitutable for the acquired IP.

[38] Critics have complained, for example, that some practicing entities transfer their patents to PAEs with instructions or incentives to litigate against their rivals while hiding the origins of the patents, and that some PAEs demand payments from alleged infringers' downstream customers rather than from the infringing manufacturers.

[39] Some enforcers have taken a contrary view. Fiona Scott Morton, when she was the Antitrust Division's chief economist, suggested that a relevant consideration in Section 7 analysis is the "business model of the buyer" and that merger analysis should focus on the welfare effects of the transaction, rather than on the effect on competition. *See* Fiona Scott Morton, Dep. Assistant Attorney Gen. Antitrust Div., Patent Portfolio Acquisitions: An Economic Analysis 1, 8 (Sept. 21, 2012), *available at* http://www.justice.gov/atr/public/speeches/288072.pdf. She acknowledged that PAEs "have the

institutional comparative advantage of antitrust is in solving competition problems, not in regulating prices, solving inefficiencies caused by the patent system, or forcing firms to adhere to their promises. Rigorous empirical research and economic analysis can, and will, play an important role in discerning the competitive consequences of various PAE business practices. The FTC can play an important role in that process; but the appropriate scope of antitrust policy related to PAEs must ultimately be determined by what we learn in the years to come about the competitive effects of their activities.

A related question is that, even if PAE activities are evaluated under traditional antitrust principles on a case-by-case basis, should they be subject to heightened scrutiny or attention, as some enforcers have suggested?[40] Thus far, I think the answer is no. I am unaware of any persuasive evidence that PAEs are operating in an industry whose structure is conducive to coordination or that PAEs have a significant and direct negative effect on consumer welfare—factors that might justify a need for greater oversight.

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potential to generate efficiencies," which, presumably, would be reflected in the competitive effects analysis. *Id.* at 9-10.

[40] *See generally* Jon Leibowitz, Chairman, Fed. Trade Comm'n, Patent Assertion Entity Workshop Opening Remarks 4 (Dec. 10, 2012), *available at* http://www.ftc.gov/speeches/leibowitz/121210paeworkshop.pdf ("[I]t is clear that the time has come to address PAE activity and its possible costs to civil society."); Morton, *supra* note 39.

Or consider another form of "special treatment" available to the FTC competition matters: the use of Section 5 to address unfair methods of competition.[41] Applying Section 5 to condemn PAE conduct as a sort of end-around to traditional antitrust analysis perfectly inverts the ideal response.[42] Rigorous empirical research and economic analysis can, and will ultimately, discern the competitive consequences of various PAE business practices when properly studied. The body of economic learning concerning the competitive implications of these practices should drive how regulators approach antitrust enforcement against PAEs. Novel applications of Section 5 to condemn PAEs before this understanding is complete commit the cardinal antitrust sin: conforming the law (and economics) to condemn a disapproved-of practice, rather than condemning a practice because it fails to conform to the law.

But antitrust is more than just bringing cases. The FTC, for example, has a long history of using its policy authority to engage in competition policy research and development to broaden our understanding of emerging business practices. This is precisely what the Commission did in hosting the PAE Workshop. Panelists included many interesting perspectives from industry representatives, patent holders, PAEs,

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[41] *See id*. at 4 (suggesting that Section 5's proscriptions against "unfair methods of competition" and "unfair acts or practices" might apply to some PAE conduct).

[42] *See* Joshua D. Wright, Commissioner, Fed. Trade Comm'n, What's Your Agenda?, Remarks at the ABA Spring Meeting (Apr. 11, 2013), *available at* http://www.ftc.gov/speeches/wright/130411abaspringmtg.pdf ("Section 5 should not be used to evade existing antitrust law . . .. This is especially the case when Section 5 is used to take advantage of a weakened requirement to prove consumer harm in the rigorous manner required in, for example, Section 2 cases").

legal scholars, and economists. The Workshop provides a useful starting point for understanding the important questions to ask about PAEs from a competition policy perspective. I will note, however, that one theme that was clear from the Workshop is that there appears to be a consensus that more rigorous study and empirical evidence is required before antitrust – a rather blunt instrument in terms of policy work – should be used.

Consensus: Need for More Empirical Evidence?

This avowed empirical ignorance proved one of the conference's key themes. As Professor Chien stated, the world doesn't "really understand the consequences, good or bad," from PAEs, much less those consequences that would be cognizable under the antitrust laws.[43] Even some of the panelists who took a skeptical view of PAEs acknowledged the lack of empirical support for their concerns. About the only conclusion for which there is robust and consistent supporting evidence is that PAEs account for a large and growing portion of patent litigation activity.[44]

From my perspective, the key issue regarding PAEs from an antitrust perspective, and for which we have very little evidence, is the extent to which PAE activity contributes to innovation. To answer that we need to know:

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[43] Chien, *supra* note 9, at 28; *see also id*. at 54 ("We don't really know the net benefits or costs.").

[44] Chien, *supra* note 9, at 32 (noting similarity of results from different studies); Shapiro, *supra* note 24, at 5.

- What are the total costs PAEs impose on practicing entities?
- What share of these costs goes to inventors (or patentees)?
- To what extent is this added compensation to inventors stimulating innovation?
- To what extent do PAE costs reduce innovation by practicing entities?

It would also be helpful to have better data on the success rate of PAE assertion claims. For example, when PAEs bring infringement lawsuits, how often are they successful, what level of damages are awarded in successful suits, and how frequently are courts granting injunctions and the ITC granting exclusion orders? Likewise, how frequently do PAEs issue demand letters, how often are these demand letters going to practicing entities' customers, and how do recipients respond to these demands? An upcoming GAO report may help answer some of these questions.[45]

Without better empirical data, there is no basis on which to discriminate among dueling theories that describe the effects of PAEs. Are PAEs a tax on innovation as practicing entities assert, promoters of innovation as PAEs assert, or does the answer depend on the specific circumstances? At this point, the available evidence does not allow us to draw a confident conclusion, but I suspect that Professor Shapiro is correct

[45] The America Invents Act, among other things, directed the Government Accountability Office to study the costs and benefits of PAE litigation. *See* Leahy-Smith America Invents Act, Pub. L. No. 112-29 (H.R. 1249) (2011).

that the ratio between the increase in the patentee's compensation and the cost to the target "varies across PAE activities."[46]

We also need to consider the social costs from an erroneous condemnation of PAEs or an overbroad remedy to address any PAE activity that is shown to be harmful. As I have previously stated, it is particularly important to minimize the sum of the costs of legal errors and administrative costs in high-tech industries because innovation is critical to "the long-run health of the industry and consumer welfare."[47] In its 2011 Report, the FTC agreed, explaining that "[i]t is difficult to distinguish patent transactions that harm innovation from those that promote it, and errors that undermine beneficial transactions can harm consumers."[48]

Conclusion

Let me conclude by observing that the current debate regarding the merits and competitive implications of the PAE business model offers a valuable reminder that antitrust law should not be used to micro-manage the economy, to correct perceived problems with other legal regimes, or to correct inefficiencies in the marketplace. Rather, antitrust law should stay focused on competition problems such as cartels, acquisitions that create or enhance market power, or exclusionary conduct by

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[46] Shapiro, *supra* note 24, at 13.

[47] Joshua D. Wright, Commissioner, Fed. Trade Comm'n, Evidence-Based Antitrust Enforcement in the Technology Sector, Remarks before the Competition Law Center at 7 (Feb. 23, 2013), *available at* http://www.ftc.gov/speeches/wright/130223chinaevidence.pdf.

[48] IP Report, *supra* note 2, at 71-72.

monopolists. When enforcers engage in "mission creep" and attempt to expand the application of the antitrust laws (including Section 5 of the FTC Act) to new business models or conduct before they are sufficiently well understood, or to alleged inefficiencies not arising from the acquisition or creation of monopoly power, they risk unhinging antitrust law from sound economic foundations, introduce greater unpredictability into antitrust enforcement, and raise uncertainty and risks for the business community at large as well as for consumers.

The FTC is uniquely situated to contribute to the debate over the appropriate role for antitrust in regulating PAEs by ensuring it takes place with an eye toward empirical evidence and economic analysis. I look forward to working with my colleagues on the Commission and our excellent staff as we work our way through the many complex issues implicated by PAEs' business activities. Thank you for your time.