The Internet Association

U.S. DEPARTMENT OF JUSTICE, ANTITRUST DIVISION & FEDERAL TRADE COMMISSION

WORKSHOP ON PATENT ASSERTION ENTITIES

COMMENTS OF THE INTERNET ASSOCIATION

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PUBLIC COMMENTS OF THE INTERNET ASSOCIATION

The Internet Association commends the Department of Justice (DOJ) and the Federal Trade Commission (FTC) for holding their December 2012 Workshop and current comment proceeding on the significant and growing concerns raised by patent assertion entities (PAEs) and by patent abuses that are commonly, although neither universally nor exclusively, associated with PAEs. The Internet Association is pleased to submit the following comments and looks forward to continuing discussion and investigation regarding this important policy area.

I. The Internet Association's Interest and Overall Perspective

The Internet Association is the unified voice of the Internet economy, representing the interests of leading Internet companies and their global community of users.[1] The Internet Association is dedicated to advancing public policy solutions to strengthen and protect Internet freedom, foster innovation and economic growth, and empower users.

Our members are innovative companies that favor a transparent and effective intellectual property (IP) system that enables those who invest in research and development to recoup their investments. Each year, our members invest millions of dollars, driving the development of new technologies and societal freedoms through their creativity and innovation, and they rely on IP to protect their investments.

However, our members are concerned that the current U.S. patent system is susceptible to large-scale abuse, and that the growing wave of patent abuse poses one of the principal threats to the growth of a free, open, innovative and dynamic Internet economy. Innovators of all sizes are thwarted and deterred when successful innovation becomes a magnet for patent suits and threats of patent suits that are often founded on dubious patents and dubious infringement claims, but that are nonetheless effective because of the costs, risks and uncertainties associated with litigation. In effect, abusive patent assertion imposes a huge and rapidly increasing tax on innovation generally, and on the Internet economy in particular.

Not all patent abuse is by PAEs. Many non-practicing entities (NPEs) fund and generate valuable innovation that others put into practice.[2] In the last few years, however, PAEs have

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[1] The IA's members include AirBnB, Amazon.com, AOL, eBay, Expedia, Facebook, Google, IAC, LinkedIn, Monster Worldwide, Rackspace, salesforce.com, TripAdvisor, Yahoo!, and Zynga.

[2] NPEs hold patents but do not commercialize their technology by bringing it to market in the form of goods or services. Many NPEs, such as universities, benefit the innovation economy by generating innovation and make it broadly available through licensing or other arrangements, without making undue use of patent litigation.

PAEs are distinguished, if not clearly defined, as entities that (1) typically buy patents after innovation has occurred, rather than directly funding innovation upfront, and (2) exist primarily to monetize their patent portfolios by litigating and threatening litigation. These comments address the typical characteristics and business practices of PAEs, which are sufficiently common and important to merit a focused policy response. However, organizations, business practices and patent assertions vary, and any analysis of specific cases should take into account all the specific facts, which may vary from the typical PAE characteristics discussed here.

come to dominate patent litigation, and the PAE business model generates litigation advantages and facilitates several forms of patent abuse. As a result, while the ultimate problem for the innovation economy lies in patent abuse, PAEs are at the center of a huge and growing problem for the Internet economy.

II. The Distinctive Characteristics and Impacts of PAEs

Unlike The Internet Association's members and most traditional businesses, PAEs typically bring no goods or services to market and have no relationship with consumers. Instead, PAEs operate in technology markets in which the value of their assets – their patent portfolio – is determined by litigation and the threat of litigation rather than by consumers in the marketplace. As a result, the competitive effects of PAE conduct are determined by the rules governing patent acquisition, threats of patent litigation, and patent litigation, and not by typical market forces. Insofar as the patent system is flawed and susceptible to abuse, PAEs have the ability to exploit those opportunities and harm competition without facing normal competitive discipline.

While individual entities vary, patent assertion by PAEs is typically not constrained by various factors that tend to limit other patent litigation to relatively manageable levels. Insofar as PAEs are not selling products and services, they need not fear patent infringement countersuits, and there is no opportunity to resolve their claims by cross-licensing. Insofar as PAEs face neither consumers nor securities markets, they are not significantly constrained by reputational concerns. Insofar as PAEs commonly derive their revenue on a backward-looking basis derived from alleged damages for pre-suit infringement, they lack a strong interest in cooperation to grow markets going forward, so they may be more apt than traditional productive companies to pursue litigation all the way through to ruining the defendant. In addition, insofar as PAEs operate only in technology markets in which, given the inherent uncertainties of measuring the market power inherent in each patent, antitrust analysis is often more difficult than in markets with obvious market share data, it may be more difficult in practice to enforce the antitrust laws effectively against PAEs than against consumer-facing businesses.

Moreover, the PAE business model conveys some advantages that tend to tilt the economics of patent litigation in the PAE plaintiff's favor. Insofar as a PAE is just a buyer of a patent, and not an inventor or practitioner of the technology, a PAE is likely to face a minimal discovery burden. PAEs are built for litigation; whereas other firms have to address concerns that patent litigation will impose opportunity costs by distracting managers and innovators from productive work, litigation and threatening litigation is the PAEs' *raison d'etre*. Insofar as PAEs buy large portfolios of patents, they enjoy economies of scope and scale in patent assertion and litigation, which enable them to bear the risks of litigation uncertainty much better than a defendant that depends on a particular product line. And insofar as PAEs are neither consumer-facing nor publicly traded, they have opportunities to shield their technology portfolios from disclosure, creating opportunities for patent assertion ambushes.

These distinctive characteristics of PAEs suggest a potential for the PAE business model to spawn increased patent assertion and to tilt the balance of patent litigation in the plaintiff's favor. Empirical evidence strongly supports that hypothesis. PAEs and PAE-instituted litigation and litigation threats have grown exponentially over the past few years because PAEs are an

extraordinarily effective vehicle for exploiting the patent system. Most patent litigation in the United States is now PAE-initiated litigation – 61% of new claims in 2012 – and a very large proportion of that litigation is initiated by a small number of PAEs that concentrate their efforts in communications and Internet technologies.

Moreover, this growth of PAE litigation does not simply represent a transfer of patents, and a transfer of litigation, from non-PAEs to PAEs. Non-PAE litigation has not fallen. The rapid growth of PAE litigation has resulted in a rapid growth of the overall patent litigation burden on the U.S. economy. In 2012, PAEs filed an average of 7 new patent suits per day, and patent suits are just the tip of the iceberg: the potency of the threat of patent suit compels defendants to settle in a very high proportion of cases (and threats impose costs on defendants who have to respond to them even if the threat is withdrawn).

III. Patent Assertion Abuses and Costs

If the patent system were perfectly pro-competitive, PAEs' efficacy in exploiting it would only be a good thing. But because it is neither perfectly efficient nor free from abuse, the patent system imposes significant costs on U.S. business, and particularly on the Internet economy.

First, the patent system suffers from significant inefficiencies. The PTO has an extremely difficult job in determining what patent claims to grant. This is particularly true in highly active areas such as Internet and communications technology where there is an enormous thicket of patents to navigate, technology is evolving swiftly, and there is an enormous and increasing volume of patent applications to process. Patent litigation imposes huge costs -- typically substantially larger than the amount plausibly at stake. Thus, the vast majority of cases and potential cases settle, and for an amount frequently determined more by the prospect of litigation cost and the parties' relative risk and cost tolerance than by evaluation of the merits.

In addition, particularly in the Internet and communications technology context, the thicket of overlapping patents makes liability determination difficult and unpredictable. The complexity and interrelatedness of allegedly infringing products, such as multi-functional communications devices and related apps, makes the determination of the value due to one of many incorporated technologies, and thus appropriate damages, difficult and unpredictable. Accordingly – even without specific abusive conduct – bad, overbroad, vague and insufficiently disclosed patents are granted, and unpredictable and erroneous liability and damages determinations are made. Even when the merits are all perfectly determined, litigation costs and differences in cost and risk tolerance frequently overwhelm them in determining settlements. As a result, successful innovators, startups and manufacturers who have a lot to lose in patent litigation are vulnerable targets. Broad, vague and complex patent claims are potent weapons regardless of their merit. The ultimate value of a patented innovation to consumers often bears little relation to the value of the patent as a litigation weapon. The growth of PAEs and their efficiency in exploiting the patent system have exacerbated these problems.

Second, the patent system is subject to abuse, most significantly but not solely by PAEs. The Internet Association's members and the small and medium-sized firms with which they

partner to bring innovative products to market repeatedly encounter abuses, including some if not all of the following:

- vague and overbroad patents;
- litigation in which the PAE or other potential plaintiff asserts multiple patents in shotgun fashion, with little regard for which patent(s) arguably read(s) on the accused product;
- litigation threats, particularly by PAEs, in which a substantial settlement payment is demanded while refusing to even identify the specific patent claims at issue;
- ownership concealment: abusive use of privately held subsidiaries and affiliates to conceal the real-party-in-interest and the full extent of a patent portfolio;
- litigation by ambush: PAEs and other plaintiffs wait to threaten suit until a product has been successful in the market, or until the defendant is at a critical stage of its business growth, in order to extract a settlement value that reflects the defendant's marketing success or business vulnerability, and/or consumer lock-in, over and above the value of any incorporated patented innovation;
- abusive litigation tactics, such as forum-shopping and discovery abuses, calculated to coerce settlements based on litigation cost;
- abuse of the threat of ITC exclusion orders to extort unreasonable settlements; and
- hybrid PAEs: arrangements whereby a product market participant houses its patents in a PAE, or partners with a PAE, to avoid accountability for patent assertions that may raise reputational or antitrust concerns.

IV. A Way Forward

There is no simple solution to these complex problems. Antitrust enforcement has an important role. PAEs should not be *de facto* immunized from antitrust enforcement merely because they do not participate in product or services markets. Patent acquisitions, agreements involving hybrid PAEs, and anticompetitive patent assertion practices should be thoroughly scrutinized under the antitrust laws. However, antitrust enforcement alone will not suffice to tackle the broader systemic problems in a patent system that imposes huge costs on America's innovators; the patent system needs to be reformed.

Some constructive reforms can already be identified. First, for example, transparency is fundamental to the patent social contract – patents are granted not to reward invention *per se*, but to reward invention plus disclosure to the public. The Internet Association supports strong and continuing real-party-in-interest disclosure requirements so that defendants will not be ambushed by hidden patent portfolios and so that antitrust enforcers can make an informed evaluation of the competitive implications of patent aggregation.[3] Second, given that litigation cost both imposes huge deadweight losses and drives many patent settlements, efforts to reduce litigation

[3] Comments of the Coalition for Patent Fairness and the Internet Association in response to USPTO, Notice of Roundtable on Proposed Requirements for Recordation of Real-Party-in-Interest Information Throughout Pendency of Patent Term, Docket No. PTO-P-2012-0047 (Jan. 25, 2013), *available at* http://www.uspto.gov/patents/law/comments/rpii-e_cpf-ia_130125.pdf.

cost should be a high priority, especially given the asymmetry in the current system, in which successful plaintiffs but not successful defendants can recover litigation costs.

More broadly, the patent system needs to be reformed and modernized to meet evolving challenges, particularly those posed by PAEs. The DOJ and the FTC have investigatory powers and a traditional role as advocates for competition that can be enormously valuable in this effort.[4] The Internet Association commends the agencies for convening the present proceeding, and hopes that it will be just the beginning of a productive ongoing discussion in the service of competition and innovation.

[4] In particular, the FTC could greatly improve public understanding of PAEs, their conduct, and the public policy challenges they pose by conducting an informational investigation of the major PAEs, using its subpoena powers.