Opening Remarks of Chairwoman Edith Ramirez
Competition Law & Patent Assertion Entities: What Antitrust Enforcers Can Do
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I want to thank CCIA and AAI for the opportunity to open today's very timely program on competition law and patent assertion entities. PAEs are relatively new players in the IP marketplace. To some, PAE activity was questionable from the start. And, the most recent evidence suggests PAEs are evolving in ways that raise red flags for competition and consumers. These entities are driving the increase in patent litigation and targeting firms in a growing slice of the economy. PAE lawsuits are no longer filed primarily against IT firms. Retailers and financial services providers that incorporate software into their products and services are now common targets. Even hotels and coffee shops are not immune. The costs to consumers from PAE activity appear increasingly tangible and direct.

Government and academics are paying attention. Of course, the issues associated with PAE activity are not new to the Federal Trade Commission. We first reported in detail on PAE activity in our March 2011 Report on the Evolving IP Marketplace.[1] Last December, we held a workshop with the Department of Justice to continue to further explore the issues.[2] There is also a growing body of academic literature evaluating the scope and impact of PAEs. The issue has even prompted the President to issue new directives to target PAE abuse, and Congress is exploring several legislative responses.

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[1] FED. TRADE COMM'N, THE EVOLVING IP MARKETPLACE: ALIGNING PATENT NOTICE AND REMEDIES WITH COMPETITION (2011) (hereinafter "2011 Report"), available at http://www.ftc.gov/os/2011/03/110307patentreport.pdf.

[2] Fed. Trade Comm'n & U.S. Dep't of Justice, Patent Assertion Entity Activities Workshop (Dec. 10, 2012), materials available at http://www.ftc.gov/opp/workshops/pae/.

The question posed by today's program is what antitrust enforcers can do. We have a role to play in advancing a greater understanding of the impact of PAE activity and using our enforcement authority where appropriate to challenge anticompetitive and deceptive conduct. This afternoon I will discuss how the FTC can do that, but I also want to stress that PAE activity raises tough competition policy and enforcement issues that defy a one-dimensional answer. Protecting consumers from harmful PAE activity requires effort from various corners of government. The PTO and courts, in particular, have leading roles to play in protecting consumers from PAE abuse.

In my remarks today, I will provide an overview of the key competition policy issues associated with PAE activity and how that activity has changed since the Commission issued its 2011 Report. I will then share possible future steps that fall within the Commission's competition and consumer protection authority. I will close by addressing the critical importance of continuing the effort on patent reform to limit the costs associated with some types of PAE activity.

I. The Evolving IP Marketplace

Let me start with terminology. The Commission defines a PAE as a firm with a business model focused primarily on purchasing and asserting patents, typically against operating companies with products currently on the market.[3] Others use the term "patent monetizer" to describe firms that earn money primarily in the secondary market for patents.[4]

In a recent policy paper, the Council of Economic Advisers defined a PAE based on behavior. Under the CEA definition, a PAE is an entity that engages in a variety of aggressive

[3] 2011 Report at 50, n.2.
[4] Sara Jeruss, Robin Feldman & Joshua Walker, The America Invents Act 500: Effects of Patent Monetization

litigation tactics, such as threatening to sue large numbers of companies at once and hiding its identity through shell corporations.[5] I will be using the Commission's definition of a PAE.

As I noted, the Commission took its first serious look at PAEs and their activities in our 2011 Report.[6] We acknowledged the important role that patents play in encouraging invention and subsequent innovation. Rewarding genuine invention is good for competition and consumers. PAEs can serve that goal by reducing the enforcement hurdles facing small inventors and start-ups. The economics of asserting patents has traditionally weighed against

targets through litigation, which shifts resources away from productive activities like R&D. When we issued our report, evidence suggested that PAE-driven litigation was rising at a steady pace and concentrated in the IT sector.

PAEs may generate even greater indirect costs by distorting incentives to innovate. Patents asserted against existing products raise the risk of patent hold-up, which can discourage investment in product development. Particularly in the high-tech sector, where patent notice is notoriously difficult, licensing fees are likely to reflect investments the implementer has made to bring a product to market, rather than the true economic value of the patent. And because licenses are always negotiated in the shadow of the law, the problems the Commission has previously identified with the framework for patent remedies – including the uncertainty associated with damage awards and the threat of an injunction or exclusion order – add to the risk of hold-up associated with PAE activities.

These direct and indirect costs, along with the evidence of benefits, led the Commission

I want to take a few minutes to highlight some of what we learned. First, data shows that beginning in 2012, the majority of infringement lawsuits were filed by PAEs.[9] The same study tells us that the share of all infringement lawsuits filed by PAEs tripled between 2007 and 2012.[10] Studies using different data and definitions give us lower numbers. But the trend across studies is the same. PAEs have been responsible for an increasing share of patent lawsuits since at least 2006.[11]

Lawsuits of course are only the beginning of the story. While data on activity outside the courtroom is sparse, some evidence, along with common sense, suggests that many more PAE lawsuits are threatened than filed.

Importantly, PAE activity is not just growing. It is also changing shape. PAEs are still fueled largely by software and IT-related patents. They still target IT firms more than companies in any other single sector. But data and anecdotal evidence suggest that PAEs now file half of all their lawsuits against firms outside the high-tech sector that merely incorporate IT into their products. Examples include retailers that do business online, restaurants with websites, and financial services companies that offer mobile banking applications. In 2005, about 40% of PAE

Many retailers and small businesses now find themselves victims of nuisance suits that are far cheaper to settle than litigate. Some PAEs send thousands of demand letters to target businesses. The sender may claim the recipient is infringing one or more patents by using ordinary office electronics purchased at the local superstore. One panelist noted that a colleague advised "just hold your nose, settle early, and get out cheap. You'll save a lot of money if you do."[12] Companies that choose not to settle are responding in other ways, such as pulling Wi-Fi from their stores or useful online tools like calorie counters from their websites.[13]

Another important development involves what is referred to in the workshop as "hybrid PAE" activity. A so-called "pure PAE" will assert its patents against any firm that is likely to be a good source of licensing fees. It has no particular financial incentive to target one firm versus another. In contrast, a hybrid PAE may have incentives aligned with those of the operating company from which it acquired the patents it is monetizing.[14] For instance, we are now hearing a great deal more about sophisticated IPR strategies by operating companies, in particular a practice described as "privateering."

Privateering, as used here, refers to a situation where an operating company transfers patents to a PAE that may read on a competitor's products. The sale may be structured in a way that encourages the PAE to target the original owner's downstream rivals. The operating company benefits indirectly if the PAE raises its rivals' costs. There are variations on this theme, but that is the core fact pattern.

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[12] Transcript of Fed. Trade Comm'n & U.S. Dep't of Justice Patent Assertion Entity Workshop at 63, available at http://www.ftc.gov/opp/workshops/pae/transcript.pdf

[13] Id.

[14] Carl Shapiro, "Patent Assertion Entities: Effective Monetizers, Tax on Innovation, or Both?" PowerPoint Presentation at the Fed. Trade Comm'n & U.S. Dep't of Justice Patent Assertion Entity Workshop 4 (Dec. 10, 2012), available at http://www.ftc.gov/opp/workshops/pae/

But while we know somewhat more today than we did in 2011, we still have only snapshots of the costs and benefits of PAE activity. If we want to see the full competitive picture, we will need to learn a lot more.

III. What the FTC Can Do

The FTC can play a significant role in filling out this picture. I am committed to ensuring that the Commission will continue to lead on research and advocacy to inform the policy debate on PAE activity.

In particular, I would like the Commission to help develop a better understanding of the PAE business model, which would inform many of the key cost-benefit questions associated with PAE activity. The Commission has authority under Section 6(b) of the FTC Act to conduct industry studies. We have used that authority in the past to gather information to inform important competition and consumer protection issues. For example, the Commission used its 6(b) authority to investigate practices associated with generic drug entry prior to patent expiration under the Hatch-Waxman framework. The investigation led to a report in 2002 that influenced reforms included in the Medicare Modernization Act of 2003.[20]

Given the developments in PAE activity and the need for more evidence to inform appropriate policy responses, I believe that the Commission should use its 6(b) authority to study the costs and benefits of PAE activity. Academics doing work in this area have already put forward suggestions for a study that the agency is reviewing. I look forward to continuing to hear from relevant stakeholders as to how the FTC could most productively use its 6(b) authority.[21]

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[20] FED. TRADE COMM'N, GENERIC DRUG ENTRY PRIOR TO PATENT EXPIRATION: AN FTC STUDY (2002), available at http://www.ftc.gov/os/2002/07/genericdrugstudy.pdf

[21] Several of the comments that were filed in collection with our workshop include a recommendation for a Commission 6(b) study. See Comment of Coalition for Patent Fairness (CPF); Comment of Computer &

The Commission also stands ready to enforce the antitrust laws. As the Commission and DOJ have stated before, standard antitrust analysis applies to issues involving intellectual property rights.[22] Accordingly, in considering whether action may be appropriate, we will focus on scenarios in which there may be competitive harm, taking into account any cognizable justifications.

With respect to PAEs, antitrust concerns may arise with respect to their formation – the assembly of a patent portfolio through one or more acquisitions – or the assertion of a portfolio once assembled. Portfolio acquisitions that combine substitute patents, for example, may raise the risk of harming competition. The assertion of patent rights by a PAE may also raise antitrust concerns, especially if the PAE is effectively acting as a clandestine surrogate for competitors. The antitrust analysis of agreements involving PAEs and operating companies will of course need to be fact specific, and the issue of market power will likely be key to any evaluation. But hybrid PAE activities may fall within the radn madestine surra8 -.000.

To be sure, problematic PAE activity may lend itself to an antitrust or a consumer protection law enforcement solution. But I am committed to ensuring that the FTC uses its enforcement power in this area where appropriate.

IV. PAE Harm is a Symptom of a Larger Problem

But Commission activity should be just one piece of a broader response. Flaws in the patent system are likely fueling much of the real costs associated with PAE activities. PAEs are good at monetizing patents. But effective monetization of low quality patents imposes a de facto tax on productive economic activity with little or no offsetting benefit for consumers. High litigation costs add to the problem by allowing PAEs to coerce targets to pay license or settlement fees that are detached from the economic value of the patents at issue. In short, PAEs exploit underlying problems in the patent system to the detriment of innovation and consumers.

There has been significant progress in addressing this core problem. For example, the America Invents Act included reforms directed at improving patent quality and expanding mechanisms to challenge patent validity, both of which are essential to reducing weak IP.[23] Third parties may now submit prior art in another's patent application. Similarly, post-grant review procedures create expedited and cost-effective alternatives to challenge patent validity. This makes it less costly for challengers to weed out weak patents. At the same time, courts have strengthened the non-obviousness requirement for patentability,[24] moved towards a more economically rational basis to award patent damages,[25] and eliminated the presumption in favor of injunctive relief.[26] But as the Obama Administration and Congress have recently recognized, more can and should be done.

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[23] Public Law No. 112-29, 125 Stat. 338 (2011).
[24] KSR v. Teleflex, 550 U.S. 398, 415 (2007).
[25] See, e.g., Uniloc USA, Inc. v. Microsoft Corp., 632 F.3d 1291 (Fed. Cir. 2011).
[26] eBay v. MercExchange, 547 U.S. 388 (2006).

The PTO can adopt rules to re

Administration announced that the PTO will provide new training to examiners on functional claiming and will develop strategies to improve claim clarity.[31]

Courts are also a key part in any solution. Meaningful use of Rule 11 to weed out plaintiffs who have not undertaken even simple investigations before filing suit can help punish and deter frivolous claims.[32] Similarly, Section 285 of the Patent Act allows courts to shift the costs of litigation in exceptional cases, including when there is evidence of misconduct. Because PAEs can have especially low litigation costs compared to defendants, vigorous fee shifting can discourage abusive litigation practices. Taken together, strong enforcement of Rule 11 and Section 285 will reduce incentives for massive nuisance suit campaigns.

IV. Conclusion

Let me conclude by noting we should be careful not to approach PAEs with one broad brush. There is mounting evidence that PAE activities may have an adverse impact on competition and consumers. But, at this stage, analysis of the costs and benefits of PAE activities remains limited.

The Commission can contribute to a broad policy response to PAEs by using its Section 6(b) authority to collect more comprehensive information on the variety of PAE business models and the scope of their activities. Antitrust and consumer protection enforcement, where warranted, can also have important roles to play in reducing the harms associated with certain PAE conduct. But patent reform and efforts by both the PTO and the courts, are critical to any effort to move the consumer welfare calculation on PAEs from cost to benefit.

Thank you, and I look forward to an interesting program.

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