Patent Assertion Entity Activities Workshop
Transcript, Part 4 of 4

December 10, 2012
4:00 PM (Afternoon Break) to 5:30 PM (End)

NOTE: This transcript has not been completely proofed and is intended to be temporary. A final version will be posted soon.

FRANCES MARSHALL: All right, we're going to go ahead and get started with our final panel of the day.

Good afternoon, everybody. My name is Frances Marshall, and I'm Special Counsel for IP at the Antitrust Division. And this is going to be our wrap 3 panel where we are going to be looking at how does antitrust apply to all of these potential efficiencies and harms that to have been identified and talked about over the course of the day.

Our format for this panel is going to be a little bit different. Phil Malone, who is yet another one captured in Boston, will join us by telephone and is going to give us an academic introduction to our topic. And Phil is the Clinical Professor of Law at Harvard Law School and Clinical Co-director and Senior Fellow at the Berkman Center for Internet and Society. And then we're going to turn to our panel. Phil will try and join our discussion. We'll see how that goes, and we will to f(hu6(for IP at/TT4 1 Tf9.055. -2.30 TD09.000(ARSTc.01dig acao. Pee anelreally(f 13Tj/Te)TJ1961.150 T

the last two panelists were just talking about, that I know people earlier today talked about. Put another way, if the acquisition and/or the assertion of patents by PAEs is a problem, can antitrust be part of the solution? And if so, what and how?

There are a bunch of different ways one could approach this. One is the one that I'm going to use to try to just quickly to identify a category of conduct, a range, of kinds of behavior, kinds of conduct, by PAEs. And then try to see whether there's a legal antitrust theory, whether it's Section 7 of the Clayton Act, Section 1 or 2 of the Sherman Act, or perhaps Section 5 of the FTC Act, that actually fits that conduct and allows us to analyze and potentially reach that sort of conduct.

I want to run initially through a, I think, very quick continuum of some of the possible PAE conduct that we might want to analyze. I suspect that much of this has been described in great detail earlier, and a lot of the panelists have laid out. And I'm sorry I missed that. I had hoped to pull that together. But I'll give you, at least, my take of some of the key categories, and then try to make some sense of whether there are antitrust theories that fit and make sense of them.

So starting at the simplest end and probably the least troubling end, and moving to more complex, we can imagine a situation where a PAE holds and asserts one or more patents. That's it. Simple ownership and assertion.

Moving up a little, a situation where the PAE actually acquires one or more patents, either initially or on top of patents it already owns. Ratchet up a little more, the PAE could acquire a large portfolio all at once or in a single transaction, and that portfolio itself could constitute a thicket in some situations. A slight variation on that is where a PAE acquires a large portfolio, but does it over time through a series of smaller transactions, each of which builds up in an increasing way the potential power that the PAE has, rather than acquiring it all at once.

And then again, going a bit further, a situation where a PAE acquires and then threatens or licenses a substantial number of patents, but in addition to the necessary patents requiring the licensing of a large package of patents, so the kind of mass aggregator situation that Thomas Ewing described in the last panel. So notice, all of those are situations where the PAE is essentially acting on its own, acting unilaterally, to acquire and then assert patents.

A second, distinct category that's important to carve out comes if you vary the details of the acquisition just a little bit, and instead of the PAE acting simply to acquire and assert some number of patents, instead we introduce some element of coordination or ongoing relationship between the PAE and the practicing entity or the operating company that was the patent holder and is the seller of the patents. Without having heard him, I think this is what Carl Shapiro referred to earlier this morning as hybrid PAEs, where there's some ongoing connection, ongoing relationship, between the PAE and the prior patent owner, practicing entity.

So I'll come back to that in a minute, but situations there where, for example, an operating company creates a shell company, a PAE, or perhaps a joint venture with a PAE, then sells patents to it, but retains the license for itself. Again, very that scenario where that happens, but

there's also an understanding or an agreement that practicing entity and the PAE maybe share profits from the licensing or have some joint control or decision making over the licensing.

And then go a step further to situations where two or more competing practicing entities either jointly create a company, jointly create a joint venture, and then license patents to that PAE and take licenses back, and potentially cross license as well. So a number of hybrid situations. And then finally, a separate scenario that we might want to have on the table where a PAE holds or acquires patents that are encumbered in some way with FRAND licensing obligations by virtue of a previous standard-setting process or standard-setting situation.

some cases, the PAE may face very different constraints and have very different incentives than the practicing entity, the operating company seller.

Easiest example with a sale to a PAE is probably the shift from the risk symmetry, as Michael Carrier called it in his comments for the workshop, where competing operating companies, competing practicing, entities with large portfolios, run a big risk of counter sued if a assert and sue their rivals. And that often leads to smoother licensing and detente and so on. That's typically not the case with PAEs. They don't face that same risk of retaliation or counter suit because they're not doing anything. They're not practicing in a way that they can be threatened.

And PAEs also, at least in some cases, maybe likely not to have the reputational constraints that a practicing entities may not have. They may not fear the kind of reputational harm that could come from suing other practicing entities within the industry.

I think that's the sort of situation that Commissioner Rush was addressing back in his concurrence to the Commission's challenge to the Ovation acquisition of NeoProfen where he basically said he would have challenged an earlier acquisition by Ovation, the acquisition of a separate drug, because it essentially eliminated the reputational constraints and the risks to other profitable products that the current owner, at that point Merck, had. Those constraints had kept Merck from charging the monopoly price. Ovation as the acquirer of that patent wasn't faced with those constraints, and instead ended up charging 1,300% more post-acquisition than Merck had previously as a result of not facing those constraints.

And in fact, the PAE may have converse incentives to threaten and sue, and perhaps even sue over weaker patents, in order to try to establish a reputation for tough litigation and for being willing to go to the mat and sue to make its future threats even more credible than they otherwise would be.

So if we think about using Section 7 to analyze these situations, what's the theory of competitive harm? We want to ask when we're thinking about harm does it come from collusion? Does it come from exclusion of rivals? And if it's exclusion, what's the mechanism? And most likely is raising rival's costs, and I think you'll probably hear a fair amount about that from the panelists.

If we think of the acquisition of patents, they have PAE in horizontal merger terms, then it's necessarily unilateral effects, I think, that we're talking about. More interesting is likely to be thinking of it from the standpoint of vertical mergers and vertical merger theory, which is a subject I know that at least Carl wants to get into and I'm sure will say a lot more once we get into the panel. So I'll leave it at that.

Just to quickly shift back to a couple of the hybrid scenarios that I threw out for a minute, and these are scenarios that Fiona Scott Morton has raised recently in a speech or two that she's given as well. One is the patent practicing entity, an owner of a patent, that creates a new company, a new PAE-- it's either a shell company or a joint venture-- sells patents to it, and then retains a license. And then the PAE is then able to threaten and sue others, including the previous patent owner, practicing entities, rivals, potentially raising their costs. And at least in theory without the

same fears of both reputational harm and retaliation that the practicing entity would have faced itself had it taken that action and tried to raise rival's costs.

Maybe more troubling is the situation where you have two or more practicing entities to that this, that create the PAE, sell patents to it, take licenses back, and potentially cross license between them. You then have a scenario where two practicing entities who are competing in a market are effectively coordinating or even colluding, potentially, to raise their rival's costs or entrance costs. And depending on how they set it up, maybe even sharing the profits from doing so.

This category of conduct is what some have called privateering, and it's exacerbated by, I think, what Carl referred to-- or I think at least was going to refer to, I didn't hear him this morning-- of a lack of transparency. So the more difficult it is to understand the relationship between initial patent owners, sellers, shell companies, particularly where there may be large numbers of intermediary companies involved, the more difficult it is to see through those relationships, the better this sort of activity may work. Because the greater the disconnect between the prior risks of retaliation and risks of reputational effect may be. So, these kind of joint practicing entity, PAE relationships and conduct may raise Section 1 issues as well as Section 7 to the extent that they involve agreements between the PAE and the practicing entity beyond the mere sale of patents in the first place.

Finally, let me just note quickly the last category I mentioned, that is the role that FRAND commitments may play in antitrust analysis. So we can imagine a scenario where we're dealing with one or more standard, essential patents that have become part of a standard through a process that included FRAND licensing commitments. And we tend to think that patents may obtain greater market power and greater hold up possibility as a result of their inclusion into a standard and then their adoption in the market.

But if those patents which at least previously had a clear FRAND commitment are sold to a PAE, and the PAE then either outright reneges on that commitment or takes a different view of the different interpretation of what kind of FRAND commitments go with the patent-- something that [INAUDIBLE] has described before as incomplete contracts, unclear contracts-- then the PAE may be in a position to at least try to charge higher royalty rates for the patent and hold up users of the standard than would have been possible for the original participating, practicing entity.

Is there an antitrust answer to this conduct? That's a difficult question. Is there an answer in Section 5 of the FTC Act as was the case with the Commission's previous case of data against a subsequent purchaser? Maybe. That may be a case where that applies more directly.

Let me just finish with two very quick other notes that I think are worth having on the table. One is the role that Noerr-Pennington and professional real estate investor's immunity may play in defending against antitrust suits, antitrust attacks, on PAE activity. These give presumptive immunity for a patent holder asserting that patent unless the patent was either obtained by fraud on the patent office or where the infringing lawsuit itself is a mere sham, an objectively baseless sham. Or the anticompetitive effect comes from extending beyond the scope of the original patent grant.

FRANCES MARSHALL: Joining us today to discuss these what I consider to be very interesting and very complex, difficult issues are Logan Breed, who is a partner at Hogan Lovells. And Hanno Kaiser, also a partner, this time at Latham & Watkins. And then Mark Popofsky, who is a partner at Ropes & Gray.

Joining us from academia, once again, Carl Sh

HANNO KAISER: I usually think it's helpful fo

So what would be one concern that has been raised in public statements about the Mosaid Nokia/Microsoft arrangement is that you have Microsoft with its dominant position in PC operating systems. And no, Phil and Carl, I'm not relitigating the Microsoft case here, but we'll start with that. You have its alliance with Nokia, where Nokia abandoned Symbian, threw an its lot with Microsoft. It strategically aligned with Microsoft.

You have, as Mosaid described earlier today, an arrangement whereby Nokia-- or Nokia described it-- whereby Nokia, seeking to monetize some value if its intellectual property, divests some of its interest to Microsof

is Microsoft. And the government gets very concerned that if Microsoft has these patents, it's going to aim them right at Android. And so, it requires the arrangement to be rearranged, to quote the Justice Department press release, to "protect competition and open source."

Now, if it raises a meritorious Section 7 issue to have a changed incentive prob."

You get to play the role of the PAE. I know you've always wanted to do that, Frances. That's why you had the workshop.

So, I think we're trying to make a lot of antitrust here where I don't see why there is very much. Because, look, I could assert the patents against you. The competition's between me and you. We're the competitors. This PAE is basically my agent-- thank you very much, Frances-- to help me do this.

Now, there are a whole bunch of tricky things here that Frances is helping me do this. Evading commitments, and avoiding blowback, and all this other stuff. One way to think about this, I found an agent who is allowing me to attack you more effectively-- you, my competitor, to attack you more effectively. It's not the type of competition we maybe don't like so much, but I have these patents, so I'm having trouble seeing why creating this agent is reducing competition between us. OK?

There's a lot of fun and games. We might say, wait a moment, this is no good. You're evading the commitment. That's broken a contract or something. And I'm not that was all a good thing. I don't like the outcome of this behavior one bit, but I'm having trouble seeing how it constitutes a reduction in competition, the only competition I saw in this whole picture, which was between me and you.

HILL WELLFORD: This is great, because you've really teed up what I was hoping to say. Carl's point is really what is the merger-specific harm we're talking about? And that's what you've got to start with in a merger. You've got to say, how has, in a merger-specific way, the conditions changed in a way that creates am anticompetitive opportunity that the antitrust laws can reach.

And this is a cleverly done hypothetical. It doesn't specifically say how those conditions have changed. They may have. If they did-- well, let's take the situation where they don't. It's a mere sale to a patent assertion entity that is a pure play PAE. It's not a Mosaid situation. It's a pure

important to start by saying what's the merger-specific change in conditions that creates an anti-competitive opportunity?

You then have a really thorny question, which is can the government catch this in the pre-merger phase, or is it going to miss it under the HSR rules and you're going to be in the consummated merger situation? Putting a little more legal overlay on it, down into the weeds of HSR, that's really what Mark is talking about. In that situation, I think the amount that Mosaid paid, or the amount of the transaction, was at least booked at something like $20,000, but Mosaid expects the revenue to be, in just a few years, about a billion dollars.

You're in a situation there where it's not HSR reportable, so this goes very quickly-- in a situation where it's going to have potentially a major effect on a major market, I think one of the things that you've got to do in this situation is say, what is the antitrust conduct that you're concerned about and identify it very carefully. It may not be that Mosaid is trying to maximize the profit from its patent. It may be that you really can't reach that. That's what people ought to do with patents.

What you ought to say is the problem-- and I'm taking this away from Mosaid and back into the hypothetical, so I'm not attacking them-- the problem in the hypothetical is don't worry about the actions once the deal is done. Think about should we challenge this as a consummated merger if it turns out that it created market power that we didn't realize? The agencies have been quite aggressive about challenging consummated mergers, and maybe that's the way out of it, rather than trying to pound a conduct peg into a square hole.

HANNO KAISER: If I may, I just want to say something to Carl's rendition here. So, Carl, I kind of fail to see why they shouldn't be a problem.

Let me put it this way. Suppose we have two competitors. We're locked in a competitive battle. I'm a monopolist, let's say. I have significant market power in the product market. You're a new entrant into this space. I have a lot of patents, you have some patents. I would love to impose some, let's say, crippling costs on you as a competitor, but feel myself constrained in doing that because you would nuke me back. You also have some patents in this hypothetical.

Then I give my patents to a third party that is unconstrained in that regard that I can either expect or I have contractually committed to that that party attack you. So how is that not the willful maintenance of monopoly power?

CARL SHAPIRO: Sounds like the cl that you were granted, which
ad to monopoly.

ISER: Well, but wouldn't that-- I mean, going back to the baseball bat analogy in
case, right? So the fact that you've lawfully acquired an intellectual property right
n that they use .T-1.at lawfully acquired uld Tc right is also lawful.

IRO: I'll assume that's a question since I'm being deposed here.

[LAUGHTER]

CARL SHAPIRO: Sure. I mean, look, I wouldn't make such a broad argument about licensing restrictions that the court was dealing with there.

So reading this one aloud, we have two or more operating company competitors who jointly create a PAE whose interests align with the owners. The owners and the PAE benefit if the patents are asserted to exclude rivals of the operating company owners or raise the cost of their rivals. So, let's discuss this one, and maybe this time, Hill, we'll start from your end.

HILL WELLFORD: I think this is a very similar situation, except for the lack of an explicit plan

And to go back to one suggestion Phil Malone ma

situation. If that came out right. So first question, really, for you is if it changes the incentives for future behavior, isn't that still covered under a Section 7 issue?

CARL SHAPIRO: Yes, of course. I think that's what we're always looking at in mergers, because it's all in the future, so it's not consummated. Absolutely.

ANDY GAVIL: So Hill, if the only future conduct is a lawsuit, is that where Noerr kicks in?

HILL WELLFORD: If the only future conduct is a lawsuit and there wasn't any merger-specific change in the way that you would assert that lawsuit, I think Noerr does kick in.

CARL SHAPIRO: I don't want to weigh in on Noerr, but is seems to me we worry about mergers that the companies will raise price, even though, let's say, raising price itself is fine. So that doesn't mean the merger's fine just because the price increase later would be-- in fact, the reason you have to look at the merger is because the price increase later would be fine.

I was making a different point, which is the merger-- this is actually the use of an agent to assert my patents. It's not a merger at all, or the best of patents to this agent-- that's you again, Frances. It doesn't diminish the competition between me and my rivals out there in the audience. It is just, like I said, a clever stratagem for doing that. The fact that it's later going to be perfectly legal for me to make those assertions-- or excuse me, for you, Frances, you're going to be the one doing it-- is neither here nor there from my point of view.

HANNO KAISER: I just want to say a word to the Noerr issue, because I find this really interesting. First of all, Noerr is a defense to a particular antitrust conduct. It's not an immunity. So in other words, it protects a defendant from liability, but not from suits. So stating it as an immunity goes very far.

But more importantly, I think the case law is very clear that a defendant cannot create a defense to an anticompetitive scheme simply by inoculating it or bookending it, if you will, with a Noerr-immunizable conduct. Noerr-immunizable, I said it. Kind of like Noerr-defensible conduct.

[LAUGHTER]

HANNO KAISER: With the Noerr-defensible conduct, if you look at that conduct in isolation. And, so that's why I think these hypotheticals are really well chosen, because we're not just looking at an individual company asserting a patent in court. Obviously if that's all there is to it, even if that company is monopolist, that would be Noerr-Pennington protected. That here, the lawsuit bookends, if you will, a certain type of conduct that began at an earlier stage, and I don't think that Noerr goes that far.

ANDY GAVIL: All right. We're going to move on to our final-- I can't actually see if it-- yeah, C. Great. Scenario C is a PAE buys patents from an operating company. The PAE can monetize the patents to a significantly greater extent than the operating company because the PAE does not have the same reputational constraints or need for cross licenses as the seller. Any antitrust issues? Logan, we'll start with you again.

Microsoft case, that essentially say patent acquisitions are not immune from the antitrust laws. These are not very helpful. They're somewhere in the middle here.

So I think what really matters here is, one, as Logan said, what is the relevant market here? And the other thing, what's the quality of the patents accumulated here? If we're looking at, let's say, the substitute patents, there are four technologies out there-- well, three technologies out in the market-- all alternatives for operating companies. And then, somebody aggregates all of them together. So then, I think, we're looking at a somewhat normal, horizontal merger analysis.

But what kind of thicket it is that if you're just accumulating competing technologies? I think in

of acquiring substitutes. Very hard to get your arms around given the opacity of this market. Or in my original hypothetical, maybe because it affects the downstream markets so significantly in a product market to have the changed incentive.

The last thing here for the pure play example Hanno talked about is intriguing. Carl said earlier today he wasn't very creative, and he confirmed that, I think, a few minutes ago--

[LAUGHTER]

MARK POPOFSKY: --where he said if you have non-substitute patents and you aggregate them, I can't think of an antitrust theory. And I think the ultimate defense to the theory I was spinning out earlier, which is if there is, to borrow a random quote of someone in this room, safety in numbers, that the very big portfolios create an incentive to the IBM style enforcement that you just can't beat.

The counter to that is what Carl said earlier. These are likely Corno complements, that if we're concerned there's an anticompetitive effect of shielding weak patents, we have to weigh against that the benefits of creating a pool. And I suggest that if we were to explore this theory, one would try to find the right industry where one thinks, based on the research that is done, the Corno compliment effects are weaker. Maybe we've

I do not think, in fact, that patents are quite that probabilistic, to use that word that Carl has helped make famous. Litigation is not quite that random, but there's something to that illustration.

However, I do not see that antitrust has anything to do with the illustration. I don't think there's a hook there of just worrying about numerosity of patents. I think you have to find some plus. Being able to evade a FRAND obligation, so that as Logan mentioned, you could pop into

Have you thought about thinking about the operating company as being a licensor, having a business in licensing intellectual property? And the PAE has a business in licensing intellectual property, and they compete with each other in the market for licensing intellectual property? Would that affect your answer?

CARL SHAPIRO: Yes.

[LAUGHTER]

MARK POPOFSKY: We'd agree on that.

ANDY GAVIL: I see a hand, one here.

JERROLD: Thank you. Jerrold A couple of things. In scenarios A and B particularly, I'm reminded of why oh, it's not working.

[LAUGHTER]

JERROLD: I have this effect on everything electronic. I'm reminded of why I liked hypotheticals so much in law school, because you Just to talk about different things. But in A and B particularly, the biggest complaint people seem to have earlier was that the effect of this type of enforcement, of PAE enforcement-- sorry about that.

[LAUGHTER]

JERROLD: This better be really good, huh? The effect of PAEW enforcement was to take questionable patents and suggest that at the end of the day, by the time you bundle things together, you're paying $100,000, $200,000 settlements for cases that really aren't worth very much. A question of the panel, really, is is the type of enforcements you're talking about from antitrust perspective, and certainly anticompetitive types of behavior, does that really move the needle? Are these types of things the types of things that the FTC and the DOJ should be concerning itself with?

The second issue really is, to me, you're talking about changing incentives and reputational constraints. And so, what you do is you, instead of suing company A yourself, you give the patents to a PAE and say, you go sue them. Well, in any circumstance like that, I would say, having litigated for some 40 years, the odds are pretty darn good that the company's going to figure out what you've done and sue you back anyway without regard to the fact that it was done through the PAE. So I just wonder if the hypothetical isn't just that and doesn't really reflect in any way what the real world is likely to be.

MARK POPOFSKY: A couple responses. One, I gave a non-hypothetical hypothetical that had nothing to do with the strength of the patents. It simply had to do with royalty commitments that were made. I think that shows how this can happen in the real world.

Second, I think the gentleman was quite right. I think the logic of you've got the enforcement agent who's not going to nuke it back is the other guy's going to get an enforcement agent if he can-- Maybe not always-- and nuke you back. And I think it's really an asymmetric situation that the agencies really should be looking for and that you might see in litigation. Some reactions.

ANDY GAVIL: One last question. The gentleman over here.

SPEAKER 1: Thank you. This is a question directed at Hill, I think at the end. Maybe this is just late in the day and I got off a red eye, but i was just wondering. I was a little taken aback at your last comment about the goal of the patent not bei

the PTO is engaged in important efforts to improve patent quality and increase the transparency surrounding changes in patent ow