



INTELLECTUAL PROPERTY COMMITTEE

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Special Edition – Commentary on the FTC's Recently Released Study on Patent Assertion Entities (PAEs)

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Theory versus Evidence: A Cautionary Tale for Interpreting the FTC’s 6(b) PAE Study

By Anne Layne-Farrar¹

The FTC’s long-awaited 6(b) study on Patent Assertion Entities (PAEs) provides an intriguing view into the business operations of litigation-oriented PAEs. Through the study, we learn where such PAEs obtain their patents (50% buy patents from individual inventors or from those inventors’ employers); the kinds of patents they acquire (88% fall into Computers & Communications or Other Electrical & Electronic technology categories and 75% include software-related claims); and how they assert those patents (the majority file patent infringement litigation and then settle quickly for payments averaging around \$300,000).

To fully understand the findings in the PAE report, however, we need to understand how the study was constructed. In particular, understanding who the FTC did and did not interview has crucial implications for both the study’s results and the FTC’s policy reform recommendations. In this brief note, I highlight some important elements of the FTC’s study methodology and the impact that methodology has on interpreting the PAE report.

Consider first how the FTC identified the PAE respondents to which it sent its queries. The Commission relied on data from RPX, a for-profit patent defense company that has created a database on NPE patents.² RPX acquires patents that NPEs assert in litigation and then offers licenses to those patents to its members. The proprietary RPX database is therefore litigation-oriented. As a result, the bulk of the FTC’s respondents identified through the RPX database – 18 of the total 22 PAEs included – are classified by the FTC as “Litigation PAEs.” The other 4 PAE respondents are what the FTC refers to as “Portfolio PAEs,” entities that assert their patents in infringement litigation far less often and who instead typically negotiate patent licenses without filing an infringement lawsuit. The nature of the RPX database means the FTC has far more respondents, and thus far more information, on PAEs with a litigation strategy as opposed to a licensing strategy. We do not know what proportion of the overall PAE universe (something no one has been able to define yet) is comprised of Litigation PAEs as compared to Portfolio PAEs. Nor do we know if other non-litigating PAE business models exist aside from Portfolio PAEs. As the FTC report acknowledges, the Commission found no evidence at all of patent assertion entities sending low-revenue demand letters to large numbers of end users without filing a patent infringement suit, along the lines of MPHJ Technology Investments, the firm that the FTC settled

¹ Dr. Anne Layne-Farrar is a Vice President in the Antitrust & Competition Economics Practice of Charles River Associates and an Adjunct Professor at Northwestern University School of Law.

² See <https://www.rpxcorp.com/>.

with over deceptive demand letter practices in 2015.³ Because the RPX data source focuses on litigation, it is unclear if firms like MPHJ are relatively rare or simply not included in the study.

Second, consider who the FTC did *not* include in its PAE study. In addition to the extremely limited coverage of PAEs not focused on litigation (only 4 of the 22 PAE respondents), the study includes no patent licensees and no patent infringement defendants. That is, the study examines the conduct of just one side of the patent transaction, be it litigation or licensing. While the FTC did ask for limited information on which firms the respondent PAEs were licensing and/or suing (the common answer being Computer and Electronics manufacturing firms for both Litigation and Portfolio PAEs), this is the extent of the information that the study provides on the recipients of PAE patent assertions. As a result, the report cannot offer any insight into how patent assertion recipients respond to PAE assertions, whether the potential costs imposed by Litigation PAE lawsuit tactics differ significantly from the costs imposed by other kinds of patent plaintiffs, nor whether trial discovery efforts imposed by PAE plaintiffs impose greater burdens on defendants than those imposed by non-PAE plaintiffs.

These two aspects of the FTC's methodology for the PAE 6(b) study – a bias toward PAEs who emphasize litigation over licensing and a one-sided view of that litigation – also have important implications for assessing the FTC's policy reform recommendations. In particular, the study posits that Litigation PAEs must be using nuisance litigation to extort settlements because Litigation PAEs sue first without attempting arm's length negotiations, settle quickly, and do so for roughly the cost of litigation discovery. On this basis, the FTC then recommends four policy reforms focused on the early stages of litigation: increasing pleading requirements, increasing reporting requirements for non-parties of interest, balancing asymmetric discovery burdens, and staying litigation against non-manufacturers when multiple suits are filed on the same patents. While one can certainly debate the merits of any of these four reforms – all of which have appeared in legislative proposals in recent years – the FTC study offers no evidence in support of any of them. The study does not delve into patent infringement pleading requirements or whether they are currently insufficient. The study does not investigate whether PAE lawsuit defendants are hampered in any way by not having full and complete information on all PAE parties of interest. The study does not assess whether discovery burdens are particularly asymmetric for PAE lawsuit defendants as compared to defendants in other NPE or non-NPE litigations, nor does it explain why such asymmetries would need to be corrected by legislation when unaddressed asymmetries of other sorts are common in litigation in general. Finally, the study does not examine whether judges are failing to exercise their current capacity to stay cases appropriately when multiple suits are filed on the same patents against multiple defendants, particularly in protection of end consumers.

In summary, the FTC presents novel findings on PAEs that focus on litigation, expanding our knowledge of this particular form of PAE. But it does not do more than this. Importantly, the study did not explore litigation practices and costs, and as such, the patent policy reforms presented by the study are not supported by its results. Finally, the proposals that are made do

³ Press Release, Federal Trade Commission, *FTC Approves Final Order Barring Patent Assertion Entity From Using Deceptive Tactics* (March 17, 2016), <https://www.ftc.gov/news-events/press-releases/2015/03/ftc-approves-final-order-barring-patent-assertion-entity-using>.

not target the Litigation PAEs that are the focus of the study, but instead would apply to patent litigation generally. As such, the study's recommendations are likely to have undesired, unintended consequences.