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United States Federal Trade Commission  
Office of the Secretary  
600 Pennsylvania Avenue NW, Suite CC-5510  
Washington, DC 20580

*Re: Competition and Consumer Protection in the 21st Century Hearings, Project Number P181201*

## **Issue 8: The role of intellectual property and competition policy in promoting innovation**

### **I. Introduction**

These comments are submitted in response to the U.S. Federal Trade Commission (FTC)'s announcement on the hearings on competition and consumer protection in the 21st Century. The Computer & Communications Industry Association (CCIA)<sup>1</sup> commends the FTC's study of the legal and policy challenges and opportunities that arise with the digitalization of the economy, and welcomes the opportunity to provide views on the issues identified by the Commission. As part of the upcoming hearings, we urge the Commission to continue its study and analysis of the topics identified here.

To ensure that tech-related innovation continues to drive the economy, sound competition policy and antitrust enforcement both must play a crucial role in ensuring that competition exists across markets. As discussed *infra*, balanced intellectual property policy also plays an important role in encouraging competition and innovation.

Intellectual property (IP) can play both positive and negative roles in competition policy. IP protects substantial investments in R&D, but the misuse of IP rights and the proliferation of unclear and unwarranted rights can undermine the ability to innovate and bring new goods and services to the public. Nowhere is this more apparent than in the information and communications technology industry at large. To manage this tension, IP law seeks to strike a balance between underprotection and overprotection. According to the Supreme Court, this exercise is embodied in the Constitution's IP Clause itself, which "reflects a balance between the

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<sup>1</sup> CCIA represents large, medium and small companies in the high technology products and services sectors, including computer hardware and software, electronic commerce, telecommunications and Internet products and services. Our members employ more than 750,000 workers and generate annual revenues in excess of \$540 billion. A list of CCIA members is available at <https://www.ccia.net/org/members>.



need to encourage innovation and the avoidance of monopolies which stifle competition without any concomitant advance in the ‘Progress of Science and useful Arts.’”<sup>2</sup>

As was evident in the FTC’s 2003 report, *To Promote Innovation: The Proper Balance of Competition and Patent Law and Policy*,<sup>3</sup> IP protection can impede both innovation and competition when interpreted too broadly. This phenomenon is apparent in the FTC’s subsequent research, including its 2011 report on *The Evolving IP Marketplace*<sup>4</sup> and its recent 2016 study, *Patent Assertion Entity Activity*.<sup>5</sup> As the continued relevance of these studies shows, the Commission’s study of the intersection of intellectual property and competition has been a valuable activity for courts and policymakers. Additional studies in this area would continue to provide important resources in understanding how intellectual property can both support and undermine competition.

## **II. Competition advocacy regarding the development of intellectual property law**

### **A. Novel business practices in obtaining and enforcing patent rights**

One example of novel business practices used in the enforcement of intellectual property rights that may give rise to antitrust concerns is the practice of “privateering.” In privateering, an operating company transfers patents to a patent assertion entity (PAE), typically in a deal structured such that the PAE is incentivized to target the operating company’s rivals. The operating company may benefit indirectly by raising rivals’ costs<sup>6</sup> or directly by structuring the privateering deal to include a provision returning a portion of litigation and licensing revenue to the operating company. The use of privateering arrangements can therefore raise antitrust concerns, particularly if there is a lack of transparency as to the terms of the relationship between the privateer and the original patent owner.

A similar concern to privateering is the policy concern surrounding the trend of patent owners transferring portions of their portfolios to multiple PAEs with a revenue return to the original

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<sup>2</sup> *Bonito Boats Inc. v. Thunder Craft Boats Inc.*, 489 U.S. 141, 148 (1989) (quoting U.S. Const. art. I, § 8, cl. 8).

<sup>3</sup> Available at <http://www.ftc.gov/os/2003/10/innovationrpt.pdf>.

<sup>4</sup> *The Evolving IP Marketplace: Aligning Patent Notice and Remedies with Competition* (2011), <https://www.ftc.gov/sites/default/files/documents/reports/evolving-ip-marketplace-aligning-patent-notice-and-remedies-competition-report-federal-trade/110307patentreport.pdf>.

<sup>5</sup> *Patent Assertion Entity Activity: An FTC Study* (Oct. 2016), [https://www.ftc.gov/system/files/documents/reports/patent-assertion-entity-activity-ftc-study/p131203\\_patent\\_assertion\\_entity\\_activity\\_an\\_ftc\\_study\\_0.pdf](https://www.ftc.gov/system/files/documents/reports/patent-assertion-entity-activity-ftc-study/p131203_patent_assertion_entity_activity_an_ftc_study_0.pdf).

<sup>6</sup> See Edith Ramirez, *Opening Remarks at ‘Competition Law & Patent Assertion Entities: What Antitrust Enforcers Can Do’*, at 6 (June 20, 2013), [https://www.ftc.gov/sites/default/files/documents/public\\_statements/competition-law-patent-assertion-entities-what-antitrust-enforcers-can-do/130620paespeech.pdf](https://www.ftc.gov/sites/default/files/documents/public_statements/competition-law-patent-assertion-entities-what-antitrust-enforcers-can-do/130620paespeech.pdf).



owner. This allows the patent owner to generate multiple revenue streams, rather than a single stream, which can be particularly useful in contexts such as standard-essential patents, where large portfolio licenses are common. This strategy is particularly attractive because the current state of law for calculating portfolio royalties creates a real possibility that multiple smaller portfolios will generate a higher aggregate royalty than a single large portfolio, even though the total royalty should theoretically be identical. This practice can exacerbate “royalty stacking” concerns,<sup>7</sup> increasing the royalty burden on manufacturers and ultimately raising the prices paid by consumers, even though there is no additional value provided. The Commission’s efforts to study this problem and provide guidance on the principles that should be used in valuing patent portfolio licenses could help to mitigate the risk of consumer harm from this practice.

Another example of novel business practices is the increasing usage of litigation finance arrangements, where a third party provides funding for a lawsuit in exchange for a portion of any financial recovery.<sup>8</sup> While much of litigation finance is currently conducted by traditional financial firms, the field is growing rapidly.<sup>9</sup> Similar to privateering arrangements, an operating company could provide litigation finance to patent owners conditioned on the patent owner targeting a rival as part of their assertion campaign. Such conduct could also raise potential antitrust concerns.

## **B. Novel business practices in obtaining and enforcing copyrights and trademarks**

Other novel practices have appeared outside the patent context. Building upon the Commission’s extensive prior work on patent licensing and patent assertion entities noted above, the Commission should consider the extent to which risk and information asymmetries drive other IP licensing activities. Lack of clear rights information can create competitive distortion in areas of IP beyond the field of patent licensing. The Department of Justice’s 2014 review of performing rights organizations’ (PROs) antitrust consent decrees illustrates that when any IP licensor benefits from a lack of transparency regarding rights boundaries they may take advantage of uncertain boundaries to extract supra-competitive royalties, relative to what would be negotiated in a fully transparent marketplace.<sup>10</sup>

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<sup>7</sup> See Armstrong et al., *The Smartphone Royalty Stack: Surveying Royalty Demands for the Components Within Modern Smartphones*, [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2443848](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2443848).

<sup>8</sup> LexShares, *Litigation Finance 101*, <https://www.lexshares.com/litigation-finance-101>.

<sup>9</sup> David Lat, *Litigation Finance: Its Past, Present, And (Very Bright) Future*, ABOVE THE LAW (June 1, 2018), <https://abovethelaw.com/2018/06/litigation-finance-its-past-present-and-very-bright-future/>.

<sup>10</sup> Statement of Dep’t of Justice on Closing Review of ASCAP and BMI Consent Decrees, Aug. 4, 2016, <https://www.justice.gov/atr/file/882101/download>.



As the Commission’s previous work has illustrated, patent trolls can use risk and information asymmetries offensively to extract unjustified settlements, in part because penalties for even inadvertent infringement can be extraordinarily high.

Litigation costs, switching costs, and the risk of potential liability lead to litigation settlements that far exceed the value of actual rights. Such outcomes impose a *de facto* tax on productive economic activity and a disincentive for future commercial activity, while providing no offsetting consumer benefit.

This problem is not specific to patent licensing, however. Litigation “trolls”, or assertion entities, can be found in the trademark and copyright context as well, at times in considerable numbers.<sup>11</sup> While the breadth of Title 17 entitlements means that copyright assertion entities may be less likely to exercise market power in any relevant way, such practices can certainly implicate FTC Act Section 5.

Similarly, complex copyright licensing also reflects frictions that are consistent with those observed around patent licensing.<sup>12</sup> In the music context, particularly in order to operate an online service, it can be unclear which permissions are needed, and from whom. Transparency in who controls what rights may alleviate this problem, but some licensors have sought to “weaponize” this information asymmetry.<sup>13</sup> When a potential licensee knows precisely how many gatekeepers they must come to terms with, licensing negotiations occur more easily, more efficiently, and more fairly.

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<sup>11</sup> Witness Statement of Matthew Schruers, Hearing on Copyright Remedies, Judiciary Cmte. Subcmte. on Courts, Intellectual Property and the Internet, July 24, 2014, at 3-4, <https://judiciary.house.gov/wp-content/uploads/2016/02/Schruers-CCIA-Remedies-Testimony.pdf>.

<sup>12</sup> David Balto & Matthew Lane, *The Music Industry As a Case Study for Enabling Disruptive Innovation in Consolidated Markets* (Disruptive Competition Project, Apr. 2015), <https://www.project-disco.org/wp-content/uploads/2015/04/The-Music-Industry-as-a-Case-Study-for-Enabling-Disruptive-Innovation-in-Consolidated-Markets.pdf>.

<sup>13</sup> *In re Pandora Media, Inc.*, 6 F. Supp. 3d 317, 357 (S.D.N.Y. 2014), *aff’d sub. nom. Pandora Media, Inc. v. ASCAP*, 785 F.3d 73 (2d. Cir. 2015). See generally Michael Carrier, *Innovation for the 21st Century: Harnessing the Power of Intellectual Property and Antitrust Law* (Oxford University Press, 2009), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1368931](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1368931); Michael Carrier, *Copyright and Innovation: The Untold Story*, 2012 WIS. L. REV. 891, [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2099876](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2099876) (describing how ‘Innovator’s Dilemma’ problems incentivize existing industry stakeholders to resist sectoral changes that might advantage new entrants).



**C. Contemporary standard-essential patent doctrine substantially affects innovation and raises challenges for competition policy**

Industry-developed consensus standards are critical to many aspects of modern technology, ranging from medicine to home goods to computing and telecommunications. In particular, standards are key components of established markets such as networking, cellular communications, and computing, as well as emerging markets like 5G, and these markets are heavily and increasingly reliant on standards. Within these markets, standards enable the creation of interoperable devices and software that can improve efficiencies in processes, products, and services across every sector of the U.S. economy. Standards stimulate competition and generate considerable consumer welfare. The standards development process provides a process for determining what technology will be incorporated into the standard.

However, the incorporation of a patented technology into a standard is not in and of itself an endorsement of the value of that technology. As explained by the Federal Circuit:

When a technology is incorporated into a standard, it is typically chosen from among different options. Once incorporated and widely adopted, that technology is not always used because it is the best or the only option; it is used because its use is necessary to comply with the standard. *In other words, widespread adoption of standard essential technology is not entirely indicative of the added usefulness of an innovation over the prior art.*<sup>14</sup>

Even though a standard essential technology may not be of any particular value over other alternatives, once that technology is included in a standard, any implementer of the standard can be required to take a license to the patent, even if they might prefer to use an alternative unpatented technology of equal technical merit. Without some way to prevent a patent owner from holding up, holders of standard-essential patents would be able to extract the entire value of a product incorporating the standard, not just the value contributed by the patent, even if the patent contributed no value over alternative approaches.

Just as SEP licensors deserve a fair return based on the value of the patented innovations they contribute, innovators that create products consumers value incorporating those standards deserve to enjoy the fruits of their own innovation. Productive companies must not be compelled to divest value they have themselves created by paying supra-competitive SEP licensing royalties. In order to ensure that the benefits of standardization do not unfairly accrue to patent holders, standards development organizations (SDOs) typically select some form of intellectual

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<sup>14</sup> *Ericsson, Inc. v. D-Link Systems, Inc.*, 773 F.3d 1201, 1233 (Fed. Cir. 2014) (emphasis added).



property policy.<sup>15</sup> For example, some SDOs adopt a Fair, Reasonable, And Non-Discriminatory (FRAND) that requires companies to agree to license their patents on a FRAND basis if they wish to incorporate their technology into the standard. Other SDOs decide to utilize a royalty-free approach or some other alternative. Companies may then voluntarily choose whether or not to comply with the IP policy and have their technology incorporated into the standard. IP owners who choose to agree to the IP policy and contribute their technology to the standard forgo the ability to choose whether or not to license their patents. In exchange, the IP owner ensures that those who create a product implementing the standard are required to license their patents.

Absent this type of IP policy, there is a risk of holdup, in which a patent owner extracts a supra-competitive rent from the implementer of a standard. The implementer must implement the patent in order to be compatible with the standard<sup>16</sup>; if the patent owner can choose whether or not to license the patent, they effectively obtain the ability to enjoin an implementer from creating a compatible product unless the implementer pays. The market power created by the incorporation of a technology into a standard thus allows the patent owner to extract a supra-competitive royalty that exceeds the technical value contributed by the patent. It also enables patent owners to raise the costs of competitors by refusing to license them directly and instead licensing their competitors' customers at unfavorable rates compared to their own customers.

These competition concerns are well-known and have been addressed at length by the Commission in the past, including in the 2007 *Antitrust Enforcement and Intellectual Property Rights: Promoting Innovation and Competition* report, the 2011 *Evolving IP Marketplace* report, and in Commissioner McSweeney's remarks earlier this year.<sup>17</sup> The determinations reached by the Commission over the past decade remain valid. The Commission has consistently enforced antitrust policy in the area of standard-essential patents (SEPs) on the basis of decades of development of the law and economics.

While the primary policy applied to antitrust enforcement in the standard setting process has been proven to be a desirable policy by the widespread success of standardized products both for

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<sup>15</sup> See *Apple Inc. v. Motorola Mobility, Inc.*, 886 F. Supp. 2d 1061, 1067 (W.D. Wis. 2012) (noting that FRAND rules “ensure that standards do not allow the owners of essential patents to abuse their market power to extort competitors or prevent them from entering the marketplace.”).

<sup>16</sup> See A. Douglas Melamed & Carl Shapiro, *How Antitrust Law Can Make FRAND Commitments More Effective* (forthcoming, Yale L. J.), available at <https://faculty.haas.berkeley.edu/shapiro/frandcommitment.pdf>.

<sup>17</sup> See Comm’r Terrell McSweeney, *Holding the Line on Patent Holdup: Why Antitrust Enforcement Matters* (Mar. 21, 2018), [https://www.ftc.gov/system/files/documents/public\\_statements/1350033/mcsweeney\\_-\\_the\\_reality\\_of\\_patent\\_hold-up\\_3-21-18.pdf](https://www.ftc.gov/system/files/documents/public_statements/1350033/mcsweeney_-_the_reality_of_patent_hold-up_3-21-18.pdf).



implementers and intellectual property holders<sup>18</sup> and does not require change, there are additional concerns that might be valuable for the Commission to address. In particular, while the holdup problem is typically framed in the context of a SEP holder extracting an additional monetary reward from the implementer of a standard, alternative holdup concerns exist.

One example is in the field of cellular communications. A smartphone contains significant standardized technology; it also implements significant technology that is not subject to a standard. A SEP holder may, in addition to a SEP portfolio, hold a non-SEP portfolio. Instead of raising the price of their SEPs, a SEP holder might also engage in “hold out” by refusing to license their SEPs separately from their non-SEPs, regardless of whether the licensee actually implements the non-SEP technology. By doing so, the SEP holder licenses their SEPs at the FRAND price, but still extracts a supra-competitive rent by forcing the licensee to take a license to patents they might choose not to implement.

A similar problem arises in the context of SEP portfolio licenses where the licensor refuses to license patents on an individual basis. A licensee, having reviewed a SEP holder’s portfolio, may identify a set of patents that they believe are not actually essential to the standard. However, the licensor may require the licensee to license these non-essential patents as part of a portfolio license.

Finally, a problem arises when a SEP holder which is also an implementer chooses the market segment with which they wish to negotiate. A SEP holder may be obligated to license on FRAND terms, but may choose to license only to entities who operate at a different level of the supply chain from the level at which they sell products. One example would be a baseband chip manufacturer choosing to license their patents to smartphone makers, but refusing to license the patents to competing baseband chip manufacturers.

Each of these situations represents a new challenge for competition policy which has not yet been addressed, and one in which contemporary patent doctrine and antitrust doctrine can have a significant impact on innovation while avoiding the creation of significant consumer harms. The Commission’s attention would help provide guidance to courts and policymakers in addressing the impacts on innovation and competition raised by these new issues.

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<sup>18</sup> See, e.g., IPLytics, *Empirical study on patenting and standardization activities at IEEE* (Mar. 2017), at 1 (finding that after IEEE adopted a new IP policy, standardization work at IEEE has proceeded at its highest levels ever).



#### **IV. Conclusion**

In conclusion, a balanced intellectual property regime, in the copyright and patent spaces, remains crucial to innovation and competition. The Commission's involvement in investigating issues like those addressed above would be valuable in ensuring that the intellectual property regimes remain appropriately balanced.