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Pulling Back the Curtain: The Federal Trade Commission's Study on Patent Assertion Entities

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On October 6th, 2016, the Federal Trade Commission (FTC) released a greatly anticipated study, the subject focusing on various Patent Assertion Entities' (PAE) business operations over a six year period. For purposes of the study, the FTC defined PAEs as business entities that "acquire patents from third parties and seek to generate revenue by asserting them against alleged infringers." *Patent Assertion Entity Activity, An FTC Study*, Federal Trade Commission, at 1 (Oct. 6, 2016).

The FTC, authorized by the Federal Trade Commission Act, collected confidential business information and conducted industry studies over the period January 2006 to September 2014. *Id*. at 3. The FTC sought to obtain "a deeper understanding of PAE business models" by considering behavior that was not publicly observable, including how the entities structured themselves and their confidential acquisition and licensing terms. *Id*. at 2. The FTC categorized each PAE it studied ("Study PAE") as one of two business models: (1) portfolio PAEs or (2) litigation PAEs. *Id*. at 2. The FTC defined "portfolio PAEs" as those that sought to negotiate licenses to substantial portfolios of patents prior to filing suit. *Id*. at 46. Litigation PAEs were defined as those entities that entered negotiations almost always after filing suit, settling shortly afterward, typically with a lump-sum payment. *Id*. at 47. Most of the cases documented were filed in either the Eastern District of Texas or the District of Delaware. *Id*. at 80.

The study found portfolio PAEs to make up only 9% of the reported licenses, but 80% of the reported revenue, totaling $3.2 billion over the period of the study. *Id*. at 42. Litigation PAEs accounted for 91% of the reported licenses, but only 20% of the reported revenue. *Id*. at 43. This revenue totaled $800 million over the study period. *Id*. The FTC commented that the apparent difference in the royalty payment ratio to reported licenses shows litigation PAEs partaking in behavior likened to "nuisance litigation." *Id*. A large amount of the litigation PAE agreements resulted in less than $300,000 in royalties, which was the lower end of the average early-stage costs of litigation. *Id*. In other words, the litigation costs were equivalent to the royalty payments received as a result of filing the lawsuit in most litigation PAE cases. *Id*. While the FTC recognized the important role of litigation in protecting patent rights, it noted that nuisance infringement litigation "can tax judicial resources and divert attention away from productive business behavior." *Id.* at 9.

Recommendations for Reform

The FTC concluded the study with various recommendations for patent law reform. The recommendations focused on striking a balance between promoting a robust judicial system that respects the patent laws on one hand and promoting productive business behavior and judicial efficiency on the other. *Id.*

First, the FTC proposed reforms which address discovery burdens and cost asymmetries in PAE litigation. ”Because they do not invent, develop, or manufacture products incorporating their patented technology,” PAEs have less discoverable information and can subject a defendant to exhaustive discovery requests. Legislative reform could address case management practices that take costs and asymmetries into account. The FTC proposed that this would be accomplished by amending Rule 26 of the Federal Rules of Civil Procedure (FRCP), to focus on early disclosure of asserted claims, and contentions regarding infringement and invalidity, limit discovery before preliminary motions, and require early disclosure of damages theories. *Id*. at 9-10.

Second, the FTC suggested providing courts and defendants with more information about plaintiffs that have filed infringement lawsuits. The FTC argued this would be accomplished by amending FRCP Rule 7.1 to include a broader range of non-party groups that may be interested in the litigation. By including a broader range of non-party groups, courts and defendants would become aware of all the sub-entities derived from the parent PAEs. *Id*. at 11.

Third, the FTC proposed streamlining multiple cases brought against defendants on the same theories of infringement. For example, most PAEs covered in the study brought infringement suits against both the manufacturer and the customer and/or retailer on the same theories. The FTC suggested that enactment of provisions that would result in combining those cases into one would encourage district courts to stay actions against end-users until the manufacturer suit has been resolved. *Id*. at 12.

Lastly, the FTC recommended providing notice of infringement theories surrounding PAE litigations to the courts as they continue to develop heightened pleading requirements for patent cases. *Id*. at 12-13.

While it is uncertain whether the FTC study will lead to the reforms proposed in the study, the FTC has provided an in depth and unprecedented look at the structure and licensing behavior of PAEs.

You can find the entire report here: “Patent Assertion Entity Activity: An FTC Study”.

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If you have any questions or wish to discuss how this decision impacts your business, please contact one of our Brinks Attorneys.