Patent Trolls: Broad Brush Definitions and Law Enforcement Ideas

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Before the Newport Summit on Antitrust and Economics
Newport, RI
May 31, 2008

I. Introduction

The nominal topic for discussion in our panel this morning is the Supreme Court's decision in *eBay, Inc. v. MercExchange L.L.C.*[2] In that case, the Court held that permanent injunctions should be issued against patent infringers only when the traditional four-part test historically applied by courts of equity is satisfied; otherwise, the plaintiff is entitled only to recover its damages resulting from the infringement. Put differently, in order to obtain a permanent injunction, the plaintiff must show that (1) irreparable injury has been suffered, (2) remedies at law are inadequate to compensate that injury, (3) the injunction is warranted in light of the balance of hardships between the plaintiff and the defendant, and (4) the public interest would not be disserved by a permanent injunction. Although the majority opinion does not come right out and say it, the sub-text is that the public interest is disserved if and to the extent that patent "trolls" can obtain injunctive relief. In the concurring opinion to which Justices Kennedy, Stevens, Breyer and Souter subscribed, this concern is more than sub-text. The opinion articulates the concern, embracing the Commission's Intellectual Property Report[3] and the

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[1] The views stated here are my own and do not necessarily reflect the views of the Commission or other Commissioners. I am grateful to my attorney advisor, Holly Vedova, for her invaluable assistance in preparing these remarks.

[2] 126 S.Ct. 1837 (2006).

[3] Federal Trade Commission, To Promote Innovation: The Proper Balance of Competition and Intellectual Property Law and Policy (Oct. 2003)("IP Report"), *at*

government's Amicus Brief.[4] The IP Report and Brief warned that in certain situations, injunctions can be employed as a bargaining tool to charge exorbitant fees to companies that seek to buy licenses to practice the patent. For example, when the patented invention is a small component of the product produced, and the threat of an injunction is employed simply for undue leverage in negotiations, legal damages are often sufficient to compensate for the infringement and an injunction would not serve the public interest. My remarks will focus on this concern, and how else it might be addressed.[5]

II. Defining "Troll"

The threshold issue is what is meant when we refer to a person or firm (I'll just use the word firm) as a patent "troll." At one extreme – and this occurs in the context of standard setting – is a firm that obtains a patent from a patentee who made reasonable and non-discriminatory (RAND) licensing commitments or other monetary forbearance commitments to get its patent implemented in the standard; who itself produces no product or service utilizing the patent (sometimes these entities are referred to as "non-practicing entitites" or NPEs); but who instead lies in wait for some other firm (or firms) to do so and become "locked in" to the industry standard covered by the patent; and who then sues that "locked in" firm for infringement, shrugging off the commitments that its predecessor made. This is the type of conduct that the

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http://www.ftc.gov/opa/2003/10/ipreport.htm.

[4] Brief for the United States as *Amicus Curiae* Supporting Respondent, eBay Inc. v. MercExchange, L.L.C., No. 05-130 (S.Ct.), 2006 WL 622120 (Mar. 10, 2006)("Brief").

[5] Some of my remarks here are similar to those I gave last year before Law Seminars International. *See* Remarks of J. Thomas Rosch, FTC Litigation at the Antitrust/Intellectual Property Interface, Law Seminars International, Pharmaceutical Antitrust, Washington, D.C., April 26, 2007, *available at* <http://www.ftc.gov/speeches/rosch/070426si_pharma.pdf>.

FTC addressed in its *Negotiated Data Solutions LLC* settlement. At the other extreme is a firm that obtains a patent on a product or service (or a component of the same) that it makes, uses or sells. There are no antitrust issues with this type of conduct in and of itself; it is perfectly legal and efficient and what the patent laws are designed to encourage. In between is a situation involving a firm that obtains all of the patents required to make, use or sell a product that it itself makes uses or sells, and thereafter refuses to license those patents to any other potential entrant into the product (or service) market. A fourth scenario is where a firm with a patent right which, like the first firm, does not itself make, use or sell any product or service but instead lies in wait until some other firm (or firms) does so and becomes locked into the technological process covered by the patent, and then sues that firm for infringement, but, unlike the patent in the first hypothetical, in this case the patents do not cover any standard or at least the firm's predecessor made no monetary commitment if there is a relevant standard.

I think we can all agree that the firm in the second hypothetical is not a "troll." Indeed, to treat it as such would chill patent licensing for no good reason--it would inhibit inventors from being rewarded by licensing their inventions and thereby stifle innovation. However, that cannot be said of the other three firms. In each case, their conduct can impose unwarranted barriers to entry into the product market – in the first instance by exploiting locked-in producers who are practicing a standard in reliance on a RAND commitment; in the third instance by erecting a "patent wall" that would-be rivals in the product market cannot penetrate; and in the fourth instance, by extracting more than the patent is really worth from producers who can't afford to stop producing the product or service. This is sometimes referred to as patent "hold up."

III. Enforcement Tools

The next question is whether the law enforcement tools are at hand to deal with these kinds of alleged "trolls." I would suggest that they are.

A. Patent Hold Up in the Standard Setting Context

In the first scenario outlined above, I suggest that Section 5 of the FTC Act is such a tool. A good example of the use of Section 5 against this type of conduct is the FTC's enforcement action earlier this year against N-Data.[6] There, the Commission issued a complaint and entered into a settlement agreement with N-Data respecting its enforcement of certain patents against makers of equipment employing the Ethernet, a computer networking standard used in nearly every computer sold in the U.S. The patents involved were originally held by National Semiconductor Corporation (National). In 1994 National made a commitment to an electronics industry standard setting organization, the IEEE, that if the IEEE adopted a standard based on National's patented NWay technology, National would offer to license the technology, for a one-time, paid-up royalty of $1,000 per licensee, to manufacturers and sellers of products that use the IEEE standard. N-Data obtained Nationals patents with full knowledge of National's prior licensing commitment.

After the industry became committed to the standard, N-Data refused to comply with that commitment and instead demanded royalties far in excess of the commitment. The Commission's complaint alleged that because N-Data waited until after the industry was locked into the standard, it was then able to demand royalties higher than the industry otherwise would have paid for the technologies. The Commission's complaint also alleged that consumers would be harmed because N-Data's conduct, if allowed to stand, would make firms less likely to assist

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[6] In the Matter of Negotiated Data Solutions LLC, FTC File No. 051 0094 (Consent Accepted For Public Comment, January 23, 2008), *available at* http://www.ftc.gov/opa/2008/01/ethernet.shtm ("N-Data").

in the development of industry standards, and that many firms would be unwilling to rely on such standards even if they were developed. The complaint also alleged that consumers would be forced to pay higher prices because of N-Data's conduct.

Notably, the Commission did not allege a violation of Section 2 of the Sherman Act. N-Data's conduct was arguably not actionable under Section 2 because there was arguably no "exclusionary" conduct by N-Data: N-Data itself did not make the one time $1,000 licensing commitment, rather, it reneged on National's commitment. Rather, the Commission relied solely on Section 5 of the FTC Act, alleging that N-Data's conduct was both an unfair method of competition and an unfair act or practice.[7] The Commission's Analysis of Proposed Consent Order To Aid Public Comment (Aid To Public Comment) stated that:

> "Even if N-Data's actions did not constitute a violation of the Sherman Act, they threatened to raise prices for an entire industry and to subvert the IEEE decisional process in a manner that could cast doubt on the viability of developing standards at the IEEE and elsewhere. The threatened or actual effects of N-Data's conduct have been to increase the cost of practicing the IEEE standards, and potentially to reduce output of products incorporating the standards."[8]

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[7] *See* Remarks of J. Thomas Rosch before the National Economic Research Associates 2006 Antitrust & Trade Regulation Seminar, Sante Fe, New Mexico, July 6, 2006, "Perspectives on Three Recent Votes: the Closing of the Adelphia Communications Investigation, the Issuance of the Valassis Complaint, & the Weyerhaeuser Amicus Brief," at 8, 11, *available at* <http://www.ftc.gov/speeches/rosch/rosch-nera-speech-july6-2006.pdf> (arguing that Section 5 unfair methods of competition claims may not be appropriate when there is a viable Section 2 claim, *citing* Boise Cascade v. FTC, 637 F.2d 573 (9th Cir. 1980)).

[8] In the Matter of *Negotiated Data Solutions LLC,* FTC File No. 051 0094, Analysis of Proposed Consent Order to Aid Public Comment at 4, a*vailable at* <http://www.ftc.gov/os/caselist/0510094/080122analysis.pdf> ("Aid to Public Comment").

The Commission cited *FTC v. Sperry & Hutchinson Co.*,[9] where the Supreme Court endorsed an expansive reading of the "unfair method of competition" prong of Section 5, stating that the Commission is empowered to "define and proscribe an unfair competitive practice, even though the practice does not infringe either the letter or spirit or the antitrust laws" and to "proscribe practices as unfair . . . in their effect on competition."[10]

The Commission said that N-Data's conduct was particularly appropriate for review as an unfair method of competition under Section 5 because:

> "IEEE's determination to include National's technology in its standard rested on National's commitment to limit royalties to $1,000. That commitment had substantial competitive significance because it extended not to a single firm, but rather to an industry-wide standard-setting organization. Indeed, in the standard-setting context with numerous, injured third parties who lack privity with patentees and with the mixed incentives generated when members may be positioned to pass on royalties that raise costs market-wide contract remedies may prove ineffective, and Section 5 intervention may serve an unusually important role."[11]

The Commission emphasized that it was the standard setting context that was crucial to its finding of an unfair method of competition, and that a mere departure from a previous licensing

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[9] 405 U.S. 233 (1972).

[10] *Sperry & Hutchinson*, 405 U.S. at 239.

[11] Statement of the Federal Trade Commission, In the Matter of Negotiated Data Solutions LLC, FTC File no. 051 0094 at 5-6, *available at* <http://www.ftc.gov/os/caselist/0510094/080122statement.pdf>.

commitment is unlikely to constitute an unfair method of competition.[12] Standard setting displaces the normal give and take of competition, thus any subversion of that process can have extremely detrimental effects on competition.

The Commission also analyzed N-Data's conduct as an unfair act or practice under Section 5. Unfairness claims under Section 5 must involve an "act or practice that causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers themselves and not outweighed by countervailing benefits to consumers or to competition."[13] The Commission found that N-Data's conduct met these criteria because National made non-expiring royalty commitments that N-Data later repudiated and then unilaterally increased it licensing fees (causing substantial consumer injury), which the industry could not have reasonably anticipated before the market wide adoption of the standard, and which consumers had no chance of avoiding due to network effects and lock-in.[14] As with the unfair method of competition analysis, the Commission stated that the standard-setting context in which National made its commitment was critical to the legal analysis. The Commission stated that merely breaching a prior commitment would not be enough to constitute an unfair act or practice under Section 5.[15]

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[12] *Id.* at 6.

[13] 15 U.S.C. § 45(n) (1992). The Eleventh Circuit in *Orkin Exterminating Co. v. FTC*, 849 F.2d 1354, 1364 (11th Cir. 1988) emphasized how the Commission has applied limiting principles under Section 5's unfair act or practice authority, requiring a showing that (1) the conduct caused "substantial consumer injury," (2) that injury is "not . . . outweighed by any countervailing benefits to consumers or competition that the practice produces," and (3) it is an injury that "consumers themselves could not reasonably have avoided."

[14] Aid to Public Comment at 8-9.

[15] *Id.* at 9.

Chairman Majoras and Commissioner Kovacic voted against issuance of the complaint against N-Data. In her dissenting statement, Chairman Majoras argued, other things, that the use of a Section 5 unfair act or practice claim against N-Data was unwarranted because of the ability of big firms to protect themselves with other legal defenses.[16] However, firms using those defenses are not necessarily interested in whether they serve the public interest the way the Commission does. Furthermore, that type of claim can be made about all government antitrust actions since there is a private remedial system permitting the recovery of treble damages and attorney's fees.

Commissioner (now Chairman) Kovacic criticized the Commission's use of Section 5 against N-Data because, among other things, of the risk that states' could import the Commission's theories of liability into their own unfair methods of competition or unfair acts or practices statutes, thus opening the floodgates to private parties to enforce the states' statutes in suits that permit the court to impose treble damages for infringements.[17] However, to date, the state law floodgates have not been opened against N-Data.

In short, *N-Data* illustrates the unique role for Section 5 when Section 2 is arguably not available in either public or private actions because there is a lack of "exclusionary conduct."

B. Creation of a "Patent Wall"

Now let me turn to what I described earlier in the third scenario as a "patent wall," where

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[16] Dissenting Statement of Chairman Majoras, In the Matter of Negotiated Data Solutions LLC, FTC File No. 051 0094 at 5, *available at* <http://www.ftc.gov/os/caselist/0510094/080122majoras.pdf>.

[17] Dissenting Statement of Commissioner William E. Kovacic, In the Matter of Negotiated Data Solutions LLC, FTC File No. 051 0094 at 2, *available at* <http://www.ftc.gov/os/caselist/0510094/080122kovacic.pdf>.

a firm independently develops and manufactures a product that competes in what constitutes a relevant market for antitrust purposes, and then files multiple patent applications covering certain features of the product and the patents issue. After competing products are brought to market, the firm acquires additional patents from third parties. It then uses those patents, and its prior existing patents, to threaten its present and potential competitors with litigation and "build a wall" around the market, eliminating competition and preventing entry. I would suggest that Section 7 of the Clayton Act and the Sherman Act are viable law enforcement tools in this scenario.

In fact, this is not a new scenario. In *United States v. Singer Manufacturing Co.*,[18] the Supreme Court held that, in the context of a broad monopolistic scheme, the transfer of a patent from a Swiss manufacturer to its U.S. licensee to facilitate bringing infringement actions against Japanese competitors violated Section 1. Similarly, in *Kobe, Inc. v. Dempsey Pump Co.*,[19] the Tenth Circuit found the acquisition, nonuse and enforcement of "every important patent" in the field with a purpose to exclude competition, together with other anticompetitive acts, constituted a violation of Section 2. And in *Xerox Corp.*,[20] the Commission entered into a consent decree with Xerox settling a Commission challenge to Xerox's acquisition of the Battelle patents on plain paper copiers allegedly with the purpose and effect of monopolizing the plain paper copier market.

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[18] 374 U.S. 174 (1994).

[19] 198 F.2d 416 (10th Cir. 1952).

[20] 86 F.T.C. 363 (1975).

These claims are not bullet-proof. In *SCM v. Xerox Corp.*,[21] the Second Circuit held that the same acquisitions at issue in the FTC case against Xerox did not violate either Section 7 or Section 2 because, inter alia, the acquisitions were made many years before there was a plain paper copier market. Thus, in a challenge to the creation of a patent wall it may be important from a legal standpoint to challenge acquisitions made only after the product market came into existence.

A policy concern also arises when antitrust claims are based on acquisitions of intellectual property alone. In this situation, the difference between procompetitive and anticompetitive effects may be a slippery slope. This is best illustrated in the Commission's investigation of Genzyme's 2001 acquisition of Novazyme, where in 2004 the Commission voted 3-1-1 to close the investigation (Chairman Muris, Commissioners Swindle and Leary voted in favor of closing, Commissioner Thompson dissented, and Commissioner Harbour voted NP, though she issued a separate statement expressing concerns about closing).[22]

At the time of the acquisition, Genzyme and Novazyme were the only firms developing a drug to treat Pompe disease, a rare, often fatal disease affecting infants and children, for which there is currently no effective treatment. Because of the limited number of Pompe patients, therapies for Pompe disease are covered by the Orphan Drug Act, whereby the first Pompe therapy to gain FDA approval receives 7 years of market exclusivity. A second therapy can break that exclusivity only be establishing superiority over the first therapy. At the time of the

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[21] 645 F.2d 1195 (2d Cir. 1981).

[22] *See* FTC Press Release, FTC Closes Its Investigation of Genzyme Corporation's 2001 Acquisition of Novazyme Pharmaceuticals, *available at* <http://www.ftc.gov/opa/2004/01/genzyme.htm>.

acquisition, Novazyme was conducting early pre-clinical studies relating to enzyme-replacement treatment (ERT) for Pompe disease; Genzyme was also engaged in preclinical animal testing of ERTs at the time of the acquisition. The Commission's investigation focused on the transaction's potential impact on the pace and scope of research into the development of a treatment for Pompe disease. In his closing statement, Chairman Muris stated that:

> "The Commission's investigation properly focused on how the transaction would affect the pace and scope of research into pharmaceutical products for a life-threatening medical condition affecting infants and young children for which no treatment presently exists. The facts of this matter do not support a finding of any possible anticompetitive harm. Moreover, on balance, rather than put patients at risk through diminished competition, the merger more likely created benefits that will save patients' lives."[23]

Chairman Muris emphasized that the Commission must be cautious in using innovation market analysis because "economic theory and empirical investigations have not established a general causal relationship between innovation and competition."[24] Rather, a "careful, intense factual investigation is necessary" to "distinguish between procompetitive and anticompetitive combinations of innovation efforts."[25]

C. Patent Hold Up Outside the Standard Setting Context

Turning to the fourth and last scenario, where a "putative troll" engages in patent hold up

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[23] Statement of Chairman Timothy J. Muris, In the Matter of Genzyme Corporation/Novazyme Pharmaceuticals, Inc. at 1 ("Muris Statement"), *available at* <http://www.ftc.gov/os/murisgenzymestmt.pdf>.

[24] Muris Statement at 2-3, *quoting IP Report.*

[25] *Id*. at 3.

outside the standard setting context, application of Section 5 or standard antitrust statutes as law enforcement tools is more problematic. Suppose a firm acquires one or more patents from a third party who never sought to license or otherwise assert its patents in a market. The new patent holder never seeks to develop, license, market or otherwise invest in the technologies covered by the patents. Instead, it simply puts them in its pocket and waits for others to develop products that may infringe on the acquired patents. Eventually the patent holder identifies a feature or component of the product that it believes infringe on its patents and it seeks to assert the patents against all firms manufacturing the product. The patent holder enjoys some additional leverage because redesign of the product to avoid the patent would be expensive and time consuming. Thus, the patent holder can engage in patent "hold up."

The first question is whether this conduct can be challenged under the Sherman Act. It is arguable that it can be. However, it is very doubtful that a challenge could be based on effects of the conduct in product market because by definition the "troll" does not participate as a competitor in that market.[26] Instead the theory would have to be that this course of conduct constituted monopolization of the relevant technology licensing and/or innovation market. Viewed in this light, the troll's conduct would be subject to challenge under the *Singer* and *Kobe Pump* theories discussed above – it is simply part of an overall scheme to acquire the patents necessary to monopolize the market for the *intellectual property* required to develop the products. This would require proof of a relevant technology licensing and/or innovation market, but once that is proved the other issues could be resolved as discussed above.

A challenge based on the Sherman Act would not be free of issues. For one thing, while

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[26] *See* Official Airline Guides, Inc. ("OAG") v. F.T.C., 630 F.2d 920, 925-926 (2d Cir. 1980).

the Commission has obtained a number of consent decrees which, according to the Aids To Public Comment, have been based on effects in a technology licensing and/or innovation market (as opposed to a product market)[27] neither the Commission nor the Justice Department has ever vindicated that theory in an appellate court. For another thing, generally a patent troll amasses its patent portfolio *before* there is a product market and then sits and waits for that market to develop in order to maximize the patent "hold up." As previously discussed, in *SCM v. Xerox* the Second Circuit rejected a challenge under Section 7 and Section 2 to patent acquisitions that were made by Xerox before the development of a product market. While that decision is somewhat dated, it stands as an obstacle to a Sherman Act challenge to the standard modus operandi of patent trolls.

SCM, however, would not foreclose the Commission from challenging the conduct on a stand alone Section 5 theory. Indeed, according to the Ninth Circuit's decision in *Boise Cascade v. F.T.C.*,[28] a stand alone Section 5 theory is viable only when the challenged conduct is not clearly covered by the Sherman Act. Nor would such a challenge be foreclosed by *OAG*. To be sure, *OAG* rejected a stand alone Section 5 claim where the respondent was not a participant as a competitor in the market impacted by the challenged conduct.[29] However, if the relevant market is the technology and/or *innovation* market, the troll would be a participant in the market. Moreover, in its subsequent *Ethyl* decision the Second Circuit left the door open to a Section 5 claim if there was evidence of "oppressiveness" in the form of an "anticompetitive intent" or the

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[27] *See, e.g.,* In the matter of Summit Technology, Inc. and VISX Inc., Docket No. 9286, <http://www.ftc.gov/os/caselist/d9286.htm>.

[28] 637 F.2d 573 (9th Cir. 1980).

[29] 630 F.2d at 926.

"absence of a legitimate business purpose."[30] Such evidence – whether direct or circumstantial – would be essential to support a challenge under either the Sherman Act or Section 5.

I think it is more difficult to identify limiting principles applicable to the use of Section 5 when there is no standard-setting process, or when there is no evidence of the firm reneging on a prior commitment made by a predecessor. In those instances, industry members rely in good faith on representations that critically influence their decision making at the competitive stage of a standard setting process. Thus, the competitive process is extremely vulnerable to actions that, while they may not equate to the type of "exclusion" actionable under Section 2 of the Sherman Act, fall within the purview of an unfair method of competition. When there is no similar good faith reliance on representations, and no competition for inclusion in an industry wide standard, it is more difficult to demonstrate the "oppressiveness" envisioned by the *Ethyl* Court.

IV. Conclusion

At the end of the day, the most significant deterrent against the kind of behavior I've discussed may lie in a limitation on the amount of damages the alleged "troll" can collect. It is arguable that in this situation, the lion's share of the proceeds that the product or service can fetch in the market should go to the producer of the product or service rather than to the holder of the patent because the value of the patent is little more than what the firm obtaining, but not practicing, the patent paid to obtain it. If recovery of damages were limited in this fashion, there would be little room for real "exploitation" of the producer.

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[30] *E.I. DuPont de Nemours & Co. v. FTC ("Ethyl"),* 729 F.2d 128, 139-140 (2d Cir. 1984).