The MPHJ Technology Investments Saga: A Look at the Antitrust Enforcers' Renewed Interest in Patent Assertion Entities

*By George Laevsky**

Patent assertion entities (PAEs), sometimes pejoratively referred to as patent trolls, are non-practicing entities that profit from asserting patent infringement claims. Although some PAEs are benign, others unfairly target small businesses by forcing them to enter into patent portfolio licensing agreements through pretextual patent infringement allegations that are oftentimes meritless and based on misleading information. The Federal Trade Commission and the state attorneys general have responded by targeting PAEs that assert dubious patent infringement claims against small businesses in the hopes of systematically extracting royalty payments from potentially non-infringing companies. This article examines the antitrust enforcers' renewed interest in PAEs by taking a look at their recent enforcement proceedings against MPHJ Technology Investments, LLC (MPHJ).

Overview of Patent Assertion Entities

Patent assertion entities are known as non-practicing entities because they do not make, sell, or conduct research and development into commercial products. PAEs are instead solely in the business of acquiring patents and subsequently enforcing them against potential infringers. The patents are generally either: (1) purchased from smaller inventors who are otherwise unable to monetize the patents themselves; or (2) acquired from a manufacturer with the understanding that the patents will be enforced on the manufacturer's behalf. PAEs are not automatically harmful by nature – some potentially promote innovation by helping smaller patent-holders monetize their inventions. However, their unique position in the corporate ecosystem often gives them different enforcement incentives from companies that also practice their patents, which, as discussed below, is a significant concern within the United States intellectual property regime.

PAEs maximize revenues by seeking injunctive relief against companies that develop and manufacture potentially-infringing products. The threat of injunctive relief creates a hold-up problem for manufacturers that have committed to certain product manufacturing decisions, the alteration of which – to design around the patent – would be prohibitively costly. Understanding the cost of redevelopment, PAEs are able to request licensing fees in excess of the value of their intellectual property portfolios because they know the manufacturer will incur exceptional costs if their products are found to be infringing. While a manufacturer may be disinclined to partake in this type of behavior, the unique corporate nature of a PAE gives it freedom to operate differently.

First, PAEs are liberated from the negative reputational consequences associated with asserting dubious patent claims. Manufacturing firms that engage in underhanded conduct typically develop a negative reputation with suppliers, business competitors, and consumers, which harms their subsequent ability to engage in commerce. PAEs do not suffer these consequences, and are thus able to leverage the uncertainties associated with patent rights to maximize their licensing revenues.

This is particularly effective where the PAE controls a large patent portfolio of intertwined patent holdings. Building a large portfolio allows the PAE to protect weaker patents in its control – ones that are less likely to withstand litigation scrutiny – while increasing the probability that at least one of the asserted patent claims will be found valid and infringed. Practicing entities are further deterred from challenging the PAE's patent portfolio due to the escalating costs associated with contesting the scope and validity of each additional patent. This dynamic rewards PAEs for amassing and asserting numerous questionable patent rights by enabling the PAE to leverage the enhanced risk that businesses face into higher licensing fees.

Second, PAEs have the unequivocal advantage of not being subject to injunctive counterclaims that would otherwise be possible against a competing firm within a similar line of commerce. As non-practicing entities, PAEs are extremely unlikely to engage in conduct that potentially infringes a target's intellectual property holdings. By negating the risk of starting a patent war with a competing manufacturer, PAEs are free to enforce their patents liberally irrespective of the strength of their underlying patent portfolio.

As such, businesses often decide to enter into the PAE's portfolio licensing arrangements – even if they believe that the asserted patents are invalid or non-infringed

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– because validity challenges are inherently expensive and, if successful, may confer a free benefit to industry competitors. PAEs take advantage of this dynamic by strategically structuring their royalty demands below the expected value of litigation. This is accomplished by demanding less money via royalty payments than a company would spend litigating patent validity, or in industries with high consumer pass-through pricing rates where competitors also license the patents, less money than a company would recoup from invalidating the patent.

Third, PAEs have significant economies of scale for enforcing patents against otherwise marginal potential infringers. PAEs can leverage patent enforcement expertise to seek licensing agreements from smaller firms that do not have the resources to contest the patent's scope and validity. As the next section will highlight, PAEs sometimes target small businesses through suspect infringement royalty licensing demands without ever intending to actually bring enforcement proceedings. The PAE often correctly wagers that small businesses will pay the rent to cross the proverbial bridge instead of challenging the PAE's potentially unfair and deceptive demands in court.

Finally, PAEs typically structure themselves into a labyrinth of cross-licensing subsidiaries to prevent businesses from being able to determine who the company asserting patent infringement actually is. This enables PAEs to control the amount of available public information about their business in order to minimize their patent enforcement footprint. Small businesses are thus prevented from being able to locate information on the PAE, making it hard to evaluate the nature and credibility of the PAE's potential infringement allegations.

Recent Antitrust Developments Concerning PAEs

The FTC has become increasingly attuned to the potential anticompetitive consequences associated with PAE enforcement tactics. While the FTC has not issued a formal policy statement on its view of PAEs, a number of Commissioners have made public statements in the last year describing their positions on how the antitrust laws might regulate PAE behavior. The FTC has also announced that it is conducting a study, pursuant to its authority under Section 6(b) of the FTC Act, to enhance its understanding of how PAEs operate and the effects that PAE patent enforcement activities have on the market and competitive dynamics.

Chairwoman Edith Ramirez discussed her views on the role that competition enforcers can play in overseeing PAE activity on June 20, 2013. The Chairwoman remarked that "[t]he cost to consumers from PAE activity appear increasingly tangible and direct," and that PAE activity is not only growing, but also changing shape. PAEs "still target IT firms more than companies in any other single sector. But data and anecdotal evidence suggest that PAEs now file half of all their lawsuits against firms outside the high-tech sector that merely incorporate IT into their products. Examples include retailers that do business online, restaurants with websites, and financial services companies that offer mobile banking applications." Further, Chairwoman Ramirez noted that the FTC is particularly interested in "PAEs that target small business with false claims made to induce the payment of illegitimate licensing fees," as many of these companies are victims of nuisance suits and are finding it cheaper to settle than litigate the claims. She concluded by announcing that the FTC has commissioned a study, pursuant to the agency's authority under Section 6(b) of the FTC Act, to study PAE behavior.

On November 20, 2013, Chairwoman Ramirez elaborated that the study will collect non-public information from twenty-five PAEs "on the composition of PAE portfolios (information such as the age and type of patents); whether the patents are essential to any standards or encumbered by other licensing obligations; the costs of acquiring patents, as well as whether the PAEs share an economic interest in its portfolio with other entities. [The FTC is] also seeking information on assertion activity, particularly licensing terms and assertion costs." The second part of the study will request information from other types of licensors in the wireless sector, such as manufacturers, to "serve as the basis for comparison that will help us interpret the wide-ranging information we collect on the PAE business model."

The study is designed to give antitrust enforcers a better understanding of the effects that PAEs have on the market and help formulate federal enforcement policies. The FTC currently examines PAE activity through its authority under Section 5 of the FTC Act, which prohibits "unfair or deceptive acts or practices in or affecting commerce." The FTC views certain PAE activities – such as issuing misleading licensing demands and falsely threatening litigation – to harm competition within the meaning of Section 5 of the FTC Act.

Commissioner Julie Brill discussed the FTC's role in protecting competition in light of the recent increase in PAE activity on January 8, 2014. The Commissioner identified recent evidence that indicates PAEs may have threatened over 100,000 companies with patent infringement demands in 2012 and provided an overview of recently proposed legislation aimed at addressing flaws in the patent system that PAEs are potentially exploiting. Commissioner Brill supported recent Congressional efforts to enact PAE-centric legislative reform while noting that the antitrust enforcers should meanwhile remain vigilant in pursuing PAEs that harm competition.

Commissioner Maureen K. Ohlhausen discussed her views on PAEs in a speech on June 17, 2013, in which she noted that recent studies indicate that PAEs accounted for nearly 60% of the 5,000 patent lawsuits filed in 2012. She indicated that PAEs generally make over 100 demands for each lawsuit filed and lose approximately 92% of the time when they litigate their claims to judgment. While there is evidence that PAEs typically acquire patents from smaller companies and individual investors – which may indicate PAEs help smaller inventors efficiently monetize their inventions – other studies show PAEs usually target small business with their enforcement activities. The Commissioner remarked that she would be "very cautious about expanding Section 5 competition law liability to attach to basic claims of infringement by PAEs. Only where there is some evidence of additional conduct by a PAE that tends for instance to undermine the patent process or that falls within a recognized exception to Noerr like sham or repetitive litigation would I be compelled to intervene." Commissioner Ohlhausen concluded that she is still evaluating the issues raised by PAEs and will continue to refine her position as additional information becomes available.

Commissioner Joshua D. Wright discussed his views on PAEs on April 17, 2013, remarking that there is a dearth of empirical evidence on the impact that PAEs have on competition. While some evidence suggests that PAEs are more aggressive in their patent infringement claims, Commissioner Wright indicated there are also countervailing procompetitive justifications for PAE activity, including enabling smaller inventors to profit and creating liquidity for the secondary patent-ownership market. These justifications, he stated, may create increased incentives for innovation that should be studied before deciding to condemn PAE activity. Commissioner Wright concluded that the "FTC is uniquely situated to contribute to the debate over the appropriate role for antitrust in regulating PAEs by ensuring it takes place with an eye toward empirical evidence and economic analysis."

The recent Congressional efforts referenced by Commissioner Brill include the Innovation Act, H.R. 3309, which passed the House in December and has received support from the Obama administration. The bill includes provisions requiring heightened pleading standards for patent cases that would require plaintiffs to assert specific details concerning the alleged infringing conduct. The bill also contains a controversial fee-shifting provision that requires the losing party to pay its opponent's patent litigation costs. There are also other draft provisions circulating in Congress that propose to implement a wide range of PAE-centric patent reforms. The Senate Judiciary Committee is currently in the process of revising a Senate bill that it plans to circulate in the near future.

That said, the FTC has not abdicated its authority to review PAEs pending the completion of the 6(b) study. In the interim, the FTC and state antitrust enforcers have begun targeting PAEs that leverage their economies of scale and patent validity information dissymmetry to go after small businesses that do not have the resources to combat potential infringement allegations. While these investigations are typically non-public, the details of the FTC's investigation of MPHJ Technology Investments have surfaced in light of MPHJ's bold move to preemptively sue the FTC in an effort to derail the agency's investigation into its practices. MPHJ has also been the target of several state antitrust enforcement proceedings. These investigations provide unique insights into how PAEs operate.

The MPHJ Technology Investments Saga

On January 13, 2014, MPHJ Technology Investments LLC preemptively sued the Federal Trade Commission to prevent the agency from suing MPHJ for deceptive acts or practices under Section 5 of the FTC Act. MPHJ's complaint alleges, among other counts, that the FTC lacks jurisdiction to regulate MPHJ's conduct and that its PAE activities are protected by the First Amendment under the *Noerr-Pennington* doctrine. MPHJ also alleges that the FTC mischaracterized MPHJ's conduct in the FTC's draft complaint, which is attached as an exhibit to MPHJ's complaint.

The FTC's interest in MPHJ arises from the company's September 2012 acquisition of patents relating to scanning documents to a networked computer's software applications (e.g., to an email program like Microsoft Outlook). The FTC's draft complaint alleges that MPHJ soon began a nationwide campaign to sell patent licenses by targeting small businesses located across the United States. These companies typically employed between twenty and one hundred individuals, making them unlikely candidates to challenge the validity and scope of MPHJ's patent portfolio, the FTC alleged.

According to the FTC's draft complaint, MPHJ's initial contact with potential licensees came in the form of a demand letter sent to the target company, which represented "that the recipient small businesses are likely infringing the MPHJ Portfolio by using common office equipment," and "thus likely needs to buy a license for the MPHJ Portfolio at a price of either $1,000 or $1,200 per employee." These initial demand letters allegedly misrepresented that MPHJ "had a positive response from the business community to our licensing program" at the above mentioned licensing fee arrangements.

The draft complaint further alleges that companies that did not reply to MPHJ's initial demand letters were sent a second letter from MPHJ's outside counsel. The letters did not include contact information for the firm, instead solely providing one of two call center numbers where the callers could leave a message. A third demand letter was subsequently sent to non-responding companies that threatened that "litigation will ensue" unless MPHJ heard from the company within the next two weeks. The third demand letter was typically accompanied by a draft complaint alleging patent infringement against the small business.

The FTC's draft complaint sheds light on the intricate workings of a PAE. MPHJ is primarily engaged in the business of acquiring and enforcing patents through its 101 subsidiaries. This network of subsidiaries, the FTC alleges, enables MPHJ to mask its patent enforcement activities from concerned small businesses seeking public information on the potential infringement allegations by making it difficult to ascertain the identity and credibility of the actual patent holder.

The draft complaint challenges MPHJ's conduct as deceptive acts or practices in violation of Section 5(a) of the FTC Act. The FTC asserts that MPHJ's three demand letters likely contained misleading statements designed to induce small businesses to enter into licensing arrangements with MPHJ, under the threat of patent infringement litigation, without MPHJ actually intending to initiate legal actions against non-responsible companies. MPHJ's demand letters also overstated the number of licensing agreements that MPHJ had entered into and misrepresented its typical portfolio licensing fees. The FTC concludes that these were deceptive acts designed to coerce small business into accepting MPHJ's patent licensing terms, and sought injunctive relief, contract rescission, restitution and disgorgement of ill-gotten gains.

MPHJ's alleged behavior has generated significant public backlash and ultimately resulted in multiple investigations by the state attorneys general. The Vermont AG filed a consumer protection suit against MPHJ for sending misleading potential infringement demand letters to Vermont businesses. The Nebraska AG issued a Cease and Desist order against MPHJ that was subsequently withdrawn. In addition, MPHJ was also forced into at least one private settlement with a scanner manufacturer that sought assurances that MPHJ would refrain from suing consumers who exclusively used the manufacturer's products.

To date, MPHJ has only entered into one final settlement with an antitrust enforcer. The New York State Office of the Attorney General entered into an Assurance of Discontinuance with MPHJ on January 14, 2014. The NYAG investigation's findings mirror the allegations in the FTC's draft complaint and materially focus on MPHJ issuing misleading business demands that constitute repeated deceptive acts in violation of New York law. New York Attorney General Eric T. Schneiderman commented that "[s]o-called 'patent trolls' exploit loopholes in the patent system and have become a scourge on the business community . . . State law enforcement can't cure all the ills of the federal patent system, but the guidelines established in today's settlement will put an end to some of the most abusive tactics by placing the industry on notice that these deceptive practices will not be tolerated in New York."

The Assurance requires MPHJ to refund licensing fees acquired through deceptive practices, limits MPHJ's future abilities to issue demand letters to New York consumers, and imposes numerous behavioral remedies on MPHJ that are designed to serve as guidelines for patent assertion entity behavior. These guidelines require PAEs to: (1) make good-faith efforts to determine whether targets actually infringed their patents before making accusations; (2) explain within the initial communication a credible basis for the potential infringement allegation; (3) forgo making misleading licensing fee assertions; and (4) disclose the true identity of the patent holder. The guidelines are designed to prevent PAEs from mass mailing potential infringement accusations to hundreds of small businesses across the state.

Conclusion

The ongoing MPHJ saga provides a rare glimpse into an opaque universe and will likely help forge the antitrust narrative on PAEs. MPHJ's preemptive litigation against the FTC is still pending after the FTC's motion to dismiss was denied on procedural grounds. While it is unclear whether the FTC's enforcement efforts will result in nationwide PAE conduct standards similar to those proclaimed by the New York Attorney General, the proceedings clearly demonstrate that the FTC will actively pursue PAEs that deceptively target small businesses while it conducts its 6(b) study on the competitive effects of PAE activity. These proceedings, along with any potentially forthcoming legislation, will play a crucial part in determining the role that the antitrust enforcers have in regulating PAE behavior.