United States of America

Federal Trade Commission

Strong Patent Rights, Strong Economy

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"Markets, Government, and the Common Good"
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I. Introduction

Good afternoon and many thanks to Hillsdale College and the Free Market Forum for hosting this important conference. I am pleased to join you today to discuss the importance of strong patent rights to the U.S. economy.

America's Founders understood the importance of protecting property, including intellectual property. The Constitution wisely provides that "Congress shall have power . . . To promote the progress of science and useful arts, by securing for limited times to authors and inventors the exclusive right to their respective writings and discoveries."[2] The U.S. Court of Appeals for the Federal Circuit, which handles patent matters, observed that if one were to eliminate the right to exclude from the basket of rights attached to patents "the express purpose

[1] The views expressed in these remarks are my own and do not necessarily reflect the views of the Federal Trade Commission or any other Commissioner.
[2] U.S. CONST. art. I, § 8, cl. 8.

of the Constitution and Congress, to promote the progress of the useful arts, would be seriously undermined."[3] Note the inclusion of "useful" arts among the drafters' goals – their intent clearly was to entice inventors with the lure of "exclusive" rights. The Supreme Court recognized the important role of this system to provide "an incentive to inventors to risk the often enormous costs in terms of time, research and development. The productive effort thereby fostered will have a positive effect on society through the introduction of new products and processes of manufacture into the economy . . . ."[4] In exchange for this "reward for inventions" the patent laws require the inventor to disclose his or her idea, so that after the period of exclusivity expires, the public benefits from knowing about and using the invention freely.

The Founders knew then what some seem to be overlooking today: strong intellectual property rights promote a vibrant economy by encouraging innovation. Despite the Founders' wisdom and foresight, and an over two hundred year history during which the United States, driven by technological innovation, emerged as the world's leading economy, a movement is underway to undermine U.S. patents rights. Op-eds call for limiting patent rights.[5] Reputable sources like *The Economist* voice a skeptical tone.[6] Some technology firms claim that patent lawsuits erode their R&D budgets and bottom lines.[7] And there are even calls to *abolish* the patent system.[8]

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[3] Patlex Corp. v. Mossinghoff, 758 F.2d 594, 600 (Fed. Cir. 1985) (quoting Smith Int'l v. Hughes Tool Co., 718 F.2d 1573, 1577-78 (Fed. Cir. 1983)) (abrogated by Robert Bosch LLC v. Pylon Mfg. Corp., 659 F.3d 1142 (Fed. Cir. 2011)) (recognizing that a presumption of patent harm was no longer valid after Ebay Inc. v. MercExchange, L.L.C., 547 U.S. 388 (2006)).

[4] Kewanee Oil v. Bircron Corp., 416 U.S. 470, 480 (1974).

[5] *See, e.g.*, Electronic Frontier Foundation, *Patent Fail: In Defense of Innovation*, https://www.eff.org/patent; Charles Duhigg & Steve Lohr, *The Patent, Used as a Sword*, N.Y. TIMES, Oct. 8, 2012, at A1; Richard A. Posner, *Why There Are Too Many Patents in America*, ATLANTIC, July 12, 2012; *see also* Gene Sperling, *Taking on Patent Trolls to Protect American Innovation* (June 4, 2013), http://www.whitehouse.gov/blog/2013/06/04/taking-patent-trolls-protect-american-innovation.

[6] *The problem with profits*, THE ECONOMIST, Mar. 26, 2016; *Time to Fix Patents*, THE ECONOMIST, Aug. 8, 2015; *A Question of Utility*, THE ECONOMIST, Aug. 8, 2015.

[7] *See, e.g.*, Dana Rao, Opinion, *Patent reform is within grasp*, Mar. 8, 2016, THE HILL; Steve Lohr, *With Patent Litigation Surging, Creators Turn to Washington for Help*, N.Y. TIMES, Apr. 29, 2015 at B2; John

Emerging economies view these statements through their own prisms of history and economic pressure, often citing them as justifications to disregard or diminish legal protections for U.S. proprietary technologies in their own countries. Few developing countries actively combat piracy, for instance.[9] Some scholars assert that influential jurisdictions appear to use their antitrust powers not to protect competition, but instead to regulate the price of patent rights.[10]

But, supporters of inventors' rights should not despair. The United States can continue to lead the way in protecting the rights of deserving inventors and in encouraging other countries to do the same. As the Acting Chairman of the Federal Trade Commission, I have consistently advocated for protecting intellectual property rights, both domestically and abroad.

Two fundamental principles guide my approach. First, strong patent rights are crucial to economic success. And, second, economically grounded analysis will reveal the right path through thickets of IP skepticism. I look forward to discussing these principles with you today.

II. The Importance of IP Rights

Innovation drives the development of new and improved products and services. It meets society's greatest challenges in areas as diverse as energy production, telecommunications, and medical research. But, innovation is not easy. It involves a winding road from idea to invention, through development to commercialization. Each of these steps can be risky, expensive, and unpredictable.

Chambers & Myron E. Ullman, Opinion, *Stopping the Economy-Sapping Patent Trolls*, WALL ST. J., Feb. 16, 2015.

[8] *See* MICHELE BOLDRIN & DAVID K. LEVINE, AGAINST INTELLECTUAL MONOPOLY (2010); *cf.* ADAM B. JAFFE & JOSH LERNER, INNOVATION AND ITS DISCONTENTS: HOW OUR BROKEN PATENT SYSTEM IS ENDANGERING INNOVATION AND PROGRESS, AND WHAT TO DO ABOUT IT (2007).

[9] *See, e.g.*, OFFICE OF THE U.S. TRADE REPRESENTATIVE, 2016 SPECIAL 301 REPORT (2016), https://ustr.gov/sites/default/files/USTR-2016-Special-301-Report.pdf.

[10] *See, e.g.*, Shubha Ghosh & D. Daniel Sokol, *FRAND in India* 5 (Univ. of Wis., Legal Studies Research Paper No. 1374, 2016), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2718256.

The goal of the patent system is to promote innovation in light of this risk and uncertainty. It does so by granting patent owners the right to exclude others from making, using, or selling a patented invention for 20 years. Patents create a property right for intangible ideas, which makes licensing easier and facilitates technology transfer. This property right also protects innovators from copying that could drive down prices and deter future investment.

These patent rights have real-world effects. The United States government recently reported that IP-intensive industries support at least 45 million U.S. jobs and contribute more than $6 trillion dollars to, or 38.2 percent of, U.S. gross domestic product.[11]

Empirical research supports the fundamental role that patent rights play in promoting innovation. I have written at length—most recently in the *Harvard Journal of Law & Technology*— about the positive correlation between robust IP rights and R&D investment in developed countries.[12] For example, scholars who examined data from sixty countries between 1960 and 1990 to explore the relationship between IP rights and economic growth found that intellectual property rights "affect economic growth by stimulating the accumulation of factor inputs like research and development capital and physical capital."[13]

Other researchers scrutinized data on R&D investment and patent protection from thirty-two countries between 1981 and 1995. This "evidence unambiguously indicate[d] the significance of intellectual property rights as incentives for spurring innovation. . . .

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[11] U.S. DEP'T OF COMMERCE, INTELLECTUAL PROPERTY AND THE U.S. ECONOMY: 2016 UPDATE (2016), https://www.uspto.gov/sites/default/files/documents/IPandtheUSEconomySept2016.pdf.

[12] Maureen K. Ohlhausen, *Patent Rights in a Climate of Intellectual Property Rights Skepticism*, 30 HARV. J. L. & TECH. 103 (2016).

[13] Walter G. Park & Juan Carlos Ginarte, *Intellectual Property Rights and Economic Growth*, 15 CONTEMPORARY ECON. POL'Y 51 (1997).

Countries which provided stronger protection tended to have larger proportions of their GDP devoted to R&D activities."[14]

A host of other empirical work finds a statistically significant relationship between patent strength and R&D investment. A 2013 Brookings report observed, "Research has established that patents are correlated with economic growth across and within the same country over time" and "R&D spending since 1953 is highly correlated with patenting and the patent rate."[15] Studying U.S. data between 1980 and 2010, the report concluded that "patenting is associated with higher metropolitan area productivity" and that "the most likely explanation is that patents cause growth."[16]

We also know that firms respond to changes in the strength of patent protection. A well-known study, for example, examined the U.S. semiconductor industry between 1979 and 1995. It found that "large-scale manufacturers have invested far more aggressively in patents during the period associated with strong U.S. patent rights, even controlling for other known determinants of patenting."[17]

The solid theoretical and evidentiary justifications for intellectual property rights do not mean that granting ever-stronger patent protection will inevitably lead to ever-greater innovation. The need to scrutinize the quality of patent applications and to calibrate appropriate compensation should take into account the incentives that drive R&D in various settings. Limited patent reform also may be appropriate to address identified problems such

[14] Sunil Kanwar & Robert Evenson, *Does Intellectual Property Protection Spur Technological Change?*, 55 OXFORD ECON. PAPERS 235, 249-250 (2003).
[15] JONATHAN ROTHWELL ET AL., BROOKINGS, PATENTING PROSPERITY: INNOVATION AND ECONOMIC PERFORMANCE IN THE UNITED STATES AND ITS METROPOLITAN AREAS 4, 8 (2013).
[16] *Id*. at 15.
[17] Bronwyn H. Hall & Rosemarie Ham Ziedonis, *The Patent Paradox Revisited: An Empirical Study of Patenting in the US Semiconductor Industry, 1979-1995*, 32 RAND J. ECON. 101, 104 (2001).

as insufficient quality control, the broad scope of certain patents, and inadequate disclosure. Nevertheless, strong patent rights should remain at the heart of U.S. industrial policy.

III. Patent Rights in an Age of IP Skepticism

Recent criticism of the patent system requires some explanation. What drives calls to diminish or eliminate the U.S. patent system? Several factors are responsible. For example, patenting technologies and commercializing them are increasingly separate acts, undertaken by different entities, and connected by patent licenses, if at all, after the fact. One effect of this evolution has been the rise of patent-assertion entities, known as PAEs. PAEs are businesses that acquire patents from third parties and then try to make money by negotiating with, or suing, accused infringers. Patent litigation has become more frequent and complex, making enforcing and defending against patent claims expensive. Finally, there has been a trend toward granting broad patents, which the Supreme Court has started to reverse.[18]

The implications of those factors are complicated. But even if today's patent system and associated litigation costs sometimes produce imperfect outcomes, they do not undermine the patent system's core function. Today's patent regime drives a varied, complex, and evolving array of technologies. The markets in which novel products and methods arise are themselves changing. Of course, there are imperfections in how patents execute their mission. But such complications are no reason to abandon the patent system wholesale.

Instead, policymakers should take an economically and empirically grounded approach to IP issues. This view recognizes the many benefits of patent protection, while accepting that some revisions may be necessary to promote innovation. I will describe two

[18] *See, e.g.*, Alice Corp. v. CLS Bank Int'l, 134 S. Ct. 2347 (2014) (holding that certain software claims are abstract and do not meet the statutory standards for patentability).

recent FTC initiatives that exemplify my position. In the first, the FTC gathered extensive empirical evidence to support carefully tailored recommendations. In the second, no evidence supported a substantial change, and I advocated for retention of traditional intellectual property principles.

The first initiative involved patent assertion entities. PAEs, who do not create IP themselves but rather buy and license patents to manufacturers and other users, create strong views. Some commentators decry PAEs as high-tech extortionists that tax innovators. Others respond that PAEs create patent-licensing markets in which individual inventors can monetize their technologies and manufacturers can secure the permissions they need to sell their products lawfully. Claims on both sides, however, have been light on facts and heavy on aspersions. That is why I supported the use of the FTC's research authority to study PAE markets and produce a report, which discloses previously unknown facts about how PAEs operate.[19]

The report advances our understanding of PAEs and their role within the patent and innovation system.[20] The report, which is a case study, covered PAEs that may account for over 75% of all U.S. patents held by PAEs at the end of 2013.[21] It is full of relevant findings unavailable in other studies. While I can't discuss all of them here, a few conclusions are worth noting for their contribution to larger policy discussions.

For me, the standout conclusion was that there is no one PAE business model. Rather, our data suggested that there are two main types, one of which we called Portfolio

[19] Fed. Trade Comm'n, PAE Report (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.
[20] The report is a case study, not a statistical sampling that tests hypotheses about the full universe of PAEs. The FTC's efforts to include both the most economically important PAEs and ones of various sizes, however, produced a universe of 22 Study PAEs and over 2,500 related entities. *Id*. at 2.
[21] *Id*. at 125.

PAEs and the other we called Litigation PAEs. Portfolio PAEs appear to be sophisticated firms that aggregate hundreds or thousands of patents, license their portfolios for millions of dollars apiece, and capitalize themselves through institutional and other investors. Despite making up only 9% of the licenses in the study, they generated four-fifths of the revenue.[22] They hire specialized IP-licensing professionals and typically negotiate licenses without first suing their prospective licensees. All told, Portfolio PAEs engage in conduct that is potentially consistent with an efficient aggregation service. Given the sums that change hands in arms-length transactions between Portfolio PAEs and their licensees – amounts that seem often to exceed the cost of litigation – it appears that technology users paid sums that may reflect the quality of the licensed patents.

By contrast, Litigation PAEs generally sued technology users without first negotiating and settled shortly afterward. The portfolios that they licensed often comprised no more than a few patents. They generated royalties that typically were less than $300,000, an amount that accused infringers could expect to spend through initial discovery.[23]

Given the relatively low dollar amounts of the licenses, the behavior of Litigation PAEs was consistent with nuisance litigation.[24] Despite filing 96% of the lawsuits in the study and representing 91% of licenses, they accounted for only 20% of the reported revenue.[25] Now, to be clear, infringement litigation plays an important role in protecting patent rights. The ability to sue others for copying your invention is crucial to establishing the property boundaries necessary to promote innovation. At the same time, nuisance

[22] *Id*. at 3-4.
[23] *Id*. at 4.
[24] *Id*.
[25] *Id*. at 43.

litigation, which relies on estimated costs and not the strength of the patent claims, can tax judicial resources and divert attention away from productive business behavior.

Accordingly, the report presents tailored recommendations to alleviate potential litigation abuses. For example, the report proposes case management practices that could mitigate litigation cost asymmetries between PAE plaintiffs and defendants. The report also recommends that Congress pass rules increasing transparency and encourages courts to stay litigation by PAEs against end users when parallel proceedings already are underway against the manufacturer. I support these proposals because they are narrowly-tailored to address observed behavior, without leading to unintended consequences well beyond PAE activity.

The second FTC initiative—where I did not see evidence to support substantial change—involved the recent revision of our IP licensing guidelines. In January 2017, the Federal Trade Commission and the U.S. Department of Justice jointly issued updated Antitrust Guidelines for the Licensing of Intellectual Property,[26] which state the agencies' enforcement policy with respect to the licensing of intellectual property protected by patent, copyright, and trade secret law. This is the agencies' first update since the Guidelines issued in 1995. Although IP licensing generally is procompetitive, antitrust enforcers have a role to play in protecting against competitive abuses. In the past, however, I have expressed concern when less like-minded overseas enforcers apply their antitrust laws to dilute IP rights. Doing so inappropriately morphs antitrust law into a tool for price regulation and creates harmful disincentives for innovation.

[26] U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, ANTITRUST GUIDELINES FOR THE LICENSING OF INTELLECTUAL PROPERTY (2017), https://www.ftc.gov/system/files/documents/public_statements/1049793/ip_guidelines_2017.pdf, [hereinafter 2017 Guidelines].

I am pleased to say that the 2017 Guidelines exemplify my approach to antitrust/IP issues, and offer reasonable guideposts. Most importantly, the new Guidelines continue to affirm that IP laws grant "enforceable rights," which have social value.[27] They also state, "antitrust laws generally do not impose liability upon a firm for a unilateral refusal to assist its competitors."[28] Read together with the FTC and DOJs 2007 IP Report, which stated that, "liability for mere unconditional, unilateral refusals to license will not play a meaningful part in the interface between patent rights and antitrust protections,"[29] it is clear that the Guidelines will continue to protect strong IP rights in the United States.

Some commenters called upon the U.S. agencies to create new, specialized, guidelines to address particular types of IP disputes. I did not support this because the available evidence did not require major changes to the Commission's approach. As I have said before, "IP issues are not a special case that requires a different competition jurisprudence."[30] For more than twenty years, the Guidelines have offered general guidance that has adapted to new and complicated issues in the IP space. Under this precedent, we should be careful not to establish new standards without compelling evidence to do so.

IV. Conclusion

Patents have been at the heart of US innovation since the founding of our country, and respect for patent rights is fundamental to advance innovation. The United States is more technologically innovative than any other country in the world. This reality reflects, in part, the property rights that the United States government grants to inventors. Still, foreign counterparts

[27] 2017 Guidelines at 1-2.
[28] *Id*. at 3.
[29] U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, ANTITRUST ENFORCEMENT AND INTELLECTUAL PROPERTY RIGHTS, PROMOTING INNOVATION AND COMPETITION 30 (2007) ("[L]iability for mere unconditional, unilateral refusals to license will not play a meaningful part in the interface between patent rights and antitrust protections."), http://www.usdoj.gov/atr/public/hearings/ip/222655.pdf.
[30] ABA Section of Antitrust Law's Intellectual Property Committee, *Interview of Commissioner Ohlhausen*, PUBLIC DOMAIN 11-12 (Feb. 2016).

take or allow the taking of American proprietary technologies without due payment. For example, emerging competition regimes view "unfairly high royalties" as illegal under antitrust law.[31] The FTC's recent policy work offers an important counterweight to this approach, illustrating the important role that patents play in promoting innovation and benefiting consumers.

In closing, while we may live in an age of patent skepticism, there is hope. Criticism of IP rights frequently does not hold up upon closer examination. Rather, empirical research favors the close tie between strong IP rights and R&D. This is not to say that changes to the patent system are always unwarranted. Rather, the key to addressing the U.S. patent system lies in incremental adjustment where necessary based on a firm empirical foundation. The U.S. economy stands as a shining reminder of everything that American innovation policy has achieved – and intellectual property rights, and patents, are the important cornerstones of those achievements.

Thank you for your time this afternoon, and I look forward to addressing your questions.

[31] *See* KFTC, Review Guidelines on Unfair Exercise of Intellectual Property Rights, III.3.A(3), III.3.B, III.3.7.A Mar. 30, 2016; NDRC, Anti-Monopoly Guideline on Intellectual Property Abuse (Draft), § III.(ii).1-2, Dec. 31, 2015; SAIC, Guidelines for Anti-Monopoly Enforcement against Abuse of Intellectual Property Rights (Draft), Ch. 4, Arts. 23-24 Feb. 2016.