UNITED STATES v. WIDGET CO., NEWCO, AND PATENT AGGREGATOR PLUS LLC A HYPOTHETICAL CLOSING ARGUMENT

J. Robert Robertson
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The Court: Case No. 01-2014. We are here for oral argument on the government's motion for a permanent injunction. Counsel, you have submitted significant briefs after nine days of evidence and the submission of over eight hundred exhibits. The Court understands the facts in the case, most of which were not in dispute. Therefore, I would like counsel to focus primarily on the legal issues today. You can assume that my tentative ruling on the facts is the following:

Widget is a company that makes circuits and sells them around the world, including here in the United States. Patent Aggregator Plus, or PAP, is a non-practicing entity, or NPE, which makes nothing; rather, it buys and licenses patents to others. Both companies operate out of Jackson, Wyoming, and do business here in Washington, DC, and throughout the United States. PAP appears to have over 10,000 patents in various industries. Between 2008 and 2010, PAP acquired over 1000 patents from numerous sellers in the market for circuits, or, as the government also refers to it, the market for licensing of technology for making circuits.

In February 2012, PAP met with and threatened Widget with a patent infringement lawsuit over a dozen patents but said that it would grant Widget a license to its 1000 circuit patents if Widget would assign its own family of

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300 patents to PAP. PAP proposed that all 1300 patents would then be transferred to Newco, owned by PAP. Newco would license back to Widget the right to make, use, or sell products using all the patents. Newco would then offer a license to the aggregate pool of patents to other circuit manufacturers, which compete against Widget. After Widget identified the potential infringers and analyzed possible infringement, Newco would sue those manufacturers who did not agree to the license for infringement. The defendants agreed to these terms, executed the transaction, and began to license and sue Widget's competitors.

The value of Widget patents at the time of the transaction on December 12, 2012, based on the projected Newco royalties, was in excess of $225 million. Prior to the acquisition, the same 300 patents had been valued at approximately $16 million. Widget and PAP agreed on the terms and closed the transaction. Neither side reported the transaction to the Premerger Notification Office at the Federal Trade Commission.

Competitors in the circuit board market testified that they were forced to pay more for patent licenses by Newco than they would have had to pay absent the aggregation of the 1300 or so patents in the Newco patent pool. These same competitors offered proof, substantiated by government economist, Dr. Carol Wang, that this additional cost harmed their ability to compete and caused them to charge consumers substantially more for their circuits. They also testified that many of the patents were essential for production of any new circuit produced according to certain industry standards (called standards-essential patents, or SEPs) and that many of the other patents were the preferred technology for a circuit product. However, the competitors testified that they did not infringe the hundreds of other patents at issue but could not afford the litigation costs to fight Newco. The evidence established that all of these patents were aggregated into Newco as a result of the transactions at issue.

The government corroborated this testimony with evidence from PAP that projected that it could charge more for the aggregate of patents than any owner could or did charge for the patents before PAP acquired them. In fact, PAP had solicited investors with the promise that it could get a far higher return from licensing the pool of patents.

PAP claims that there are efficiencies from its being an NPE. I would be interested in hearing how this is relevant, if at all, to my determination of this case and a potential remedy.

I also see that you are using a few slides. Please read off the title of the slide to orient those reading a transcript of these proceedings.

Counsel for the government, Ms. Jones, you may proceed. You have 30 minutes. You may reserve some time for reply. Mr. Park, you will have 30 minutes for your response for Widget and Patent Aggregator Plus.

MS. JONES: Thank you, your Honor.

Patents are assets—powerful assets. And when two companies get together to merge patent assets for the sole purpose of gouging users of circuit technology, they violate the federal antitrust laws. The defendants have harmed competition and the American consumer, who now has to pay more for a circuit.

Widget and PAP talk about promoting inventions. But in the real world, the world that we actually live in, we will all pay more for circuits because these two companies banded together to raise prices for the technology to make circuits—something they could not do without lumping together, or aggregating, thousands of patents, some useful and some useless. By aggregating these patents from each other and from others, the defendants gave themselves the power to take hundreds of millions of dollars away from Widget's competitors and consumers. It is the collection of these patents into one entity that gives them the weapon to do harm—not the First Amendment, as counsel for the defendants has stated. The defendants' agreements to acquire these patents and pool them together to form an assault echelon of immense power violate the antitrust laws. This Court should stop this illegal conduct and restore competition.

I will start by showing the Court why these patent acquisitions are not exempt from the antitrust laws. Then I will explain why these acquisitions violate Section 7 of the Clayton Act and Sections 1 and 2 of the Sherman Act. Finally, I will discuss the remedy here, which should include divestiture and conduct remedies that address what we believe is egregious, illegal conduct.

SLIDE 1: PATENTS ARE NOT EXEMPT FROM THE ANTITRUST LAWS

One of the defendants' fundamental arguments is that patents are different than other assets and that we are, thus, using some kind of novel theory to push patent acquisitions into an antitrust law framework. The defendants are incorrect. The misuse of patent pools and cross-licenses of patents has been at the forefront of antitrust law for over a hundred years. As early as 1912, in *Standard Sanitary*, the Supreme Court condemned the pooling of patents by competitors for the purpose of restraining competition and said that the "added element of the patent in the case at bar cannot confer immunity" from the antitrust laws, which act as a "limitation of [patent] rights,—rights which may be pushed to evil consequences, and [must] therefore [be] restrained."[1]

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[1] Standard Sanitary Mfg. Co. v. United States, 226 U.S. 20, 49 (1912) (the aggregation of patents is not exempt from the Sherman Act).

If there were any doubt that older cases from the 1910s through the 1960s are still good law, the U.S. Supreme Court made it clear in *Actavis*, just a few months ago, that *Standard Sanitary*, the similar cases of *Line Material* in 1948 and *New Wrinkle* in 1952, as well as the 1963 *Singer* case, remain established law.[2] In 1952, the defendants in *New Wrinkle* made almost exactly the same argument we hear from the defendants today—that patent cross-licensing should be outside of the antitrust laws. The Supreme Court rejected that argument and emphasized that "two or more patentees in the same patent field may (not) legally combine their valid patent monopolies to secure mutual benefits for themselves through contractual agreements, between themselves and other licensees, for control of the sale price of the patented devices."[3]

A single owner of a patent is allowed, under the law, to exert market power for the patent only to promote inventions.[4] That narrow exception from the antitrust laws does not apply to agreements between two or more parties, as the Court in *Actavis* made absolutely clear.[5] Once PAP entered into an agreement with Widget, it moved outside of the patent monopoly exception and into the zone of antitrust law.

The acquiring and pooling of patents to gain substantial market power have been illegal for decades.[6] It is now beyond dispute, as Dr. Fiona Scott Morton, the former Chief Economist at the Department of Justice, has explained, that patent portfolio transfers may create opportunities for opportunistic anticompetitive conduct. In particular, Dr. Scott Morton emphasized that the accumulation of large patent portfolios by PAEs can enable those entities to "obtain[ ] royalties in excess of the market value of the IP," which is the hallmark of market power.[7] That is exactly what happened in the *Singer* sewing machine case in the U.S. Supreme Court in 1963.

In *Singer*, a couple of sewing machine competitors pooled their patents in a separate, nonpracticing entity and used them to sue their competitors.[8] Isn't that exactly the business model of PAP? PAP goes to large competitors and

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[2] FTC v. Actavis, Inc., 133 S. Ct. 2223, 2232–33 (2013), *rev'g* FTC v. Watson Pharm., Inc., 677 F.3d 1298 (2012) (citing *Watson*, 677 F.3d at 1312; United States v. Line Material Co., 333 U.S. 287, 308 (1948); United States v. New Wrinkle, Inc., 342 U.S. 371, 378 (1952) (patent settlement between competitors was subject to the antitrust laws); United States v. Singer Mfg. Co., 374 U.S. 174, 190–97 (1963)).

[3] *New Wrinkle*, 342 U.S. at 379 (quoting *Line Material*, 333 U.S. at 305).

[4] *Actavis*, 133 S. Ct. at 2232.

[5] *Id.*

[6] *See New Wrinkle*, 342 U.S. at 379.

[7] Fiona Scott Morton, Deputy Assistant Att'y Gen. Econ. Analysis, Antitrust Div., U.S. Dep't of Justice, Presentation at the Fifth Annual Searle Conference on Antitrust Economics and Competition Policy, Patent Portfolio Acquisitions: An Economic Analysis (Sept. 21, 2012), *available at* www.justice.gov/atr/public/speeches/288072.pdf.

[8] United States v. Singer Mfg. Co., 374 U.S. 174 (1963).

buys their patents. PAP then pools the patents into Newco, and sues other competitors. The *Singer* Court made it clear that "[b]y aggregating patents in one control, the holder of the patents cannot escape the prohibitions of the Sherman Act."[9]

The defendants' hubris in claiming immunity from the law cannot be reconciled with their past extraordinarily secretive behavior: they never notified the FTC's Pre-merger Notification Office of any of these acquisitions and, until this Court compelled them to do so, they would not even disclose what patents they possess or which entity owns them. This lack of public disclosure has made it nearly impossible for a private plaintiff to challenge these acquisitions, which is one of the primary reasons that we are here today.

SLIDE 2: PAP'S ACQUISITIONS LESSEN COMPETITION SIGNIFICANTLY AND VIOLATE SECTION 7 OF THE CLAYTON ACT

The evidence shows that PAP's acquisitions are illegal under Section 7 of the Clayton Act. Congress wrote Section 7 to stop anticompetitive harm in its "incipiency"—meaning in its earliest beginnings—when the "effect" of an "acquisition may be substantially to lessen competition, or tend to create a monopoly."[10] Here, we have hundreds of acquisitions, not just one. We have a large market for technology to make circuits. We also have hundreds of markets for blocking and essential patents, which by definition have no substitutes and are markets in themselves, thus giving Newco monopoly power in each of these markets. The harm to competition and consumers is substantial. We are way past the incipiency standard, which is a very low bar for the government's case.

Baker Hughes explains the parties' burdens in this case. Once we show that an acquisition—in this case, hundreds of acquisitions—creates "undue concentration," we have established a "presumption that the transaction will substantially lessen competition."[11] The burden then shifts to the defendants to rebut the presumption by "show[ing] that the market share statistics give an inaccurate account of the [merger's] probable effects on competition" in the relevant market.[12] As we have seen, the defendants cannot rebut our prima facie case.

Section 7 "does not require proof that a merger or other acquisition has caused higher prices in the affected market. All that is necessary is that the

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[9] *Id.* (citing United States v. Line Material Co., 333 U.S. 287, 308 (1948)).

[10] 15 U.S.C. § 18; United States v. E.I. du Pont de Nemours & Co., 353 U.S. 586, 589 (1957).

[11] United States v. Baker Hughes Inc., 908 F.2d 981, 982 (D.C. Cir. 1990).

[12] United States v. Citizens & S. Nat'l Bank, 422 U.S. 86, 120 (1975).

merger create an appreciable danger of such consequences in the future."[13] But here, where "post-merger evidence show[s] a lessening of competition," it is obvious that we have enough evidence of an " 'incipiency' on which to base a divestiture suit," as the Supreme Court explained in *General Dynamics.*[14] In this case, we have the aggregation of thousands of patents, hundreds of which have the individual and collective ability of blocking most, if not all, of the manufacturing of circuits in this country. In other words, in each respective submarket for each narrow form of technology, each blocking patent has a 100 percent market share. For PAP to acquire another blocking patent, or even two patents that form most of the preferred methods for making the same product, would increase PAP's market power substantially.

The defendants' affirmative defense is that that patent enforcement by PAEs creates significant efficiencies that offset any potential anticompetitive effect. This makes no sense. First, transactions that create significant market concentration require "proof of extraordinary efficiencies," and courts "generally have found inadequate proof of efficiencies to sustain a rebuttal of the government's case."[15] Here, the defendants have not and cannot demonstrate any such extraordinary efficiencies. Second, the purported efficiencies cannot counter the anticompetitive effects of the transactions. These supposed efficiencies, which were not proven at all, are dwarfed by the anticompetitive price increases that we see in the market. In any case, these efficiencies are not merger-specific and therefore they are not cognizable.[16]

PAP also claims that some of its revenues are passed on to inventors to encourage more innovation. This is pure fiction. PAP has not quantified this procompetitive benefit for the Court, and there is no evidence that anyone except PAP's owners and shareholders received a significant percentage of PAP's licensing revenues. Furthermore, there is no reason to believe that Widget cannot reliably enforce its own patents and encourage innovation. In fact, in the past, Widget has often cross-licensed patents with many of its competitors and is known as a leading innovator. Yet after PAP and Widget entered its agreement, the resulting patent aggregation created much higher costs, not lower costs, for Widget's competitors. In the face of these higher costs, there is no newly inspired innovation—just money going out the door to PAP and its co-defendants.

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[13] Hosp. Corp. of Am. v. FTC, 807 F.2d 1381, 1389 (7th Cir.1986); FTC v. CCC Holdings Inc., 605 F. Supp. 2d 26 (D.D.C. 2009) (holding that the government must show that harm is " 'sufficiently probable,' " not that it "*will*" happen) (citation omitted).

[14] United States v. Gen. Dynamics Corp., 415 U.S. 486, 505 n.13 (1974).

[15] FTC v. H.J. Heinz Co., 246 F.3d 708, 720 (D.C. Cir. 2001).

[16] *Id.* at 722 (holding that the defendants must show that the "efficiencies . . . cannot be achieved by either company alone.").

The defendants also want this Court to believe that aggregating this kind of immense power is permissible because many of the patents do not compete horizontally against each other. This is incorrect for three reasons. First, the evidence shows that all of the patents cover the technology to make circuits. Some are blocking patents or even SEPs. Many others are not blocking at all and are not even infringed by any of the manufacturers of circuits. But to the extent the aggregation of these patents, blocking or not, allows Newco to coerce payments from manufacturers that Newco simply could not obtain absent the acquisition agreements, all of these patents contribute to the market power of Newco and hence the defendants.

Second, even if many of these patents did not compete against each other, the defendants' actions are still illegal. As the U.S. Supreme Court made clear in *Proctor & Gamble*, "All mergers are within the reach of § 7, and all must be tested by the same standard, whether they are classified as horizontal, vertical, conglomerate or other."[17] The only question is whether an acquisition—or in this case, many, many acquisitions—may substantially lessen competition.[18]

Third, although we have proven many markets here, the Court need not dwell on market definitions. Market definition is merely a tool that the courts use to help analyze whether a proposed acquisition is likely to harm competition in the future.[19] In this case, there is no need to engage in that hypothetical prospective analysis because we have actual evidence of anticompetitive effects that have already occurred in real life. The primary issue here is whether any of the acquisitions of thousands of patents significantly increased PAP's ability to demand more money than when the previous owners held these patents separately. The answer to that question is yes.

The proof is clear: Over 18 manufacturers testified that they were coerced into purchasing licenses for patents at prices they never would have paid but for these illegal acquisitions. Indeed, none of them had ever paid for a single license for any of these patents, and if the few SEP patents had been available

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[17] FTC v. Procter & Gamble, 386 U.S. 568, 577 (1967); Ekco Prods. Co. v. FTC, 347 F.2d 745 (7th Cir. 1965) (holding that an acquisition of a firm with a monopoly by a firm that did not compete in the monopoly market violated Section 7 when the acquiring firm protected the monopoly power it acquired by purchasing a new entrant that the acquired firm would not have purchased).

[18] *Id.*; 5 PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 1140, at 168 (3d ed. 2009) (stating explicitly that this "precedent . . . has not been overruled."); *see* Concurring Statement by Commissioner J. Thomas Rosch, FTC v. Ovation Pharmaceuticals, Inc., FTC, File 0810156 (2008), *available at* ftc.gov/os/caselist/0810156/081216ovationroschstmt.pdf.

[19] FTC v. Whole Foods Mkt., Inc., 548 F.3d 1028, 1036 (D.C. Cir. 2008) (Brown, J.) ("Although the framework we have developed for a prima facie § 7 case rests on defining a market and showing undue concentration in that market, this analytical structure does not exhaust the possible ways to prove a § 7 violation on the merits.") (citations omitted).

separately at fair, reasonable, and nondiscriminatory (FRAND) rates, they would have paid far less than they were forced to pay. All of the manufacturers testified that these fees increased their cost, harmed their ability to compete against Widget, and increased their prices to consumers. Our expert, Dr. Wang, demonstrated that Newco was able to achieve much higher license rates as a result of the aggregation of the patents into one pool.

The defendants cannot dispute these facts. In fact, they explicitly tell their investors that they can achieve higher returns on these patents than could their former owners. The story here is clear: PAP entered into agreements with several parties, including Widget, to acquire thousands of patents. Those acquisitions gave the defendants the ability to charge higher prices for licenses. Competition was harmed as a result and so were consumers. There could not be a simpler case under the Clayton Act, Section 7. These acquisitions are illegal and should be undone.

THE COURT: Counsel, didn't the D.C. Circuit's decision in *Rambus* clearly hold that conduct creating higher license fees is "beyond the antitrust laws' reach"[20] unless there is demonstrated harm to competition? Higher prices alone are not enough to find a violation, correct?

MS. JONES: Your Honor, the *Rambus* case did not involve the Clayton Section 7 incipiency standard; it involved unilateral conduct that the FTC could not prove actually caused the price increase. The conduct here is not unilateral—it is a multiparty agreement. Furthermore, causation is not in dispute: everyone agrees that the patent transactions occurred and that Newco charges more for these patents as a result. The only legal question is whether the acquisition may substantially lessen competition. The word "may" in Section 7 is a very low standard that requires the court to stop anticompetitive conduct in its incipiency.[21] Achieving market power to raise prices as a result of an acquisition more than satisfies this incipiency test. Market power exists if the defendant "can raise price without a total loss of sales."[22] If an acquisition or a series of IP acquisitions may create market power, then Section 7 has been violated.[23] That is exactly what has happened here. And, as *Singer* and *New Wrinkle* clearly held, patent transfers can also violate the Sherman Act. Which brings me to my next point:

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[20] Rambus Inc. v. FTC, 522 F.3d 456, 464 (D.C. Cir. 2008).

[21] United States v. E.I. du Pont de Nemours & Co., 353 U.S. 586, 589 (1957).

[22] 2B AREEDA & HOVENKAMP, *supra* note 18, ¶ 501, at 109 (2007).

[23] *See, e.g.*, Montedison S.P.A., 119 F.T.C. 676 (1995) (issuing a consent order resolving competitive concerns regarding joint venture that combined competing technologies and would have allegedly provided combined firm with market power in connection with technology licensing).

SLIDE 3: THE ACQUISITIONS VIOLATE THE SHERMAN ACT SECTIONS 1 AND 2

The Supreme Court, in *Actavis*, has made it clear that any agreement between two or more persons to unreasonably restrain trade is a violation of Section 1 of the Sherman Act, even if the agreement involves patent licenses.[24] In this case, when the sole purpose of the agreements to acquire patents was to give Newco power to coerce Widget's competitors into raising their costs and thus restraining competition, these agreements violate the Sherman Act.

The defendants claim that some of these acquisitions settle patent disputes, but they do far more than that. In every case, each potential infringer of even a small number of patents agreed to sell large families of patents to PAP, so that PAP's Newco could obtain higher than market rates for license fees. PAP's power grows exponentially with each patent acquisition. PAP acts like an "invasion of the body snatchers;"[25] it is like a virus that gains more strength as it takes over more and more of its host.

These numerous acquisitions gave Newco immense power to exclude Widget's competitors entirely from competition unless they agreed to cave into Newco's demands and turn over their own patents or pay higher-than-market-rate fees for licenses of the large pool of patents. This enables Widget to raise its rivals' costs and gain an unfair advantage in the downstream market for circuits.

Let me be clear, PAP is the one doing the coercion. Even though Newco now has these patents, every witness testified that PAP was the one that coordinated all discussions with potential victims. But PAP could not have achieved its power without the agreements and support of Widget.

Newco is also clearly a monopolist because it has the power to exclude and charge rates that are higher than they would be in a competitive market. That is what market power means. Newco did not achieve its monopoly through business acumen. It achieved it though illegal acquisitions and has maintained it by demanding licenses for patents, regardless of whether it has any good-faith belief that the victims have actually infringed the patents.

The aggregation of these thousands of patents into one company is what gives Newco so much power to do harm. Aggregation, by the way, is just another word for tying, a per se offense—except this is tying on a massive scale. This isn't just the usual case of one blocking or essential patent being used to force a customer to buy a license for another patent. We are talking about a thicket of thousands of patents. In the but-for world of competition, no

[24] FTC v. Actavis, Inc., 133 S. Ct. 2223, 2232–33 (2013).

[25] *Invasion of the Body Snatchers* (Allied Artists Pictures Corp. 1956).

one would buy all of these licenses, and indeed the evidence shows that no one *was* buying all these licenses. But now that the patents are bundled—and in particular, the entire portfolio is tied to the SEPs that everyone must license—the entire industry is subject to supracompetitive license fees for a bunch of patents it neither wants nor needs.

The elements of a tying case are simple: The defendants must condition the purchase of one product (the tying product) on the purchase of the other tied product; the defendant must have sufficient economic power in the tying product; and there must be a competitive effect in the tied product.[26] The defendants effectively concede the first two elements. The only prong of the test that the defendants contest is the last one—they claim that there is no competitive effect in the tied product market. But the competitive effect here is clear: Companies are paying exorbitant license fees for the tied patents that they otherwise would never have paid. It is the aggregation, combined with threats of sham litigation, that has forced companies to pay out hundreds of millions of dollars that they would not otherwise pay. To say that there is no competitive harm ignores the real world.

PAP, through Newco, is exercising "its control over the tying product[s] to force the buyer[s] into the purchase of a tied product that the buyer[s] either did not want at all, or might have preferred to purchase elsewhere on different terms."[27] That's how the Supreme Court defined an illegal tie in *Jefferson Parish*,[28] and we have that here in spades.

SLIDE 4: REMEDY

When a defendant has violated Section 7 of the Clayton Act, divestiture is the appropriate remedy. The Supreme Court made that clear in *California v. American Stores*, and so did the Fifth and Eleventh Circuits respectively in *Chicago Bridge & Iron* and *Polypore*.[29] The defendants say that such a remedy should be precluded because it has been several years since they acquired most of these patents. That is simply not the law. For example, in *du Pont*, the Supreme Court required the divestiture of du Pont's stock in General Motors nearly two decades after the fact,[30] and the divestiture of the companies each had purchased in *Chicago Bridge & Iron* and *Polypore* were ordered by the

[26] *See* Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2, 18 (1984).

[27] *Id.* at 12; *see* Dennis W. Carlton & Michael Waldman, *The Strategic Use of Tying to Preserve and Create Market Power in Evolving Industries*, 33 RAND J. ECON. 194 (2002); Michael D. Whinston, *Tying, Foreclosure, and Exclusion*, 80 AM. ECON. REV. 837 (1990).

[28] *Jefferson Parish*, 466 U.S. at 12.

[29] California v. Am. Stores Co., 495 U.S. 271, 278–296 (1990); *see* Polypore Int'l Inc. v. FTC, 686 F.3d 1208, 1219 (11th Cir. 2012); Chicago Bridge & Iron Co. v. FTC, 534 F.3d 410, 440 (5th Cir. 2008).

[30] United States v. E.I. du Pont de Nemours & Co., 366 U.S. 316, 329–31 (1961).

Fifth and Eleventh Circuits, respectively, years after the original acquisitions. Divestiture is likewise appropriate for the defendants' violations of the Sherman Act. As the Supreme Court said in *du Pont*, divestiture "should always be in the forefront of a court's mind when a violation of § 7 has been found."[31]

The Court should rule that PAP's agreement with Widget is unlawful, rescind the agreement, and order the return of the Widget patents to Widget. The hundreds of other patents identified by Dr. Wang as giving substantial market power to PAP should be divested within 180 days to Court-approved purchasers. We have asked in our Proposed Order for a Special Master to supervise those divestitures and to auction any remaining patents that remain unsold after 180 days. The Special Master should ensure that the patents are not divested to another entity that will have the incentive and ability to misuse the patents as PAP has done.

But divestiture alone will not remedy all of the competitive harms in this case. Because much of the harm in this case arose from the requirement that Widget's competitors license the entire portfolio of patents, even though they only needed licenses to a relative handful, the Court should enjoin the Defendants from offering licenses in the aggregate unless the licensor first requests such a package. If the Defendants then do so, they cannot charge more than a FRAND rate for any SEP, as determined by a neutral arbitrator. Moreover, they would have to offer claim charts on each patent being offered to a potential licensor.

We also ask that the Court require that the defendants notify the Department at least 60 days prior to the acquisition of any patents that are in the same field of use of those patents each one already owns. Considering the past conduct, we believe this is necessary to ensure that the defendants do not continue to violate the law. This is not an unprecedented remedy—it is commonplace in consent orders that resolve anticompetitive acquisitions to require the parties to provide pre-merger notification of future transactions in the relevant market. Moreover, the remedy is similar to the requirement that brand-name pharmaceutical manufacturers and generic drug applicants file notice of certain patent settlement agreements with the FTC and the Department of Justice.

Finally, as much of the harm that was caused by PAP was done in secret, we ask that PAP publicly identify all patents that it or its affiliates hold and in which entity they are held. Transparency is necessary to ensure that future licensees are not faced with the prospect of choosing between a series of lawsuits or a license to an immense undefined set of patents that they probably do not infringe, and which may not even be valid.

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[31] *Id.* at 331.

Your Honor, I reserve the remainder of my time.

THE COURT: Mr. Park, you have 30 minutes.

MR. PARK: Your Honor, the fundamental question in this case is whether the patent pool at Newco increases the output of innovation or reduces it.[32] An agreement between Widget and PAP does not reduce output in the market for innovation in circuit boards. In fact, such agreements can encourage *more* output in the long run by providing greater rewards to innovators who can, in turn, use those resources to fund even more innovation. Further, agreements that enable PAP to license technology more efficiently than Widget could on its own do not have the purpose of stifling competition. Rather, they have the purpose and effect of unlocking the financial potential of new ideas, thereby encouraging more innovation and consumer welfare enhancements.

Therefore, PAP and Widget have not engaged in any anticompetitive conduct. Rather, they have done exactly what the antitrust and patent laws encourage companies to do—they have found ways to maximize efficiencies and monetize the inventors' innovations as effectively as possible. It is not against the law to make money. That is what the American free-market system is designed to encourage. Federal patent law gives Widget the right to extract as much value as possible for its inventions. That is what inspires inventors to invent. That is why the protection of patent rights is right there in the first article of our Constitution.[33]

PAP is merely using its experience and business acumen to help ensure that Widget and others can capture the full and lawful benefit of those inventions. Widget's competitors have not been harmed. They are simply paying the rightful value of the intellectual property that their products infringe. Purchasers of circuit boards have not been harmed because, in the long run, the effective monetization of innovation in circuit boards will encourage future developments that will make circuit boards better, cheaper, and more reliable. The government says repeatedly that patent pooling is somehow illegal, as if there is no defense to that position. Not correct. The government also spends much of its argument trying to dress this up as a merger or acquisition case. It simply is not. Nor is it wrong to pool patents. Pooling patents is a legitimate business strategy. Finally, the assertion of Widget's patents in court is protected from antitrust scrutiny according to the Supreme Court's First Amendment jurisprudence under the *Noerr-Pennington* doctrine. I will now go through each argument in turn.

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[32] 1 HERBERT HOVENKAMP ET AL., IP AND ANTITRUST § 7.3, at 7–15 (2d ed. 2009) ("The purpose of the rule of reason is to determine whether, on balance, a practice is reasonably likely to be anticompetitive or competitively harmless—that is, whether it yields lower or higher market-wide output.").

[33] U.S. CONST. art. I, § 8, cl. 8.

SLIDE 1: THE GOVERNMENT CANNOT MAKE OUT A PRIMA FACIE CASE FOR SECTION 7

First, I must point out that these patent assignments are not acquisitions at all. The Pre-Merger Office has explained repeatedly that licenses with retained rights in the original owner of the patent is not an acquisition.[34] In every case, each original patent assignor retained some rights to the patents at issue, so there is not one complete sale of anything here. A complete sale is what one sees in every other acquisition case ever brought under the Clayton Act, and that is why these assignments should not be treated as acquisitions here.

But more importantly, the government has not even begun to prove a merger case. The Court should notice that the government largely skipped over the market definitions in this case. At best, it claims a technology market for patents that have something to do with circuits. None of these patents are truly substitutes for one another, which makes sense because patents are by their very nature unique. The Supreme Court in *Brown Shoe* clearly held that the "outer boundaries of a product market are determined by the reasonable interchangeability of use or the cross-elasticity of demand between the product itself and substitutes for it."[35] In this case, the government is way outside the outer boundaries of market definition. Counsel is simply throwing thousands of patents up against the wall to see what will stick. But a whole lot of something doesn't mean it's a market.

As *Brown Shoe* teaches us, in a Section 7 case, the law requires proof of markets.[36] A Sherman Act violation requires no less—see the *Independent Ink* case.[37] For example, how can it be determined that a defendant is a monopolist when we do not even know what market it is supposedly monopolizing?

Despite the government's claim that market definition is irrelevant here because there is some claimed actual anticompetitive effect, the Supreme Court made clear in *Philadelphia National Bank* that Section 7 cases always rely on market shares and "undue concentration."[38] Here, there is no evidence in the record regarding who else has patents in the circuit business or PAP's share of the market for circuit patents. Just because the government claims license

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[34] HSR Informal Interpretation Letter No. 0704015 (Apr. 20, 2007), www.ftc.gov/bc/hsr/informal/opinions/0704015.htm; HSR Informal Interpretation Letter, No. 0704016 (Apr. 25, 2007), www.ftc.gov/bc/hsr/informal/opinions/0704016.htm.

[35] Brown Shoe Co. v. United States, 370 U.S. 294, 325 (1962).

[36] *Id.*

[37] Ill. Tool Works Inc. v. Indep. Ink, Inc., 547 U.S. 28, 31 (2006) (holding that in a tying case, one has to prove market power in a particular market; just proving a patent is insufficient proof of market power).

[38] United States v. Phila. Nat'l Bank, 374 U.S. 321, 363 (1963).

rates went up doesn't mean it can avoid proving the relevant market. That is why the FTC lost the *Lundbeck* case, even when prices went up over a thousand percent. It couldn't prove the market definition because there was no proof that one technology was a substitute for the other technology.[39] And that was a two-patent case. Here, there are thousands of patents and none appear to be substitutes for each other.

As Judge Howell said in the *H&R Block* case, quoting the D.C. Circuit and the Supreme Court, "Merger analysis begins with defining the relevant product market."[40] This is the very first step of merger analysis, and the Court cannot just skip over it. Judge Howell emphasized that "[d]efining the relevant market is critical in an antitrust case because the legality of the proposed merger in question almost always depends upon the market power of the parties involved."[41] Indeed, the relevant market definition is often "the key to the ultimate resolution of this type of case because of the relative implications of market power."[42] Here, the government has failed to get to first base. It hasn't proved any market, much less the hundreds of markets it talks about. Our expert, Dr. Bright, showed the lack of elasticity between many, many of these patents prior to the acquisitions, which shows there aren't horizontal markets here—just many unique patents. That is exactly what the court saw in *Lundbeck* when it ruled against the government,[43] and the Court should do the same here.

Clayton Act Section 7 prohibits acquisitions that tend to "substantially lessen competition" in a relevant antitrust market. There is absolutely no evidence that PAP's acquisition of Widget's patents has lessened competition in any relevant market. Since PAP does not produce any products for consumers, the only market that could possibly be affected by the transaction is a "technology market." The Department of Justice defines technology markets as "the intellectual property that is licensed (the 'licensed technology') and its close substitutes—that is, the technologies or goods that are close enough substitutes significantly to constrain the exercise of market power with respect to

[39] FTC v. Lundbeck, Inc., 650 F.3d 1236, 1242–43 (8th Cir. 2011); *see also* FTC v. Lab. Corp. of Am., SACV-10-1873 AG (MLGx), 2011 WL 3100372, at *15 (C.D. Cal. Mar. 11, 2011) (denying preliminary injunction, in part because government failed to prove its alleged markets), *following* FTC v. Freeman Hosp., 69 F.3d 260, 268 (8th Cir. 1995); United States v. Engelhard Corp., 970 F. Supp. 1463, 1466 (M.D. Ga. 1997) ("In order to prevail, the Plaintiff must carry the burdens of proof and persuasion regarding market definition."), *aff'd*, 126 F.3d 1302 (11th Cir. 1997).

[40] United States v. H&R Block, Inc., 833 F. Supp. 2d 36, 50 (D.D.C. 2011) (quoting FTC v. Swedish Match, 131 F. Supp. 2d 151, 156 (D.D.C. 2000) (citing *Brown Shoe*, 370 U.S. at 324)).

[41] *Id*. (quoting FTC v. Cardinal Health, Inc., 12 F. Supp. 2d 34, 45 (D.D.C.1998)).

[42] *Id.*

[43] *Lundbeck*, 650 F.3d at 1242–43.

the intellectual property that is licensed."[44] In this case, the government has not proven the existence of any technology market over which PAP has market power. Circuits often incorporate thousands of patents, and most of them are not substitutes for each other. Therefore, those patents are not all in the same technology market, which means that the aggregation of those patents cannot possibly be a Section 7 violation. The government simply has not engaged in the fact-intensive inquiry necessary to determine whether there is some cognizable technology market over which PAP has market power.

Instead of doing the proper analysis, the government points to the fact that members of the circuit board industry testified they were forced to pay more for patent licenses by Newco than they would have had to pay absent the aggregation. But this alone, even if true, does not mean that PAP has market power in any relevant market. Rather, it is a reflection of the efficiencies that are created when a PAE aggregates a large portfolio of relevant intellectual property and is able to obtain the full value for the intellectual property. These transactions mean that circuit board manufacturers no longer need to engage in protracted licensing negotiations with hundreds of entities—they can simply get a license from PAP. The manufacturers retain some of the benefit of those efficiencies, and PAP enjoys some of it in the form of higher license fees. That is not wrong; it's the result of a competitive market.

In short, the government simply takes PAP's success in a licensing program and says that is proof of an antitrust violation. The fact that PAP was more successful in gaining higher prices for these valuable patents does more to inspire innovation than if the government succeeds in keeping patents in the hands of those who cannot license them efficiently at their full potential value. The Court should recognize that the separation of a patent portfolio from an operating company can result in higher license fees without triggering any of the concerns typically associated with antitrust law.

SLIDE 2: PATENT TRANSFERS AND EXCLUSIVE LICENSES FROM WIDGET TO PAP ARE NOT ILLEGAL

Patent transfers and exclusive licenses are usually thought to be procompetitive. They are not illegal.[45] As the Court can see on the slide, the Department of Justice Antitrust Division and the Federal Trade Commission noted in their Guidelines for the Licensing of Intellectual Property that patent transfers

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[44] U.S. Dep't of Justice & Fed. Trade Comm'n, Antitrust Guidelines for the Licensing of Intellectual Property § 3.2.2 (1995), *available at* www.ftc.gov/bc/0558.pdf.

[45] *See* U.S. Dep't of Justice & Fed. Trade Comm'n, Antitrust Guidelines for the Licensing of Intellectual Property § 1 (1995), *available at* www.ftc.gov/sites/default/files/attachments/competition-policy-guidance/0558.pdf (Exclusive licensing arrangements "may have procompetitive effects [by] encourag[ing] the licensee to develop and market the licensed technology or specialized applications of that technology." *Id.* § 4.1.2).

> can lead to more efficient exploitation of the intellectual property, benefiting consumers through the reduction of costs and the introduction of new products. Such arrangements increase the value of intellectual property to consumers and to the developers of the technology. By potentially increasing the expected returns from intellectual property, licensing also can increase the incentive for its creation and thus promote greater investment in research and development.[46]

It is precisely these outcomes that the antitrust laws are intended to promote, and this is exactly the benefit provided to consumers by PAP.

Pooling of patents in one company is not illegal. Now, my friend from the government likes to use old cases but has passed over the actual case on point here: *Standard Oil* in 1931, where the Supreme Court said that the aggregation of patents was not a violation of the antitrust laws at all.[47] And there is no violation here. In *Standard Oil,* the Court explained that each of the original patent holders already had the right to "determine who should use" its patent and at what rate, and simply pooling them together did not change that power.[48] To use government counsel's analogy: one plus one does add up to two. If the original right to exclude is legal, pooling up several rights to exclude does not make them illegal.

THE COURT: But counsel, don't the *New Wrinkle* and *Singer* cases show that patent aggregation can be an antitrust violation?

MR. PARK: Your Honor, those cases involve fact patterns that are totally inapposite. In *New Wrinkle*, the parties were defending the use of a license to create what otherwise would have been a per se illegal cartel among the entire industry.[49] There is no such allegation in this case. In *Singer*, a group of sewing machine manufacturers conspired to assign and enforce patents with the goal of excluding their common competitors.[50] PAP and Widget do not compete in any downstream product market, so there is no allegation here that competitors in the circuit board market are conspiring to engage in anticompetitive conduct against their competitors.

Also, patent assertion is a unilateral act, and it does not involve any of the agreements that may be challenged under the Sherman Act. PAP's assertion

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[46] *Id.* § 2.3.

[47] Standard Oil Co. v. United States, 283 U.S. 163, 179 (1931) (holding that using cross licenses and a royalty pool to settle conflicting patent claims that created disincentives for additional licenses did not create monopoly or unreasonably restrain competition). Patents give the holder the right to exclude. *See* United States v. United Shoe Mach. Corp., 247 U.S. 32, 57–58 (1918) (holding that leases that restrict use of lessor's patents are not an antitrust violation); United States v. Westinghouse Elec. Corp., 648 F.2d 642, 647 (9th Cir. 1981) (doing "no more than to license some of its patents and refuse to license others" is not antitrust violation).

[48] *Standard Oil*, 283 U.S. at 179.

[49] United States v. New Wrinkle, Inc., 342 U.S. 371, 371 (1952).

[50] United States v. Singer Mfg. Co., 374 U.S. 174, 189 (1963).

of patents assigned by Widget does not require or entail any collaboration or meeting of the minds that could even implicate a per se claim.

Moreover, any understandings between Widget and PAP regarding enforcement of PAP's patents are merely ancillary to the procompetitive assertion of the legal rights held by PAP, and therefore they do not violate the Sherman Act. Judge Bork explained that, "[t]o be ancillary, and hence exempt from the per se rule, an agreement eliminating competition must be subordinate and collateral to a separate, legitimate transaction."[51] Here, communication and understanding between Widget and PAP is vital to determine the most efficient way to ensure the effective enforcement of the patents at issue. What the government would want us to do is not have Widget look at the infringing conduct of its competitors, but instead have another company do the same job more inefficiently. That makes no sense.

Widget is the best-positioned entity to determine which companies' products infringe the patents. Those companies happen to be Widget's competitors, but that fact alone does not make the enforcement of those patents anticompetitive. If Widget had enforced the patents against its competitors itself—as companies increasingly find it reasonable to do—there would be no argument that Widget's actions were entirely consistent with the antitrust laws.[52] Widget's decision to harness the efficiency of PAP's patent enforcement expertise does not convert a lawful exercise of the patents at issue into an antitrust violation.

SLIDE 3: PAP'S ACTIVITY BENEFITS CONSUMERS, ENHANCES COMPETITION, AND SATISFIES THE RULE OF REASON TEST

Any antitrust challenge to PAP's activity therefore must be examined under the rule of reason, which compels the court to balance the potential harm to competition—which is notably absent in this case—against the significant procompetitive benefits that accrue from the increased liquidity in the patent market provided by PAP's actions.

PAP's conduct does not have any anticompetitive effect, even if Widget's competitors had to pay a higher license fee than they would have paid to Widget. PAP has simply asserted property rights that have been granted under federal law by the patent system, and PAP has every right under the patent laws to extract as high a price as possible—even a monopoly price—for the

[51] Rothery Storage & Van Co. v. Atlas Van Lines, Inc., 792 F.2d 210, 224 (D.C. Cir. 1986).

[52] *See, e.g.*, Unitherm Food Sys. v. Swift-Eckrich, Inc., 375 F.3d 1341, 1356 (Fed. Cir. 2004) ("As a general rule, behavior conforming to the patent laws oriented towards procuring or enforcing a patent enjoys immunity from the antitrust laws."), *rev'd on other grounds*, 546 U.S. 394 (2006).

patents that it may legally assert.[53] In fact, the patent system is supposed to create opportunities for innovators to receive financial rewards for their efforts. As President Lincoln said, "The patent system added the fuel of interest to the fire of genius."[54] Unless the asserted patent is invalid, enforcement of that patent is completely procompetitive, regardless of the business model of the asserting entity.

Even if there were some reduction in competition as a result of PAP's enforcement actions, we must balance it against the significant procompetitive benefits of PAP's activity. PAP enhances consumer welfare and promotes competition in two primary ways.

First, entities like PAP enable small inventors and other nonpracticing entities to benefit from their innovation by creating a more liquid market for intellectual property rights. PAP purchases patents from inventors who do not have the expertise or resources to engage in licensing negotiations with practicing entities whose products infringe those patents, and then it monetizes those patents to the benefit of the inventor. PAP is effective and experienced at monetizing patents, and it is able to achieve a higher rate of return for inventors than the inventors could gain themselves. It is good at finding unscrupulous practicing entities that have appropriated other people's inventions without paying for them, and it is experienced and skillful at negotiating fair royalty rates. PAP also absorbs the risks inherent in patent litigation, making it more likely that the original patentee will be able to monetize its patents. Unlike PAP, Widget was not in a position to enforce these patents effectively and thus inspire innovation as much as PAP does. As Dr. Bright explained, the efficient aggregation of patents increases the incentive to innovate, which benefits consumers and supports the primary underlying purpose of the patent system.

PAP also enhances consumer welfare by helping provide an efficient connection between technology innovators and implementing licensees. PAP reduces the transaction costs associated with securing licenses to all the patents that read on an implementer's products. The Supreme Court noted the procompetitive benefits of such aggregation in the *Broadcast Music* case, which involved an antitrust challenge to the practice of aggregating music copyrights to create blanket licenses that covered a large range of intellectual property.[55] As Your Honor can see on the slide, the Supreme Court found that

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[53] *See, e.g.*, Axis, S.p.A. v. Micafil, Inc., 870 F.2d 1105, 1111 (6th Cir. 1989) ("A lawfully acquired patent creates a monopoly that does not violate the antitrust laws.").

[54] Abraham Lincoln, Lecture Before the Phi Alpha Society of Illinois College at Jacksonville (*Second Lecture on Discoveries and Inventions*) (Feb. 11, 1859), *reprinted in* 3 THE COLLECTED WORKS OF ABRAHAM LINCOLN 363 (Roy P. Basler ed., 1953), *available at* quod.lib.umich.edu/l/lincoln/lincoln3?view=toc.

[55] Broadcast Music, Inc. v. CBS, 441 U.S. 1 (1979).

this aggregation created a compelling procompetitive reduction in transaction costs that could satisfy the rule-of-reason test:

> This substantial lowering of costs, which is of course potentially beneficial to both sellers and buyers, differentiates the blanket license from individual use licenses. The blanket license is composed of the individual compositions plus the aggregating service. Here, the whole is truly greater than the sum of its parts; it is, to some extent, a different product.[56]

Similarly, the aggregation of patents relevant to a circuit board into one package that can be licensed together is much more efficient than negotiations with tens or hundreds of patent holders for licenses to much smaller portfolios. The *Broadcast Music* Court noted that avoiding "the delay of prior individual negotiations" with numerous holders of relevant intellectual property is a significant procompetitive benefit.[57] PAP offers that same benefit to circuit board manufacturers, but only by engaging in the procompetitive conduct that the government has challenged in this case. There is no other proven way to do it.

Our expert, Dr. Bright, detailed the merger-specific efficiencies that enable these patents to have the maximum value that patent law allows. He showed how Widget and other patent assignors reduced their costs in patent licensing administration by giving the job to an efficient patent-licensing company, Newco. Outsourcing of administrative work is nothing new to the world of business. It certainly isn't an antitrust violation.

After failing to fit this case into any kind of an antitrust box, the government tries to say this is illegal tying. It is not. The best example of what we have here is the aggregation of channels on cable TV. Surely they are tied together, and surely there is less choice. But it is not at all illegal. In the *Brantley* case in the Ninth Circuit, the court threw out this exact claim because an illegal tie must foreclose competition in the tied product.[58] The court observed that the government's tying "case cannot succeed . . . merely by alleging the existence of a tying arrangement, because such an arrangement is consistent with procompetitive behavior."[59] Rather, the government must prove an "actual adverse effect on competition" in the tied products.[60] In this case, the government claims that the tied products are patents that no one

[56] *Id.* at 21–22.

[57] *Id.* at 22.

[58] Brantley v. NBC Universal, Inc., 675 F.3d 1192, 1201 (9th Cir. 2012).

[59] *Id.* at 1200 (quoting Hirsh v. Martindale-Hubbell, Inc., 674 F.2d 1343, 1349 n.19 (9th Cir.1982) ("[I]ntru[sion] upon consumers' freedom of choice by compelling the purchase of unwanted products . . . has been implicitly rejected by the Supreme Court as a sufficient independent basis for antitrust liability.")).

[60] Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2, 31 (1984).

wants. It's just like the many TV channels we don't watch on cable. But that isn't an antitrust case. There isn't any market foreclosure in unwatched TV channels, and it doesn't sound like there is some kind of market foreclosure in unwanted patents. There simply isn't a case here.

SLIDE 4: PAP'S ENFORCEMENT ACTIVITY IS PROTECTED BY THE *NOERR-PENNINGTON* DOCTRINE

Finally, all of the conduct at issue is squarely protected by the *Noerr-Pennington* doctrine, which provides immunity from antitrust liability for certain litigation-related conduct.[61] The doctrine is an indispensable bulwark against the erosion of the constitutional right to political speech, and it allows citizens to petition the government without fear of antitrust liability.

The Supreme Court extended this protection to litigation in *Professional Real Estate Investors v. Columbia Pictures*, or *PRE*.[62] *PRE* provides presumptive immunity for a patent holder asserting patent rights unless that patent is obtained by fraud on the patent office; the infringement lawsuit is objectively baseless, or sham; or the anticompetitive effect arises from some cause beyond the original patent grant. The Supreme Court in *PRE* articulated a two-part test to determine the existence of "sham" litigation. First, such suits must be "objectively baseless in the sense that no reasonable litigant could realistically expect success on the merits."[63] If that threshold is met, the court will inquire whether the suit demonstrates evidence of a subjective intent to use governmental process to interfere with a competitor's business.[64]

PAP's conduct does not meet either prong of the *PRE* test. First, the government has not shown any evidence that PAP's patent claims are objectively baseless. Rather, Widget's patents and PAP's patents are so strong that almost every major circuit board manufacturer in the world has recognized the need for licenses to the combined portfolio. Second, there is absolutely no evidence that PAP has a subjective intent to use litigation to interfere with a competitor's business. PAP has never filed a complaint against a "competitor" because it does not manufacture any circuit boards. Moreover, PAP's intent has always clearly been to monetize its patent portfolio as effectively and efficiently as possible. Frankly, it could not care less about the downstream competition between Widget and other manufacturers. PAP is only focused on achieving the licensing revenue that the patent law entitles it to receive.

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[61] United Mine Workers v. Pennington, 381 U.S. 657 (1965); E. R.R. Presidents Conf. v. Noerr Motor Freight, Inc., 365 U.S. 127 (1961).

[62] Prof'l Real Estate Investors v. Columbia Pictures Indus. (*PRE*), 508 U.S. 49 (1993).

[63] *Id.* at 60.

[64] *Id.* at 60–61.

Therefore, the sham exception doesn't fit here, and *Noerr-Pennington* protects PAP's litigation activities.

Finally, the First Amendment protection enshrined in *PRE* extends even to pre-litigation conduct. In the Federal Circuit's decision in *Globetrotter Software, Inc.*, the court held that the *Noerr-Pennington* doctrine also applied to the defendant's pre-suit demand letters, and not just to enforcement litigation.[65] In short, the government has failed to identify any conduct that isn't immune under *Noerr-Pennington.*

The *Noerr-Pennington* doctrine has precluded similar lawsuits against patent assertion entities like PAP. For example, Cisco, Motorola, and Netgear recently brought a suit under the Racketeer Influenced and Corrupt Organizations Act (RICO Act) against Innovatio IP Ventures, a PAE, alleging that the defendant had made false statements in its demand letters. The court properly dismissed these claims on *Noerr-Pennington* grounds[66] because the manufacturers could not establish that the PAE's threats were so "objectively baseless in the sense that no reasonable litigant could realistically expect success on the merits."[67] For the same reason, the government's flawed claims in this case should also be dismissed.

SLIDE 5: THE PROPOSED REMEDIES MAKE NO SENSE

Just a word or two about the proposed remedies: A remedy in an acquisition case is not supposed to penalize the defendant; it is supposed to remedy the actual harm to competition. That is what the Supreme Court said in the *du Pont* case.[68] Instead, even if a violation is found—and there simply is none here—the remedy in an injunctive relief case should "restore competition."[69] In this case, the only supposed harm is Newco's offering of patent licenses in bulk. Our chief executive officer, Mr. Zeeg, said that he had no problem offering individual licenses, but that no one had ever asked for one. If the Court wanted Newco to affirmatively offer different types of licenses (single, multiple, blanket, etc.) that would remedy the only harm the government claims in this case. If the Court then wanted to order that all SEP licenses be offered at FRAND rates and offered separately, unless a licensee wanted to combine licenses, that would not be an issue either. The real problem here is that my

[65] Globetrotter Software, Inc. v. Elan Computer Grp., 326 F.3d 1367 (Fed. Cir. 2004).

[66] *In re* Innovatio IP Ventures, LLC, 921 F. Supp. 2d 903, 912–21 (N.D. Ill. 2013) (dismissing RICO, unfair competition, civil conspiracy, intentional interference with prospective economic advantage, and unclean hands claims on the basis of *Noerr-Pennington* immunity).

[67] *PRE*, 508 U.S. at 60.

[68] United States v. E.I. du Pont de Nemours & Co., 366 U.S. 316, 326 (1961) (stating that remedies must be "effective" to "restore competition.").

[69] *Id.*

clients' customers prefer multiple or blanket licenses. Taking that option away from them makes no sense at all.

The evidence is clear that a divesture of all of these patents would simply destroy PAP and abolish all the efficiencies it brings to patent licenses in the circuit business. It does nothing to restore competition, and it will make it more expensive for patent holders to license their patents and diminish the value of patents, which would deter innovation.

In sum, the government has sued Widget and PAP only because my clients have been successful in licensing and enforcing patents. There is a tendency in this town for success to be branded "illegal" by agencies, even when that success is the result of our free-market system that is protected by the First Amendment and the antitrust laws. Federal courts, however, have not been so blinded by the antibusiness bias of the agencies. We ask this court to find that the government has failed to meet its burden here and dismiss this case with prejudice.

Reply Slide 1: The Harm Is Established

Ms. Jones: As Your Honor stated up front, the facts are mostly not in dispute. The defendants acquired thousands of patents in the circuit market and used them to exclude competition and raise the prices of licenses and the products themselves far above the level the patents could reach absent aggregation. PAP entered into a contract with a competitor, Widget, to pool patents and attack Widget's competitors to drive up their costs and thus restrain competition. The defendants think the patent laws give them this right.

But the patents do not give them this power. The defendants want you to ignore how they obtained the illegal market power. If Newco owned a patent, and that patent had market power, that alone would not be a case. But if Newco acquires even one more patent that enables it to raise prices above competitive levels, then that additional power comes from the acquisition—not just from a patent. This is not a one-plus-one-equals-two world. It is a one-thousand-plus-one-thousand-equals-five-thousand sleight of hand by the defendants. If an acquisition or agreement creates additional, substantial market power, it is illegal under Section 7 or Section 1, and, as Dr. Wang explained, it would violate Section 2 when it leads to a monopoly as it does here in many markets.

The defendants have created a patent thicket that harms competition. And like the age-old problem of not seeing the forest for the trees, that is what the defendants' case looks like: they are saying that we should look at each patent and see if it is a market and whether competition is foreclosed for that particular patent. And we can ignore essential patents because they give the patent holder the right to exclude. But it is the combination of the thousands of patents here that create far more market power than the sum of the individual patents. Dr. Wang demonstrated that the average royalty rate for these same patents increased by over 1000 percent, and in many cases far more than that. This is way above the typical 5 to 10 percent increase in price that the agencies usually consider to be substantial. The defendants have created an exclusionary patent thicket. There is immense market power here. There is harm to competition and to consumers, and we are well beyond the incipiency standard of Section 7.

In arguing that an acquisition of a patent is not a transaction under Section 7, the defendants incorrectly rely on some FTC staff informal interpretations. The FTC itself explained that these interpretations had to do with distribution agreements, where the original patent holder retained the rights to manufacture the patented goods and simply licensed others to do the same.[70] Patent acquisitions are the purchase of intellectual property assets, and they clearly have substantial value. Contrary to the defendants' argument, it is often the case that a seller retains some rights (e.g., a minority ownership or stock position) in the sale of an asset, but that does not mean there was no sale of an asset. If the defendants' argument were correct, any purchaser of any asset, including a billion-dollar company, could allow the seller to retain a small bit of ownership and thus skirt the antitrust laws. This argument has no support in the law.

And counsel's argument that *Singer* and the other cases do not apply here is simply incorrect as well. As I pointed out earlier, *Singer* is right on point here. The power that a company has in its own patents may be lawful, but when that company bands together with another to restrain competition in the market "[b]y aggregating patents in one control, that conduct "cannot escape the prohibitions of the Sherman Act."[71]

And all the other cases cited in *Actavis*, which the defendants cannot walk away from, also apply to the Sherman Act claims as well. The only case the defendants can cite in their favor on this point is *Standard Oil*, but the defendants omit the reasoning of that case, which is determinative here. In *Standard Oil,* contrary to the defendants' argument, the Supreme Court held that "The lawful individual monopolies granted by the patent statutes cannot be unitedly exercised to restrain competition."[72] The only reason that the Court did not find the patent pooling illegal in that case was that there was no evidence of any "restriction of competition," because the patents at issue affected less than

[70] Premerger Notification; Reporting and Waiting Period Requirements, 77 Fed. Reg. 50,057, 50,058–59 (proposed Aug. 20, 2012) (to be codified at 16 C.F.R. pt. 801), *available at* www.ftc.gov/sites/default/files/documents/hsr_statements/77-fr-50057/120813hsr-ipnprm.pdf.

[71] United States v. Singer Mfg. Co., 374 U.S. 174, 189 (1963).

[72] Standard Oil Co. v. United States, 283 U.S. 163, 174 (1931).

26 percent of the gasoline products at issue.[73] The lack of effects present in *Standard Oil* is the opposite of what the evidence shows here: here we have large groups of blocking patents with 100 percent market share and restrictions on competition that have held the entire circuits industry at bay. Nor does PAP win its argument by saying that its patents were not in the same market as Widget's. That argument reinforces the fact that the pooling and coercive licensing of pools of patents are indeed illegal ties. These ties are not like the packages of television channels that several competitors offered in *Brantley*.[74] In that case, competitors offered essentially the same channels in different packages to consumers. Here, it is all or nothing. One must accept the licenses offered by PAP or face exclusion in the marketplace. There is no other competing package; that's the point.

REPLY SLIDE 2: THE MARKETS ARE PROVEN

The defendants argue that we cannot stop their aggregation of patents because we have not proven a market. This is incorrect for two reasons. First, unsurprisingly, because there are many patents, we alleged many markets in which the defendants have violated the law: the market for licensing of circuit technology; the market for technology to satisfy circuit standard 000-001 of the IEEE; and the market for circuit products. Dr. Wang testified that each of these was a proper antitrust market because a hypothetical monopolist could profitably raise prices on licenses for the technology; in fact, we have produced compelling evidence showing that the prices for these licenses actually *did* rise a significant amount. She also showed how particular SEPs can comprise their own "markets" and therefore the defendants were able to exclude and achieve higher license rates than they could have achieved absent the acquisitions at issue here.

But even if we disregard Dr. Wang's expert testimony regarding market definition entirely, the incontrovertible facts of this case are sufficient to prove an antitrust violation. In a Section 1 case, direct proof of anticompetitive effects is sufficient to prove a case. Even in a Section 7 case, one does not have to prove a market directly—just a line of commerce and a geographic area of the country, which here is the entire United States. That's what courts have held for years, and the agencies explained this thoroughly in the 2010 Horizontal Merger Guidelines.[75]

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[73] *Id.* at 176–77.

[74] Brantley v. NBC Universal, Inc., 675 F.3d 1192, 1203–04 (9th Cir. 2012) (holding that plaintiff failed to show harm to competition).

[75] U.S. Dep't of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines § 2.1.1 (2010) [hereinafter Horizontal Merger Guidelines], *available at* www.justice.gov/atr/public/guidelines/hmg-2010.html ("Evidence of observed post-merger price increases or other changes adverse to customers is given substantial weight. The Agencies evaluate whether such changes are anticom-

Market definition and concentration are merely a proxy for the real test—whether consumers will be harmed by higher prices and lower output—so when we have direct evidence of the harm, we don't need to go through the market definition analysis.[76] Here, we have clear evidence of higher prices as a result of the transaction and many, many markets, so we have established more than a prima facie case of a Section 7 or Sherman Act violation.

The defendants' two arguments that their conduct is not illegal and that it is justified under the rule of reason appear to be the same argument. Their view is that these acquisitions are simply the result of patent settlements and that the efficiencies in license aggregation is a defense. As we stated earlier and at length in our brief, the Supreme Court in *Actavis* put the final nail in the coffin of the "anything goes because it is a patent" defense. Now, let's turn to the so-called efficiencies.

REPLY SLIDE 3: THE DEFENDANTS FAILED TO REBUT THE PRIMA FACIE CASE; ITS EFFICIENCIES DEFENSE FAILS

The defendants' only affirmative defense of "efficiencies" fails because the price increase is greater than the amount of transaction costs that would have been incurred by the circuit board manufacturers if they had to negotiate licenses with both PAP and Widget (which is considered the "but for" world).

If we compare the extensive evidence of efficiencies that was rejected in *H&R Block*, we can see why the claimed efficiencies here do not save the thousands of acquisitions at issue in this matter.[77] High market concentration levels, as we have here, requires "proof of extraordinary efficiencies," and in cases with far less concentration than we have here, courts "generally have found inadequate proof of efficiencies to sustain a rebuttal of the government's case."[78] That is why the defendants cannot offer even one example of a Section 7 case that was won solely on the basis of an efficiency defense.

The defendants cannot just give the court a list of efficiencies and call it a day. Judge Howell explained in *H&R Block*, citing substantial case law on point, that "the court must undertake a rigorous analysis of the kinds of efficiencies being urged by the parties in order to ensure that those 'efficiencies' represent more than mere speculation and promises."[79] As the Merger Guide-

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petitive effects resulting from the merger, in which case they can be dispositive."); *id.* § 4 (explaining that evidence of competitive effects "also may more directly predict the competitive effects of a merger, reducing the role of inferences from market definition and market shares.").

[76] FTC v. Ind. Fed. of Dentists, 476 U.S. 447, 460 (1986) (holding that direct proof of anticompetitive effects obviates the need to prove market definition or power).

[77] United States v. H&R Block, Inc., 833 F. Supp. 2d 36, 89–90 (D.D.C. 2011).

[78] *Id.*

[79] *Id.* (quoting FTC v. H.J. Heinz Co., 246 F.3d 708, 721 (D.C. Cir. 2001)).

lines explain, "Cognizable efficiencies are merger-specific efficiencies that have been verified and do not arise from anticompetitive reductions in output or service."[80] As Judge Howell explained, just because the owners of pre-merged assets didn't bother to find efficiencies before an acquisition does not mean that post-acquisition efficiencies are "merger specific."[81]

The defendants have not met their burden here. The increased costs to Widget's competitors in the form of supracompetitive license fees dramatically outweigh whatever efficiencies are achieved from PAP's supposed expertise in licensing negotiations. Moreover, the defendants' "but-for" world is merely a straw man. If PAP had not aggregated the patents, Widget's competitors would not have had to get licenses from hundreds of patent holders—they would not have needed licenses to most of the patents at all, so there would not have been any additional costs incurred in getting those licenses.

Let's be clear: the defendants' only defense is that of efficiencies. Whatever those efficiencies are, they are minimal, and pale in comparison to the market power to raise prices, in several cases, by over 1000 percent above what was being charged in a competitive market. Could the defendants offer some of these efficiencies to patent owners without aggregating patents and bludgeoning companies with patent pools? Absolutely. And courts have been very clear in this Circuit that the defendants must demonstrate that their restraint of trade is the least restrictive alternative to create these efficiencies. I note that this has been the law in this Circuit since at least 1984, in the *Kreuzer* case.[82] And more importantly, the defendants cannot prove that these efficiencies are merger related or that they outweigh the anticompetitive effects here. Instead, it looks pretty obvious that PAP and its investors plan on keeping almost all of the money. As Judge Hogan said in the *Staples* case, that isn't a basis for an efficiencies defense.[83] In *Staples*, the issue was whether the small pass-through of efficiencies to consumers would counter the large potential price

[80] Horizontal Merger Guidelines, *supra* note 75, § 10.

[81] *H&R Block*, 833 F. Supp. at 91.

[82] Kreuzer v. Am. Acad. of Periodontology, 735 F.2d 1479, 1495 (D.C. Cir. 1984) (concluding that "because the [defendant] has failed to demonstrate that the limited practice requirement is the least restrictive method available to achieve the asserted goal it is, at this stage of the proceeding, an insufficient justification for a practice that in other respects has an anticompetitive potential—albeit minimal."); *see also* White Motor Co. v. United States, 372 U.S. 253, 270–71 (1963) (Brennan, J., concurring) (less restrictive alternative inquiry was "pertinent" to the rule of reason inquiry because the role of the court is not only to determine if the defendant has a procompetitive justification for its restraint, "but whether the restraint so justified is more restrictive than necessary, or excessively anticompetitive, when viewed in light of the extenuating interests.").

[83] FTC v. Staples, 970 F. Supp. 1066, 1089 (D.D.C. 1997) (rejecting defendants' efficiencies arguments because they were unsubstantiated, and most of the money would likely be retained by the company).

increases resulting from the merger.[84] The defendants' argument did not work there, but in this case, the defendants do not even try to make the right argument. The reason is simple: whatever efficiencies the defendants have achieved in this case have not deterred the increases in royalty rates, which have all gone up exponentially. Whatever efficiencies there may be are going to PAP's owners, not to consumers, and that is not a defense.

REPLY SLIDE 4: *NOERR-PENNINGTON* HAS NO APPLICATION HERE

Now, let me turn to *Noerr-Pennington,* or the right to petition government. This doctrine simply has no role here at all. There is no petitioning of government in an acquisition. It is ironic that the defendants did their best to avoid even telling the government about these acquisitions, and yet it wants to hide behind a petitioning the government defense. This makes no sense. This case is not about the right to sue over one patent, if that right were obtained lawfully. Newco obtained these patents and the aggregated power through acquisitions and agreements—that's what makes them illegal.

And that is the question: how did Newco obtain its immense market power? The Supreme Court has been very clear that to evaluate a *Noerr-Pennington* defense, the court should look at how the defendant got the right to sue in the first place, not whether suing someone is somehow protected. The best examples can be found in the *Actavis*, *Unocal*, and *Walker Process* cases. In *Actavis*, the Supreme Court said that a patent settlement, like many of those here, can be challenged under the antitrust laws.[85] In *Unocal*, the Federal Trade Commission held that a patent holder could be restrained from collecting royalties if it had gained market power through fraud.[86] *Walker Process*, another Supreme Court patent case, said the same thing and specifically held: a patent "'is an exception to the general rule against monopolies and to the right to access to a free and open market'" and noted the "'paramount'" public interest "'in seeing that patent monopolies spring from backgrounds free from fraud or other inequitable conduct and that such monopolies are kept within their legitimate scope.'"[87] We have more than inequitable conduct here. We have clear violations of Section 7 of the Clayton Act and Sections 1 and 2 of the Sherman Act. *Noerr-Pennington* cannot protect the defendants. If it could, then almost every acquisition would be immune from the antitrust laws, if even one patent was involved. That is not the law.

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[84] *Id.*

[85] FTC v. Actavis, Inc., 133 S. Ct. 2223, 2234–35 (2013).

[86] Union Oil Co. of Cal., 138 F.T.C. 1 (2004), *available at* www.ftc.gov/sites/default/files/documents/commission_decision_volumes/volume-138/volume138.pdf.

[87] Walker Process Equip., Inc. v. Food Mach. & Chem. Corp., 382 U.S. 172, 177 (1965) (quoting Precision Instr. Mfg. Co. v. Auto. Maint. Mach. Co., 324 U.S. 806, 816 (1945)).

REPLY SLIDE 5: THE REMEDY MUST RESTORE COMPETITION

Finally, this Court has "large discretion" to grant relief here. As the Supreme Court explained in the *Ford* and *du Pont* cases: "The relief in an antitrust case must be 'effective to redress the violations' and 'to restore competition.'"[88] And the defendants cannot explain why divestiture is not "particularly appropriate" here, as the Supreme Court said in *Ford*.[89] Also, the *Ford* court, like many other courts, endorsed broad remedies far beyond simply divesting overlapping assets.[90] Simply telling the defendants not to exert market power that they achieved illegally is like handing a loaded weapon back to an armed burglar and asking him to please not use the weapon again.

What we have here is a case in which, for many years, thousands of patents made tiny ripples throughout the circuit industry while spawning a tidal wave of innovation. Circuit manufacturing companies spent money on innovation and reduced costs to consumers. But then PAP's Tony Zeeg had a better idea: enter into agreements with companies that had these innovative patents and create a patent juggernaut that could squeeze huge payments from the circuit industry. PAP offered nothing in return except threats and the high cost of dealing with PAP. These agreements have cast a wide net over the circuit industry and are clearly anticompetitive. They have increased PAP's market power to the detriment of circuit companies and consumers. Mr. Zeeg's war on the circuit industry must be stopped, and that is why we are in our country's court representing the people of the United States. We ask for judgment against the defendants. Your Honor, thank you.

THE COURT: Thank you, counsel. Both of you have raised very serious issues for me to consider. I appreciate the government's argument that antitrust issues involving patents are not new, and the mere fact that an agreement involves patents does not immunize it from antitrust scrutiny. On the other hand, the defendants are correct that the antitrust laws are designed to promote innovation, and they generally encourage patent exchanges and licenses.

The first legal question I must decide is whether market definition is essential to the government's claims. The government argues that SEPs each comprise their own relevant product markets, and therefore the defendants have market power in those markets by definition and that other markets have been proven as well. It has also argued, in the alternative, that I do not need to find a relevant market using the traditional test because there is actual evidence of

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[88] Ford Motor Co. v. United States, 405 U.S. 562, 573 (1972) (quoting United States v. E.I. du Pont de Nemours & Co., 366 U.S. 316, 326 (1961)).

[89] *Id.*; *see* Polypore Int'l, Inc. v. FTC, 686 F.3d 1208, 1219 (11th Cir. 2012) (ordering divestiture); Chicago Bridge & Iron Co. v. FTC, 534 F.3d 410, 440 (5th Cir. 2008) (ordering divestiture).

[90] *See* cases cited *supra* note 89.

anticompetitive effect in the form of supracompetitive license fees that exceed whatever merger-specific efficiencies exist. The defendants have focused on the fact that market definition is an essential element of each claim in the case, and the government has not carried its burden of proof regarding any proposed market. The second key legal question is whether the defendants' activities violate the rule of reason, which will depend on which "but-for" world we use as a baseline for the analysis and to what extent I should credit the claimed efficiencies as a cognizable procompetitive benefit. Finally, I must decide whether the *Noerr-Pennington* doctrine is an absolute bar to antitrust enforcement in this area, even though, as I understand it, the government's fundamental challenge is against the initial acquisitions and agreements.

The case is taken under advisement. We are adjourned.