

The Patent Privateering Iceberg

Abstract

For better or worse, non-practicing entities (NPEs) have become a prolific fixture in today's innovation markets. These entities produce no goods or services and exist exclusively to build a portfolio of patents on which to profit through licensing fees or lawsuits. Along with the rise in NPEs come the rise of NPE and practicing entity (PE) relationships. These relationships can be pro-competitive, but they can also raise serious competition concerns.

The nature of the PE/NPE relationship greatly differs between pro-competitive and anti-competitive transactions. In a pro-competitive transaction the PE wants to license its technology to the market but lacks the talent or resources to receive a competitive rate for the use of their technology. However, in an anti-competitive transaction, referred to as patent privateering, the PE is seeking something more than a competitive rate.

This paper has identified three troubling strategies for generating anticompetitive harms to rivals. In a market power strategy the PE has identified an NPE with key substitute patents and seeks a transfer knowing that the additional patents will increase the NPEs bargaining power with the PE's competitors. Substitute patents cover different technologies for accomplishing the same thing. Control of enough substitute patents will allow an NPE to charge monopoly prices. The PE becomes immune to these monopoly prices by taking a license back as part of the transaction. In a dilution strategy the PE seeks to spread its patents out to raise transaction costs, Cournot complement costs, and royalty stacking for its competitors. In a "Hybrid PAE" strategy the PE either creates the NPE or otherwise establishes control over the NPE's activities. This strategy allows the PE to remove the natural conflict of interests between harming the PE's competitors and generating licensing revenues. A Hybrid NPE can forego profits in order to generate greater harm to a competitor. These strategies can be employed individually or in combination with each other.

Patent privateering has several advantages that aid in the success of these anticompetitive strategies. NPEs often employ a complicated ownership structure consisting of many shell companies to hide patent ownership. Hidden patent ownership has advantages including making it difficult for market participants to identify patents they may potentially infringe, making it harder for regulatory and law enforcement agencies to identify bad behavior, and reducing the threat of negative publicity. NPEs may also be better situated to exploit weaknesses in the patent system like patent overvaluing, high costs of defense, and patent thickets. These issues create a larger problem than is immediately visible.

This paper seeks to address the anticompetitive concerns caused by patent privateering. The paper discusses legal precedent that identifies which patent privateering activities under the three strategies could be found illegal under competition laws. The paper then selects real world transactions with characteristics of anticompetitive transactions in order to demonstrate which behaviors should cause concern. The paper also discusses additional advantages of using NPEs for anticompetitive ends and finally offers solutions to the patent privateering problem.