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Re: Comments regarding the FTC/DOJ Patent Assertion Entity Activities Workshop

The American Association of Advertising Agencies ("4A's") is pleased to submit these comments to the Federal Trade Commission and the Antitrust Division of the Department of Justice in connection with the Patent Enforcement Entity ("PAE") workshop held on December 10, 2012.

The 4A's is the national trade association of the advertising agency business. A non-profit management-oriented association, the 4A's helps its members build their businesses, and acts as the industry's spokesman with government, media, and the public sector. The agencies it serves in the U.S. employ approximately 65,000 people, offer a wide range of marketing communications services, and place nearly 80 percent of all national advertising. Agencies in the 4A's range from shops with less than ten people to global networks and multi-agency conglomerates, and can be either privately held or publicly traded. Most members of the 4A's have fewer than 75 employees.

As discussed below, competition in the fasted growing parts of the advertising agency industry has been inhibited by the actions of PAEs.[1] PAE activities have led to a riskier industry and have reduced the returns to innovation by the some of the nimblest and most innovative firms in the industry and their technology suppliers. Because of PAE practices, competition by smaller ad agencies for the digital advertising of large marketers is being stifled. Action by the competition agencies is necessary to help

[1] The 4As understands that there is a distinction between PAEs and other types of non-practicing entities ("NPE") such as research universities or independent inventors. As we understand it, PAEs differ from other NPEs because PAEs purchase patents solely to monetize them. These comments are only intended to discuss the challenges created for the industry by the practices of PAEs.

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provide some balance to the debate in Washington, and this comment provides some ideas for the competition agencies to that.

1. The Advertising Agency Business

Advertising agencies develop marketing communications strategies, ideas and executions for the benefit of their clients. The services that agencies provide to clients can be incredibly broad. Agency services include: creating and producing TV ads, newspaper and magazine ads, radio spots, outdoor ads as well as Internet and mobile display ads, videos and search ads. Agencies act as intermediaries between media sellers – like newspapers, television stations and websites – and marketers, buying media on behalf of marketers. Agencies design and build websites for their clients, curate social media content, conduct consumer and customer research, develop and execute promotional offers, sweepstakes and contests, and organize events and trade shows.

Although often a relatively small part of most marketing budgets (generally less than twenty-five percent), the fastest growing components of marketing activity are in the digital technology area. The main examples of this are interactive web-based communications, marketing on mobile devices, and communicating with customers on social platforms. Digital and Internet marketing activity has grown from less than 5 percent of total US ad expenditures in 2001 to nearly 20 percent last year. By 2015, digital is expected to rise to more than 25 percent.

US Advertising Expenditures in $Millions (current prices)					
	2001	2012	2015	$ change 2012-2015	% change 2012-2015
Television	49,714	62,129	68,327	6,198	9.98%
Radio	18,800	16,718	17,716	999	5.97%
Magazines	21,540	17,984	16,440	-1,544	-8.58%
Newspapers	45,778	24,975	19,448	-5,527	-22.13%
Outdoor	4,814	7,589	8,785	1,196	15.76%
Internet	6,600	30,704	50,443	19,739	64.29%
Cinema	-	725	839	114	15.76%
TOTAL MAJOR MEDIA	147,246	160,823	181,999	21,176	13.17%

Source: ZenithOptimedia 12/2012

Because of this growth in digital and internet marketing activity, agencies now routinely produce digital work product that includes software to perform functions to hold viewers' attention or to enable advertising to be presented.

The growing importance of digital platforms for advertising has opened competition in this space beyond the competition available for more traditional assignments. For the first time, smaller agencies are able to compete with some of the largest agencies in the world for the advertising needs of large-scale advertisers. The market for digital advertising is one of the most dynamic and competitive advertising markets because of the participation of smaller and younger independent agencies. Similarly, the growth of digital platforms means that smaller technology firms can supply solutions that will be used to support the marketing campaigns of even the largest marketers. The participation of these smaller, independent agencies and technology firms is critical to the growth and innovation in the services our members provide to their clients.

Agencies deal with intellectual property as part of their regular business practices. Agencies buy and develop art and technology on behalf of their clients and the rights to that property is generally transferred to the client on receipt of payment from the client. For most IP, agencies have developed practices that allow work to go forward while protecting the rights of the artists and developers that create the IP. For example, it is relatively easy – and familiar territory – to search for words and logos to learn whether a third party owns trademark rights that may present a problem for an ad campaign under development. Similarly, the mechanisms for securing copyright or taking a license to photographs and other artwork are well-understood. And, agencies know how and when to get model releases to avoid publicity rights claims. In addition to these practices, agencies are able to further manage litigation risk by securing ad liability insurance, which can protect against errors or omissions relating to either copyright or trademark. Notably, this insurance is available at a cost that is feasible for digital marketing budgets for even the smallest projects.

But patents are different. Patents, and especially software patents, are notoriously difficult to understand, and agencies – especially the smaller agencies that have flourished in the digital economy – have little to no built in capability to interpret patents. Unlike copyright or trademark, there is no established way to "clear" patents before substantial resources are sunk into a project. Because of this, it is nearly impossible for agencies or marketers to manage this risk ahead of time. Even when potentially relevant patents are identified, the current patent system makes it nearly impossible to gauge the risk. For example, for many patents, it is impossible to know who the real owners of the patent are. This makes it difficult for agencies with clients that might have licenses in the space to understand whether additional licenses need to be obtained. Further, the cost of establishing whether a given patent is valid is generally too high relative to the digital budget to undertake before a project begins, particularly when there are a number of such patents and it isn't clear at the outset what any of them cover.

Given the unpredictable and potentially unbounded risk involved in using digital technologies to develop Internet-based ad campaigns it is not surprising, although it is unfortunate, that unlike other areas of IP, there is no insurance for patent liability that can be used by ad agencies.

2. PAEs inhibit dynamism and innovation in our industry

Because agencies of all sizes develop marketing strategies that include web-based technologies, our member's clients have become targets of PAEs who often use Internet technology related patents as their weapon of choice. PAE practices in the advertising space are just as abusive as they are in other spaces, and they target the vulnerabilities of agencies and marketers. Among these practices are letters that provide too little information for the agency to understand which technologies are alleged to infringe, and the assertion of likely invalid patents coupled with royalty demands that are just low enough to ensure that agencies pay the toll rather than challenge the patent.

It is important to recognize that many of the costs that the patent system and PAEs impose on the ad agency business are incurred even before the patents can get challenged in court. The knockout blow happens when a PAE issues a demand letter to an agency on a tight digital budget. Agencies generally must adopt a flight-or-flight response to these demands given the size of their digital budgets: they either pay the royalties and deal with the fact that a share of the return to their creativity and hard work is going to go to a PAE, or they drop the project entirely when it becomes clear that the size of the digital budget doesn't justify paying the toll. It is rare that these budgets even justify the use of patent lawyers to do prior art searches. It is improbable that the budgets and timelines of these projects justify litigation.

It is also important to recognize that a major impact of PAEs on this industry is to limit the ability of the most innovative new agencies and technology firms to participate. This is the result of a trickle-down effect where the PAE sues the marketer for patent infringement as a result of a website or other execution that the agency creates on behalf of the client. The client then looks for indemnification from the agency, who might then look for indemnification from the technology company that created the technology. Given the scale of the PAE problem in this industry, some clients are demanding indemnification up front. What this means is that the larger and more established agencies and technology companies that are capable of credibly indemnifying their clients get a competitive advantage in the market. Smaller agencies and technology companies are often not able to meet the indemnification requirements of large marketers because of the potentially unconstrained liability that these marketers might have to as yet unidentified PAE plaintiffs. As a result, the need for indemnification brought about

by PAEs can disqualify small innovative agencies and technology companies that otherwise would compete aggressively for the work.

Patents have been asserted against our members and their clients by a number of PAEs including PixFusion, Denizen, Webvention and the multi-faced PAE formerly known as "Project Paperless." The functionality alleged to infringe these patents include what most of us would consider basic functionality including one click shopping, the hyperlink, online shopping carts, targeted banner ads, video streaming, pop-up windows, online payment using credit cards, scanning documents and then emailing them, and basic Wi-Fi functionality. Individual agencies are understandably reluctant to come out with their stories for fear that by doing so they would be painting targets on their backs. However, the rare circumstances where patent infringement allegations in this industry actually go to court illustrates some aspects of these problems.

PAE demands can have unexpected negative effects on consumers. For example, in DietGoal Innovations LLC v. Arby's Restaurant Group, Inc., et al. (October 2011), the holder of a 2003 patent (No. US 6,585,516 B1) for meal builder software (essentially a program for a monthly calorie counter diet plan) claimed that over thirty large fast food restaurants and other food and media industry-related companies infringed its patent, each by virtue of having created a section of its website that allows consumers to build a meal from picture menus and view calorie content. Digital marketing agencies were faced with client demands for indemnification regarding license fees that far exceeded the cost of building the relevant section of each site. Notably, the nutritional information provided on the sites was closely aligned with recent healthcare legislation mandates. As such, this suit not only distorts the market for digital advertising services, but it also acts to frustrate the laudable public policy goal of widespread dissemination of consumer health information.

Another example stems from the actions of GeoTag, Inc. The principal patent enforced by this PAE is truly ancient. Applied for in 1996 and granted in 1999, the '474 patent bounced between tax havens like Liechtenstein, the West Indies, and the British Virgin Islands for ten years before being bought up by GeoTag for a purported $119 million according to a complaint filed by Google and Microsoft against GeoTag. According to the complaint, the owners of GeoTag intended to take the company public, with its principal business strategy being to license and enforce its patents. According to the complaint, GeoTag had sued more than 300 companies in ten separate actions in district court in Marshall Texas alleging that the companies' use of Mapping Services to create store locators and similar locator services on websites infringed their patent. The FOSS Patents website includes a list of nearly 400 companies sued by GeoTag. A

number of the companies whose websites were targeted by GeoTag were created by our members. One member, a small agency whose largest and oldest client is a large retailer named in one of GeoTags suits might go out of business because of the client's request for indemnity.

3. Possible actions by the FTC and the DOJ

Despite the problems created by the current patent system for many industries, patent reform has been difficult as many potential reforms aimed at curbing the excesses of the system often have champions in legitimate industries. For example, what seems like a bizarre and wasteful tactic in the high-tech industry can be a basic good practice in the pharmaceutical industry. The most effective reforms against PAEs might be to challenge the worst aspects of the way they do business. Most of the recommendations we make below can be described as reforms that focus on limiting these aspects of PAE activity. The recommendations are broken down into policy recommendations and enforcement recommendations.

(a) Policy Recommendations

The FTC and DOJ should step up their efforts to advocate for ways to improve the information that the PAEs have to provide in their demand letters. Patent royalty demand letters should identify: the specific patents potentially infringed; accurate real party in interest ("RPI") information, especially when a PAE uses multiple shell holding companies to hide its real interests in patent licensing discussions; information regarding any serious challenges to the validity of the patents at issue; the products or services alleged to infringe and how the patents cover those products or services (i.e., the PAE should be required to document specific examples and provide appropriate documentation for any alleged infringement).

The competition agencies should also study and advocate for: (1) use-it-or-lose-it rules for PAEs similar to trademark requirements (a patent holder should be required to commercially use the patent as a prerequisite for enforcing patent rights); (2) an expanded use of the English rule on attorney's fees for PAEs, so that PAEs would have to pay the attorney fees for both sides if they cannot prove infringement; (3) rules that might further improve patent quality, along the lines discussed in the recent USPTO workshops on patent quality in software; (4), shorter patent terms for web-related and design patents because the speed of web innovation and the incremental nature of web functionality would seem to dictate that a five year patent term is far more appropriate and reasonable than a twenty year term for web software and design patents, and (5) ways to improve the market for insurance for patent infringement claims, including possibly direct federal

support for insurance similar to the support the federal government provides for flood insurance.

The Commission (or both agencies) should also consider implementing the policy initiative noted in the Commission's 2003 Report to request that the PTO "reexamine patents that raise competitive concerns when a substantial new question of patentability exists."[2] In support of this, the Commission should establish the capability to evaluate patents regularly used by PAEs and the impact of those assertions on consumers and innovation, and use that information to identify candidate patents for the Commission to report to the PTO. The Commission might also consider petitioning the PTO for a post-grant review of a patent that appears to be of questionable quality where the patent threatens to seriously harm competition.

(b) Enforcement Recommendations

On the consumer protection side, the FTC should consider bringing unfair and deceptive acts and practices actions against PAEs that rely on deceptive claims in demand letters, including deceptive RPI information, to increase the royalties they get, especially from smaller companies. The Commission could also consider issuing guidelines identifying deceptive practices that PAEs should avoid in demand letters.

On the competition side, the FTC should consider bringing unfair methods of competition claims against PAEs to limit the ability of these firms to buy patents or patent families from other firms and then enforce the patents in ways that are contrary to the way the innovative firms did. To the extent that the industry has grown to rely on one interpretation of the patent families as a result of the practices of the innovator company (or any other company that uses the patents to support the sale of products and services in the marketplace), a PAE should not be able to grossly re-interpret those patents simply to increase royalties. This use of section 5 would be similar to uses of Section 5 by the Commission in *Dell* and *N-Data,* where the use of equitable defenses formed the basis for the theories of unfair methods of competition.

Respectfully submitted,

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[2] Fed. Trade. Comm'n, To Promote Innovation: The Proper Balance of Competition and Patent Law and Policy, ch. 6, at 22 (Oct. 2003), *available at* http://ftc.gov/os/2003/10/innovationrpt.pdf.