Interview with FTC Commissioner Julie Brill

Editor’s Note: In this interview with The Antitrust Source, Commissioner Julie Brill discusses her experience at the Federal Trade Commission thus far, which includes the Commission’s recent successes and setbacks in the courts in merger enforcement, coordination with states on antitrust matters, and her goals for the Commission’s antitrust and consumer protection agendas. Commissioner Brill also discusses the potential for collaboration with the new Consumer Financial Protection Bureau and the Commission’s own efforts in consumer financial protection matters, her thoughts on emerging data security and privacy issues, and her insights into the workings of the Commission.

Commissioner Brill, a Democrat, was sworn in as a Commissioner of the Federal Trade Commission on April 6, 2010, to a term that expires on September 25, 2016. Prior to her appointment, Commissioner Brill was the Senior Deputy Attorney General and Chief of Consumer Protection and Antitrust for the North Carolina Department of Justice, a position she held from February 2009 to April 2010. Prior to her work in North Carolina, Commissioner Brill was an Assistant Attorney General for Consumer Protection and Antitrust for the State of Vermont from 1988 to 2009. This interview was conducted in writing by Editor Kristin McPartland for The Antitrust Source.

ANTITRUST SOURCE: You arrived at the FTC after a significant career working at the state level. How has your work at the state level informed your approach as a Commissioner?

JULIE BRILL: I worked at the state level for over twenty years before my appointment to the FTC as Commissioner. My state level experience informs my approach as a Commissioner pretty much every day. If I had to narrow it down though, I would say that my state experience instilled in me a hands-on, no-nonsense, consumer-focused approach to my work as a Commissioner. As a state enforcer I worked up close with consumers, businesses, and state agencies in a hands-on way, whether it was working to get refunds to consumers who had been victimized by various scams or deceptive practices, or providing practical antitrust advice to state and local entities. Similarly, I approach my work here at the Commission with a consistent consumer focus. That’s my North Star. Also as a state AG, I was a no-nonsense prosecutor. I represented my state in court and in multi-state negotiations with corporations. Here at the Commission, I bring that approach to the table.

ANTITRUST SOURCE: What do you mean by “no-nonsense” approach?

BRILL: My no-nonsense approach flows from having been a senior state enforcer with a large docket to manage with limited resources. To be effective in my role, I had to manage that docket with those resources as efficiently as possible, and the smart way to do that was with a straightforward, practical, and direct approach to the work. I bring that very practical viewpoint to all of our enforcement and policy work here at the Commission.

ANTITRUST SOURCE: You’ve been at the FTC for just over a year and a half now. What, if anything, has surprised you about the experience?

BRILL: Over my twenty years as a state antitrust and consumer protection enforcer, I became very familiar with the FTC—its enforcement philosophy, its policies, and the key personnel. Although I
had not worked at the FTC before becoming a Commissioner, it felt like I knew quite a bit about the work the FTC does from day one. So I have not been particularly surprised by anything we do, or how we do it, in the enforcement arena. As a Commissioner, however, I am involved in a wide array of decisions outside the enforcement arena, such as our policy work, and also the day-to-day administration of the agency. In the policy arena, we Commissioners deliberate over and vote on the issuance of reports, such as the Privacy Report1 and the Authorized Generics Report.2 Although I hadn’t previously experienced how closely the public watches the agency’s policy work, I thoroughly enjoy this aspect of the job. On the administrative front, we consider and vote on FTC budget proposals and various other issues. Having managed a large state consumer protection and competition division before coming to the FTC, I was pretty familiar with this aspect of the job.

ANTITRUST SOURCE: Since you’ve been at the FTC, has your work focused more on antitrust or consumer protection?

I am interested in everything . . . .

When dealing with the Commission’s external stakeholders, I have focused principally on consumer protection issues, in particular privacy and financial practices. Yet I’m also very interested in competition issues, and have had a lot of interaction with our external stakeholders on the competition side as well.

ANTITRUST SOURCE: A high priority for the agency has been putting a stop to so-called pay-for-delay pharmaceutical settlements. The agency has had a number of setbacks in the courts, and Congress has yet to pass a legislative solution. What are your thoughts on the pay-for-delay issue and what do you think the FTC’s strategy should be in light of these setbacks?

Pay-for-delay remains a key priority for this Commission. The FTC is taking a two-pronged approach to restricting pay-for-delay agreements. First, we continue our law enforcement work in the area, and second, we’re talking to Congress about legislation. There have been setbacks in the courts, but the cases continue apace. Our Cephalon case is ongoing in the Eastern District of Pennsylvania (in which the district judge recently held that Cephalon’s patent was invalid and unenforceable), and we await the Third Circuit’s decision in K-Dur, as well as the Eleventh Circuit decision in Androgel.

I believe that some pay-for-delay deals result in a large amount of consumer harm, and we should not let the setbacks you refer to deter us from continuing to do the right thing by protect-

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ing consumers and competition. The FTC has estimated that pay-for-delay costs consumers $3.5 billion per year, or $35 billion over ten years. That's a lot of consumer harm.

The issue has also received bipartisan support in Congress. Pay-for-delay subverts the congressional mandate underlying Hatch-Waxman, and many in Congress agree with us that the practice is something that they need to look at through the legislative process. We are grateful for their support, and are eager to assist.

ANTITRUST SOURCE: You mention continuing to pursue legislation and litigation, but since those approaches have had some trouble gaining traction, is there another approach that the FTC could or should pursue? Or do you think the FTC should stay the course on these two approaches?

BRILL: Well, I'm an optimist by nature, so the short answer to your second question is “yes.” Right now, our resources in the pay-for-delay area are focused primarily on investigations and law enforcement actions, and I support that approach. Also, as an optimist, I see the “glass-half-full” and think that we are actually gaining some traction in the courts. In the Cephalon case, the judge denied the defense’s motions to dismiss and has since ruled that the patent at issue is invalid and unenforceable. In K-Dur, both the FTC and DOJ participated as amici, including at oral argument before the Third Circuit. I see these developments in a positive light, and sincerely hope that the judges involved will see the evidence and arguments as we do.

ANTITRUST SOURCE: The FTC has brought two recent cases—North Carolina Dental and Phoebe Putney—that prominently featured the state action issue, another agency priority over the last decade. Given your background at the state level, do you approach this issue differently from the other Commissioners? Do you expect the agency to continue to look for cases to narrow the state action doctrine?

BRILL: I should say at the outset that I was recused from North Carolina Dental, the most recent Commission decision involving the state action doctrine, but I am happy to talk about the doctrine as it relates to Phoebe Putney, and more generally.

In the ongoing Phoebe Putney hospital merger case, state action was a gating issue. The defendant hospitals and the county hospital authority argued that the transaction was exempt from federal antitrust liability under the doctrine. We believed the transaction was motivated and planned exclusively by Phoebe, with the hospital authority serving only as a “straw man” to shield an anticompetitive merger to monopoly. All the Commissioners felt strongly that we needed to call the defendants on their state action arguments, despite some tough precedent in the Eleventh Circuit. Did I approach the issue differently from the other Commissioners because of my background in state enforcement? I would say that the answer to that is “no.” I think that had I been confronting the same evidence during my time as a state enforcer, I would have made the same call. So, I was pleased but not surprised that the Georgia Attorney General joined forces with us in the Phoebe Putney case. This really spoke to the strength of the Commission’s evidence.

With respect to other matters that raise state action issues—particularly bills under consideration in various state houses—my past experience may lead me to think a bit differently about how

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7 FTC v. Phoebe Putney Health Sys., Inc., 793 F. Supp. 2d 1356 (M.D. Ga.), aff’d, 663 F.3d 1369 (11th Cir. 2011).
we approach state policymakers to express any concerns we may have. Having seen the state legislative process up close and personal over many years, I’m sensitive to how few antitrust resources the vast majority of state houses possess.

Your second question is an interesting one. I don’t know that I see the FTC so much as looking for cases as having cases brought to it, particularly in the merger arena. Through the HSR process, the FTC and the DOJ filter many mergers, the majority of which are benign and receive early termination of the review process. With some mergers, however, we take a closer look. *Phoebe Putney* was one such merger, and it happened to involve a state action doctrine issue. When we took a hard look at it, however, it became clear to us that state action was being used by the hospitals to shield an otherwise anticompetitive merger from antitrust scrutiny. I would hope that we as an agency will identify these issues when they are presented to us by merging parties, and that we would react appropriately, as I think we did in *Phoebe Putney*.

**ANTITRUST SOURCE:** In light of your comment regarding the antitrust resources available to state legislatures, could you say a word or two about the kind of assistance and advice that the Commission, primarily through its Office of Policy Planning, provides to state legislatures on antitrust matters?

**BRILL:** The assistance and advice you refer to is our competition advocacy work. Within the Beltway, it is a less well-known aspect of the FTC’s mission, but it is something I am quite familiar with through my work as a state enforcer. FTC competition advocacy work often involves an advisory letter from FTC staff to a state legislature or professional board that is contemplating a change to existing laws or regulations, or adopting new laws or regulations, that impact competition. The FTC advocates for competition principles to be considered in the legislative or rule-making process. In recent times, much of the FTC competition advocacy work at the state level has been in the healthcare arena. We are a very transparent agency. All of our advocacy letters are available on our website.8

**ANTITRUST SOURCE:** In the *LabCorp/Westcliff* litigation, the FTC terminated both the federal court and administrative proceedings after the district court declined to issue a preliminary injunction and the Ninth Circuit refused to grant an emergency stay.9 You voted against terminating the appeal and issued a dissenting statement explaining your reasoning.10 What are your thoughts on when the agency should continue to challenge an unconsummated merger when the agency fails to obtain a preliminary injunction?

**BRILL:** Decisions about cases—whether to bring them, whether to appeal, how far the appeals should go—turn on the facts as well as the law. So it is difficult, and arguably not particularly useful, to try to discuss in the abstract when it might be appropriate to continue a merger challenge absent a preliminary injunction. From my perspective, the answer will almost always be, “It

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depends.” That said, I am happy to explain my reasoning in *LabCorp*, and why I thought we should have continued our challenge in that case.

In *LabCorp*, the district court paid only lip service to the principle that pre-integration relief is often far more likely to remedy competitive problems than post-integration divestiture. In other words, the district court failed to recognize that it’s very hard to unscramble the eggs. I believed, and still believe, that the *LabCorp* opinion ignored two important parameters that the district court judge should have operated within: congressional intent and Ninth Circuit precedent. Congress recognized the difficulty of unscrambling the eggs when it granted us authority to seek a preliminary injunction under Section 13(b) of the FTC Act. The Ninth Circuit precedent also recognized the principle, and I thought that the court of appeals should have been given an opportunity to weigh in on the issue.

My vote in *LabCorp* was also context-specific. In that case not only did the district court judge ignore important legal principles, but he did so in the context of a healthcare market. I felt that an appeal was worth the expenditure of resources given the importance of the industry involved. As I noted in my dissent, healthcare costs continue to rise dramatically in this country, and there is considerable debate over how best to contain them. In my opinion, vigorous antitrust enforcement plays an important role in bending the healthcare cost curve, and we should be especially vigorous in cases where price increases or output reductions are foreseeable, as was the case in *LabCorp*.

**ANTITRUST SOURCE:** You have spoken on the changes in the 2010 Horizontal Merger Guidelines and have stated that you don’t think the move away from a lockstep analysis—first analyzing market definition and then proceeding through the other steps—is a significant change. Many in the industry, however, would argue that the Guidelines represented a significant break with precedent. What is your response and do you think the concern over the Guidelines will quiet down over time as people see them in action?

**BRILL:** I find this question interesting, looking at it as I do from the perspective of an FTC Commissioner, as opposed to someone from industry. That is to say, from my perspective the 2010 Merger Guidelines do not mark a significant break from precedent but are instead part of a continuum. If you look at the 2006 Merger Guidelines Commentary, the agencies clearly stated then that they did not apply the 1992 Guidelines in a linear fashion. I believe the word we used in 2006 to describe the approach taken was “integrated.” The 2010 Guidelines also take an integrated approach to merger analysis.

What the 2010 Guidelines did was to take a step away from the use of market definition, market structure, and market shares as gating issues. The 2010 Guidelines consider competitive effects first, and I think we got this right. The new Guidelines also provide important guidance about the kinds of evidence we and the DOJ will look at in analyzing competitive effects.

I believe the courts—as well as industry—will see the sense in our flexible approach and, over time, adopt it. Remember, the courts did not adopt the 1992 Guidelines overnight, but rather did so gradually, as merger cases were brought before them by the agencies. I think the courts will continue down this path with the 2010 Guidelines, as one court did recently in the *ProMedica* preliminary injunction decision.\(^{11}\)

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**ANTITRUST SOURCE:** You’ve also commented on the Commission’s goal in making Part 3 administrative adjudications more expeditious. How would you assess the Commission’s performance over the past year?

**BRILL:** The major Part 3 rule revisions were in place in 2009 before I got to the Commission, but I can speak to the more recent 2011 revisions, and how I see the new rules operating in practice.

The rule revisions came about in response to a concern that the Part 3 adjudicative process had become too protracted, particularly in merger cases. The feeling was that the adjudicative process had created reluctance on the part of some federal district court judges to grant preliminary injunctions in cases brought under Section 13(b) by the FTC. The FTC listened closely to these concerns, but at the same time we recognized that we have been given a job to do by Congress as an administrative agency. That job is to enforce our statute and our mandate as an administrative agency with expertise in antitrust and consumer protection. So we decided to fence ourselves in—to self-regulate, if you will—and to speed up the Part 3 process, while at the same time preserving our mandate as an administrative agency.

My assessment of the Part 3 rule changes is: “So far, so good.” Although I cannot comment on the substance of the *North Carolina Dental* decision, I know that it was produced in accordance with the new rules, and the appropriate deadlines were met. In fact, my understanding is that the Commission issued a decision in record time—slightly over four months from the date of the respondent’s notice of appeal. I see no reason why this trend will not continue, both in merger and non-merger cases, and look forward to playing my part in it.

**ANTITRUST SOURCE:** There has been a great deal of discussion concerning the scope of Section 5 in competitive matters, including the FTC’s 2008 workshop on the topic. In your opinion, how broadly can the FTC act under Section 5, particularly in relation to the other antitrust statutes, and how broadly should the FTC act under Section 5 when it comes to curbing anticompetitive behavior?

**BRILL:** In commenting on how broadly the FTC can act under Section 5, it is helpful to remind ourselves of the congressional intent behind Section 5. As with the pay-for-delay issue, I think the congressional intent matters a great deal here. When you look at the congressional record, it’s pretty clear that Congress intended Section 5 to be about three principles: one, to be broader than Sherman Act Sections 1 and 2; two, to cover conduct likely to have some demonstrable adverse effect on competition; and three, to be a common law statute, the interpretation of which would be developed through case-by-case analysis. So to answer your first question: the Commission was given a pretty broad mandate from Congress to curb anticompetitive behavior. I should also note here that the Supreme Court has held that Section 5 of the FTC Act is broader than the Sherman Act.

Your second question goes to what the Commission should do with this broad congressional mandate. As I see it, two key parameters around this question are the courts and the limited reme-

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dies available to the FTC under Section 5. The FTC has in the past received mixed reactions from some courts to standalone, unfair methods cases under Section 5. This is an important factor to take into consideration in deciding how the FTC should bring cases under Section 5, but there are others. As the Commission has emphasized in recent enforcement actions—Intel comes to mind—the risks of Section 5 enforcement are limited since it does not give rise to treble damages actions in the way that Sherman Act enforcement might. These two factors, and perhaps others, need to be weighed along with the available evidence in an individual case when deciding whether or not to bring an action against unfair methods of competition under Section 5.

**ANTITRUST SOURCE:** Given that Section 5 has been developed, as you say, on a case-by-case basis and that there have been only a handful of recent cases outside the invitation to collude context, how should antitrust practitioners counsel their clients to avoid violating Section 5?

**BRILL:** In addition to invitation to collude cases, Section 5 was also recently applied in the standard-setting context in the N-Data case. I’d advise counsel to look at the Commission’s statement at the time, in which the Commission made clear that N-Data’s conduct constituted an unfair method of competition within the meaning of Section 5. Outside the standard-setting context, Chairman Leibowitz and Commissioner Rosch have spoken extensively to practitioners and others about their views on the scope of Section 5, particularly at the time of the Commission’s Section 5 Workshop in 2008. In his remarks at the time, then Commissioner Leibowitz not only spoke about Section 5 in the standard-setting context, but also in cases involving inequitable conduct before the PTO, for example. I think these statements are useful sources of information for counsel to guide their clients.

**ANTITRUST SOURCE:** Turning to consumer protection topics, you were confirmed just before the Dodd-Frank Act was passed, which created the Consumer Financial Protection Bureau (CFPB), and there has been a great deal of conversation about how the CFPB and the FTC will work together. As a Commissioner, how will the presence of the CFPB inform your perspective and recommendations on consumer protection issues involving financial products?

**BRILL:** I’m looking forward to working with the new CFPB “cop on the beat.” Coming from state enforcement, as I do, I am very comfortable with shared jurisdiction. While the provisions of Dodd-Frank required us to give up some rulemaking authority to the CFPB, in reality we did not have that much rulemaking authority with respect to financial services to begin with. Congress gave the CFPB broad authority for rulemaking, and the Commission gains the ability to enforce the CFPB’s rules concerning entities within our jurisdiction. So I see it as a large net plus for our overall authority.

And we have other statutes and rules within our jurisdiction that we will continue to enforce: Section 5 of the FTC Act, the Telemarketing Sales Act, the Telemarketing Sales Rule, the GLB

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Safeguards Rule, the Children’s Online Privacy Protection Act, and the CAN-SPAM Act, to name just a few. Both in the financial realm and otherwise, there is plenty of work for all of us to do.

In terms of our substantive work, having the CFPB up and running will give us—as well as industry and consumers—an additional expert to consult and work with regarding issues surrounding financial products. I look forward to that high level of consultation. I’m not sure the Bureau’s presence, per se, will change the way I view consumer protection issues involving financial products, but I hope the Bureau’s views will become part of the conversation to be considered by all regulators, as well as industry and consumers.

ANTITRUST SOURCE: At the ABA Fall Forum in November 2011, where you spoke on a panel with Peggy Twohig and Howard Beales, you seemed to suggest that the CFPB needed to be careful about “agency capture” and drew a contrast with the low risk of agency capture at the FTC. Could you explain your concerns and your thoughts on how the new agency could reduce the chances of agency capture?

BRILL: The discussion at the ABA Fall Forum was a theoretical discussion. I was speaking about the theoretical dangers of agency capture that come from being too close to the regulated community and not close enough to the public—those whom you are charged to protect. The CFPB has broad authority to directly engage with those they regulate, in a way that the Commission does not. The CFPB has the authority to conduct supervision over many companies—to actually go in and examine the books and the company’s operations. The CFPB is also focused on a narrower sector of the economy in a way that the FTC, with its more diffuse jurisdiction, is not. The abstract concern I was expressing is that this more narrow focus, coupled with close ongoing relationships with the businesses the agency is regulating, can theoretically lead to regulatory capture.

To balance that direct connection with the regulated community, the agency must also have a direct connection with consumers. So, while I flagged capture as a theoretical issue, I have no doubt that the CFPB has begun to vigorously and directly engage with consumers. For example, the Bureau has a division devoted to consumer outreach and education, led by Gail Hillebrand, and it has created entire offices devoted to outreach towards vulnerable consumer populations, including senior citizens and the military. And the Bureau is already taking credit card and mortgage service complaints directly from consumers. It will expand the number of issues about which it will accept complaints as time goes on. The Bureau has committed to sharing those complaints with other law enforcement agencies nationwide, including the FTC, through our Consumer Sentinel database.

So I believe the CFPB has done a good job of setting up systems to engage directly with consumers, and will undoubtedly work hard to avoid any theoretical concerns about agency capture.

ANTITRUST SOURCE: You talked about consumer outreach by the CFPB. The FTC itself has engaged in a fair amount of consumer outreach through Sentinel, consumer alerts, and consumer-directed information on the FTC website. Would you comment on how and to what extent consumer complaints influence the Commission’s direction?

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19 This term refers to a situation in which a regulatory agency is “uniquely susceptible to domination by the industry [it is] charged with regulating.” Thomas W. Merrill, Capture Theory and the Courts: 1967–1983, 72 CHI.-KENT L. REV. 1039, 1043 (1997).
BRILL: The consumer complaints in the Consumer Sentinel database\(^{20}\) are incredibly important for both the Commission’s work and that of our law enforcement partners. Over the past five years, through Sentinel, the FTC has collected and shared more than 16 million complaints with over 1900 law enforcement organizations in the U.S., Canada, and Australia. The Sentinel database enables law enforcers to spot consumer fraud and deception trends quickly, to target the most serious illegal practices reported by consumers, and to coordinate law enforcement efforts. States, federal, and international agencies, as well as non-governmental agencies, such as the Better Business Bureau, contribute consumer complaints to Sentinel, continually increasing the number and types of complaints available to law enforcement. And we are especially pleased that in February 2012 consumer complaints from the CFPB will be added to the Sentinel database.

There are many members of the law enforcement community, including the FTC, that use the information in Sentinel as a guidepost in case selection and development. Of course, Sentinel is just one tool that we use in developing our enforcement agenda, but it is a very useful tool.

ANTITRUST SOURCE: You have been active in the area of consumer protection issues arising in debt collection, giving a speech to the ACA in July 2010\(^{21}\) and issuing a concurring statement to the Commission’s FDCPA Enforcement Policy Statement on collecting decedent debt in July 2011.\(^{22}\) Would you call debt collection one of your signature issues?

BRILL: I’m not sure that debt collection is one of my signature issues, but it is certainly one about which I care deeply. In the down economy, debt collection has been an incredibly important issue for me. And it is one where the Commission has been active.

With regard to the decedent debt policy statement, I thought it important to recognize the legitimate need of the industry to find the person with whom they are authorized to speak, but it was also important to recognize the potential for abuse, and to be clear that if such abuse occurs we will take appropriate action.

The Commission has been very active in debt collection enforcement. A good example is our case against West Asset Management, one of the country’s largest debt collectors.\(^{23}\) The Commission alleged that West Asset Management engaged in abusive collection practices, such as repeated calls, threats of arrest, disclosure of debts to third parties, and unauthorized withdrawal of funds from bank accounts. To settle our charges, West Asset Management agreed to injunctive relief and to pay a record civil penalty of $2.8 million.

And we just announced another important decision involving Asset Acceptance, the largest debt buyer in the country.\(^{24}\) The Commission believed that Asset had engaged in a host of collection activities that violated the FTC Act, the Fair Debt Collection Practices Act, and the Fair Credit Reporting Act, including asserting that consumers owed debt that Asset could not sub-


 instantiate, failing to disclose that debts were too old to be legally enforceable or that partial payment would extend the time the debt could be enforced, and failing to notify consumers when Asset provided negative information to credit reporting agencies. To settle our charges, Asset agreed to pay a $2.5 million civil penalty. More importantly, the company agreed to significant injunctive relief, including that Asset would notify consumers that it will not sue on debt that it knows or has reason to know is time-barred and, once that disclosure is given, that it would be barred from filing suit even if partial payment revives the debt.

Going forward, we will continue to consider the issues raised by the collection of time-barred debt—that is, efforts to collect debt where a collection action would be barred by the statute of limitations. Some debt buyers convince consumers to make a partial payment on debt that is time barred without informing them that such payments may revive the stale debt.

**ANTITRUST SOURCE:** There has been a great deal written about the use of consumer and credit reports in the media since the recession began, and several states have passed laws addressing the use of consumer or credit reports in hiring. The New York Times reported in December 2011 on new consumer reports that are drawing from untraditional sources, such as payday lenders or homeowner’s associations, for consumer information. What do you see as the FTC’s role in overseeing these issues and how can the FTC work with the states to address potential concerns?

**BRILL:** The Fair Credit Reporting Act, which we enforce, addresses the use of credit reports. To be a credit report under FCRA, the report must be a communication bearing on a consumer’s credit worthiness, character, general reputation, and the like; and it must be used for decisions about credit, insurance, employment, housing and the like. So, for instance, if a report contains information about your character and is used for employment purposes, its use may very well come under the FCRA. The most important implication of applying the FCRA to these reports is that the law provides consumers with certain notification rights about the use of credit reports, as well as the right to access and correct information contained in the reports.

Now, with the much greater ability to gather information across websites, including social media, I believe we need to ensure the same safeguards are in place for a broader array of reports on consumers. The rights of the consumer to view and correct reports should be on a sliding scale with the sensitivity of the information being gathered and the consequences for the consumer of the way the information is being used. Employment is a good example of where the consequences are very high, and so access and correction rights should be in place.

Indeed, the FTC staff recently sent warning letters to three mobile app companies that market background screening apps that provide users with information often used to screen potential employees. Staff informed these companies that the use of their apps for employment purposes would trigger the FCRA, and all the consumer rights that go along with the FCRA. In addition to enforcement, I think the FTC should play an active role in encouraging the data industry to be more transparent about the data it collects and sells for sensitive uses, like employment, housing, and credit. Many consumers do not know who these data brokers are or where to find them. I believe the data broker industry should become much more transparent and provide consumers

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with a simple mechanism to find out who they are, what kind of information they collect and pro-
vide to others, and in appropriate circumstances, to provide them with the ability to access the
information the companies hold and to correct the information if it is inaccurate.

**ANTITRUST SOURCE:** The FTC has recently announced settlements with both Google and Facebook
regarding privacy violations. Still, there are calls on the Hill for legislation to address privacy. Do
you see a need for legislation in this area or can the FTC and the states address the issue with
their current tools?

**BRILL:** The FTC’s authority to address privacy issues stems from a number of statutes and rules.
We bring many of our data security and privacy cases under our Section 5 authority prohibiting
unfair and deceptive practices. We enforce other statutes and rules in the privacy realm, includ-
ing the GLB Act, COPPA, FCRA, the Red Flags rule, the Health Breach notification rule, CAN
SPAM, and Do Not Call. In addition, states have “mini” FTC Acts that mirror Section 5, as well as
breach notification and, in some cases, data security laws. These laws are effective in address-
ing a wide range of activities concerning collection, use, retention, and disposal of consumer data.

The Commission as a whole has called for federal legislation in the areas of data security and
breach notification. Enactment of a federal data security and breach notification law would bring
us into line with the states that already have such legislation in place. But more fundamentally, I
am concerned that currently there is no federal law establishing baseline principles governing the
collection, use, retention and sale of consumer data by the vast bulk of companies that collect and
use this information. As just one example, outside some sector specific laws (HIPPA and GLB)
there is no requirement that these companies establish a privacy policy or inform consumers
about their data collection and use practices. The dearth of information available to consumers
about data collection and use in the mobile space has been well documented by our agency27
and the Future of Privacy Forum.28 I think a federal law that establishes baseline privacy protec-
tions would be helpful to consumers and industry.

**ANTITRUST SOURCE:** What are some key elements that you would like to see in a federal data secu-
ritiy and breach notification law?

**BRILL:** A federal data security and breach notification law should create data security require-
ments that are flexible and technology neutral, so any law does not lock in or promote particular
technologies or approaches. And in creating a federal standard for data breach notification, the
law will have to address the variety of issues that have been addressed by over forty-five states,
such as when the requirement to provide notice is triggered, how long the entity that suffered the
breach can delay in the event of a law enforcement investigation, and the like.

**ANTITRUST SOURCE:** In a September 2011 speech before the IAPP,29 you spoke about the privacy

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www.ftc.gov/os/2012/02/120216mobile_apps_kids.pdf.

28 FPF Finds Nearly Three-Quarters of Most Downloaded Mobile Apps Lack a Privacy Policy, Future of Privacy Forum (May 12, 2011),

29 Julie Brill, Comm’r, Fed. Trade Comm’n, Privacy: From the Woods to the Weeds, Address Before the Int’l Ass’n of Privacy Professionals,
issues that arise with the collection of browsing information and the aggregation of that information and highlighted the need to have a common understanding of terms, such as “track” and “commonly accepted practices” in the context of Do Not Track mechanisms. What is your definition of “track”?

**BRILL:** This is an important issue because it is unclear whether these terms are being used consistently—we need to develop some consensus as to what these terms mean. So thanks for asking the question. I define both terms from the vantage point of the consumer.

I believe that “tracking” should be understood broadly, in part because I believe that is how consumers understand that word, and in part because I think that is the fairest approach. So I believe that when consumers are given a choice about “tracking” they should have the choice not only about how their information is used, but also about whether and how their information is collected in the first place.

**ANTITRUST SOURCE:** On a broader agency note, most federal agencies are facing significant budgetary constraints, and the Antitrust Division recently announced it was closing several field offices to save money. How has the current budgetary climate affected the FTC and are you concerned about the agency’s ability to maintain its enforcement mission?

**BRILL:** I may be a little biased, but I think that the FTC is doing a great job maintaining its enforcement mission given the current budgetary constraints. I would say that the key tools here include smart case selection and a continued emphasis on focus and efficiency once we are in litigation. I should also emphasize that, although we pick our battles carefully through our case selection process, once we have decided to enter the fray, we make sure that our staff has the resources and budget they need to get the job done.

Our current litigation docket is probably the best data point with which to illustrate my points. Right now, the FTC is litigating a merger challenge in Rockford, Illinois. Many members of the Rockford team also litigated the ProMedica merger challenge in Ohio and before the ALJ here at the Commission last year. The experience of the ProMedica litigation will no doubt make our Rockford effort both focused and efficient. Similarly, in the ongoing Cephalon litigation, the judge ordered the FTC to coordinate our discovery efforts with the other plaintiffs in the case, which we did. For example, we split some expert fees with the other plaintiffs, allowing some of our resources that would have been spent in that case to be deployed elsewhere.

Our productivity is a direct result of the dedication and effectiveness of our wonderful staff. As our Chairman likes to say both publicly and internally, “We are a small but mighty agency.”

**ANTITRUST SOURCE:** Another challenge the agency is facing is a desire by some in Congress to give the agency’s headquarters building to the National Gallery of Art. What is your reaction to this proposal?

**BRILL:** We Commissioners feel strongly about this issue. When he laid the cornerstone for the FTC building over seventy years ago, President Roosevelt told those gathered that our building was...
intended to be the permanent home of the FTC.\footnote{For a downloadable recording of President Roosevelt’s dedication speech, see \url{http://www.ftc.gov/ftc/turns100/audio/1937-fdr-speech.mp3}.} I believe history and symbols matter. We also understand that forcing us to move from our building would impose additional costs on taxpayers. We made our views known publicly in a letter to Congressman Mica last year, and we hope to continue our dialogue with him.

**ANTITRUST SOURCE:** In a speech given in September 2011 at New York University School of Law,\footnote{Julie Brill, Comm’r, Fed. Trade Comm’n, Finding Heroes in a Small World. Robert Abrams Public Service Lecture, New York Univ. School of Law (Sept. 12, 2011), \url{http://www.ftc.gov/speeches/brill/110912nyubobramsspeech.pdf}.} you encouraged law students to find a small world in which to practice law and within that world, to find issues of great significance. What would you describe as your own issues of great significance?

**BRILL:** One of the points I try to make to law students and young lawyers is that they may find great and meaty issues in unlikely places, and so they should keep their eyes open to spotting these issues from the very beginning of their careers. Early in my career, I was fortunate to work on two issues that directly impacted not just Vermont consumers, but also consumers nationwide: credit reporting and tobacco. Not long after I joined the Vermont Attorney General’s office, I worked with residents of small towns from all walks of life who were being rejected for mortgages and refinancing, many of them inexplicably. We discovered through our investigation that the large, national credit reporting agencies had misread Vermont’s town records, registering everyone who received a property tax bill as failing to pay. In other words, residents of entire towns were registered as deadbeats. I worked hard to correct the problems that arose, and my work led me to testify before the U.S. Senate and House of Representatives about what ultimately became changes to the Fair Credit Reporting Act. After considering the problems in Vermont and elsewhere under the law, Congress enacted the 2003 revisions to the Fair Credit Reporting Act. And my work also led to my leadership role among the states on privacy issues, a role that I continue to play at the Commission.

Similarly, my work leading Vermont’s efforts on tobacco issues brought me into contact with other state AGs, industry, and members of Congress. Our work focused on the tobacco industry’s deceptive practices, including advertising to children and misleading the public about the harm smoking causes. We entered into protracted litigation with the tobacco industry, culminating in a historic settlement with the industry. My work on tobacco issues led directly to my interest and concerns about advertising substantiation and marketing practices related to health, issues that I continue to focus on at the Commission.

Many of the issues in which I played a leadership role at the state level continue to be of great importance to me as a Commissioner. Today, the issues of great significance to me now are privacy and data security; financial services like credit reporting, financial scams, and debt collection; advertising substantiation particularly with respect to health; and competition in health care and high tech.
New Agency, New Authority: An Update on the Consumer Financial Protection Bureau

John E. Villafranco and Kristin A. McPartland

The fact is the financial crisis and the recession were not the result of normal economic cycles or just a run of bad luck. They were abuses and there was a lack of smart regulations. So we’re not just going to shrug our shoulders and hope it doesn’t happen again. We’re not going to go back to the status quo where consumers couldn’t count on getting protections that they deserved. We’re not going to go back to a time when our whole economy was vulnerable to a massive financial crisis. That’s why reform matters. That’s why this bureau matters. I will fight any efforts to repeal or undermine the important changes that we passed. And we are going to stand up this bureau and make sure it is doing the right thing for middle-class families all across the country.

—President Obama, July 18, 2011

The passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act\(^2\) in July 2010 created a single new agency, the Consumer Financial Protection Bureau (CFPB), responsible for the regulation of consumer financial products.\(^3\) President Obama, in signing the Act into law, described the CFPB as “a new consumer watchdog with just one job: looking out for people—not big banks, not lenders, not investment houses—looking out for people . . . as they interact with the financial system.”\(^4\) Under the Act, the CFPB is vested with broad authority to implement and enforce most existing federal consumer financial laws,\(^5\) including the Truth in Lending Act, the Fair Credit Reporting Act, and the Federal Debt Collection Practices Act.\(^6\) Additionally, the CFPB has

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5. The complete list of laws now under the CFPB’s authority is as follows: Alternative Mortgage Transaction Parity Act of 1982; Consumer Leasing Act of 1976; Electronic Fund Transfer Act, with the exception of section 920; Equal Credit Opportunity Act; Fair Credit Billing Act; Fair Credit Reporting Act, with the exception of sections 615(e) and 628; Home Owners Protection Act of 1998; Fair Debt Collection Practices Act; subsections (b) through (f) of section 43 of the Federal Deposit Insurance Act; Sections 502 through 509 of the Gramm-Leach-Bliley Act, with the exception of section 505 as it applies to section 501(b); Home Mortgage Disclosure Act of 1975; Home Ownership and Equity Protection Act of 1994; Real Estate Settlement Procedures Act of 1974; S.A.F.E. Mortgage Licensing Act of 2008; Truth in Lending Act; Truth in Savings Act; section 626 of the Omnibus Appropriations Act; and Interstate Land Sales Full Disclosure Act. See Dodd-Frank Act, tit. X, § 1002 (12), 124 Stat. at 1957.

6. Id.
specific authority to prevent unfair, deceptive, or abusive acts or practices in connection with any transaction with a consumer for a consumer financial product or service.7 “Consumer financial product or service” is broadly defined and includes (with some exceptions) extending credit or servicing loans, real estate settlement services, deposit-taking activities, stored payment card systems, check-cashing, collection or guaranty services, financial advisory services, consumer report information, and debt collection.8

Since the signing of the Act, the CFPB has come under increasing political fire, and operated without a Director until one was installed in January 2012 through a controversial recess appointment. Throughout 2011, however, the agency staffed up, with approximately 750 employees as of the end of 2011,9 and in July 2011 began to oversee banks that have over $10 billion in assets. At the same time, the agency has been rolling out new initiatives focused on mortgage and credit card products and increasing its consumer outreach efforts. And last month, with a Director in place, the agency also launched its non-bank supervision program.

This article will look back on what the CFPB accomplished in various areas during its first year in business and for each of those areas discuss what may lie ahead in 2012.

Staffing the Agency

President Obama’s nominee for Director, former Ohio Attorney General Richard Cordray, received high profile attention due to the political fight over his nomination. Many had expected President Obama to nominate Elizabeth Warren, his original choice to “stand up” the agency,10 and the former Assistant to the President and Special Advisor to the Secretary of the Treasury on the Consumer Financial Protection Bureau. However, the President ultimately chose Cordray, then-current Director of Enforcement, as the nominee on July 18, 2011. The Senate Committee on Banking, Housing, and Urban Affairs held a September confirmation hearing and in October voted on party lines to send Cordray’s nomination to the full Senate. On December 8, 2011, Senate Republicans blocked an up-or-down vote on Cordray’s nomination, leaving the CFPB without a Director in place going into the new year.

The December vote was not surprising, particularly in light of a May 2011 letter to President Obama signed by forty-four Republican Senators opposing the nomination of any CFPB Director “absent structural changes that will make the Bureau accountable to the American people.”11 Specifically, the letter called for three major reforms: (1) replacing the single Director position with a Board of Directors; (2) changing agency funding to be subject to the annual congressional appropriations process rather than funded through the independent Federal Reserve; and (3) establishing more oversight tools for federal bank regulators to ensure that CFPB regulations “strike the right balance between consumer protection and safety and soundness.”12 In a state-

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7 Id. tit. X, § 1031(a), 124 Stat. at 205.
ent accompanying the May letter, Senate Minority Leader Mitch McConnell (R-KY) called the letter “a commitment by 44 Republican Senators to fix the poorly-thought structure of this agency that will have unprecedented reach and control over individual consumer decisions—but an unprecedented lack of oversight and accountability.” Republicans in both chambers of Congress have proposed legislation that would include these structural reforms, and in July 2011, the Republican-controlled House of Representatives passed H.R. 1315, the Consumer Financial Protection Safety and Soundness Improvements Act, although prospects for enactment this year remain slim with a Democrat-controlled Senate.

With no resolution in sight on the Senate Republicans’ objections, President Obama moved forward with a controversial recess appointment on January 4, 2012, installing Cordray as Director. While the Constitution grants the President the power to make appointments whenever the Senate is in recess, Republicans contend that a resolution to formally adjourn was never adopted and the Senate had been meeting every three days in pro forma sessions. They argue that, based on precedent, recess appointments cannot be made during a recess of less than ten days. Consequently, the move has generated criticism of executive overreach and court challenges are eventually expected, with Senator McConnell calling the move “uncertain legal territory.”

The recess appointment will last until the end of the next session of Congress (i.e., the end of 2013) unless an individual (either Cordray or someone else) is nominated, confirmed, and permanently appointed to the Director position prior to the end of that congressional session. Either way, with the appointment of a Director, the CFPB is moving forward in regulating non-bank lenders. Due to the language of the Act, the CFPB had been unable to begin regulating non-bank lenders until a Director was in place, leaving payday lenders and mortgage brokers among those that had not yet been brought under the CFPB’s regulatory authority. Some lawmakers, however, including Ohio Republican Senator Rob Portman, argue that the recess appointment is irrelevant and that the CFPB is still without its full authority. As Portman said in a release issued following the appointment:

The irony is that while this recess appointment may advance the White House’s political goals, it does nothing to advance the work of the CFPB. The statute creating the CFPB makes clear that only Senate confirmation of a Director—not a recess appointment—can activate the new powers of this agency to regulate consumer transactions with Main Street businesses.

The Obama administration stresses that it does not see a distinction between a recess-appointed Director and a Senate-confirmed Director. In prepared remarks to the Brookings Institute on January 5, 2012, Cordray brushed aside these objections, stating, “Now, for the first time, we can exercise the full authorities granted to us under the new law. That is the specific difference that having a director makes.”

Garnering less media attention but key to future agency action, the CFPB announced eight new hires in November 2011, including several personnel with previous experience in the White House.

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13 U.S. Const. art. II, § 2, cl. 3.
Roberto Gonzalez, a former Associate Counsel to the President and Special Assistant to the President, was named Principal Deputy General Counsel after serving as Deputy General Counsel. Rohit Chopra was named Private Education Loan Ombudsman, a position created to assist private student loan borrowers. Nicholas Rathod was hired as the Assistant Director for Intergovernmental and International Matters from his prior position as Deputy Director for Intergovernmental Affairs at the White House, and Lisa Konwinski, a former Deputy Assistant to President Obama and Deputy Director of the White House Office of Legislative Affairs, was named as the CFPB’s Assistant Director for Legislative Affairs. The CFPB’s website was also updated in December 2011 to include an infrastructure chart showing its six divisions.17

In October 2011, the CFPB made available online its Supervision and Examination Manual, outlining how the agency will supervise and examine consumer financial service providers for compliance with federal consumer financial law.

CFPB Supervision and Guidance

In July 2011, the CFPB began to oversee the 111 depository institutions (along with their affiliates and subsidiaries) with over $10 billion in assets. Collectively these institutions account for more than 80 percent of industry assets.18 The CFPB’s examination staff is deployed throughout satellite offices in Chicago, New York, San Francisco, and Washington, D.C., and examiners are expected to spend much of their time on site at depository institutions and other consumer financial services companies, in addition to consulting internally within the CFPB and drafting reports. While many examiners have been transferred to the CFPB from other supervisory agencies, the CFPB has also been recruiting examination staff from outside sources. Examiners are expected to review available information from other agencies and public sources; develop a preliminary risk focus and scope for the onsite portion of the exam; spend time on site to observe, conduct interviews, and review documents and information; and draft examination reports.19 In addition to conducting regular examinations of entities, the CFPB will also have the ability to conduct reviews that focus on a particular situation or issue of concern (e.g., particular customer complaints or particular products or practices) that has arisen and affects either a single entity (a “target review”) or multiple entities (a “horizontal review”).20

In October 2011, the CFPB made available online its Supervision and Examination Manual, outlining how the agency will supervise and examine consumer financial service providers for compli-

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17 The CFPB’s infrastructure chart is available at http://www.consumerfinance.gov/the-bureau/. A modified version of the chart showing the names of key agency leadership is available at http://www.americanbar.org/publications/the_antitrust_source.htm [References tab].


20 Id. Overview 6.
ance with federal consumer financial law. Labeled “Version 1.0,” the Manual is being continually updated as compliance requirements evolve. The Manual is divided into three parts, (1) Compliance Supervision and Examination, (2) Examination Procedures, and (3) Examination Process Templates. Perhaps most helpfully, the second section, Examination Procedures, is divided into subject headings entitled Unfair, Deceptive or Abusive Acts or Practices, the Equal Credit Opportunity Act, the Truth in Lending Act, the Fair Credit Reporting Act, and the Fair Debt Collection Practices Act, among others, with each heading describing the principles of enforcement for the respective body of law.

The Manual’s guidance on unfair and deceptive acts and practices will be familiar to FTC practitioners. An unfair act or practice is defined in the Manual as one that: (1) causes or is likely to cause substantial injury to consumers, (2) is not reasonably avoidable by consumers, and (3) is not outweighed by countervailing benefits to consumers or to competition. For the first prong, an act or practice that causes a small amount of harm to a large number of people may be deemed to be a substantial injury. Moreover, actual injury is not required in every case, and a significant risk of concrete harm may be sufficient. For the second prong, the inquiry will turn on whether an act or practice hinders a consumer’s decision-making, by, for example, withholding information until the consumer has committed to purchasing the product. For the third prong, the act or practice must be injurious in its net effect, an analysis that may include offsetting consumer or competitive benefits as well as costs that would be incurred to prevent the injury. As with the FTC’s jurisprudence, the Manual states that “public policy considerations by themselves may not serve as the primary basis for determining that an act or practice is unfair.”

A representation, omission, act or practice is deceptive when (1) it misleads or is likely to mislead the consumer, (2) the consumer’s interpretation of the representation, omission, act, or practice is reasonable under the circumstances, and (3) the misleading representation, omission, act, or practice is material. For the first prong, the Manual emphasizes that a consumer need not already have been misled; rather, an act or practice may be deceptive if it is likely to mislead consumers. Moreover, statements, representations, and omissions will be evaluated in the context of the entire advertisement, transaction, or course of dealing, such that written disclosures may be insufficient to correct a misleading statement or representation. Here, the Manual specifically cites the FTC’s test for evaluating whether a representation, omission, act, or practice is likely to mislead. For the second prong, the representation is evaluated from the perspective of a reasonable member of the target audience. Additionally, it is not required that a majority of consumers in the target class share the consumer’s interpretation; if a significant minority of consumers are misled, the act or practice may be considered misleading. For the third prong, an act or practice is considered material if it is likely to affect a consumer’s choice or conduct, with certain categories of information presumed to be material, including information about the central characteristics of a product like costs, benefits, or restrictions on the use or availability of the product or service. Express claims with respect to a financial product or service are presumed material. Even if a representation or claim is not presumed to be material, it may be material if there is evidence that it is likely to be considered important by consumers.

22 EXAMINATION MANUAL, supra note 19,UDAAP 3. See generally id.,UDAAP 2–3.
23 See generally id.,UDAAP 5–7.
On January 20, 2012, the FTC and the CFPB signed a memorandum of understanding (MOU) to coordinate enforcement efforts and promote consistent regulatory treatment of "consumer financial products or services." The CFPB also published its Mortgage Origination Examination Procedures, a field guide for CFPB examiners tasked with evaluating mortgage originators in both the bank and non-bank sectors of the industry, on January 11, 2012. Although these procedures focus on a particular product—namely, mortgages—they are an extension of the more general Supervisory and Examination Manual, and they similarly describe the types of information to be reviewed as part of the assessment process. On January 19, 2012, the CFPB published a similar update for short-term, small-dollar lending, commonly known as payday lending, which likewise identified examination procedures and priorities for those specific products.

The examinations, for both banks and non-banks, may involve a combination of tools, including requiring businesses to file reports, reviewing the materials used by companies to offer products and services, reviewing corporate compliance systems and procedures, and reviewing promises made to consumers. The CFPB has indicated that it will generally notify non-banks of an upcoming examination.

**CFPB Memorandum of Understanding with the FTC**

On January 20, 2012, the FTC and the CFPB signed a memorandum of understanding (MOU) to coordinate enforcement efforts and promote consistent regulatory treatment of "consumer financial products or services." Director Cordray described the agreement as "important to making sure markets for consumer financial products are getting efficient and effective federal govern-

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24 The CFPB Supervision and Examination Manual is replete with examples of unfair and deceptive acts and practices taken from past FTC enforcement actions. See id., UDAAP 3–5 & 7–8.

25 "Abusive" is defined in Dodd-Frank as an act or practice that (1) materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service; or (2) takes unreasonable advantage of (A) a lack of understanding on the part of the consumer of the material risks, costs, or conditions of the product or service; (B) the inability of the consumer to protect the interests of the consumer in selecting or using a consumer financial product or service; or (C) the reasonable reliance by the consumer on a covered person to act in the interests of the consumer. Dodd-Frank Act, tit. X, § 1031(d), 124 Stat. at 2006.


27 Id.


31 CONSUMER FIN. PROT. BUREAU & FED. TRADE COMM’N, MEMORANDUM OF UNDERSTANDING (2012) [hereinafter MOU], available at http://www.ftc.gov/os/2012/01/120123ftc-cfpb-mou.pdf. Under the MOU, the term “consumer financial product or service” has the same meaning as under Section 1002(5) of the Dodd-Frank Act. Id. at 1, § I.B. This includes, but is not limited to, the following: extending, servicing, acquiring, purchasing, selling and brokering loans or other extensions of credit; extending or brokering certain leases of personal or real property that are the functional equivalent of purchase finance arrangements; providing certain real estate settlement services; engaging in deposit-taking activities, transmitting or exchanging funds, or otherwise acting as a custodian of funds; selling, providing or issuing
ment oversight. We are both motivated by the same thing: To do right by consumers. We look forward to this partnership.”

The agencies agree to coordinate law enforcement activities and investigations, and in particular, to notify each other as to all stages of an enforcement action against a “covered person” under “consumer financial laws” in connection with offering or providing “consumer financial products or services.” Specifically, the agencies will work together prior to commencing an investigation, will provide ten days notice, if practicable, to each other before filing a complaint or similar initiation of agency action, will provide ten days notice prior to filing a settlement, if practicable, and will permit each other to intervene in any covered court action upon prior notice.

For rulemaking, the agencies agree to consult each other regarding any rulemaking activity related to consumer financial products or laws. Additionally, the agencies agree to meet periodically to discuss and coordinate initiatives regarding advisory opinions and comprehensive guidance that interpret or apply the applicable laws. The MOU also sets out consultation and notification requirements, including that either agency notify the other of its intention to issue proposed or final rules prohibiting unfair, deceptive, and abusive acts or practices by “covered persons” in the offering of “consumer financial products and services” and that the agencies consult on formal comprehensive agency guidance documents written by either party that address unfair, deceptive, or abusive acts or practices.

The MOU requires that the agencies meet quarterly to discuss and coordinate the CFPB’s examinations of “covered persons.” To facilitate coordination, the FTC may request to review any planned examinations of “covered persons” by the CFPB. In addition, the CFPB will turn over to the FTC specific examination reports, such as reports pertaining to any “covered person” subject to the FTC’s jurisdiction. The CFPB must also notify the FTC of any modifications made to a previously produced examination report. Upon written request by the FTC, the CFPB agrees to provide the FTC with any information the CFPB collects through its supervision of a “covered person” subject to the FTC’s jurisdiction unless good cause is shown to preclude disclosure.


33 The term “covered person” means any person (including an individual, partnership, corporation, trust, estate, cooperative, association, or other entity) who offers or provides “consumer financial products or services” other than a bank, thrift, federal credit union, or other person excluded from the FTC’s jurisdiction under the FTC Act. MOU, supra note 31, at 2, § II.F.

34 The term “consumer financial laws” includes, but is not limited to, the Dodd-Frank Act, 12 U.S.C. §§ 5301 et seq.; the Telemarketing and Consumer Fraud and Abuse Prevention Act, 15 U.S.C. §§ 6101-08; and the Federal Trade Commission Act (FTC Act), 15 U.S.C. §§ 41–58. Id. at 2, § II.E.

35 See generally id. at 3–7, § IV.

36 See generally id. at 7–9, § V. Such consultation would be made pursuant to Section 1031 of the Dodd-Frank Act, Sections 5 and 18 of the FTC Act, the Omnibus Appropriations Act of 2009, the Fair Debt Collection Practices Act, and the Fair Credit Reporting Act.

37 See generally id. at 9, § VI.

38 Such a request would be made pursuant to CFPB regulation, 12 C.F.R. § 1070.43(b), and the CFPB’s other policies and procedures.
The MOU further addresses consumer complaints, and outlines shared responsibility between the agencies, including consumer education responsibilities. One issue of note is that the MOU states that all information provided or received under the terms of the MOU is to be used only for official regulatory, supervisory, or law enforcement purposes. The MOU provides that all nonpublic information shared under its terms will remain the property of the providing agency unless otherwise authorized in writing. The agencies agree to take all actions reasonably necessary to preserve, protect, and maintain all privileges and claims of confidentiality related to nonpublic information provided pursuant to the MOU, including any information the CFPB collects through its supervision of “covered persons.” No further disclosure of nonpublic information may be made by the receiving party without the written permission of the disclosing agency.

**CFPB Consumer Outreach and Complaint Handling**

In addition to its guidance to industry, the CFPB has been setting up a forum for submission of consumer complaints regarding mortgage and credit card issues. First, the CFPB began taking consumer complaints relating to credit cards on July 21, 2011 and released an interim report on November 30, 2011. In the first three months, CFPB received more than 5000 credit card complaints and forwarded them to credit card companies for handling. Companies reported resolving more than 3100 complaints, with consumers disputing the responses less than 13 percent of the time.

Second, the CFPB began taking consumer complaints about mortgages through its website in December 2011. A consumer may choose a complaint category from a drop-down menu, describe his or her problem, and ask for a resolution. The CFPB will forward a complaint to the relevant lender and provide the consumer with a tracking number to monitor the progress of his or her filing. Finally, the CFPB expects to be ready to handle complaints for all other financial products and services by the end of 2012.

The CFPB is in the process of refining its complaint collection and handling process and has proposed the creation of a searchable public database of complaint information, meaning personally identifiable information would be expunged. Certain credit card complaint data would be publicly available for research and analysis and published in periodic reports issued by the CFPB, so as to give consumers meaningful information about credit card use. This furthers the CFPB’s statutory purpose to help consumers “make responsible decisions about financial transactions” and to ensure that markets for consumer financial products “operate transparently and efficiently.” Information to be disclosed includes the name of the card issuer, the complainant’s zip code, the date of the complaint, the subject area at issue, and whether and how the issuer responded.

The extent to which this complaint data will be reliable or probative remains an open question. In a similar situation, the Consumer Product Safety Commission (CPSC) began making public disc-
closures of consumer complaints earlier in 2011, and this move raised concerns about the misidentification of companies or false reporting by consumers.\footnote{See Business— Frequently Asked Questions (FAQs) (subtopic “Accuracy”), U. S. CONSUMER PROD. SAFETY COMM’N, http://www.cpsc.gov/safer/faqs-business.html#accuracy (last visited Feb. 24, 2012).} The CFPB has claimed in its Notice of Proposed Policy that its database will differ from the CPSC’s because the issuer can be reliably identified from the submitted credit card number.\footnote{Disclosure of Certain Credit Card Complaint Data, 76 Fed. Reg. 76,628, 76,631 (proposed Dec. 8, 2011).} In the event that a credit card company represents to the CFPB that it has been wrongly identified, the CFPB has proposed that it will keep the company’s name confidential pending a determination of the correct issuer,\footnote{Id. at 76,632.} although the procedure for removing the company’s name is unclear. The comment period for the CFPB’s proposal closed on January 30, 2012, and it remains to be seen whether changes will be made to the proposed form of the database and potential public access. Regardless of the concerns that have been raised, it is likely, as those familiar with the FTC’s Sentinel system\footnote{See Consumer Sentinel Network, FED. TRADE COMM’N, http://www.ftc.gov/sentinel/ (last visited Feb. 24, 2012).} know, that the CFPB will use the complaint information to support its oversight and supervision activities as well as its regulatory policy and rulemaking functions.

**CFPB Rulemaking**

One of the most important pieces of CFPB rulemaking in 2012 will be the “larger participant” rule. This rule will establish the parameters of the CFPB’s supervision over nonbank companies, which have historically been subject to FTC oversight through enforcement actions. Under the nonbank supervision program, the CFPB will supervise companies of all sizes in the mortgage, payday lending, and private student lending markets but other businesses, such as those involved in consumer installment loans and debt collection, will be subject to CFPB supervision only for “larger participants.” As a result, the “larger participant” rule, which will be issued by July 21, 2012, will have great impact on participants in those latter industries.

The CFPB published a Notice and Request for comment on issues presented in drafting a proposed rule on June 29, 2011, and comments were due by August 15, 2011.\footnote{Defining Larger Participants in Certain Consumer Financial Products and Services Markets, 76 Fed. Reg. 38,059 (proposed Feb. 17, 2012) (to be codified at 12 C.F.R. ch. X).} The rulemaking sought public input on six markets for potential inclusion in an initial rule—debt collection; consumer reporting; consumer credit and related activities; money transmitting, check cashing and related activities; prepaid cards; and debt relief services. The CFPB sought feedback, among other issues, on criteria and relevant time periods to measure the size of a market participant, thresholds for inclusion, and whether to adopt a single test or use specific tests for different markets. An initial proposed rule directed at the markets for debt collection and consumer reporting was published for comment on February 16, 2012, and it set thresholds of $10 million and $7 million in annual receipts, respectively, above which entities in these markets would be considered “larger participants” subject to CFPB regulation.\footnote{Defining Larger Participants in Certain Consumer Financial Product and Service Markets, 77 Fed. Reg. 9,592 (proposed Feb. 17, 2012) (to be codified at 12 C.F.R. ch. X).} A series of rulemakings covering larger participants in other consumer financial markets will follow.

In December 2011, the CFPB issued waves of regulation in an exercise of its inherent rule-making authority under the Dodd-Frank Act.\textsuperscript{51} The interim final rules transfer the rulemaking authority originally vested in seven other Federal agencies to the CFPB and duplicate the existing regulations, making only technical, formatting, and stylistic changes. None of the proposed regulations imposed new substantive obligations on already regulated entities. For example, three interim final rules divest the FTC of rulemaking authority for consumer protection provisions involving the Fair Debt Collection Practices Act, the Federal Deposit Insurance Act, and the Mortgage Acts and Practices and the Mortgage Assistance Relief Services Rule.\textsuperscript{52} All interim final rules transferring rulemaking authority to the CFPB had an effective date of December 30, 2011, with comments due in February 2012.

**Looking Ahead in 2012**

The past year saw the official opening of the CFPB’s doors on July 21, 2011, the beginning of the agency’s bank supervision program, and official transfer of authority to the agency for several consumer protection regulations. With the recess appointment of a Director, the CFPB started 2012 by rolling out its non-bank supervision program and continuing its consumer outreach efforts to collect and analyze consumer complaints. Proposed new forms for mortgages and credit card disclosures continue to undergo testing and are likely to be finalized and introduced this year. At the same time, the agency will continue to roll out new proposed rules. In the year-and-a-half since its creation by the Dodd-Frank Act, the agency has already staffed up and begun to make its imprint on the consumer finance industry.

With the ongoing political controversy regarding the CFPB’s structure, financing, and authority, and its own increasingly high profile as it moves forward with regulations, supervision, and enforcement actions, we expect that the agency will stay in the headlines throughout the coming year. Industry participants should therefore pay close attention to the news in the coming months.


\textsuperscript{52} Other transferred provisions relate to the Home Mortgage Disclosure Act, the S.A.F.E. Mortgage Licensing Act, the Consumer Leasing Act, the Equal Credit Opportunity Act, the Fair Credit Reporting Act, the Interstate Land Sales Registration Program within the Interstate Land Sales Full Disclosure Act, the Gramm-Leach-Bliley Act’s provision titled “Disclosure of Nonpublic Personal Information,” and the Truth in Savings Act.

Richard S. Taffet

In March 2011, the U.S. Federal Trade Commission issued its report, *The Evolving IP Marketplace: Aligning Patent Notice and Remedies with Competition (IP Report).* The IP Report includes a number of observations and proposals that are directed not to antitrust law, but rather to proposed modifications of U.S. patent law. In particular, the IP Report proposes reforms of existing patent notice rules and patent infringement remedies. It argues that such reforms are necessary because technology patent holders presently are exacting unacceptable rewards by enforcing their patented technologies and thereby “holding up” technology implementers and impeding technological innovation.

A previous issue of *The Antitrust Source* included two articles (one by a member of the Commission and her attorney advisor, and the other by an attorney advisor to another Commissioner) expressing views supportive of the IP Report’s analyses and proposals. This article, in contrast, takes the view that the IP Report’s analyses and proposals are premised on flawed assumptions concerning the definition and nature of “hold-up” and the actual existence of conditions that, according to the report, support the need for reforms. As a result, as discussed here, the IP Report does not appear to address any actual marketplace failures, anticompetitive distortions, or limitations on innovation, but instead proposes reforms that would reorder existing legal and economic principles and impose a wealth transfer from patent owners to downstream patent users, which could deter innovation—an effect directly contrary to the report’s stated purpose.

The IP Report’s focus can be discerned from its definition of hold-up, which is based on certain underlying assumptions that are at a minimum questionable. It also reflects a definition of hold-up that is inconsistent with the common understanding of that term as used in legal and economic contexts, or as understood in the technology standard-setting community. Flowing from its flawed definition of hold-up, and contrary to the suggestion of at least one observer that the proposals in the report are procedural and largely modest, the IP Report in fact calls for a radical transformation of the policies underlying patent law. The report’s proposals would upend the incentive scheme of existing patent law that the U.S. Constitution, Congress, and the judiciary

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3 Su, supra note 2, at 12.
have devised to encourage investment in new inventions and the dissemination of such inventions through technology transfers (i.e., licensing). The result would be to refocus patent law to advance the interests of patent users, but at the expense of well-established and longstanding rights of patent owners. Any doubt that such an approach would represent a sea change is resolved by the fact that Congress recently rejected many of the IP Report’s proposals in its consideration of patent reform and its adoption of the America Invents Act.4

In addition, there is a significant question whether the proposed reforms of the IP Report are at all practical in light of actual marketplace realities involving patent enforcement and licensing, and the actual state of innovation and competitiveness, particularly in the technology sector. The problem as defined by the report is that patent holders are able to extract from users of patented technology (e.g., manufacturers) greater value than should be attributed to the patented invention, and that incentives of patent users to engage in commercial endeavors are impeded because of the excessive costs that may be imposed upon them.5 Accordingly, the IP Report says, patent owners should be permitted to realize only the “incremental value” of their inventions as determined by a formula that has been neither tested nor shown to be appropriate theoretically or practically.

The incremental value approach proposed by the IP Report, besides raising numerous practical problems, itself risks inhibiting innovation by patent owners and even patent users, and causing increased costs to consumers. More specifically, the incremental value test would limit the value of a patented invention to the difference between its value and the value of a next-best alternative (both values to be determined by some yet-to-be accepted method), determined prior to the time that a patent user (i.e., infringer) makes any investment in implementation of the patented technology, but after inventors and investors have sunk their own resources into developing and commercializing the patent technology. As a result, and as explained below, this test would limit the return that patent owners realize on their investments, and conversely increase incentives for infringing conduct and expensive litigation.

Another byproduct of the IP Report’s view that patent rights and remedies should be limited is the suggestion that the well-recognized complementary balance between patent law and antitrust law, as established by Congress and enforced in the courts, should be adjusted. The report gives greater weight to the antitrust law’s focus on advancing short-term static efficiencies at the expense of allowing consumers to benefit from the dynamic rewards of reinvestment in technology advancements promoted by a strong patent enforcement environment. This, too, reflects a radical departure from settled law, which recognizes the consumer welfare benefits of dynamic, long-term efficiencies that are fostered by the ability of patent owners to realize returns on their investments in developing patented invention so that further investment in follow-on innovation can be supported.6 Furthermore, settled law also has long recognized that the complementary balance between antitrust law and patent law is based on the fact that each advances competitiveness through its distinct approach: antitrust law’s focus on static effects, and patent law’s focus on dynamic efficiencies and the encouragement of long term investment in innovation-enhancing endeavors.7

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5 See IP Report, supra note 1, at 5 ("Patent hold-up can overcompensate patentees").

6 See infra notes 41–42 and accompanying text.

Even more problematic, however, is the absence in the IP Report, and in the supporting commentary, of any empirical support (either quantitative or anecdotal) that the problems assumed by the report actually exist. While reform of existing laws may be appropriate if circumstances warrant, the report offers no evidence to support its core premises that hold-up is a problem, that excessive exercise of patent rights has harmed innovation, or that the savings from reduced license fees or infringement damages would be passed on to consumers. There is likewise no empirical or other analysis of the impact of the proposed incremental value test on incentives to invest in invention and innovation. The FTC’s own Patent Standards Workshop held on June 21, 2011, and the comments received in connection with the workshop, confirm that if anything, existing evidence indicates robust and effective utilization of patented technology to advance innovation and competitiveness, all to the benefit of consumer welfare.

The IP Report’s Definition of Hold-Up

Many of the issues raised by the IP Report can be traced to its definition of hold-up. As stated in the IP Report, hold-up occurs as follows:

Ex post licensing to manufacturers that sell products developed or obtained independently of the patentee can distort competition in technology markets and deter innovation. The failure of the patentee and manufacturer to license ex ante with technology transfer results in duplicated R&D effort. When a manufacturer chooses technology for a product design without knowledge of a later asserted patent, it makes that choice without important cost information, which deprives consumers of the benefits of competition in the technology market. If the manufacturer has sunk costs into using the technology the patentee can use that investment as negotiating leverage for a higher royalty than the patented technology could have commanded ex ante, when competing with alternatives. The increased uncertainty and higher costs associated with ex post licensing can deter innovation by manufacturers.

Putting aside for the moment whether this is an accurate definition of hold-up (and as discussed below there is disagreement on this point), an examination of the assumptions underlying it suggests that those assumptions may not be well founded.

For example, this definition assumes that at the time a patent holder asserts its patent rights, manufacturers will have undertaken duplicative R&D efforts to develop independent (albeit infringing) technologies. It is more likely (or at least equally likely), however, that the manufacturers merely copied the patent holder’s technology, whether willfully or through ignorance, thereby free riding off the investments made by the patent holder in developing the infringed technology, as well as the investments by other (authorized) patent users who used the patented technology to create, along with the patent holder, the market for the patented technology.

A second questionable assumption of the IP Report’s definition of hold-up is that infringing firms will be acting without knowledge of potential patent rights. Of course information regarding patent rights is not perfect, but there is little to suggest that sophisticated firms competing in tech-

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9 IP Report, supra note 1, at 8. See also Ramirez & Kimmel, supra note 2, at 4 (“Patent hold-up is a specific example of opportunism in the face of sunk costs.”). In connection with the FTC’s Patent Standards Workshop, held on June 21, 2011, the FTC defined “hold up” as “a demand for higher royalties or other more costly licensing terms after the standard is implemented than could have been obtained before the standard was chosen.” Fed Trade Comm’n, Request for Comments and Announcement of Workshop on Standard-Setting Issues, 76 Fed. Reg. 28,036, 28,036 (May 13, 2011), available at http://www.gpo.gov/fdsys/pkg/FR-2011-05-13/pdf/2011-11704.pdf.
nology industries cannot and do not avail themselves of the extensive information available to them regarding significant patent holders in such industries. To the contrary, experience suggests that patent-using firms systematically and aggressively undertake patent clearance efforts, especially in technology industries where the existence of extensive patent rights, and the holders of such rights, are widely known. Such efforts are common, and indeed good practice, and the costs of such clearance efforts are well spent; potentially relevant patents can be identified; potential infringing conduct can be avoided; and investment can be efficiently directed to non-infringing efforts that may be complementary to or improvements on existing technology, as well as to new competitive technologies. Firms might also be able to identify advantageous licensing opportunities from their clearance efforts and thus pursue authority to use a patent owner’s technology to advance their downstream competitive opportunities. In all events, the efforts would not be duplicative of an existing patent holder’s efforts, and would be competition-enhancing.

Another questionable aspect of the *IP Report*’s definition of hold-up is the implication that a patent holder should be required affirmatively to seek out potential users of the patented technology and to give notice of infringing use before such infringing use occurs. This implication arises from the definition’s concept that hold-up occurs merely because a patent holder enforces its patent against a patent user that invested in the patented technology without knowledge of the patent. Imposing on the patent holder the burden of forewarning potential infringers or otherwise risk a diminished recovery would be wholly impracticable: how can a patent holder determine the intended strategies of potential infringers? It would also be directly contrary to the fundamental core of patent law, which is that a patent holder has no duty to make a patented invention available whatsoever, and may use its invention entirely to the exclusion of third parties. As discussed further below, defining hold-up in this way may also encourage infringement (including knowing and willful infringement) and result in competitive distortions by undermining incentives to innovate.

The *IP Report*’s definition of hold-up has been questioned by comments made in connection with the FTC’s June 2011 Patent Standards Workshop. A number of commenters expressly took issue with the FTC's premise that hold-up would occur simply if a patent user infringes and makes some investment toward its infringing activities before it is charged with infringement. For example, Microsoft and the Telecommunications Industry Association, a leading standard-setting organization, both questioned this concept of “naked” hold-up by commenting that hold-up must include some “intentional and deceptive conduct,” and that “routine bilateral disagreements over licensing terms” are not hold-up. Similarly, Professors Epstein, Kieff, and Spulber took issue with the *IP Report*’s definition of hold-up by commenting that “[t]he term ‘hold-up’ has a very precise definition in the economic literature,” as explained by Oliver Williamson, who referred to it as “opportunism,” and defined it as “self-interest seeking with guile.” Epstein et al. also comment that Joseph Farrell, Director of the

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10 See 35 U.S.C. § 154(a)(1) (patent owners have the “right to exclude others from making, using, offering for sale, or selling the [patented] invention”). Notably, the Patent Act also already limits damages recoverable by a patent owner that does not mark its products. 35 U.S.C. § 287. The *IP Report* would further limit the patent owner’s damages under the proposed “incremental value” test.


FTC’s Bureau of Economics, previously in a co-authored paper defined hold-up differently than the way it is used in the *IP Report*, by explaining that, “in very broad terms, opportunism or hold-up arises when a gap between economic commitments and subsequent commercial negotiations enables one party to capture part of the fruits of another’s investment, broadly construed.” Thus, Farrell et al. went on to say, “Hold-up can arise, in particular, when one party makes investments specific to a relationship before all the terms and conditions of the relationship are agreed.” Under that definition, the phrase “hold-up” would not encompass a patent owner’s challenge to infringing activities where some investment had been made by the infringer before the assertion of the patent, but rather would describe conduct by patent users who seek to free ride on the significant investment made by patent holders in the development or commercialization of patented technologies.

The Consequences of the *IP Report*’s Definition of Hold-Up

From the *IP Report*’s questionable definition of hold-up follows the radical legal and policy transformation proposed by the report. Rather than encouraging the legitimate use of patented technology, the *IP Report*’s approach would have the effect of encouraging infringing conduct. If an infringing patent user can limit its financial exposure by investing in infringing activities before a patent owner learns of such activities, the patent user will more likely do that than invest in clearance analyses and licensing negotiations. This misdirected incentive will only be exacerbated by the suggestion of the *IP Report* that injunctive relief should be precluded where there is hold-up as defined by the *IP Report*. Besides being contrary to the Supreme Court’s rejection of such a categorical rule in *eBay*,14 diminishing patent owner’s rights will elevate infringement risks and concomitantly lessen the potential for procompetitive innovation, as the Federal Circuit explained in *Fromson v. Western Litho Plate & Supply Co.*:15

Thus a cold, “bottom line” logic would dictate to some a total disregard of [such a patentee’s] patent because: (1) ill-financed, he probably would not sue; (2) cost of counsel’s opinion could await suit; (3) the patent may well be held invalid on one of many possible bases; (4) infringement may not be proven; (5) if the case be lost [by the infringer], a license can be compelled, probably at the same royalty that would have been paid if the patentee’s rights had been respected at the outset.16

These same observations apply *a fortiori* when the infringer’s worst-case scenario is not the payment of a “reasonable” royalty, but a royalty capped by the *IP Report*’s proposed incremental value test, which, as discussed below, would deny a patent owner the recovery of the full value of its invention. Patent users would not be concerned with the risk of having to pay such a royalty many years after commencing their infringing conduct; they would face only the prospect of

13 Id. at 18–19 (quoting Joseph Farrell et al., *Standard Setting, Patents, and Hold-Up*, 74 ANTITRUST L.J. 603, 604 (2007)).
16 Id. at 1574. See also *Smith Int’l, Inc. v. Hughes Tool Co.*, 718 F.2d 1573, 1578 (Fed. Cir. 1983) (“[W]ithout the right to obtain an injunction, the right to exclude granted to the patentee would have only a fraction of the value it was intended to have, and would no longer be as great an incentive to engage in the toils of scientific and technological research.”).
damages limited by the incremental value of the infringed patent, even if the infringement had been knowing and willful or the infringer had refused a license on terms acceptable to others.

Under the proposed incremental value test the infringer would be subject only to damages equal to the difference between the value of the patented technology and the value of the next best alternative technology, as determined before (ex ante) the infringer invested in its infringing activities, but after the patent holder had made its investment in the patented technology. Such an approach would woefully undercompensate patent holders, dissuade litigation-tolerant infringers from seeking licenses, and diminish any incentives to invest in inventive activities.

In simplest terms, under the IP Report’s concepts of hold-up and incremental value, if patents A and B cover alternative technologies and are valued at $12 and $10 respectively prior to the time an infringer makes any investment in its infringing activities and regardless of such activities, the owner of patent A would hold up the infringing patent user if it sought to recover more than $2 in a royalty. This reflects the clearest illustration of the legal transformation that would result if the IP Report’s proposals were adopted, and also cannot be squared with commercial realities or the necessary incentives to advance innovation on a number of levels.

First, the FTC’s approach to hold-up and its incremental value test would reject established law, as well as the FTC’s own prior guidance. For example, as explained by the Supreme Court in Kewanee Oil v. Bicron Corp., the patent laws offer “a right of exclusion for a limited period as an incentive to inventors to risk the often enormous costs in terms of time, research and development. The productive effort thereby fostered will have a positive effect on society through the introduction of new products and processes of manufacture into the economy . . . .” The Federal Circuit has spoken similarly in Patlex Corp. v. Mossinghoff.

Even the FTC has recognized the innovation-facilitating nature of invention based on the strong enforcement of patent holder rights. The 2007 report of the DOJ and FTC on antitrust enforcement and intellectual property explains:

Intellectual property laws create exclusive rights that provide incentives for innovation by “establishing enforceable property rights for the creators of new and useful products, more efficient processes, and the original works of expression.” These property rights promote innovation by allowing intellectual property owners to prevent others from appropriating much of the value derived from their inventions or original expressions. These rights also can facilitate the commercialization of these inventions or expressions and encourage public disclosure, thereby enabling others to learn from the protected property.

See also Ramirez & Kimmel, supra note 2, at 7–9.


Id. at 480.

758 F.2d 594, 600 (Fed. Cir. 1985) (“The encouragement of investment-based risk is the fundamental purpose of the patent grant, and is based directly on the right to exclude. As the Supreme Court observed in Kaiser Aetna v. United States, [444 U.S. 164, 176 (1979)], the ‘right to exclude others’ is ‘one of the most essential sticks in the bundle of rights that are commonly characterized as property. And as [the] court stated in Smith International, Inc. v. Hughes Tool Co., [718 F.2d 1573, 1577–78 (Fed. Cir. 1983)], without the right to exclude ‘the express purpose of the Constitution and Congress, to promote the progress of the useful arts, would be seriously undermined. This right is implemented by the licensing and exploitation of patents.’” (emphasis added).


Stated simply, the patent law’s protections of patent holders’ rights are directed to the encouragement of inventive activities, leading to the follow-on innovation that comes about by the commercialization of inventions by patent holders themselves and by third parties who learn of the patented invention through the publication of the patent and who can then engage in their own inventive and innovation-enhancing activities, or through licensing. Thus, while the IP Report comments that “[c]ondemning efficient, legitimate uses of patent rights can undermine those incentives [to innovate] and harm consumers,”23 its primary focus (on hold-up) would do exactly that.

The IP Report’s restatement of established understandings of innovation is also reflected by what one commentator has argued is the report’s proper elevation of innovation (as conceived in the report) over invention, with invention being given less significance as merely the first step in innovation, which in turn only occurs at the commercialization stage.24 But this dichotomy is flawed. Most notably, it ignores, as explained in the 2007 IP Report (above), that invention is a necessary first step in the innovation process. It is correct that for a number of reasons not all patentable inventions will result in commercialized new products,25 but absent invention the type of innovation upon which the IP Report focuses (i.e., innovation based on patented technology) would not result in the first instance.

Second, specifically with respect to the incremental value test, awarding a patent holder only the $2 incremental value of its invention would expropriate from it the full value of its invention—rendering pointless the investment of capital in risky research and development. No business, including those in competitive markets, could survive for very long or attract capital if its prices were limited to “incremental” value as defined in the report. Indeed, the FTC has elsewhere recognized that prudent businesses must set prices to recover their sunk investment.26 For example, General Motors is not and should not be required to limit the price of its mid-size sedan to the increment, if any, by which the value of the GM sedan exceeds the value of Ford’s mid-size sedan.

Third, the IP Report’s approach entirely ignores the risks necessarily borne by those engaging in innovation-enhancing efforts, including the risk of technical or commercial failure and the risk of failing to detect or obtain compensation from infringers. Investing in technology invention is inherently risky, and there may be as many failures as there are successes. But that is exactly the type of competitive “race to invent” that the patent laws encourage.27 And the loser of a particular lap in a race should continue to be encouraged to finish the race strong by investing further in inventions that might put it over the finish line first or that will allow it to win the race for the next generation of technology. This is why it is settled that market-based compensation for a violation of a patent holder’s rights in successful projects is necessary to maintain properly directed incen-

23 IP Report, supra note 1, at 1.
24 Su, supra note 2, at 2.
25 These reasons may include the absence of sufficient capital or access to commercialization opportunities for the patent owner, especially if the patent owner is a small company or individual. Such patent owners may also lack the wherewithal to protect their patented inventions from infringement by larger firms that may undertake infringing activities knowing that assertion of the patent is not certain, and if litigation does ensue, that they can outspend the patent owner.
26 See Administrative Complaint at 21, Intel Corp., FTC Dkt. No. 9341 (Dec. 16, 2009) (alleging that firms with market power must price products and services “well above” average variable cost plus a multiple thereof sufficient to cover contribution to sunk costs), available at http://www.ftc.gov/os/adjpro/d9341/091216intelcmpt.pdf. Incremental value takes no account of variable or fixed costs of inventors or investors.
27 See Potts v. Coe, 145 F.2d 27, 31 (D.C. Cir. 1944) (“The patent law is designed to encourage competition among inventors by giving a patent to the ingenious [party] who wins in a race for discovery.”).
tives for continued investment, and properly takes into account failed projects as well.\textsuperscript{28} The \textit{IP Report’s} approach would not.\textsuperscript{29}

It is thus unsurprising that the \textit{IP Report’s} approach of relying solely on an incremental value test to cap royalties has been rejected by the courts.\textsuperscript{30} It is also inconsistent with and would limit the long-established \textit{Georgia-Pacific} approach to determining reasonable royalty damages based on market factors existing at the time that infringement occurs.\textsuperscript{31}

Equally notable is Congress’s rejection of reforms of patent remedies analogous to the \textit{IP Report’s} incremental value test when it passed the America Invents Act. Early versions of proposed patent reform bills would have limited reasonable royalty damages to that portion of the “economic value” of the infringing product or process attributable to the patented invention’s “specific contribution over the prior art.”\textsuperscript{32} This test, which is materially indistinguishable from the \textit{IP Report’s} incremental value test, was viewed by many as an effort by certain companies (primarily large users of patented technologies) to lessen their potential infringement liability by eliminating consideration of the broad range of market factors that influence a negotiated or litigated royalty.\textsuperscript{33} By 2009, the Senate Judiciary Committee had abandoned proposed changes to the law on patent damages, concluding that the federal courts could exercise a “gatekeeping” role over the factors and methodologies for determining damages.\textsuperscript{34} Senator Jon Kyl’s observations in this regard are noteworthy.

In debating the patent reform proposals, he commented that prior to the Federal Circuit’s recent decisions, “I [had] underestimated the courts’ ability and willingness to address these problems on their own. And I certainly did not anticipate the speed with which they might do so. . . . The pres-

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ent bill appropriately leaves patent-damages law to common law development in the courts.\textsuperscript{35} The decisions to which Senator Kyl referred are a series of decisions between 2009 and 2011 where the Federal Circuit vacated damage awards based on speculative or otherwise unreliable evidence or metrics.\textsuperscript{36} The American Invents Act ultimately passed by Congress included no amendment to existing patent damages law as now proposed by the \textit{IP Report}.

Fourth, measuring incremental value as proposed by the \textit{IP Report}, at the time before an infringer expends costs in furtherance of its infringing conduct, is not in fact ex ante at all. By that time, the patent holder (whether the original inventor or an assignee) will have already incurred sunk costs in developing or commercializing the patented technology, including through enforcement and licensing efforts. The proposed incremental value test, however, would not compensate the patent holder for that investment at all, and would create an imbalance in the negotiating positions of patent holders and infringers that strongly favors infringers, which as commented previously would be even more imbalanced if rights to injunctive relief were eliminated.

Fifth, in the standard-setting context, the distortion of invention- and innovation-enhancing incentives will be even more pronounced under the \textit{IP Report}'s approach to hold-up and incremental value. By definition, the standards process picks winners and losers by selecting one technology over another. Consistent with the patent law’s policy to encourage a race to invent, the standards process also seeks to encourage the availability of technically optimal solutions for consideration in the standardization process. These very well may be patented solutions, and although there are not always real technical alternatives before a standard is adopted, the standards process at least is designed to provide incentives for technology owners to create and contribute the greatest amount of “best” technology as possible, whether or not patented, and allow the standards process to develop a consensus around a preferred technology. But the greater the number of candidate technologies, the smaller may be the incremental value of one technology over another, and if the value realizable by an owner of a standards-essential patent is capped by what will be the small incremental difference in value between its technology and the technology not accepted for inclusion in the standard, the incentive to contribute optimal technology to the standards process will be undermined.

Sixth, the \textit{IP Report}'s approach to hold-up and incremental value ignores the economic reality that inventors already gain only a small fraction of the total social value created by their inventions, while users of their inventions, including downstream product and service providers, as well as consumers, capture the lion’s share of overall social value.\textsuperscript{37} A \textit{Strategy for American Innovation}, issued by the National Economic Council, the Council of Economic Advisers, and the Office of Science and Technology Policy in February 2011, explains this point succinctly:

The social gains from innovation typically greatly exceed the private return. For example, the inventions of the telephone, transistor, light bulb, dishwasher, laser CT scan, web browser and antibiotics have all had enormous, broad and ongoing social benefits far in excess of any commercial profits.

\textsuperscript{35} 157 CONG. REC. S1373–74 (daily ed. Mar. 8, 2011). Cf. Ramirez & Kimmel, supra note 2, at 9 (calling for courts to exercise their gatekeeping function “more vigorously by excluding expert opinions that are based on facts or methods that have no bearing on the outcome of a hypothetical negotiation between the parties in the case”).

\textsuperscript{36} See, e.g., Lucent Techs., Inc. v. Gateway, Inc., 580 F.3d 1301 (Fed. Cir. 2009); ResQNet.com, Inc. v. Lansa, Inc., 594 F.3d 860 (Fed. Cir. 2010); Uniloc USA, Inc. v. Microsoft Corp., 632 F.3d 1292 (Fed. Cir. 2011). These cases also demonstrate that even assuming there was truth to the assertion that patent damages have been excessive, courts are well-equipped to ensure proper calculations. Recent studies, however, indicate that median damage awards have remained relatively stable year after year. See PriceWaterHouseCoopers, 2008 Patent Litigation Study, available at http://www.pwc.com/en_US/us/forensic-services/assets/2008_patent_litigation_study.pdf.

\textsuperscript{37} Einer Elhauge, Do Patent Holdup and Royalty Stacking Lead to Systematically Excessive Royalties?, 4 J. COMPETITION L. & ECON. 535, 553–70 (2008) (suggesting that patent owners may be under-compensated for their inventive investments).
Moreover, the policy choice reflected in the IP Report reflects a competitive policy choice favoring one segment of the economy (manufacturers and sellers of products based on patented technology) over another (the owners of the patented technology). But this type of competitive policy decision is the responsibility of Congress, and not the FTC, the courts, or others. And Congress has spoken, most recently through the America Invents Act.

Moreover, the policy choice reflected in the IP Report ignores the complementary balance that has long been recognized by the courts and the FTC—that competition is properly advanced through effective enforcement of both the antitrust and the patent laws. The 2007 IP Report succinctly explains that these two bodies of law “share the [same] fundamental goals of enhancing consumer welfare and promoting innovation . . . work[ing] in tandem to bring new and better technologies, products and services to consumers at lower prices.” As further explained by former Assistant Attorney General Thomas Barnett, the complementary nature of the antitrust and patent laws maintains the proper balance between static and dynamic efficiencies. Static efficiency refers to competition that occurs within an existing technology whereby firms compete primarily by cutting costs, making incremental improvements to efficiency, and lowering prices. Imposing caps on royalties that would lower costs to manufacturers is an example of a static efficiency. Dynamic efficiency, on the other hand, refers to competition “that does not merely improve upon old methods, but leaps ahead into something new.” The invention of new technologies through the investment of risk capital and its subsequent commercialization reflects dynamic efficiency. And, according to one observer, “dynamic efficiency . . . is responsible for the vast majority of economic growth and increased consumer welfare.” But if the return a patent owner will be able to enjoy the original creators. General estimates suggest that the private profits from an innovation typically account for a tiny fraction—a few percent—of the social value.

Seventh, the IP Report reflects a competitive policy choice favoring one segment of the economy (manufacturers and sellers of products based on patented technology) over another (the owners of the patented technology). But this type of competitive policy decision is the responsibility of Congress, and not the FTC, the courts, or others. And Congress has spoken, most recently through the America Invents Act.

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78 Nat’l Econ. Council, Council of Econ. Advisers & Office of Science & Tech. Policy, A Strategy for American Innovation 10 (Feb. 2011), available at http://www.whitehouse.gov/sites/default/files/uploads/InnovationStrategy.pdf. The Strategy identified three reasons why social gain exceeds private return. “First, users will only pay for the innovation if its benefits exceed its price. These consumer benefits—the ‘consumer surplus’—mean that much of the innovation’s value will immediately accrue to users. Second, the innovative business will face pressures to lower prices as other businesses imitate and improve upon the successful innovation. . . . Finally, a successful innovation often launches hosts of additional innovations by other firms, the benefits of which are not captured by the original innovator.” Id.

79 See United States v. Topco Assocs., 405 U.S. 596, 611–12 (1972) (“If a decision is to be made to sacrifice competition in one portion of the economy for greater competition in another portion this . . . is a decision that must be made by Congress and not by private forces or by courts. . . . To analyze, interpret, and evaluate the myriad of competing interests and the endless data that would surely be brought to bear on such decisions, and to make the delicate judgment on the relative values to society of competitive areas of the economy, the judgment of the elected representatives of the people is required.”).

80 See Simpson v. Union Oil Co., 377 U.S. 13, 24 (1964) (“The patent laws . . . are in pari materia with the antitrust laws and modify them pro tanto.”).


82 Barnett, supra note 41, at 2.

83 Id. at 3.

realize through royalties is capped, whether by the IP Report’s proposed incremental value test or otherwise, the incentives to invest in activities that advance dynamic efficiencies will be harmed. The IP Report’s approach to hold-up threatens such a result.

Eighth, the IP Report’s approach to hold-up and incremental value also ignores the realities of licensing conduct. Licensing of wireless communication patents is illustrative. There have been many thousands of patents declared by hundreds of companies as potentially essential to 2G, 3G, and now 4G wireless standards. To access these patents efficiently, firms typically engage in extensive portfolio licensing and cross-licensing, thus realizing efficiencies and broad operating freedom free from threats of infringement suit. But to determine the retrospective incremental value of an entire portfolio as against an unbounded set of potential “alternatives” is an impossible task. It just could not be done with any practical accuracy. This is particularly true because, even without portfolio licensing and cross-licensing, the “value” of a patent and its alternatives can change dramatically over time as the result of market developments, new and competing and complementary technologies, and further investments by the parties and third parties. The IP Report’s incremental value test simply will not work as proposed.

In sum, the IP Report’s definition of hold-up and its proposals for a sweeping reordering of legal and policy standards, most notably by the imposition of the proposed artificial incremental value test, should not be substitutes for the marketplace-driven determinations of royalties, fees, and other value that a patent owner may obtain through either licensing negotiations or litigation. Substituting an ironclad rule for the flexibility of marketplace negotiations and existing standards for determining reasonable royalties will also limit the ability of patent users to gain a competitive advantage over other users by emphasizing certain licensing terms over others (monetary and non-monetary) that they believe will best advance their business strategies, and by moving faster to obtain licenses and avoid infringing conduct. Imposition of the incremental value rule as proposed would eliminate the benefits of such competitive foresight, and instead award the infringer (or simply the less insightful or slower moving patent user) with an adjustment of the competitive playing field in its favor.

None of the foregoing discussion should be understood to suggest that concerns are not legitimate in connection with conduct that might properly be considered as hold-up—for example, where a patent owner willfully engages in unlawful conduct by intentionally misrepresenting or omitting information concerning its patented technology, thereby inducing firms to engage in otherwise infringing conduct as the result of the patent owner’s unlawful conduct, and causing a competitive distortion in the marketplace. If such conduct can be proven, the law (whether antitrust, patent, common law contract, or equitable principles) provides remedies. But systematic reordering of the patent laws or standards process of the sort suggested by the IP Report is not necessary.

The Lack of Proof Establishing the Need for Reform

The IP Report’s proposals are even more questionable given the absence of any objective empirical evidence that current standards for patent enforcement and remedies have led to actual competitive or economic distortions, or constraints on innovation. Neither the IP Report nor its proponents have made such a showing. And contrary to the somewhat alarmist and empirically unsupported cries of widespread patent hold-up and a broken patent system, available objective evidence indicates the absence of any systemic problems and, indeed, the existence of robust innovation and competitiveness.

45 See Comments of Epstein et al., supra note 12, at 41–43.
Comments submitted in connection with the FTC’s Patent Standards Workshop are on point. A number of commenters explained that they simply had not experienced the type of hold-up problem identified by the IP Report. These submissions are significant because they represent the views of organizations representing a broad range of interests, not just the views of a small group or class of stakeholders that may have strategic or competitive reasons to seek reforms that will advance their own business models and strategies.

The American National Standards Institute, for example, reported that only “a relatively small number of questions have ever been formally raised regarding the ANSI Patent Policy, including issues relating to improper ‘hold up.’” 46 The comments of the Telecommunications Industry Association (TIA) and the Alliance for Telecommunications Industry Solutions (ATIS) are even more instructive. TIA and ATIS are the two leading U.S.-based organizations developing standards for all generations of wireless technologies. Commenting on the FTC’s definition of hold-up, TIA states that it “has never received any complaints regarding such ‘patent hold-up’” and it “believes that the FTC is presuming that ‘patent hold-up’ is a widespread and fundamental problem, without considering the practical experiences of standard-setting organizations such as TIA.” 47 ATIS similarly reported that it “has not experienced the hold up problem [as identified by the FTC], nor has any such problem impeded in any way ATIS’s standards development efforts.” 48 Further, according to the Association for Competitive Technology, small businesses are “not convinced that there is a wide-spread patent hold-up problem.” 49 The U.S. Chamber of Commerce reported that “empirical evidence supporting a concern with a widespread risk of holdup is lacking.” 50 Similarly, the American Intellectual Property Law Association (AIPLA) commented that the FTC’s Request for Comments ” [a]ppears to suggest that there may be reasons for substantial concern arising from the incorporation of royalty-bearing patented technologies in technical standards,” but that the AIPLA “does not share this view.” 51 Other submissions were to like effect. 52


48 Comments of Alliance for Telecommunications Industry Solutions 1 (June 14, 2011), available at http://www.ftc.gov/os/comments/patentstandardsworkshop/00015-60529.pdf. The author is outside counsel for ATIS and assisted in the preparation of ATIS’s comments.


51 Comments of AIPLA 2 (June 14, 2011), available at http://www.ftc.gov/os/comments/patentstandardsworkshop/00012-60634.pdf. The author chairs the AIPLA Antitrust Committee and contributed to the comments prepared by that committee, which were approved by the AIPLA Board of Directors for submission to the FTC.

52 Professor Jay P. Kesan of the University of Illinois College of Law commented that “there is little or no empirical evidence indicating that there is a significant problem with patent ‘hold up.’” Comments of Jay Kesan 2 (June 14, 2011), available at http://www.ftc.gov/os/comments/patentstandardsworkshop/00022-60546.pdf. Similarly, Keith Mallinson of WiseHarbor, a leading wireless industry consultant, reported that “there has been no evidence of ‘windfall gains’ to patent owners impeding the adoption of any technology-based standards.” Comments of WiseHarbor 8 (June 12, 2011), available at http://www.ftc.gov/os/comments/patentstandardsworkshop/00007-60459.pdf. See also Comments of Microsoft Corp., supra note 11, at 16 (there is “little evidence that ‘patent hold-up’ in the standards context is a real problem”); Comments of InterDigital, Inc. 2 (Aug. 5, 2011) ("based on our firsthand experience participating in industry standards, we do not believe that the current policies and practices of the various standards organizations in the wireless industry lead to unreasonably high prices to consumers, or otherwise result in market distortion"), available at http://www.ftc.gov/os/comments/patentstandardsworkshop/00043-80175.pdf; Comments of Epstein et al., supra note 12, at 14 (“the success on the ground bears out the theoretical insight that hold-ups are not a serious threat to collaboration over and around standards”).
Some commenters took a contrary view, opining, for instance, that hold-up in the standards context specifically is, in fact, real, and greater intervention and structural reform are necessary.53 But while suggesting that hold-up is a serious problem requiring attention and government intervention, these comments offer no empirical or quantitative proof of systemic distortion of the standards process or the patent system and offer no showing why existing remedies are not sufficient to deter actual unlawful or anticompetitive conduct.54

At the closing of the FTC’s Patent Standards Workshop, Joseph Farrell commented that the absence of proof did not mean that there is not a hold-up problem.55 Such a statement, however, provides little ground for the radical transformation that would result from the IP Report’s recommendations.56 Identification of speculative or theoretical risks may present interesting academic issues, but hardly justifies policy decisions of the sort being made by the FTC. Farrell’s suggestion that the absence of evidence of a hold-up problem results from the silence of consumers57 is also questionable, given the abundance of evidence over the past decade and longer of advancements of technology, the entry of competitors, and the introduction of new products with enhanced features and functionality, combined with declining costs, all of which have directly benefited consumers.

As estimated by the U.S. Patent and Trademark Office, tens of thousands of standards are approved annually, as international and American National Standards,58 and many more tens of thousands of technical reports and specifications are developed by standard-setting bodies around the world each year. Many of these standards and other technical documents incorporate patented technology and have led to the rapid uptake of standards-compliant products and services based on such technologies, without any evidence of a systemic breakdown in standard setting or the patent system. If anything, the handful of cases that have addressed what might be considered hold-up under any definition, if anything, illustrate the ability of parties to pursue remedies to address actionable conduct.59

The enormous contribution to innovation made by patented technologies in the wireless technology sector, specifically through the successful adoption and promulgation of such technologies through standardization, illustrates the success realized under the status quo. The technological


54 See Roger C. Brooks, Patent “Hold-Up,” Standards-Setting Organizations and the FTC’s Campaign Against Innovators, 39 AIPLA Q.J. 435, 438 (2011) (“[T]he recommendations in the Report appear to be based on uncritical reliance on unsupported assertions by licensees with particular business models, and on simplified economic constructs that bear no relationship to real markets, IP licensing or otherwise.”).

55 Closing Remarks of Joseph Farrell, Dir. of FTC Bureau of Economics, FTC Patent Standards Workshop, Tr. at 239 (“We can’t assume that the presence of a dispute means the presence of a problem. We also can’t assume that the absence of a dispute means the absence of a problem.”), available at http://www.ftc.gov/opp/workshops/standards/transcript.pdf.

56 See Comments of InterDigital, Inc., supra note 52, at 3 (“[I]n the absence of any empirical data suggesting the current system of standardization does not adequately serve consumer interests, it would be misguided to seek to scale back or restrict intellectual property protection for patents generally, and for standards-essential patents particularly.”).

57 Closing Remarks of Joseph Farrell, supra note 55, Tr. at 239–41.


59 See, e.g., Broadcom Corp. v. Qualcomm Inc., 501 F.3d 297 (3d Cir. 2007).
advances in this sector also reflect the benefits consumers have realized from the introduction of new products and services. Keith Mallinson, for example, points to “the successful deployment and rapid growth” of the patent-heavy GSM and WCDMA technologies as such proof. More specifically, Mallinson reports that “[s]uccessive generations of mobile technology have increased massively in performance with end-user data rates increasing 1,000-fold in 20 years,” from 56 kilobits per second in the mid-1990s to tens of megabits per second today, and that by 2020 new technology will provide 5.5 times the network capacity achieved by existing 3G technologies while using the same amount of spectrum. “Other standards-based innovations have substantially improved voice encoding, reduced power consumption, and enabled multimedia messaging and location tracking.” Standards implementers—that is, users of the patented technology incorporated in wireless standards—have also benefited from the breakneck pace of innovation in wireless technology, as have consumers. For example, the number and types of smartphones offered in the United States have grown dramatically over the past five years, with ever-expanding offerings of features and functions. And “mobile operators are as eager as ever to invest in new technologies to improve performance and lower total costs. New technology cost savings outweigh licensing fees.” For consumers, based on total ownership expenditures, it also cannot be said that patent fees or costs constrain demand for even more innovation at a faster pace, further bellying any suggestion that innovation has been impeded by a strong patent environment.

Finally, given the attention devoted to non-practicing entities (NPEs) and patent assertion entities (PAEs) by the IP Report to support adoption of special remedy rules for these entities, the actual data are also revealing. According to statistics cited in the IP Report, PAE infringement suits account for 17 percent of suits of computer-related patents between 2000 and 2008 (and 26 percent of defendants because many such suits name multiple defendants). But as former Chief Judge Paul Michel of the Federal Circuit observed, he was not convinced that there had been any meaningful increase in patent cases in total, or that the cost of infringement cases was attributable to the greater number of cases rather than the high costs of civil discovery in all cases. Moreover, as recently reported by PriceWaterhouseCoopers, the median damages recovery in

60 Comments of WiseHarbor, supra note 52, at 7 (“The flourishing market for mobile phones, which have transformed our business and daily lives, is evidence of the success of the economic incentives created by the IP system and the market-driven FRAND framework for licensing standards-essential IPR.”).

61 Id. at 10.


63 Comments of WiseHarbor, supra note 52, at 18.

64 Id. at 18–22.

65 See, e.g., IP Report, supra note 1, at 59–72 (suggesting that PAEs may be increasing the problem of patent “hold up”); Ramirez & Kimmel, supra note 2, at 3 (“PAEs may exacerbate the risks associated with patent hold-up”); Su, supra note 2, at 4–6 (NPEs potentially harm innovation by asserting acquired patents).

66 IP Report, supra note 1, App. A.

2010 was the lowest in the period 1995–2010, with a downward trend of median patent damages awards since 2005 (with only one aberrational year), further suggesting no distortion of the patent system requiring a systemic overhaul.\(^{68}\)

Pointing at NPEs and PAEs as undermining innovation also misses the important role such entities can play in advancing innovation. Sixty percent of U.S. patents are granted to small inventors; yet less than 10 percent of U.S. patent revenues are realized by small inventors.\(^{69}\) This disproportionate allocation of revenues as compared to inventiveness may be understood to confirm the generally observed fact that small inventors have difficulties commercializing their inventions and stand a very high risk that large, well-capitalized patent users (including those technology manufacturing firms that are seeking the type of radical change to the patent laws promoted by the \textit{IP Report}) will misappropriate their inventions, betting that small inventors will not be able to weather the battle of litigation, or will simply settle for a fraction of the invention’s worth. What the FTC characterizes as NPEs or PAEs are a source of risk capital that small inventors can use to commercialize or defend their inventions against such misappropriation and thus can facilitate and enhance innovation and competitiveness.\(^{70}\)

\textbf{Conclusion}

No doubt the environment for innovation can always be improved. It does not follow, however, that the entire focus of existing patent laws, and the incentives the patent laws provide for advancing innovation, should be overturned. This is especially so in the absence of compelling objective evidence of a broken system, lest the remedy be worse than the offense.

The FTC’s \textit{IP Report} seemingly takes this latter approach, and by so doing risks undermining the incentives for investment in invention—and innovation-enhancing efforts. And it does so based on: a questionable definition of hold-up, and despite a lack of evidence that there is any systemic problem that requires reform; Congressional action contrary to the IP Report’s proposals; and recent Supreme Court and Federal Circuit decisions that already address the issues raised by the \textit{IP Report},\(^{71}\) and that reject “categorical rules that might have wide-ranging and unforeseen impacts,” favoring instead a case-by-case approach to enforceability, remedy and procedural issues.\(^{72}\)

Given these circumstances, the FTC might determine it appropriate to reconsider the \textit{IP Report}.\(^{\circ}\)
Editors’ Note: Editor Allan Shampine comments on a paper that examines criticisms of ex ante licensing requirements implemented by standards-development organizations. Send suggestions for papers to review to: page@law.ufl.edu or jwoodbury@crai.com.

—William H. Page and John R. Woodbury


This paper provides an empirical study of one possible solution to the problem of patent hold-up. The threat of patent hold-up has been widely discussed in recent years, including in two articles appearing in the August 2011 issue of The Antitrust Source. FTC Commissioner Edith Ramirez and Lisa Kimmel describe patent hold-up as a problem that arises when a patentee negotiates a license with a producer that has already developed a product that depends on the patent: in this sort of ex post licensing, a “patentee can use the licensee’s sunk costs as leverage to negotiate a higher royalty than it would have been able to get ex ante.” These concerns often arise in the context of standard-setting organizations (referred to in Professor Contreras’s paper as standards-development organizations or SDOs). Such organizations develop standards that may call for the use of one or more patents, but the organizations do not themselves hold the patent rights. Patent holders may exploit this situation by seeking unanticipated or unbudgeted royalty payments after users of the standard have sunk costs in designing and implementing the standard.

SDOs are well aware of the dangers of patent hold-up, and many have put formal policies in place to address the problem. Those policies typically require that participants in the standard-setting process disclose any relevant patents upfront and/or that the participants make some sort of ex ante commitment about licensing terms. One common commitment is to license any patents

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2 Ramirez & Kimmel, supra note 1, at 3.


4 The royalty payments may be unanticipated in that the patent holder did not disclose the patent prior to the development of the standard, or unbudgeted in that the patent holder’s royalty demand is higher than what adopters of the standard expected to have to pay prior to the development of the standard. Professor Contreras’s paper focuses on the latter problem, which some say may be cured by policies requiring ex ante disclosure of licensing terms.
“essential” to the standard on “fair, reasonable and non-discriminatory” (FRAND) terms. However, such commitments have been frequently litigated because the SDOs themselves do not define “reasonableness” or “nondiscrimination.” Some SDOs have therefore explored another option—requiring participants to disclose explicit licensing terms ex ante, before the standard is finalized.

Ex ante licensing requirements raise potential antitrust and standard-setting process concerns for both the patent holders and the licensees. With respect to antitrust, requiring joint ex ante licensing could potentially facilitate collusion by the patent holders by making it easier to exchange information on terms and negotiations. Alternatively, it could facilitate market power for the licensees (oligopsony) by allowing them to negotiate jointly through the SDO. With respect to the standard-setting process, critics of such requirements have suggested that the addition of licensing negotiations to the process may delay the introduction of new standards; that members will leave SDOs rather than agree to such requirements, thereby reducing the effectiveness of the requirements and undermining the SDOs’ ability to implement standards; and that SDOs may therefore “settle” for technically inferior but less expensive technologies.

Professor Contreras’s paper tests the validity of the foregoing criticisms using data on SDOs that have required ex ante licensing disclosures. The paper identifies five testable implications of the criticisms: that an ex ante licensing requirement would (1) reduce standardization activity, (2) cause standards to take longer to develop, (3) require standards developers to devote more time to standardization activities, (4) cause members to withdraw from SDOs that adopt them, and (5) cause standards to decrease in quality. It then analyzes the available data to determine whether they are consistent with these supposed effects.

The paper uses data from three SDOs. The first, VMEbus International Trade Association (VITA), requires members to disclose maximum royalty rates for any “essential” patents during the development of the standard. Any patents that are not disclosed must be licensed royalty-free. To address antitrust concerns, VITA obtained a business review letter from the U.S. Department of Justice prior to implementing this policy in 2006. The second and third SDOs, the Institute for Electrical and Electronics Engineers (IEEE) and the Internet Engineering Task Force (IETF), have policies encouraging, but not requiring, members to disclose maximum royalty rates and other licensing terms during the development of the standard. The IEEE policy, which was also subject


7 Id. at 52–53; Skitol, supra note 3, at 735–39.

8 See, e.g., Michele Herman, The Quandary of a Balanced IPR Policy, Licensing J., Oct. 2006, at 5, 7–8; 2007 IP REPORT, supra note 6, at 50. There is some debate as to whether “settling” for a technically inferior patent at a lower royalty rate is a “bug” or a “feature.” Arguably, the use of any patent in a standard should be evaluated on a cost-benefit basis. For example, there may be technical advantages to using synthetic diamond rather than glass in a standard for windows, but glass is much less expensive and so may be socially preferable.


10 The policy explicitly prohibits joint licensing negotiations.

to a DOJ business review, became effective in April 2007.\textsuperscript{12} The IETF policy is more informal. Members are required to disclose the existence of relevant patents, but are allowed to, and frequently choose to, provide information about licensing policies as part of those disclosures.

The data include, by year for 2004 to 2010, the number of standards started, the number of standards approved, the length of time before final approval of the standard, and the number of members joining and withdrawing from each organization. Data on the number of patents disclosed as being relevant to standards was collected for 2007 to 2010.

Generally, the paper argues that there is no statistically significant evidence to support the criticisms of ex ante licensing requirements. In particular, the paper finds that the introduction of the ex ante licensing policies did not result in any statistically significant decline in the number of standards started or the number of standards adopted, and that the length of time before final approval of the standard increased on average, but apparently as part of an industry-wide trend.

There are several important caveats to these results. First, the average standard in the SDOs studied takes between three and five years to complete. Thus, virtually all of the standards completed after introduction of an ex ante licensing requirement were begun prior to the requirement. Second, the paper identifies only one SDO, VITA, which has a mandatory requirement to list a maximum royalty rate. IEEE and IETF have optional policies which members often do not choose to use. For example, only 11 percent of IEEE patent disclosures included any licensing terms whatsoever. Furthermore, almost none of the IEEE and IETF disclosures on licensing terms actually contained a royalty rate.\textsuperscript{13} The paper suggests that the differences in disclosures between VITA and the other two SDOs are evidence that members will only disclose specific royalty rates ex ante if they are required to do so. This means that the paper’s results depend heavily on VITA’s experience with a mandatory disclosure requirement. However, VITA approved only eighteen standards between 2007 and 2010, and there were only seven licensing disclosures.

In recognition of the importance of VITA and the limitations of the data, the author did a survey of all VITA members to obtain anecdotal information. A little over half of the members responded to the survey. The survey results are consistent with the statistical results on the number of standards begun and completed, and length of time to complete. Members tend to be supportive of the ex ante licensing requirement and to believe that the policy has either speeded up the completion of standards or had no effect on the time to complete the process. Similarly, the survey results indicate that members did not spend any more time working on the standards than before the requirement was put in place. Surveyed members also felt that the requirement resulted in better, not lower, quality standards. The paper notes that VITA standards had never won any industry awards prior to adoption of the requirement, but have won a number since then, and that the number of citations, as measured by Google “hits,” of VITA standards has remained relatively constant. However, the industry-award argument is hampered by the fact that the award-winning VITA standards were most likely begun prior to the licensing requirement being instituted, and that Google “hits” may be a poor proxy for quality.

\textsuperscript{12} Letter from Thomas O. Barnett, Asst. At’y Gen., U.S. Dep’t of Justice, to Michael A. Lindsay regarding the business review request of the Inst. of Elec. and Elecs. Eng’rs, Inc. (Apr. 30, 2007), available at http://www.justice.gov/atr/public/busreview/222978.pdf. This business review by the DOJ highlights the fact that even a policy of voluntary disclosure of ex ante licensing terms can raise antitrust concerns about collusion and oligopsony. Given those concerns, there is arguably a substantive difference between an SDO with an explicit policy allowing ex ante disclosure of licensing terms and an SDO without such a policy.

\textsuperscript{13} The licensing disclosures were typically either a commitment not to charge royalties for a particular patent or a description of other licensing-related issues, such as a willingness to undertake reciprocal licensing or defensive suspensions, which allow the patent holder to terminate a license if the licensee sues the patent holder.
The survey data also allow the paper to look at whether members left the SDO in response to the adoption of the ex ante licensing requirement. The paper argues that there was no significant impact on VITA membership as a result of the requirements being instituted. VITA had a net loss of eight members in 2007 and a net gain of twenty-one members in 2010 (with 2008 and 2009 having little change). However, the paper did not attempt to weight the membership changes by size, patent holdings, or other factors. Such weighting could be important. Only one member left stating specifically that its departure was because of the ex ante licensing requirement, but that member was Motorola, which left VITA in 2007 immediately after the requirement was instituted.

The paper concludes by asking whether the ex ante licensing requirements had any impact on royalty rates. The paper argues that there is no evidence that VITA's ex ante requirement has lowered royalty rates, and that there has been only one dispute arising out of a licensing disclosure. That dispute concerned a defensive suspension provision and not the rate itself. However, the paper's conclusion may be better stated as finding no evidence of collusion or oligopsony. That is because the paper has no benchmark to determine whether the disclosed rates are higher or lower than rates prior to the requirement being instituted. The survey, however, found that 33 percent of respondents indicated that they had felt, at least once, that a disclosed rate was too high and had taken some (legal) action as a result. Survey results, by their nature, are unlikely to provide indirect evidence of collusion by either patent holders or licensees, but these results do suggest the licensing disclosure requirement placed some constraint on royalty rates. That effect is consistent with preventing hold-up—the stated goal of the licensing requirement.

—AS