Trolls 2.0

BY STUART MEYER

Last week, a bipartisan quartet of senators introduced yet another round of patent reform legislation. As with the prior unsuccessful attempts in recent years, the bills proposed in the House and the Senate address a variety of issues, such as the measure of damages that a patentee can recover from an infringer.

Numerous commentators have observed that recent attempts at patent reform are aimed, in part, at limiting the upside potential of companies that own patents but do not actually market products or services incorporating those inventions. So-called non-practicing entities are allowed under current U.S. law to enforce their patent rights in essentially the same manner as traditional companies that actually sell their inventive products. This has led to a practice some call "inventing patents" rather than patenting inventions, for the sole purpose of asserting those patents against companies that actually sell products or provide services.

A few examples illustrate the prevalent business models. Ronald Katz has been active for decades in patenting inventions relating primarily to telephone call center processing. He has been characterized as a patent troll not so much as a result of holding rather than using patented inventions (in fact, he was active in the industry), but because of the aggressive way that he sought and enforced his patents. Katz patents include literally hundreds of claims each, and his licensing company has not hesitated to bring infringement suits against those in the industry who refuse his licensing offers.

Acacia Research, a publicly traded company, runs a number of subsidiaries that purchase patents in diverse areas ranging from computer media to medical devices. These subsidiaries then engage in extensive market research to determine what companies arguably have products or services covered by such patents. The target companies are then notified, invited to a PowerPoint presentation of how Acacia believes that the patents are infringed, and offered a license. Typically, Acacia approaches a number of such target companies in parallel. Those who push back are typically sued en masse in a single lawsuit, which until recently was generally filed in the Eastern District of Texas (a recent Federal Circuit case has made it more difficult to keep cases there if the subject matter has little relationship to that district). Once the action has been filed, Acacia continues negotiations with the defendants, and is generally successful at obtaining a settlement at a price point just below the defendant's threshold of pain for maintaining the fight. It is rare indeed for an Acacia action to make it past pretrial discovery, much less trial. Acacia grew to where it is today through a combination of individual purchases and larger acquisitions, such as the 2005 acquisition of Global Patent Holdings LLC, itself considered a formidable patent licensing company at the time.

Congress would be well within its power to change patent law to limit the ability of non-practicing entities to seek large damages or injunctive relief when others infringe their patents. Copyright law, for example, provides a system of compulsory royalties for musical performances. And in some other countries, such as Australia, if the patent owner does not "work the patent" then a third party can seek a compulsory license to ensure that the public promptly gets the benefit of the invention.

While the business models of non-practicing entities may be legal under the current regime, they are often viewed with distaste, and sometimes disgust, by the larger business community. The pejorative term "patent troll" is now the most common way to reference companies that focus on purchasing and licensing patents. Commentators suggest that such companies are imposing an underserved private tax on industry without fully upholding their side of the traditional quid pro quo on which our patent system is based.

Perhaps sensing that the court of public opinion may impact the future of their businesses, in recent years we have seen the emergence of patent holding companies that market themselves as being different from the conventional trolls.

Perhaps the first of these was Intellectual Ventures, founded with little fanfare nearly a decade ago by two ex-Microsoft executives and a pair of technology lawyers. While the company quietly markets itself as a quaint inventors' shop in which smart people brainstorm ideas and turn them into patents, the company has also been extremely active in buying and licensing patent from various sources. Last year, the *Wall Street Journal* characterized the Intellectual Ventures portfolio as "a trove of 20,000 plus patents and patent applications" making it one of the world's largest patent holders. The Intellectual Ventures Web site says that litigation is not one of its goals, as "litigation takes a lot of time, costs a lot of money and most importantly, takes attention away from the core business." As the *Wall Street Journal* noted, however, Intellectual Ventures has secured patent licenses with large companies, some of which are measured in hundreds of millions of dollars — each. Reportedly, Intellectual Ventures' "relationship with the tech industry has become increasingly adversarial." It seems inevitable that a large company that balks at paying a license fee will at some point find itself subject to an infringement lawsuit.

A more recent entry in the field is RPX, a patent holding company launched in November 2008 by two ex-VPs of Intellectual Ventures and a lawyer who represented the licensing foundation formed by Jerome Lemelson, considered by some to be the original patent troll. The team touts that its collective experience totals "over $2 billion in patent-related transactions." Rather than presenting itself as yet another patent licensing company, RPX markets itself as a hedge against trolls, sort of an "anti-troll." The home page of the RPX Web site leads off with an assertion that RPX was formed to provide companies with protection against patent assertions by non-practicing entities. The RPX model is based on an annual fee for which member companies get covenants not to sue and term licenses for their operations. RPX has been very active in acquiring patent rights, and has even entered into a relationship with Acacia to extend a portion of its portfolio to RPX's members.

Traditionally, companies considering a defensive patent strategy mainly directed their analysis at competitors. They would analyze competitors' patent portfolios for non-infringement, invalidity or unenforceability arguments. They would seek to obtain patents in areas to which their competitors were likely to migrate, even if not core to their own business.

Now, however, with aggregation of huge portfolios by non-competitive organizations, a different approach is needed. Simple mathematics illustrates why this is the case. Say, for example, that patents statistically have a 70 percent chance of being upheld as valid in litigation. An accused infringer faced with a single patent may well decide to launch a defense based in part on invalidity, because the 30 percent chance of success is significant. However, if a patent aggregator collects just four potentially applicable patents, and if the arguments for invalidity are independent for each, then the defender has less than a 1 percent chance of establishing that all four patents are invalid (the chance of succeeding with all four arguments is 30 percent of 30 percent of 30 percent of 30 percent, or 0.3 raised to the fourth power).

It may be that Congress at some point decides to change the rules, but companies are not waiting to find out. A number of larger players are choosing to sign up with, or even invest in, these patent holding companies. Smaller companies are adopting a number of clever strategies to become less attractive litigation targets as well. More energy is being put into fighting plaintiffs' venue selections; technology differentiators are being emphasized so that plaintiffs have difficulty lumping all defendants together for purposes of infringement analysis; defendants are forming joint defense teams more effectively than used to be the case.

Just to give one specific example of emerging defensive techniques, if a patent holding company has a portfolio of 300 issued patents and a handful of applications in a particular area of technology, the company's duty of disclosure to the U.S. Patent and Trademark Office regarding the pending applications may extend to the "prior art" evident from the file histories of all 300 issued patents, as well as those that the company considered but did not acquire. Thus, large patent holding companies are potentially subject to far more extensive pretrial discovery than would be the case for individual patent holders. As always, countermeasures will continue to evolve along with these new businesses, and will be reset from time to time as Congress or the courts step in.

We are entering a new age, a second generation, of patent holding company activities. Companies that are not prepared with new strategies will find this new era costly and potentially fatal to their existing operations, while those who have ongoing involvement with the process can find ways to work with it. As always, awareness and foresight will be key predictors of success.

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