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## **Strategies for Battling Patent Trolls<sup>1</sup>**

by Gina Carter



### **The Problem and Some Context**

The controversy over “patent trolls,” which has been simmering for years, has finally heated up and caught the attention of state and federal legislators, attorneys general (AGs) and even President Obama. Patent trolls, more objectively referred to as Non-Practicing Entities (NPEs), are companies formed to purchase patents and then, without using them to produce any products, enforce the patents through licensing programs or litigation. NPE’s can also include universities or solo inventors that hold patents but do not produce or sell any products or services using their patented inventions.

NPEs normally have all or some of the following characteristics:

- No intention to practice the invention
- Often acquire older patents and enforce against newer technologies
- Often are represented on a contingent fee basis
- Use threat of litigation and associated costs to force licensing of patent
- Typically NPEs look to purchase broad patents in key technology areas within a particular industry
- NPEs select speedy, more pro-plaintiff jurisdictions for lawsuits
- Those with weaker patents target small companies who they believe can’t afford a defense (in 2013, average patent infringement costs in cases brought by NPEs, when \$1 million to \$10 million in damages was sought, was \$1.2 million through discovery and \$2.1 million through trial)<sup>2</sup>
- Business method and software patents are often asserted by NPEs

The more negative moniker, patent troll, no doubt arose from the NPEs’ tactics of alleging infringement and making a license demand without providing any real analysis of whether its target was actually infringing the claims of the patent or even disclosing the actual identity of its owners. The recent NPE tactic of blanketing small- to medium-size companies with cease and desist letters on a range of business method and software patents has raised awareness of the federal and state legislative and executive branches as the NPEs have brought their tactics and lawsuits to Main Street.

The other perspective advanced by some economists and the NPEs is that the increase in lawsuits reflects a legitimate activity of facilitating markets for technology. Those touting the benefits of NPE activities often point to the sole inventor who lacks the financial wherewithal and business expertise to exploit the invention he or she has developed or to enforce their patents. In the view of some, NPEs provide a service to the economy by acting as market intermediaries that provide liquidity to inventors and increased efficiency to patent markets.

The fundamental public policy issue is whether the proliferation of NPE patent litigation is stifling innovation or is providing market efficiency in an economy where markets are king. The furor caused by some NPEs’ recent strategies of demanding payment and threatening suits against end users who simply use the technologies sold to them by others (e.g., software products to run their business or architecture for their e-commerce sites) has attracted the attention of federal and state governments. Even President Obama weighed in by issuing five executive orders in 2013 and offering seven legislative recommendations to Congress to help curb the challenges from NPEs.

Congress and the states are facing the difficulty of addressing the patent troll concern because it requires restricting the patent rights found in the U.S. Constitution. States are similarly challenged and also will be blocked by the federal preemption doctrine that leaves the patent sphere to federal law. Finally, drawing the line to protect some patent owners while restricting the rights of others is no easy feat without running afoul of the Constitution.

This paper explores the effects of NPEs on businesses' proposed federal and state legislative and regulatory responses and effective strategies for businesses to minimize the costs of dealing with NPEs.

## **By The Numbers: Statistics of NPEs – Actions and Impact on Businesses**

As an initial matter, it should be noted that reasonable minds differ on whether there is a patent troll crisis. David Kapos, who headed the U.S. Patent and Trademark Office (USPTO) from 2009-2013, asserts that there is no such crisis at hand and that NPEs are not responsible for the increase in patent litigation.<sup>3</sup> In addition, the Government Accounting Office (GAO) issued a report in August 2013 that was required by § 34 of the America Invents Act (AIA)<sup>4</sup> that suggests that increase in litigation by NPEs is not as dramatic as posited by certain other studies by academics.<sup>5</sup> Specifically, the GAO report found that NPEs brought approximately 20% of the filed patent cases between 2007 and 2011.<sup>6</sup>

In contrast, according to RPX Corporation, a publically traded company that offers patent risk management and acquisition services, in 2013 NPEs initiated 63% of all new patent litigation (measured by total defendants).<sup>7</sup> In addition, in 2012, according to a study by Patent Freedom, an entity that tracks NPE lawsuits, NPEs sued more “low-tech” industries like retailers and financial institutions than technology companies.<sup>8</sup> Many of the patents asserted by NPEs against retailers and financial institutions involve software or business method and process patents.

Recent articles from two Boston University professors estimate that direct costs by defendants in patent suits by NPEs were \$29 billion in 2011.<sup>9</sup> The same authors concluded that NPE lawsuits caused \$500 billion of lost wealth to the targeted businesses from 1990 to 2010.

A 2014 National Bureau of Economic Research paper by professors from Harvard University and the University of Texas at Dallas concluded that the substantial increase in NPE lawsuits has had a detrimental effect on innovation.<sup>10</sup> The findings of this research revealed the following:

- NPEs tend to sue firms that have significant pools of cash reserves or have recently experienced positive cash inflows: “A one standard-deviation increase in cash level increases the probability of being sued by an NPE by 11%. Given that the mean probability is 2%, this is more than a fivefold increase.”<sup>11</sup>
- Companies with smaller legal teams and a higher number of ongoing legal cases are more likely to be sued by NPEs. This suggests that they “target firms with a higher likelihood of settling,” thus “maximizing the expected profitability of winning.”<sup>12</sup>
- Comparing companies involved in lawsuits brought by NPEs where target defendants win a dismissal to companies where lawsuits are settled or continue to final court adjudication, the study found that the latter group of companies spent an average \$211 million less on research and development in the years after the litigation compared to the firms that had won the suits by dismissal. In addition, companies forced to settle or proceed through litigation significantly reduced their patenting activity in subsequent years.<sup>13</sup>

The authors concluded that “The stakes of how to organize intellectual property disputes are massive.” “If the United States becomes a less desirable place to innovate because NPEs are left unchecked, innovation and human capital and the returns to that innovation and human capital will likely flee overseas.” They suggest that the “marginal policy response should be to more carefully limit the power of NPEs or increase the cost of bringing suit against commercializers of innovative ideas.”<sup>14</sup>

## **How NPEs Operate**

NPEs normally enforce patents that are applicable to a broad range of products or services. Prior to the passage of the AIA NPEs would join multiple defendants in one lawsuit. Post AIA NPEs must file separate lawsuits against each defendant. Even with this change, NPEs often file a number of lawsuits in the same court against many individual defendants. While each defendant has the right to its own trial, they now find that many district courts such as the Eastern District of Texas have consolidated many aspects of the pre-trial process such as discovery to conserve judicial resources.

NPEs often identify defendants that have a lot to lose, such as companies whose business is substantially dependent on the product that allegedly infringes the NPE's patent or that cannot afford costly litigation in hopes of obtaining an early victory in court through summary judgment or a settlement. After getting a more vulnerable defendant to take a license, the NPE

hopes to encourage other companies to submit to licenses without the need for litigation.

NPEs tend to bring lawsuits in federal district courts that are seen as more friendly to patent owners, such as the Eastern District of Virginia, the District Court of Delaware, the Eastern District of Texas and the Western District of Wisconsin.<sup>15</sup> These districts tend to have shorter time-to-trial, higher success rates for patent owners and greater median damage awards.<sup>16</sup> More and more NPEs are suing the retail sellers of products that they claim infringe, not just the manufacturers. This is permissible because under U.S. patent law, patent owners can sue any party that “makes, uses, offers to sell, or sells any patented invention.”<sup>17</sup> Many smaller retailers unaccustomed to involvement in patent litigation are often more likely than technology companies to agree to a license early on to avoid the uncertainty and unpredictability of a patent trial. NPEs are aggressively enforcing software and business method patents involving online shopping technologies and interactive navigation features and mobile applications that permit retailers to interface with customers.

A common practice for NPEs is to blanket businesses or manufacturers with cease and desist letters before filing suits. These letters often contain general allegations of infringement without specifying how exactly the service or product is infringing the patent. These letters contain an offer to license the patent for an amount that is significantly less than the fees and costs of litigation, which on average are more than \$2 million through trial. NPEs often recite the list of well-known companies that have already taken licenses for the patent from the NPE to encourage other companies to settle without significant delay that could increase the NPEs’ costs in extracting a settlement.

Not surprisingly, NPEs try and reduce transactional costs in securing settlements and are most often represented on a contingency basis by the law firms they hire to draft the demand letters and file suits. Technical experts are sometimes hired on a contingency basis as well.

As the GAO study noted, there is not “reliable data on patent assertion outside the court system,”<sup>18</sup> therefore the full extent of payments by business to NPEs cannot be easily measured. The Electronic Frontier Foundation (EFF) and others are urging Congress to require NPEs to report publically the cease and desist letters they send.<sup>19</sup> In the meantime, the EFF is collecting data from business that receive such letters and the information is available at <https://www.trollingeffects.org>. Interestingly, the Federal Trade Commission (FTC) has taken on NPEs that send out cease and desist letters that contain deceptive

representations. Specifically, the FTC entered a settlement with MPHJ Technology Investments, LLC which has contacted thousands of small businesses over its scanner patents and alleged the businesses infringed the patents by scanning documents to email.<sup>20</sup> The FTC ordered MPHJ to stop using “deceptive sales and phony legal threats” in its patent licensing demand letters.

## Legislative and Regulatory Efforts to Curb the Certain NPE Activities

Beginning in the fall of 2013, several bills were introduced in the U.S. Congress to address some of the tactics of NPEs that were causing U.S. businesses concern. The Innovation Act (H.R. 3309) introduced by House Judiciary Committee Chairman Bob Goodlatte (R-Va), passed the House of Representatives but became stalled in the Senate. With the new Republican majority in the Senate, Rep. Goodlatte and Rep. Darrell Issa (R-CA), the Intellectual Property Subcommittee Chair, have pledged to move the legislation forward again. The bill that passed the Congress in late 2013 had the following key features:

- a requirement that the Patent Assertion Entity (PAE) plaintiffs provide much more detail on exactly what products infringe which patent claims;
- an attorney fees shifting clause that would make it easier for defendants who prevail in the suits to recover their attorneys’ fees from the plaintiff;
- a limitation on core discovery from the plaintiff prior to claim construction; and
- a customer-suit exception.

The customers-suit provision allowed manufacturers and suppliers to join the lawsuits and stay the case against the customers until the other parties litigated the matter.

In addition to these federal legislative efforts, several state AGs have responded to the outcry from small- and medium-size businesses, who are often the targets of PAEs, who know that these business cannot afford the millions of dollars that a litigation defense costs. The AGs of Vermont, Minnesota and Nebraska have relied on state unfair trade practice statutory powers to go after PAEs who engage in the mass mailing of cease and desist letters to smaller businesses. The Vermont legislature also passed a bill permitting the recipient of a “bad faith” infringement claim to sue the PAE in state court.

The Nebraska AG, using state consumer protection laws, launched a suit in 2013 against NPEs MPHJ and Activision TV. In September 2014, a federal court ruled that the Nebraska AG’s attempt to curb cease

and desist letters was a violation of the NPEs First Amendment Rights and that federal law preempts state consumer protection laws. It even awarded the NPE \$750,000 in attorneys' fees against that state.<sup>21</sup> The Nebraska AG has vowed to fight on.

In contrast, the Minnesota AG obtained a consent decree from one PAE requiring that it stop sending infringement demand letters to state business unless it first gives the AG notice and obtains its consent to proceed. The AG in Vermont has fared better in at least one attempt to use state consumer protection laws to restrain NPEs. As of December 2014 that case is proceeding in state court in Vermont.<sup>22</sup>

It is very difficult to legislate against certain NPE tactics. As mentioned previously, reasonable minds can differ on whether there is even a problem with NPEs, at least measured by the data available on filed law suits and adjudications. In December 2014, at a patent reform discussion held by the Federalist Society for Law and Public Policy Studies, former Chief Judge Paul Michel, who headed the U.S. Court of Appeals where patent cases are heard, stated that the push for patent reform comes from "massive PR and what I would characterize as propaganda."<sup>23</sup> However, businesses across America are reporting to their elected officials and state and federal regulators that NPEs are costing their businesses money by attempted enforcement of invalid patents.

## Strategies for Dealing with NPEs

### Responding to the Cease and Desist Letter

It is important to review and understand the allegations in the letter sent by the NPE. If the letter is vague and lacking specifics as to what products or services offered by the business are infringing and how they are infringing the business should seek more specifics. This buys more time to conduct due diligence on the patent and the NPE. The business receiving the cease and desist letter and licensing demand needs to determine whether:

1. It makes or uses the patented invention;
2. The scope of the patent and when it will expire;
3. There are any ownership or assignment problems (e.g., is the NPE the actual owner of the patent?);
4. There is a third party that provided the product or service to the business that might have an obligation to indemnify the business in the event of an infringement allegation?;
5. The NPE has sued anyone under the patents asserted and what has been the result?; and
6. There are lawsuits in process and, if so, has a joint defense group formed that could be contacted for further information on the NPE and the patent?

Focusing for a moment on No. 4 above, it is important, especially in IT and technology law contracts, to include indemnification provisions that require the software vendor or technology consultant to indemnify the business in the event of a third-party allegation of infringement. Such provisions should include the obligation to defend against such claims including the costs and fees of any litigation. As soon as a cease and desist letter is received, businesses should check the relevant vendor contracts and, if an indemnification provision exists, the business should be sure to comply with all requirements for notice. Even if there is no provision in the contract a common law indemnification claim might exist under applicable state law.

### Reducing Costs of Defending NPE Suits

If the NPE has filed suits on the same patent(s) against multiple defendants, a business should form or join a joint defense group. Subject to a specific, written joint defense agreement that will help maintain an attorney-client privilege among the members of the group, the members can divide up much of the work and spread the cost burden among group members. It is important to stay active in such groups and participate in weekly calls to be sure that if a very active member settles early the remaining members are in a position to proceed to defend the case knowledgeably.

If early settlement is an option it is important to conduct an analysis to determine the strength of the infringement claims, the likely damages if the NPE prevails and the chances of prevailing in a summary judgment motion without a trial. Clearly the costs and business disruption must be considered as well. Part of this analysis should include gaining a firm understanding of the technology accused of infringing that includes outside counsel, inside counsel and the relevant business and marketing staff. It is possible that a very clear argument for non-infringement might emerge that will convince the NPE to move on to its next target.

While many businesses feel like they are being extorted by NPEs and may decide to fight on principle, if a low-dollar settlement can be obtained quickly it should be considered.

Businesses should be very careful in setting forth deadlines and discovery requirements in case management and discovery orders. Remember the NPE will have little or no discovery to provide but the defendant will have a significant burden in these cases.

Finally, if the NPE comes calling, business should consider invoking the post-grant challenge options that were expanded by the AIA. This could disrupt any court litigation. They include: a) post-grant review;<sup>24</sup> b) ex parte reexaminations;<sup>25</sup> and c) inter-partes reexaminations.<sup>26</sup> These new proceedings must be completed with a year. While they are less expensive

than federal court legislation, they could still cost hundreds of thousands of dollars to pursue, but not the millions that a patent case in federal court could cost.

## Tools Available at the USPTO to Challenge Bad Patents

**1. Post-Grant Review.** This is an administrative proceeding heard by the Patent Trial and Appeal Board (PTAB) instituted by a third party to cancel issued claims on any available statutory ground. This proceeding is only available for patents filed March 16, 2013 and after and it is only available for the first nine months after the patent issues. Any aspect of patentability can be challenged and could include: unclear claims, lack of an enabling disclosure, inadequate written description, subject matter that is not eligible for patent and/or an invention that is already known or obvious when considering the supplied prior art. A post-grant review cannot be filed if the challenger already filed a declaratory judgment action in federal court. If a declaratory judgment action is filed on or after petitioning for post-grant review, the declaratory judgment action will be automatically stayed until the patent owner moves the court to lift the stay, the patent owner files a court action or counterclaim alleging the post-grant review petitioner has infringed the patent or the petitioner moves the court to dismiss the court action.<sup>27</sup> It should be noted that a challenger in a post-grant review cannot reassert in subsequent USPTO or International Trade Commission proceedings or District Court litigation, issues that were raised or reasonably could have been raised in the post-grant review.

**2. Reexaminations.** Any person can request reexamination of a patent based upon new prior art (printed publications). There are two types of reexaminations.

- Ex parte. After reexamination is granted, only the patent owner can participate in the USPTO proceedings.
- Inter partes. The requestor and patent owner participate in prosecution before the examiner.

It should be noted that the requestor is estopped from raising in federal court litigation the same issues or issues that could have been raised in the USPTO proceedings. A defendant can request a stay of an infringement litigation if reexamination of the asserted patents is ongoing. It is advisable to file the request at an early stage of the litigation, and the chances are better for the stay if all asserted claims are being reexamined. The grant of a stay is in the discretion of

the district court judge, and the denial of stay cannot be appealed. In addition, even if stay is not granted, the rejection of claims in reexamination may have significant influence on the jury.

So far, these new USPTO tools have been invoked even more frequently than anticipated to challenge patents of all sorts.<sup>28</sup> These proceedings often result in the cancellation of some claims.<sup>29</sup>

## Conclusion

Addressing the challenges to businesses caused by an increase in patent litigation brought by NPEs is clearly, as this paper shows, not an easy task. At its core the problem has quite a bit to do with the issuance of questionable, weak patents. There is no question that bad patents engender more lawsuits. Limiting the scope of patentable subject matter and providing the patent office the resources it needs to better do its job is crucial. For example, perhaps Congress should focus on closing the Pandora's Box opened by the U.S. Federal Circuit Court of Appeals when it broadened the scope of patent protection by recognizing the patentability of business methods and software. The U.S. Supreme Court has effectively adopted this view by declining to rule, when given the opportunity, that business method patents are categorically un-patentable.<sup>30</sup> Ironically, the U.S. Supreme Court in recent years has tried to fix the patent system through a series of decisions limiting the scope of patentable subject matter<sup>31</sup> and by lowering the standard to prove invalidity by showing that an invention is "obvious" in light of prior inventions and known science and technology.<sup>32</sup>

Given the constitutional constraints of limiting the patent right and the risks inherent in trying to limit certain NPEs while protecting others, *e.g.*, individual inventors who do not commercialize the invention or universities that generate many patentable inventions through the research of faculty but do not commercialize focusing on improving the quality of patents by weeding out overbroad, obvious and vague patents at the issuance stage remains critical. Clearly courts have a part to play in managing patent litigation brought by any party, including NPEs, to achieve early disposition of cases before trial and managing and limiting discovery abuses that are often part and parcel of these NPE lawsuits. Legislative initiatives that improve the patent examination process to improve the quality of patents and the efficiency of patent litigation are also important and should be supported by all sides in this debate.

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