

# A new tool for a new kind of patent adversary

PatentFreedom is an online database and information exchange designed to help companies that are developing strategies to deal with the challenges posed by non-practising entities

By **Daniel P McCurdy** and **Chris Reohr**

Non-practising entities (NPEs), sometimes called patent trolls or worse, pose a large and growing threat to companies that make and sell products and services. In seeking to enforce their patent rights, NPEs differ in several crucial respects from even the most aggressive operating companies. To assess and respond more effectively to the threat they pose, executives at operating companies require new perspectives, strategies and tools.

This article explores the activities of NPEs and offers some suggestions for responding to them. Its authors founded PatentFreedom, which launched in April 2008, to provide operating companies with better information and tools to manage the threat posed by NPEs. Throughout the article, data on NPEs is provided which is drawn from the extensive, proprietary database compiled by PatentFreedom, representing more than 20,000 hours of cumulative research and analysis.

## **Selling a product no one wants – a brief history of patent licensing**

To understand better the unique nature of the threat posed by NPEs to operating companies, it is helpful to review a bit of basic history. The patent system was established to encourage beneficial innovation. Patents confer a negative right: the right to exclude others from using a

patented invention. As originally conceived, the patent system was intended to provide a temporary monopoly to the holder of a patent and thus reward innovation in the marketplace through the sale of products and services unconstrained by competitive threat. In some cases, most notably the pharmaceutical industry, this practice still predominates. But in other industries, particularly high-tech, the use of patents has become much more complex and, perhaps invariably, contentious.

Since at least the early 1990s, product companies in these industries have increasingly focused on monetising their patent portfolios. The Licensing Executives Society and innumerable conferences around the world have provided such companies with new techniques to derive value from intellectual property.

The techniques employed in such monetisation efforts are relatively straightforward:

- Amass a significant portfolio of patents through research and development, with some that might be required to practise an industry standard or deliver a critical function at an affordable price.
- Within this portfolio, identify a handful of patent assets potentially used by others in successful products.
- Drawing upon these patents, demonstrate that a potential licensee should want a licence to the broader patent portfolio (on average, only 2% to 3% of patents contained in most patent portfolios deliver substantial value – the rest provide sufficient uncertainty about the perils contained in the portfolio to entice the potential licensee into a much broader, royalty-bearing cross-licence).
- Where necessary, offer know-how that could be used by the licensee to improve

products and/or margins as a spoonful of sugar to help the medicine of a patent licence go down a bit easier.

For certain companies with extensive patent portfolios and effective, often aggressive strategies, this practice yielded rich rewards: hundreds of millions, even billions, of dollars' worth of high-margin licensing income on patent portfolios built up over many years and resting on the back of substantial R&D investment. IBM, Texas Instruments, Lucent and others pioneered the practice, delighting their shareholders even as they irritated their peers and competitors in the marketplace.

To defend against such patent enforcement activities, companies needed to ensure that their own patent portfolios contained an adequate number of sufficiently strong patents to serve as a credible deterrent. In discussions, they needed to be able to counter-assert with strong patent assets and thus hope to eliminate or at least lessen the size of any royalty to be paid for a cross-licence. Though many companies were initially caught unaware and vulnerable, most began to adapt to the new environment and invested in further R&D to bolster their patent portfolios. Companies that for years had invested substantially in R&D could rely on the strength of their portfolios in the event that a licensing discussion emerged with another operating company seeking to monetise its patents.

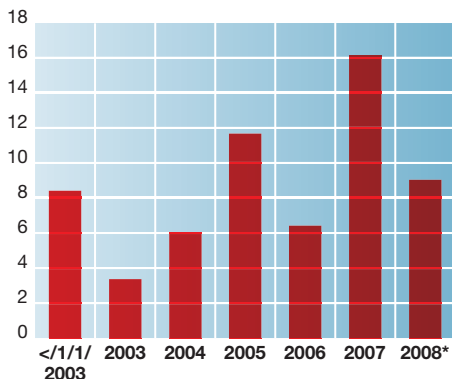
Thus, some parity existed among and between operating companies, and in most cases a mutually acceptable cross-licensing arrangement was reached. Licensing income would flow to those with the strongest patent portfolios and the most effective enforcement campaigns.

**Enter the non-practising entity**

In contrast to operating companies, NPEs do not practise their inventions in products or services offered in the marketplace. Instead, they derive or plan to derive the majority of their income from the enforcement of patent rights. This is, of course, perfectly legal, and indeed there are many who genuinely believe that such business practices help to reward and thus encourage innovation to the benefit of society as a whole.

Some would argue that NPEs provide a ready source of income by purchasing patents that individual inventors, small companies and even larger companies with too many assets in a given area, or that have abandoned a product line, wish to sell for near-term cash. Others argue that NPEs

Figure 1: Average new cases/company – top 15 companies



\*Annualised based on first six months.

Source: PatentFreedom © 2008

exploit the vulnerable and buy valuable inventions for pennies on the dollar.

Whatever side one takes on this often divisive issue, it is clear that patent enforcement actions brought by NPEs differ in two critical respects from those brought by other operating companies. First, there is essentially no ability for an operating company to counter-assert against an NPE and thus achieve what it might perceive to be a more equitable outcome. No matter how large your patent portfolio might be, no matter how many billions you may have invested and continue to invest in R&D, your intellectual property provides zero leverage in any discussions you might have with an NPE. Because they do not sell products or services (other than the licensing of intellectual property), almost by definition NPEs do not infringe on the patent rights contained in most patent portfolios. Whether or not this was ever anticipated or intended in the original design of the patent system, there is little that operating companies can do to address this particular disadvantage.

A second difference is what we call the information asymmetry. In contrast to operating companies, about which much is often known, the existence and activities of NPEs are often very difficult to discern. Typically, they are small, private entities, which employ shell companies and other (perfectly legal) strategies to hide their activities and gain an advantage in their interactions with operating companies. As operating companies seek to assess and respond to often veiled allegations of patent infringement, they struggle to know even basic information about the party making

such allegations. Who are they? What have they done in the past? Is my company the only one being approached or am I one of many being targeted in a shotgun campaign?

But in contrast to the inability to counter-assert, the information asymmetry is a disadvantage which can be overcome. This is what PatentFreedom was established to do.

**Analysing recent NPE activity**

NPEs have been around for many years, of course, but their number and activity level have risen dramatically over the past few years. Operating companies are increasingly threatened by their activity.

As of 31st August 2008, PatentFreedom’s research had identified and profiled over 160 distinct NPEs (a number which continues to increase). Since 1985, these NPEs have been involved in litigation with over 3,000 different operating companies in over 1,800 distinct actions. And the pace of activity is clearly increasing. Nearly 75% of the suits between these NPEs and operating companies were filed since 2003. As Figure 1 shows, the top 15 companies have been relentlessly pursued.

Patent lawsuits in the US involving NPEs have been steadily increasing over the last decade (see Figure 2). This has been fuelled by: the significant increase in the numbers of patents awarded over the last several decades (see Figure 3); and financial investors who speculate on potentially massive returns on the relatively modest cost of purchasing patents on the open market, where the median price for a patent

is approximately US\$100,000, and the mean approximately US\$400,000. In addition, the now often-cited payment of US\$612 million in 2006 (following a series of judgments in 2003 to 2005) to NTP in its patent assertion victory over Research In Motion (the supplier of the popular BlackBerry device) was a significant – but by no means exceptional – catalyst to the growth in investment in and by NPEs.

**NPE practice – some trends and perspectives**

NPEs recognise, as do all who attempt to enforce patents, that they are selling a product no one wants. Because patents offer only a negative right, the burden is on the patentee to enforce them. There is little incentive for a company to discover whether it may be using the invention of another (especially when to do so may subject the company to a claim of treble damages). While all respectable product companies would pay a royalty for the use of a valid and infringed patent (though there may be dispute over whether a patent is indeed valid or infringed in a given circumstance), the negative patent right generally provides no encouragement for the product company to seek to tax its products by offering to take a licence without first having been approached by the patentee.

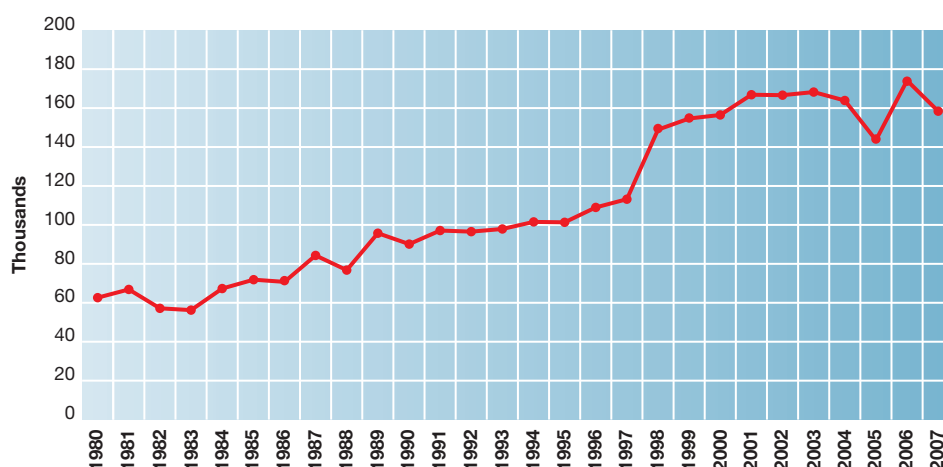
With a few notable exceptions, in building their patent arsenals NPEs have not modelled their strategies on the techniques used by the largest and most successful product companies. Such companies are focused on building large patent portfolios

Figure 2: US litigation involving NPEs

Case file year	No of cases by NPE	% of total NPE cases
Before 1998	98	5.4%
1998	43	2.4%
1999	62	3.4%
2000	47	2.6%
2001	75	4.2%
2002	148	8.2%
2003	158	8.8%
2004	117	6.5%
2005	268	14.9%
2006	260	14.4%
2007	299	16.6%
Til Aug 2008	227	12.6%
<b>Total</b>	<b>1,802</b>	<b>100%</b>

Source: PatentFreedom ©2008. Data captured as of 31st August 2008

Figure 3: US issued utility patents 1980-2007



Source: PatentFreedom ©2008

that would create a fear of the unknown in adversaries. Instead, most NPEs have focused their acquisitions on a smaller number of patents they believe will withstand the rigorous challenges to validity and infringement they will almost certainly face.

Alliacense, with 57 issued US patent families in its portfolio identified by PatentFreedom to date, and the Plutus IP group, with 23 issued US patent families in its portfolio identified by PatentFreedom to date, are examples of such firms. Indeed, of the 160 NPEs profiled by PatentFreedom at present, only 20 hold more than 100 patent families in their portfolios. With portfolios of this small size, potential licensees can readily assess the potential risk of the portfolio, provided they can learn all of the patents owned by the NPE, in itself a complex and expensive exercise made much easier by PatentFreedom.

Other NPEs, with Intellectual Ventures being by far the most notable, concluded that they would – in a sense – try to replicate the model of product companies. They would purchase large quantities of patents, knowing that only a small percentage of these would be the real treasure highlighted in each approach to a potential licensee. The ominous size of the portfolio, the financial ability to acquire many more patents on an ongoing basis and the availability of what the NPE would argue was a reasonable royalty to take a licence to the current and/or future portfolio might make at least some product companies entertain such a licence. If such a model were to work, NPEs might hope to build a substantial royalty stream without relying on litigation.

Unfortunately, however, as the experience of product companies engaged in licensing has consistently demonstrated, some amount of litigation is almost always required to demonstrate to a potential licensee that the alternative to failure to take an amicable licence may be more unpleasant and costly. It is likely, therefore, that all NPEs may ultimately have to utilise litigation to entice companies into buying the product (a patent licence) that no one wants. The likelihood of this outcome is underscored by the litigation activities of the most active plaintiff NPEs, which are summarised in Figure 4.

The increase in litigation activity by NPEs could be, in part, the result of the US Federal Circuit's 26th March 2007 decision in *SanDisk Corp v STMicroelectronics Inc*, in which the court held that: "Where a patentee asserts rights under a patent based

Figure 4: The most litigious NPEs

NPE name	Total cases	Cases since 2003	% of total by NPE
Acacia Technologies	308	239	78%
Rates Technology Inc	130	38	29%
Millennium LP	99	90	91%
Cygnus Telecommunications Technology LLC	69	31	45%
General Patent Corp International	66	36	55%
Plutus IP	59	59	100%
Papst Licensing GmbH	59	31	53%
F&G Research Inc	56	51	91%
Ronald A Katz Technology Licensing	54	48	89%
Catch Curve Inc	53	36	68%

Figure 5: Favoured venues for NPEs

Court	NPE as plaintiff		NPE as defendant		Total cases by NPE
	No of cases	% of total	No of cases	% of total	
Eastern District of Texas	332	94%	20	6%	352
Northern District of California	156	70%	66	30%	222
Central District of California	152	86%	25	14%	177
Southern District of New York	122	92%	10	8%	132
Northern District of Illinois	100	93%	8	7%	108
Northern District of Georgia	76	92%	7	8%	83
Delaware	57	69%	26	31%	83
Eastern District of New York	73	94%	5	6%	78
New Jersey	56	88%	8	13%	64
Southern District of Florida	56	97%	2	3%	58

Source: PatentFreedom ©2008. Data captured as of 31st August 2008

on certain identified ongoing or planned activity of another party, and where that party contends that it has the right to engage in the accused activity without license, an Article III case or controversy will arise and the party need not risk a suit for infringement by engaging in the identified activity before seeking a declaration of its legal rights."

With this ruling, the standard required to file a declaratory judgment action was materially reduced, allowing product companies to file such actions more easily against an NPE. While the costs and risks associated with litigation may in fact reduce the likelihood that a product company would file an action seeking a declaratory judgment against an NPE willing to engage in discussions, some NPEs have clearly decided that the risk of having an action placed in a less plaintiff-friendly jurisdiction was not worth taking and have opted instead to sue first and talk later to preserve venue. The preferences by NPEs to

file actions against product companies in certain jurisdictions is demonstrated in Figure 5.

**Get informed. Get connected. Take action**

With the significant growth in NPE activity, the old ways of managing patent assertions were inadequate. Operating companies could no longer rely on traditional methods to manage an adversary largely invulnerable to counter-assertion and operating in the dark of night. The asymmetry of information had to end. Funding to NPEs – at least the funding by companies and financiers seeking or holding relationships with the intended targets of the NPEs being financed – had to be exposed so that all parties had an opportunity to assess their relative positions and respond accordingly. It is with this objective that PatentFreedom was created.

PatentFreedom is a subscription-based, online community of operating companies that have come together to access and share information about NPEs and explore opportunities for defence. To date, PatentFreedom has invested more than 20,000 hours of research and development to create a database of detailed dossiers on more than 160 independent NPEs, which identify over 700 subsidiaries and more than 9,500 US patent families owned by them (plus foreign counterparts). The litigations in which each NPE has been a plaintiff or defendant have been recorded and, over time, the substantive filings associated with each will be appended to the NPE profiles.

To augment the extensive profiles described above, there are additional data that until now could be known only by each operating company that received a phone call, a letter, an email or some other communication from an NPE. Such communications often invite the company to review patents that “would surely lead [the company] to conclude it wishes to take a licence to the patent portfolio”.

PatentFreedom helps to unlock the value of such information by providing a secure online platform and a set of tools to identify other similarly situated companies that have been asserted against by the same NPE with one or more of the same patents. The platform allows operating companies to share and exchange such information (with the exception of licensing or settlement terms during the course of negotiations or information subject to confidentiality obligations) with other member operating companies, while protecting their identity should they wish to do so. In short, it allows

similarly situated companies to find one another and explore collaborative opportunities for defence, including shared prior art searches or the formation of joint defence arrangements.

Having launched in April 2008, PatentFreedom already has a dozen leading high-tech companies from across the globe as members and is in advanced discussions with many more. Members view PatentFreedom as an important part of their efforts to assess and respond to the threat posed by NPEs, and understand that its value will only increase with the growing size of its membership.

While the phenomenon of NPEs appears to be here to stay, PatentFreedom will help operating companies to level the playing field in their interactions with NPEs. The existence of PatentFreedom, whether alone or in combination with other defensive tools such as Allied Security Trust and the newly formed RPX Corp, indicates that operating companies are finally gaining access to the kinds of tools and strategies they need to manage and respond to the various threats posed by NPEs. *iam*

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