

The intangible investor

Written by
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Patent system's bad actors are not confined to trolls

The headlines proclaim that NPE suits are up and awards paid to them are higher than for operating companies. The reasons why, and who among IP plaintiffs and defendants act in bad faith, can be revealing

Bad actors that undermine the patent system are not confined to those non-practising entities (NPEs) with dubious rights and nuisance suits. They include operating companies that are frequent defendants in suits which hold thousands of patents, but perhaps not the right ones. Businesses with insufficient freedom to practise all of the inventions that underlie their complex products have been known to decry those that offer them a licence.

Patent enforcement, distasteful to both defendants and plaintiffs, is an effective if inefficient means of identifying abuse and establishing the quality and value of invention rights. Parties have yet to come up with a more reliable alternative. Businesses such as defensive aggregator RPX and licensing engine Acacia may be moving in that direction.

Data from litigation consultants Lex Machina and PwC indicates that recent increases in patent suits are attributable to NPE activity. Suits filed by patent monetisation entities accounted for 19% of US patent suits in 2007, but that number increased to 56% in 2012. The PwC study found that the median damages recovered by NPEs in patent litigation are nearly twice as high as those of operating companies, but in either case we are not talking about dramatic returns. Over the 2006-2011 period it was US\$6.9 million (NPE) versus US\$3.7 million (operating companies). The amount of the median NPE award, in fact, is down by 37.7% from 2001-2005, when the figures were US\$10.9 million versus US\$5.6 million.

While the two studies report increases in the number and value of NPE suits, they do not provide much context.

The last time I looked, there were at least half a dozen types of NPE, only a handful of them acting disreputably, with questionable patents, and banking

on the high cost of litigation for a quick settlement. Many NPEs hold good patents that operating companies wish they had secured through R&D or acquisition. Until about 1990, businesses had been able to get away with many patent portfolio mistakes. Quality was less relevant, because it was unlikely to be tested. Today, with patent holders asserting more good rights and with many more valuable rights to assert, the pendulum has swung in their favour. Regarded another way, the rise in patent enforcement is merely the patent system and markets doing their job. For innovation to evolve, it is necessary to require that businesses pay for the invention rights they need to sell a product. For those who have never had to play on a level field, being forced to can seem unfair.

By my count, only a few licensing businesses are what could accurately be referred to as businesses that do not contribute to innovation or commerce. They are frustrating, but they exist less because of weaknesses in the patent system than because of the high cost of patent litigation. This would appear to benefit larger, better-capitalised businesses. Painting all non-practising patent enforcers as trolls is inaccurate and potentially dangerous. Some NPEs settle early not because their patents lack quality, but because – given the economics of patent disputes and the risk of losing even under the best circumstances – early settlement is often a wise business decision. As one astute patent manager told me recently: “Intelligent patent enforcement has become more of a singles and doubles game. Those who swing only for the fences are more likely to strike out.”

‘Black hat’ or bad trolls are responsible for generating the headlines, but not the story. There are at least four reasons why NPE activity is up, and none of them has to do with a lack of patent quality or frivolous patent suits, a term that even President Obama has learned to use. They include the following:

- Patent grants have been rising steadily and were up 27.3% between 2009 and 2010 alone. More useful inventions mean more disputes.

- Declaratory judgment rulings require a plaintiff to file suit before a defendant can establish a more favourable venue. Many NPEs believe that they must file suit first and talk later. Perhaps even more important, for small and medium-sized enterprises, universities and NPEs to be taken seriously in licensing negotiations, they virtually have to file.
- More capital is available from more investors to fund enforcement activities and more law firms are willing to partner with NPEs, and more options are available, including better access to experienced managers. There also is greater investor awareness of undervalued, un-monetised IP value.
- NPEs simply are better at monetising patents than most operating companies. Some work with third-party or ‘privateer’ NPEs to achieve their licensing objectives. The stigma associated with patent monetisation continues to decline despite the best efforts to cast NPEs in a negative light.

Electing not to license an invention often comes down to a business decision; so too does how patent infringement gets resolved. For many businesses, the risk of – to put it delicately – ‘not volunteering to take a licence’ makes economic sense. In the unlikely event that an infringer is caught, the potential cost in terms of a settlement or licence is typically a fraction of the return that has been, and will continue to be, realised. Designing around an invention is extremely expensive and difficult; buying or licensing the patent, too. For many, ‘catch me if you can’ remains a viable IP strategy; especially in conjunction with ‘I had no idea we were infringing someone’s invention’.

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