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What To Do About NPEs: Do We Risk Throwing the Baby Out with the Bath Water?

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Goodwin Procter LLP Hosts Forum On Non-Practicing Entities

On October 9, 2013, more than 45 leaders from private practice, industry, government, and academia gathered at the New York office of Goodwin Procter LLP to participate in an invitation-only discussion sponsored by the New York Intellectual Property Law Association on the impact of non-practicing entities on innovation and patent litigation. The question for discussion was "What to do about NPEs: Do We Risk Throwing the Baby out with the Bath Water?"

Framing the Issue

NYIPLA Past President Mel Garner laid out the issue. NPEs typically acquire and attempt to monetize patents by seeking licensing fees from target companies that allegedly infringe those patented inventions. But the monetization of patent rights is not a new phenomenon. By definition, a patent is transferable personal property that entitles its owner to a bundle of property rights, including the right to exclude third parties and seek damages for their infringement whether or not the patent enforcer has a competing product. Jerome H. Lemelson is an early example of an inventor and entrepreneur who sued countless companies, ultimately obtaining more than $1 billion in license fees over the decades. And many large companies, for example Texas Instruments and IBM, license their patent holdings and garner revenues that can exceed that from product sales.

In recent years the number of suits filed by NPEs has increased. NPE-initiated lawsuits accounted for roughly 4,700 patent lawsuits filed in 2012 – an uptick of 29% from two year earlier. Many NPEs conduct no business other than patent assertion and typically bring suit in plaintiff-friendly jurisdictions. This litigation strategy has been successful: NPEs have won over 40% of their cases before the Eastern District of Texas and the District of Delaware, compared to less than 25% of their cases nationwide.

Coupled with a rise in NPE litigation are incidents of abusive strategy, for example, NPEs that assert questionable patent claims against small entities which cannot afford the high cost of defending a patent litigation. While larger corporate patent owners with extensive patent portfolios can use their patents defensively to mitigate exposure to potential plaintiffs by cross-licensing, NPEs often are not vulnerable to such defensive strategies and thus may have more leverage to negotiate a settlement.

NYIPLA Past President Marylee Jenkins noted that exposure to aggressive enforcement has caught the attention of the C-suite and led to increased political action and lobbying to address NPE activity. Congress is considering proposals for legislation that would heighten pleading standards for infringement and limit discovery—steps generally thought to make litigation less "friendly" for NPEs. In February 2013, Reps. Peter DeFazio and Jason Chaffetz introduced the SHIELD Act, which would require NPEs that lose in court to pay the legal costs and fees of the defendant. Because the cost-shifting proposed by SHIELD only applies when the plaintiff is an NPE, the bill includes a mechanism that allows for defendants to move for a ruling before the court that the plaintiff is an NPE. According to the proposed legislation, if a court determines that

the plaintiff is an NPE, the plaintiff will be required to post a bond to cover defendant's legal costs. If implemented in its current form, SHIELD has the potential to disrupt the NPE business model by making it prohibitively expensive for an NPE to file concurrent actions against a large number of defendants.

But Congressional reform is only one front on the battle against NPE activity. The Federal Trade Commission recently initiated a Rule 6(b) investigation into "patent assertion entity" activity, calling for public comment on proposed questions to pose to about 25 such entities. Among the information the FTC seeks is the number of patent infringement demands, time spent analyzing actual infringement before filing them, and the license agreements and revenue obtained. Several state governments have likewise targeted NPEs using those states' fair competition and deceptive practices statutes. And on October 9, 2013, a startup company called FindTheBest.com filed a federal Racketeering Influenced and Corrupt Organizations Act (RICO) lawsuit in the Southern District of New York, alleging that individuals and companies associated with a "patent troll," Lumen View Tech LLC, conspired to extort licensing fees through baseless patent infringement lawsuits.

Against this backdrop, the five featured speakers at the Forum presented their perspectives on the issue: Alex Poltorak, Founder, Chairman, and CEO of General Patent Corporation; Vermont Attorney General William Sorrell; Professor Hugh Hansen from Fordham Law School; Marian Underweiser, Intellectual Property Counsel at IBM; and the Honorable Paul R. Michel, former Chief Justice of the Court of Appeals for the Federal Circuit.

"He who pays the piper calls the tune."

Alex Poltorak, Founder, Chairman, and CEO of General Patent Corporation, questioned why so much attention is being paid to NPEs now. After all, Mr. Poltorak stated, an NPE acquires patents, which are personal property that can be freely transferred. An NPE asserts patents to exclude others, which is the only right granted in a patent: the right to exclude another from practicing an invention. An NPE not practicing an invention cannot truly be a problem, as society does not require a songwriter to sing her own song, or an architect to live in the house he designed. Mr. Poltorak challenged the audience to consider that maybe the problem is caused by a few bad actors, which is not a reason to overhaul the entire patent enforcement system. As to the increased attention paid to NPEs at the highest echelons of government, Mr. Poltorak suggested that the lobbying efforts of large companies with deep pockets have taken hold, and as always in politics, "he who pays the piper, calls the tune."

"States will act to protect their citizens."

Vermont Attorney General William Sorrell explained that Vermont takes an aggressive stance against NPEs as bad actors. General Sorrell explained that Vermont recently passed legislation targeting bad faith assertion of patent infringement, recognizing the pressure that NPE lawsuits have had on Vermonters. Vermont also filed the first state action against a NPE resident of a foreign state: a September 2012 lawsuit against NPHK LLC, a Texas corporation, which threatened litigation against Vermont non-profits and small businesses, like coffee shops, alleging infringement of four patents related to scanning and emailing documents. The state also filed a lawsuit in May 2013 against an NPE alleging a violation of Vermont's consumer protection act. That case was removed to federal court, but Vermont is fighting to move the case back to Vermont courts. Taken together, General Sorrell explained how Vermont's efforts evidence a strong desire by states to curtail bad faith attempts by an entity to sue for patent infringement, an activity it recognizes as harmful to the commercial activities of its citizens.

"NPE issues should be dealt with "In the Family.'"

Professor Hugh Hansen from Fordham Law School suggested that the NPE issue arose because something went wrong "In the Family," referring to patent practitioners and scholars, and The Family has ceded control of the discussion to other non-patent interests. Professor Hansen noted that NPEs have gained so much attention that outside players (and their non-patent interests) now dominate the completely polarized landscape, with academics and some non-governmental organizations

declaring the patent scheme irreparably broken, and patent bar associations staunchly defending the status quo. In short, The Family has let the NPE issue become one highly visible battle in the larger war for and against intellectual property generally. Professor Hansen suggested that neither Congress nor the Executive branch are equipped to help The Family address perceived problems, leaving the courts as the most promising forum for meaningful progress.

"Don't blame the patent system, curb abusive litigation practices"

Marian Underweiser, Intellectual Property Counsel at IBM, brought the perspective of a large corporation to the table. Ms. Underweiser stated her disapproval of the good versus evil approach that is often used to frame the NPE issue. She said that the root of the problem does not lie with patents themselves, but with the behavior driving business decisions. She believes that the U.S. patent system is very robust and that innovators like IBM will continue to rely on the patent system to protect ideas for many decades, in part because it will continue to evolve to address any challenges, including those posed by bad litigation practices. Ms. Underweiser suggested that alternatives to the patent system are insufficient to give innovators security, so practitioners must work together to curb litigation abuses and shore up patents' foundation as the main protector of technological progress in the future.

"Abusive litigation behavior is an equal opportunity practice"

The Honorable Paul R. Michel, former Chief Justice of the Court of Appeals for the Federal Circuit, called patenting "an important right that must be preserved because of its beneficial effects on the economy and scientific progress." He said in no uncertain terms that a "strong patent system directly affects the income of individuals. If we can make the system right, it will make everyone better off." The Judge noted that the U.S. Patent system, in particular, is the best on the planet, but that domestic forces are acting to weaken it. Abusive litigation behavior is an equal opportunity practice and is not unique to patent litigation. While Judge Michel did note that patent litigation was too costly, slow, unpredictable, and has too high of an error rate, he attributed inefficiencies in the system to aggressive litigation practices, not the fact NPEs are the plaintiffs. Counseling and warning against a prescription that would not cure the disease, Judge Michel was optimistic that the courts themselves are taking useful steps to streamlining litigation not directed at NPEs (*e.g.*, discovery reforms and local patent rules). In the face of this progress, Judge Michel implored Congress to tread carefully, avoid micromanaging the courts, properly fund the courts and end fee diversion at the U.S. Patent and Trademark Office.

The Forum Discussion

After hearing the views of the invited speakers, the Forum audience and speakers engaged in a two-hour open conversation about NPEs and paths forward from the current state. From this discussion, three essential points of consensus emerged.

Abusive litigation practices must be controlled.

The Forum generally agreed that NPEs themselves are not the problem, but that the litigation system has not effectively limited NPEs' exploitation of lax rules to suit their business goals. Some in the audience lauded reform efforts like the SHIELD Act, but others remained skeptical about its implementation and questioned which entities would qualify as an NPE.

The Forum agreed that the challenge is not about NPEs versus other plaintiffs, but rather to sort out frivolous lawsuits from meritorious ones. To this end, efforts to streamline litigation were generally viewed positively. For example, proposals for an earlier *Markman* hearing, earlier cutoff date of discovery, and a preliminary determination of whether potential damages are large enough to justify allowing the litigation to proceed would all help remedy the phenomenon of frivolous lawsuits clogging up the courts. The Forum rejected the notion currently popular in some quarters that lawsuits brought by NPEs are inherently suspect, if not patently frivolous.

The judiciary already has the tools it needs to address litigation problems.

The second point of consensus among the Forum was that courts are already equipped with the mechanisms to handle abusive litigation, and that Congress cannot "fix" the NPE issue without causing unintended consequences.

Many noted that Rule 11 of the Federal Rules of Civil Procedure requires attorneys to certify that a pleading is not presented for a frivolous purpose and allows for attorney's fees as sanctions. As for 35 U.S.C. § 285, however, which permits enhanced damages or an award of attorneys' fees for exceptional cases, most participants felt that the Federal Circuit's recent interpretation limiting that avenue for relief set too high a standard, and welcomed the Supreme Court's view in *Octane Fitness, LLC v. ICON Health & Fitness* (No. 12-1184) and *Highmark Inc. v. Allcare Health Management*. (No. 12-1163).

The NPE issue distracts attention from other important issues in patent law

A third point of consensus is that NPE litigation is merely the flavor of the month in patent litigation. The spotlight has become brighter due to the intense lobbying efforts of affected companies in certain technological areas.

Suggested reading:

- *U.S. Accountability Office, GAO Report to Congressional Committees, Assessing Factors That Affect Patent Infringement Litigation Could Help Improve Patent Quality(August 2013)*
- *Farrar, Anne Layne, The Brothers Grimm Book of Business Models: A Survey of Literature and Developments in Patent Acquisition and Litigation (March 12, 2012)*
- *Bessen, J. and Meurer, M., The Direct Costs From NPE Disputes (June 28, 2012)*
- *Lu, Jiaqing "Jack", The Economics And Controversies Of Nonpracticing Entities (NPEs): How NPEs And Defensive Patent Aggregators Will Change The License Market (June 2012)*
- *Love, Brian J., An Empirical Study Of Patent Litigation Timing: Could A Patent Term Reduction Decimate Trolls Without Harming Innovators?, University of Pennsylvania Law Review Vol 161:1309*
- *Ewing, T. and Feldman, R., The Giants Among Us, 2012 STAN. TECH. L. REV. 1*
- *Lemley, M. and Melamed D., Missing the Forest for the Trolls (2013)*
- *Chien, Colleen V., Patent Assertion And Startup Innovation, New America Foundation, Open Technology Institute (September 2013)*
- *Transcript of Proceedings, Patent Assertion Entities Activities Workshop (hosted by Federal Trade Commission and U.S. Department of Justice, December 19, 2012)*
- *Intellectual Ventures, The Red Herring of Transparency, IV Insights Blog (December 6, 2012)*
- *Tracking PAE Activity: A Post-script to the DOJ Review, http://www.rpxcorp.com/index.cfm?pageid=14&itemid=27*
- *Why do patent trolls love East Texas and Delaware? They win more there, The Washington Post (Sept. 19, 2013), http://www.washingtonpost.com/blogs/the-switch/wp/2013/09/19/why-do-patent-trolls-love-east-texas-and-delaware-they-win-more-there/*