

Assault On Patent Trolls Leaves NPE Model In Peril

By Erin Coe | August 1, 2016

When Alexander Poltorak founded General Patent Corp., which touts itself as the oldest patent licensing firm in the world, he was not looking to generate a profit, but to right a wrong against the small computer-technology company he was running at the time.

His company, Rapitech Systems Inc., developed devices that would later be known as PC card modems and worked with then-modem leader Hayes Microcomputer Products Inc. to commercialize the technology. But the relationship fractured when Hayes stole its trade secrets and took the products to market without Rapitech while infringing its patents, according to Poltorak.

Rapitech's board was loath to pour limited resources into an expensive legal battle, and Poltorak felt an acute sense of injustice that the company wasn't able to enforce its patent rights. He decided to start a company in 1987 that would become General Patent and obtained Rapitech's patents with the goal of enforcing them.



Alexander Poltorak founded General Patent Corp. in 1987 to enforce his technology company's patents for PC card modems. (Credit: Law360)

Poltorak eventually linked up with Fish & Richardson PC and other law firms to take litigation on a contingency basis, but he didn't stop at suing Hayes. He lodged 26 suits against a host of technology companies including IBM Corp. and negotiated 160 licenses. Eventually 98 percent of the PC card modem industry agreed to take a license to the patents, Poltorak said. Hayes eventually settled and took a license, but it never paid because it declared bankruptcy shortly after the settlement, according to Poltorak. Hayes' assets were liquidated in 1999. A company that purchased the Hayes brand name did not respond to a request for comment.

It wasn't long after this first successful patent battle that Poltorak began receiving calls from inventors and small companies in similar predicaments seeking to have his company — a small operation headquartered in a turn-of-the-century mansion in Suffern, New York — champion their patents.

"The business arose by itself," he said. "I never thought about doing it for other people, only to enforce my own company's patents. But the mission was born to help inventors protect legitimate rights."

General Patent is among a large number of patent licensing companies that have been referred to as nonpracticing entities because of their focus on the licensing and enforcement of patents rather than on the development of products. Now, the business model of such companies, sometimes referred to disparagingly as "patent trolls," is under attack as challenges under the 2011 America Invents Act — passed in an effort to curtail the industry's most abusive litigation practices — leave behind a trail of invalidated patents, and a battery of recent U.S. Supreme Court decisions thwart their ability to succeed in court.

With accused infringers better equipped than ever to challenge their patents and fight them in court, nonpracticing entities are finding it harder to enter license agreements and are accepting lower settlement amounts, vying against more competitors and having a tougher time getting their cases taken on a contingency basis, experts told Law360.

To Poltorak and others, the future of the industry seems bleak.

“The pendulum has swung out of the box,” he said, “and it’s never coming back.”

Backlash Takes Root

Nonpracticing entities are those that derive or plan to derive the majority of their revenue from the licensing or enforcement of patents, according to RPX Corp., which itself has been called an NPE. They include patent assertion entities that earn revenue mainly by suing over patents, as well as universities and research institutions, individual inventors, and noncompeting entities that operate businesses asserting patents outside their areas of product or service.

NPEs can be quite large. Intellectual Ventures Management LLC has acquired 70,000 intellectual property assets that cover more than 50 technology areas, and it has more than \$3 billion in cumulative licensing revenue and more than \$6 billion in committed capital, according to its website. Acacia Research Corp. has multiple subsidiaries, and Acacia and its partners have signed more than 1,200 licensing agreements with other companies, its website says. But plenty of midsize and smaller ones are part of the market as well.

Such companies have been criticized harshly for not practicing the inventions their patents describe, but they are quick to point out that throughout history, many U.S. inventors took a similar tack. Elias Howe was granted a patent in 1846 for a key part of the sewing machine — a device for making a lockstitch — and I.M. Singer & Co., which is responsible for bringing the machines into the homes of thousands of U.S. consumers, took a license from Howe, according to a 2013 report by the U.S. Government Accountability Office. This only came about, though, after Howe sued it for patent infringement, the report said.

Jerome Lemelson, known for inventions including those related to barcode readers, automatic teller machines, cordless phones and personal computers, created a patent licensing and litigation program around the 1980s that purportedly resulted in more than \$1.5 billion in royalties, according to a 2005 paper by Sterne Kessler Goldstein & Fox PLLC founder Robert Greene Sterne and other attorneys. His success, which came in part from engaging a patent litigator on a contingency basis, is said to have given rise to an industry of contingency patent litigation in the electronics space, the paper said.

10.2
MILLION

patents in force in 2014

Source: World Intellectual Property Organization

326
THOUSAND

patents were granted
in the U.S. in 2015

Source: United States Patent and Trademark Office

The term “patent troll” was popularized after Peter Detkin, then-vice president and assistant general counsel at Intel Corp., used the phrase in the late 1990s to describe a nonpracticing entity that had no products and asserted what he saw as nuisance patent litigation. In an interesting twist, Detkin later helped found Intellectual Ventures in 2000.

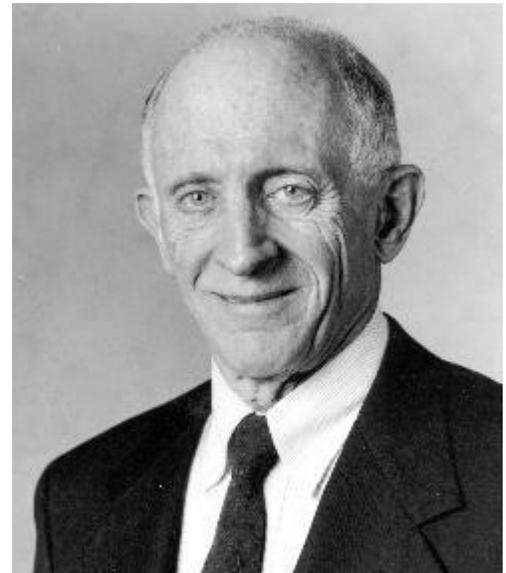
Over the last 15 years, the number of nonpracticing entities has grown from 50 parent-level companies to 1,000, according to RPX Senior Vice President Daniel McCurdy, whose figures don’t count subsidiaries.

The companies have played an ever-expanding role in patent litigation. In 2005, 26 percent of all patent suits filed in federal courts were brought by nonpracticing entities, according to research by RPX. By 2015, that percentage had grown to nearly 70 percent, according to RPX.

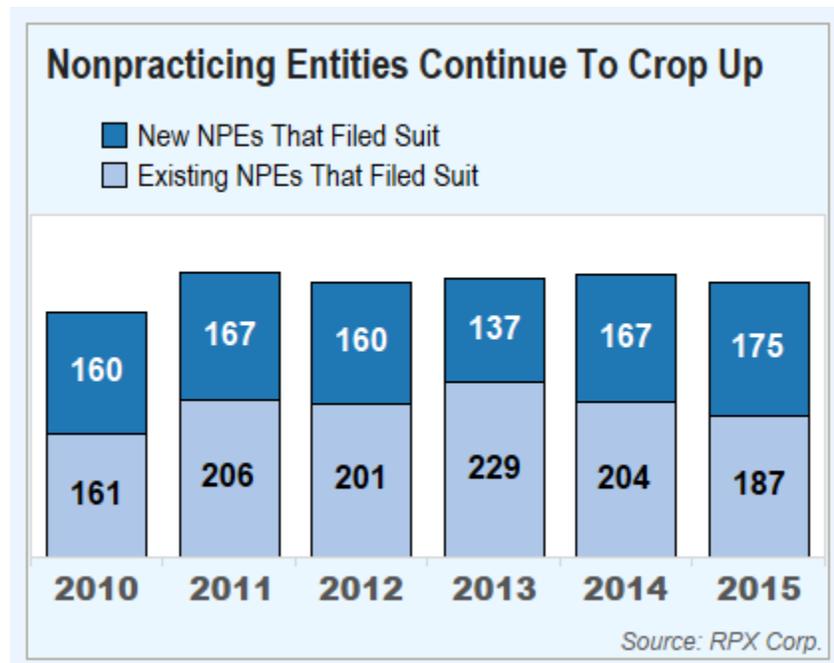
Between 2011 and 2015, NPEs won damages in patent cases that were nearly three times greater than awards to practicing entities — \$13.3 million in median damages, compared with \$4.9 million, according to a May study by PricewaterhouseCoopers LLP.

But recent years have seen a string of efforts by accused infringers, lawmakers and others who view the companies as nuisance litigants to push back against some of the industry’s worst practices, including suing wide swaths of unrelated companies in a single lawsuit.

During early public discussions on patent reform in 2009, Micron Technology Inc.’s chief executive officer at a Senate Judiciary Committee hearing claimed his company was one of the many victims of a growing wave of patent litigation and blamed the increase in patent litigation costs on the “proliferation of the nonpracticing entity business model.” At that same hearing, Mark Lemley, a founding partner of Durie Tangri LLP, said a number of the patent rules have given NPEs an unfair advantage by allowing them “to enforce dubious patents in favorable jurisdictions and use the rules of patent remedies to obtain more money than their inventions were actually worth.”



A holder of more than 600 patents, Jerome Lemelson created a licensing and litigation program that relied on contingency lawyers and became a model for others.



After the U.S. House of Representatives Judiciary Committee passed the America Invents Act in April 2011, Rep. Lamar Smith, R-Texas, the bill's co-sponsor, wrote a letter to colleagues saying he drafted the initial patent reform measure to address "the problem of 'trolls' who sue both large and small companies to extract patent licenses or large jury awards."

"Trolls typically own weak patents that they will never commercialize," he wrote. "Their goal is to get rich the old-fashion[ed] way — by suing."

The America Invents Act was signed into law in September of that year. It shifted the U.S. from a first-to-invent to first-to-file patent system, established new post-grant review procedures, and limited false marking suits so they could be filed only by the government and competitors that were injured by the marking of products with incorrect patents. Also, in an effort to bar patent suits against dozens of unrelated companies, the law restricted plaintiffs from joining multiple defendants in a patent case unless the suit met certain requirements.

In 2012, the Patent Trial and Appeal Board rolled out procedures under the AIA for hearing patent validity challenges, and thousands of such actions have been filed with the agency, which many accused infringers view as a quick and cost-effective alternative compared with prolonged district court litigation.

Then came a bombshell from the U.S. Supreme Court. In June 2014, the court issued its decision in *Alice Corp. Pty. Ltd. v. CLS Bank International*, which held that abstract ideas implemented with a computer cannot be patented under Section 101 of the Patent Act, knocking out a wave of software and business method patents that had formed the core of some NPEs' business.

The decision came less than two months after the high court's ruling in *Octane Fitness LLC v. Icon Health & Fitness Inc.*, which relaxed the standard for courts to award attorneys' fees as a sanction in patent cases, a ruling that has been viewed as another blow to plaintiffs in patent litigation.

The decisions were the latest in a string of rulings in recent years that have undercut NPEs, starting with the 2006 ruling in *EBay Inc. v. MercExchange LLC*, which made it harder for patent plaintiffs to obtain permanent injunctions.

"The powers that be who were behind the AIA, Alice and the anti-nonpracticing entity movement have won," said Raymond Niro, a litigator who represents NPEs. "They managed to convince Congress, the courts and the public that only the big companies should enjoy the privilege of patent protection."

NPEs Lose Leverage

Erich Spangenberg, chief executive officer of predictive analytics firm nXn Partners LLC, is no stranger to the term "patent troll." His former company, IP Navigation Group, was called "one of the most notorious patent trolls in America" by Rackspace US Inc. when it lodged a declaratory judgment action in Texas in 2013 against IP Nav and Parallel Irons LLC. Parallel had accused Rackspace and 11 other defendants in a Delaware suit of infringing its patents.

26
PERCENT

of all patent suits filed in federal courts in **2005** were brought by nonpracticing entities

70
PERCENT

of similar suits were brought by NPEs in **2015**

Source: RPX Corp.

Spangenberg's outlook for the future of NPEs is grim. In addition to the Alice and EBay rulings, he said, other cases have hit NPEs hard, including the Supreme Court's 2007 decisions in KSR International Co. v. Teleflex Inc. and MedImmune Inc. v. Genentech Inc., which made it easier for accused infringers to invalidate patents based on obviousness and for licensees to challenge patents, respectively.

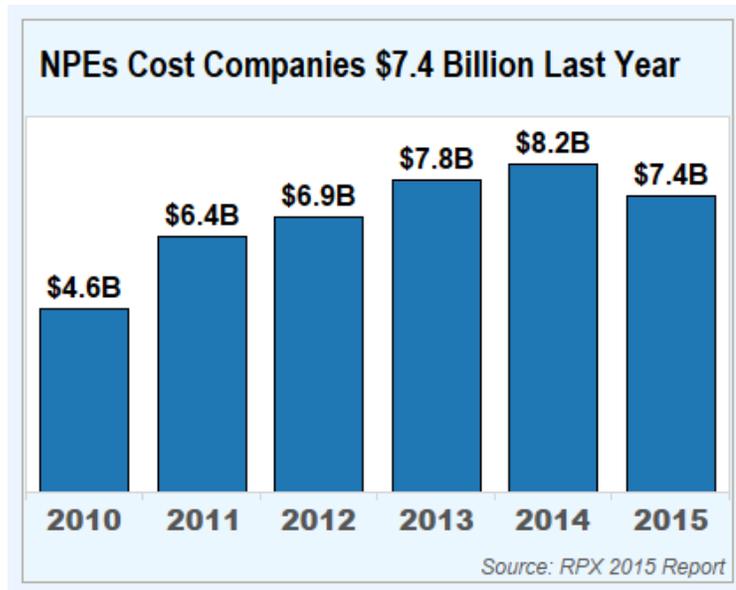
"Leverage has been given to the licensee between Alice and KSR," Spangenberg said. "Those decisions have created significant challenges and will wipe out more than half of the nonpracticing entity population."

As a result of these developments, the value of patent licenses has changed dramatically, he said.

"Four or five years ago, you'd have the ability to see licenses valued at \$1 million or \$1.5 million, but the market has bifurcated, and now we're seeing \$50,000 licenses, which I have no interest in doing," Spangenberg said.

Ten years ago, small companies had a decent shot at asking large companies to take a license, and if it was a reasonable patent, the company would acquiesce, said Richard Baker, president of New England Intellectual Property, a consulting firm that works with inventors, nonpracticing entities and businesses.

"But with the changes from Alice and the AIA, almost every company's approach is, 'No, we won't take a license. We'll run it through the patent office and then the courts, and only then will we pay,'" he said. "Only after individuals have put out \$5 million to defend the patent will they get to a situation where a company might take a license."



Recent data shows accused infringers have a good shot at getting an AIA review instituted and invalidating all of the instituted claims. The institution rate was at its highest soon after the AIA was implemented, at 86.8 percent in fiscal year 2013, according to data by Sterne Kessler that includes joinders as institutions. Although it began to decline in fiscal year 2014 and hit a low of 62.5 percent in the fourth quarter of fiscal year 2015, the institution percentage has steadily hovered in the mid- to high 60s in fiscal year 2016, the firm said.

The percentage of final written decisions that have resulted in all instituted claims being found unpatentable is 76.3 percent, and those that have resulted in some claims being found unpatentable is 12.1 percent, according to the firm's data from 2012 through June 2016.

If companies are accused in a suit of infringing a software or business method patent, they also have a good chance of winning an Alice motion under Section 101 to get rid of it. Courts across the U.S. have granted 71 percent of motions arguing that patents are invalid under Alice, according to an August 2015

study by the Electronic Frontier Foundation, although the Eastern District of Texas, known as a plaintiff-friendly venue, has granted just 27 percent of those motions.

“The odds of paying an inventor are well below 10 percent,” Baker said. “There are so many ways to shut the patent down.”

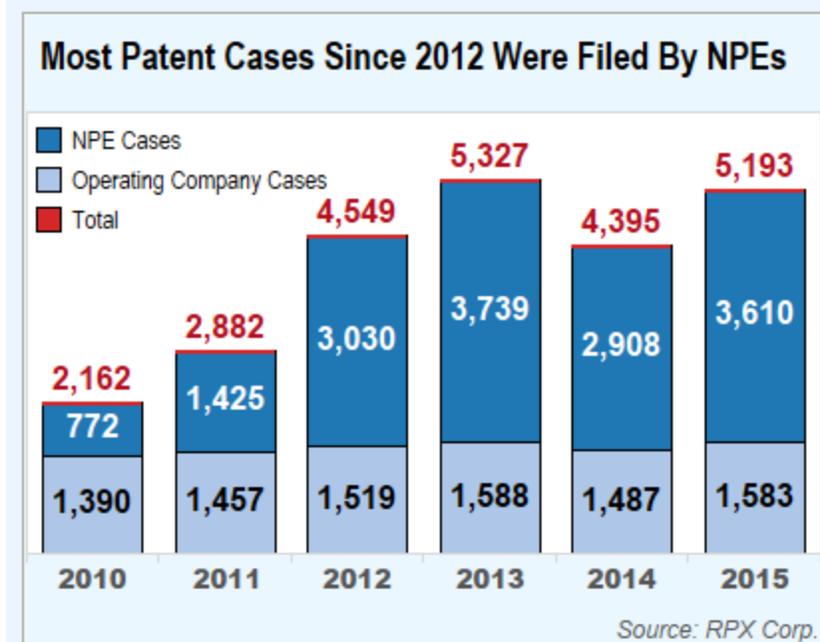
Even more devastating for NPEs, the impact of such a loss doesn’t end there, but it extends to other companies they might accuse of infringing the patent, noted R. David Donoghue, deputy leader of Holland & Knight LLP’s IP practice.

“With either an Alice motion or an IPR, if the [accused infringer] wins, it is defeating the asset of the nonpracticing entity not just for that defendant, but for all the targets in the nonpracticing entity’s entire program,” Donoghue said.

Incentives for Attorneys Drop

The leverage nonpracticing entities have in negotiating patent settlements also has eroded. Accused infringers used to see patent settlement demands based on the minimum cost of defending district court litigation as a benchmark for the valuation of the settlement, but today, the benchmark is based on an early Alice motion if the case involves a software patent or an inter partes review under the AIA, Donoghue said.

“You’re going from \$1 million-plus for the cost of a patent litigation resolution to \$100,000 to \$300,000 as a benchmark,” he said.



According to data by RPX, settlement amounts secured by nonpracticing entities appear to have gone down. In 2012, the total estimated direct nonpracticing entity cost, which accounted for settlement or judgment costs as well as legal costs such as fees paid for outside counsel, experts and discovery, was \$6.9 billion. That figure rose to \$7.8 billion and \$8.2 billion in 2013 and 2014, respectively, but last year, the cost dropped to \$7.4 billion.

At the same time, 2015 saw more patent litigation — 5,193 suits, of which nearly 70 percent were brought by nonpracticing entities, compared to 4,395 suits in 2014, of which 66 percent were brought by nonpracticing entities. Given that about 95 percent of nonpracticing entity cases settle, the data suggests more cases are settling for less money, an RPX spokeswoman noted.

“There’s been a real re-pricing in the marketplace on how much nonpracticing entity cases are worth,” said Steven Moore, a partner at Kilpatrick Townsend & Stockton LLP. “A lot of nonpracticing entities file and quickly settle for amounts that are far less than what we were seeing three or four years ago. There have been a lot of settlements in the five-figure range with a run-of-the-mill nonpracticing entity, which before might have aimed for \$250,000 to \$500,000.”

Compounding the struggles for nonpracticing entities, some plaintiffs attorneys are rethinking the traditional contingency fee model before taking these often riskier cases, said Joey Liu, a One LLP litigator who has represented and defended against nonpracticing entities.

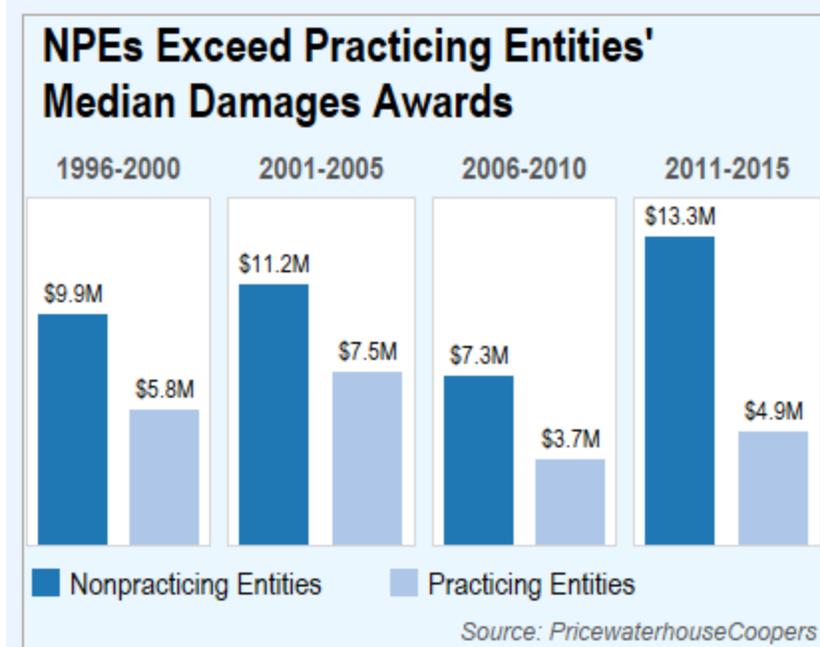
One decision that has made attorneys think twice before taking a patent case is the Supreme Court’s 2014 ruling in *Octane Fitness*, which held judges can award attorneys’ fees in a case that merely “stands out from others,” rejecting the Federal Circuit’s rule that sanctions are appropriate only when a case is “objectively baseless.” The decision has been seen as making it easier for accused infringers to get attorneys’ fees awarded when victorious.

“For attorneys who are willing to take on these riskier cases, we’re seeing some of the economic terms of contingency cases shifting toward attorneys receiving extra compensation, taking higher percentages of fees recovered or having separate agreements to offset costs,” Liu said. “For instance, when an attorney files suit on behalf of a plaintiff on a contingency fee basis, an inter partes review [initiated by the accused infringer] is to be expected and tends to involve a significant amount of additional work earlier in the case. So

now, attorneys are negotiating whether to handle an inter partes review as part of the contingency fee agreement or as part of a separate agreement.”

Once a prolific filer of patent suits on behalf of inventors and nonpracticing entities, Niro, a senior partner at Niro Law Ltd., now says these cases are no longer good bets.

Niro said his firm used to consistently rank among the top 10 firms filing new patent suits. In 2011, his firm brought 102 new patent cases for plaintiffs, but the numbers have fallen off over the years, with the firm filing 26 suits last year and one suit so far this year, according to Lex Machina data. Niro noted that because of the AIA’s joinder limits, many of the 26 suits involve asserting the same patent against different defendants, and if counting only suits involving different patents, the number is actually far smaller.



Instead of patent cases, Niro said, breach of contract and trade secrets cases are what the firm is opting to handle.

“The AIA is just a huge impediment to the enforcement of patents,” he said. “And [in court], there are so many procedural problems for plaintiffs. It’s either an Alice motion if it’s a software patent or a summary judgment motion in one form or another. If you have a patent and want to enforce it, you have a one in 10 chance of success.”

Switching Course

The increasingly severe environment for patent holders is driving many nonpracticing entities to look beyond patent licensing and enforcement activities to seek out new revenue, such as opportunities in the development space. They also are being more selective with the patents they acquire and fine-tuning their litigation tactics.

Intellectual Ventures has been moving away from just owning patents for assertion and licensing purposes to getting involved in the development of products and using its expertise to help companies build new inventions, according to Matthew Rappaport, co-founder and managing director of patent analytics firm IP Checkups. It has created dedicated programs or separate entities to invent technologies and bring them to market. Such spinouts include TerraPower, which focuses on nuclear energy solutions, and Echodyne, which focuses on developing metamaterials-based radar technology.

Marathon Patent Group, a patent acquisition and licensing company, also notes on its website that it has launched its first commercialization vehicle, 3D Nanocolor, a startup whose technology “lets glass adapt to meeting changing needs — like enhancing privacy and conserving energy — without the need to replace existing windows.”

“When legislation beats you back and decisions are being made that make it more difficult to operate in the patent space, these companies are being forced to change their model,” Rappaport said. “Nonpracticing entities are not just buying, licensing and asserting patents. They are trying to tie themselves to new innovation and product development.”

Nonpracticing entities are doing greater due diligence at the front end to find better patents that will survive an AIA review and an Alice motion, said Mark Scarsi, head of Milbank Tweed Hadley & McCloy LLP’s IP litigation and technology practice, who represents defendants in patent cases. They are working with inventors and getting involved in the patent application process to control how the claims are drafted and how the patent turns out.

“You will see successful nonpracticing entities be involved much earlier in the process,” he said. “They will need to if they want to survive in the current landscape.”

Papst Licensing GmbH & Co. KG, a global licensing and monetization firm based in Germany, has always conducted a thorough due diligence process before buying others’ patents, said Daniel Papst, one of the managing directors. The company was founded in 1992 and began acquiring third-party patents beyond its original portfolio from its former operating company in the early 2000s.

Of the 1,400 patent portfolios it has considered, it has only agreed to acquire and monetize 16. In light of Supreme Court decisions unfavorable to patent holders and the AIA, Papst said U.S. patents have

become less attractive, and his company is even more careful in analyzing such patents before acquiring them.

“We certainly in the last few years have put a stronger focus on European patents,” said Papst, who co-owns the company with his two brothers. “In Germany, it doesn’t matter if you’re a nonpracticing entity or an operating company. If you bought patents from someone else or it’s your own invention, the courts look at whether the patent is valid and infringed. In a little over a year to a year and a half, you will have your day in court. The proceedings are very streamlined, and there is no inflated discovery or fight over issues that in the end help defendants’ attorneys make money.”

Spangenberg, of nXn Partners LLC, said he expects to see more nonpracticing entities filing suits with a larger number of patents to boost the chances of multiple claims surviving AIA reviews. He also predicted an uptick in entities investing significantly more time on the validity side before they buy and assert patents.

“Nonpracticing entities are going to have to be much more critical of the patents they acquire and focus more on validity than before, because the last thing they want 24 months after buying and asserting a patent is to see it be wiped out,” he said. “They have to have a revised game plan or they will end up as road kill.”

The changes have already had some casualties. Intellectual Ventures, co-founded by former Microsoft Corp. Chief Technology Officer Nathan Myhrvold, in February 2014 announced that it had laid off 5 percent of its workforce and consolidated positions elsewhere in the company as part of a restructuring.

At the time, its website stated the company had 800 employees. Today, that number stands at about 500. Compared with its peak in litigation activity in 2013, with 39 patent suits, Intellectual Ventures has been more restrained over the last few years, with 10 suits in 2014, eight suits last year, and five so far this year, according to data from Lex Machina.

At one point in July 2013, stock in Acacia, another major power player in the industry, was selling at \$25.14 per share. But it’s been on the decline over the years, and at the close of July 15, it was selling at \$4.63 per share. Representatives for Intellectual Ventures and Acacia did not respond to requests for comment.

“A lot of nonpracticing entities are struggling,” said Baker, who, like Spangenberg of nXn Partners, expects about half of nonpracticing entities to fail. “There is no revenue coming in. They are running their programs, but nobody’s taking a license.”

Certain nonpracticing entity business models may be hurting more than others, and large nonpracticing entities in particular may need more time to readjust, noted McCurdy of RPX.

“Because the environment is changing at a rapid pace, smaller entities that have less of a capital requirement and fewer people can be nimble and respond to these changes more readily than very large companies can,” he said. “For any of the larger, highly invested entities, they will have a more difficult time being agile than a small entity that doesn’t have the same expectation of return.”

The Road Ahead

While some nonpracticing entities may have fallen on hard times, the sheer number of patents still on the market and the industry's history of adapting suggest they won't fade entirely from the patent litigation landscape, experts say.

"This is a low point, but I don't think it's an industry that's going away," IP Checkups' Rappaport said. "It's just evolving."

According to the World Intellectual Property Organization, there were 10.2 million patents in force in 2014. And according to the U.S. Patent and Trademark Office, nearly 326,000 patents were granted in the U.S. in 2015 alone.

"As long as there is this huge collection of patents that nonpracticing entities can go and buy, whatever the changes are in the landscape, they can adjust with what they are asserting," McCurdy said. "If business methods are harder to assert because of Alice, they simply will go after another technology."

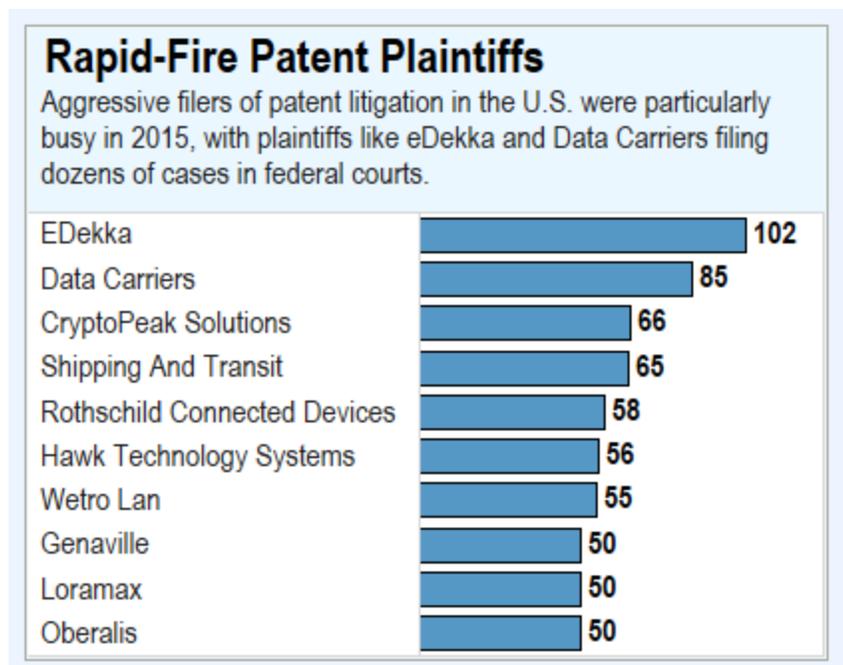
Nonpracticing entities also still have a significant presence in patent litigation, and new crops of them are filing suit year after year. Between 2012 and 2015, nonpracticing entity cases made up the majority of all patent infringement cases filed, only fluctuating within a narrow range of 66 percent and 70 percent, according to RPX. Of the 362 nonpracticing entities that filed new patent suits last year, 175 were new nonpracticing entities; of the 371 entities that lodged suits in 2014, 167 were new entities; and of the 366 entities that brought suits in 2013, 137 were new entities, according to RPX.

"The industry as a whole has proven to be both amazingly resilient and amazingly flexible," McCurdy said.

The number of patent suits has gone up and down over the last several years. In 2014, there were 4,395 patent complaints filed, a nearly 18 percent drop from the previous year's 5,327 complaints, but in 2015, complaints climbed up to 5,193, according to RPX data. So far in the first half of this year, 1,949 patent suits were filed, according to RPX.

"Some companies may have thought in 2014 that they won the war [against nonpracticing entities], but by early 2015, it was apparent they were just regrouping," McCurdy said. "They were figuring out new products to assert, and instead of fighting a long time, they were going after more companies where they would settle for \$200,000 versus \$200 million."

Although nonpracticing entity settlement amounts have decreased, McCurdy said that is part of the trade-off of being flexible, and while those settlements may not work for all models, many small nonpracticing entities can still make a living. "I don't see the nonpracticing entity model



dying,” Donoghue said. “Even with these new abilities to challenge the patents, the process is complex and expensive, and there will always be some settlement value even if it trends lower.”

While accused infringers have a good chance at getting the PTAB to institute an inter partes review — the most popular AIA review — the rate of institutions has been going down. And as weaker patents are weeded out of the system, patents that may be on the borderline won’t likely be as easily defeated, McCurdy said.

“There is no guarantee a petitioner will win and get every claim invalidated,” he said. “And even if only one applicable claim of the patent survives, it comes out stronger than when it went into an inter partes review, which can give a nonpracticing entity the upper hand to get more money through litigation or an enhanced settlement.”

Several decisions also have come down recently that may give a boost to nonpracticing entities. The Supreme Court in June discarded the Federal Circuit’s strict test for awarding enhanced damages in patent cases, giving judges broad discretion to award triple damages in *Stryker Corp. v. Zimmer Inc.* and *Halo Electronics Inc. v. Pulse Electronics Inc.*

“If it results in more pre-suit demand letters where nonpracticing entities can put accused infringers on notice that they could be on the hook for willfulness ... that would be a positive development for anyone who asserts a patent,” Kilpatrick’s Moore said.

And the Federal Circuit’s decision in May that a judge wrongly oversimplified two database patents when she found that they covered only abstract ideas in *Enfish LLC v. Microsoft Corp.* may help to limit the scope of the *Alice* holding.

“There’s a way to thread the needle and avoid *Alice* for patent owners,” Donoghue said.

Regardless of obstacles in their way, nonpracticing entities will continue to find new avenues to license and litigate patents, sources said.

“Nonpracticing entities are going to be looking for the next big thing, like the Internet of Things, where there is a lot of technology packed into products that could involve a lot of patents and is eventually going to spawn a lot of patent litigation,” said Mark Supko, a partner at Crowell & Moring LLP.

Spangenberg left the patent licensing market in 2012, but this year he made his return. He believes following the AIA and the Supreme Court decisions, the patent space is approaching or has hit the bottom, meaning a rebound may not be far off.

“I am of the view that the inter partes review procedures will absolutely improve patent quality,” he said. “I think we’re seeing it with the volume down of patent filers in the U.S. It’s been a painful process, but it may turn out to be a good thing.”

Erin Coe is a feature reporter for Law360's In-Depth magazine.