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# UNMASKING THE PATENT TROLL: BRINGING TO LIGHT THE ROLE OF PATENT ASSERTION ENTITIES IN OUR PATENT SYSTEM

*Daniel Shen*<sup>1</sup>

## I. INTRODUCTION

In 2013, MPHJ Technology Investments mounted an assault against the business world: it accused 99 percent of all office workers in the U.S. of using its patents, and they wanted those people to pay. At the time, MPHJ owned a series of patents that covered scanning and directly emailing documents, originally claimed as a patent in 1997.<sup>2</sup> To make their image worse, the company was not manufacturing anything—they were a patent assertion entity (PAE), a type of non-practicing, patent-holding (i.e. not using its patents for their claimed purposes) firm that earned its money mainly through lawyers sending demand letters to infringers. Such is the common image evoked of patent “trolls,” a colloquial term used for PAE’s that incorporate patent enforcement as a major (or even the sole) aspect of their business structures.

With this negative image of patent trolls in mind, it is easy to understand why recent legislation has been implemented to combat

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1 Daniel Shen is a senior studying economics and French. He will be attending law school in the fall. Riley Busby and Ben Metcalf, excellent editors who both plan on attending law school in the next few years, made this paper a reality with their continual dedication and support.

2 Joe Mullin, *Meet the Nice-Guy Lawyers Who Want \$1,000 per Worker for Using Scanners*. ARS TECHNICA (Apr. 7, 2013), <http://arstechnica.com/tech-policy/2013/04/meet-the-nice-guy-lawyers-who-want-1000-per-worker-for-using-scanners/>

them. The 2011 Leahy-Smith America Invents Act (AIA) was the first attempt at major patent reform in the last half-century, and has provisions that specifically target patent trolls. President Obama has also joined the discussion in voicing his animosity towards PAE's and giving his support for legislation with the goal of curtailing or even eliminating them, such as the recent Innovation Act (H.R. 3309) passed by the House of Representatives<sup>3</sup>. However, despite the negative attention PAE's have been receiving, they form an integral part of today's patent system. This article will discuss why PAE's are vital to our patent economy, their legality, and why current and future legislation against patent assertion ought to be rejected.

## II. BACKGROUND

At the very heart of each patent holder's rights is the right to exclude.<sup>4</sup> In essence, this is the right to exclude others from potential profits. These potential profits are considered rivalrous, meaning that if one firm were to obtain profits in a given market, it must come about through another firm's loss of profits in the same market. Others are able to legally enter such markets and produce patentees' inventions only with authorization through patent license agreements. But what if a patent holder does not use his patent? Will he still be entitled to money made from his invention if he did not attempt to produce it himself? According to the law, the answer is yes—though the general populace and even President Obama seem uneasy about this concept.

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3 OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT, STATEMENT OF ADMIN. POL'Y (2013). [HTTP://WWW.WHITEHOUSE.GOV/SITES/DEFAULT/FILES/OMB/LEGISLATIVE/SAP/113/SAPHR3309R\\_20131203.PDF](http://www.whitehouse.gov/sites/default/files/omb/legislative/sap/113/saphr3309r_20131203.pdf)

4 See 35 U.S.C. § 153(a)(1): "Every patent shall contain a short title of the invention and a grant to the patentee, his heirs or assigns, of the *right to exclude* others from making, using, offering for sale, or selling the invention throughout the United States..."(Emphasis added). Feldman (2008) makes the important note that this is a negative, instead of an affirmative right and that patentees actually do not possess the right to make or sell their inventions.

The law not only protects patent holders, but it also punishes those who infringe on, or illegally produce, their patents. When this occurs, there are two forms of relief: injunctive and compensatory.<sup>5</sup> With regard to compensation, the court will award “damages adequate to compensate for the infringement but in no event less than a reasonable royalty for the use made of the invention by the infringer, together with interest and costs as fixed by the court.”<sup>6</sup>

With this statute, patent holders must prove that profits were lost due to infringement. If they are not able to do so, or if they would not have suffered any lost profits (such as research institutes with no production capabilities), then the court awards patent holders a reasonable royalty – the sum of money that the patentee and the infringer would have agreed upon for a patent license before the infringement occurred.<sup>7</sup>

Patent trolls aggressively assert their rights to the patents they hold, effectively changing patent protection from a “shield” to a “sword.”<sup>8</sup> Since they do not manufacture any products of their own (or only do so minimally), their business model revolves around lawyers sending claim letters to infringing firms and demanding licensing fees for infringed patents. The recipients of these letters—oftentimes small businesses—have the choice of either challenging the claim and going to court, or paying a less costly settlement with

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5      Though injunctions are not covered in the scope of this essay, it is interesting to note that they are determined independently of compensation. This is brought about by section 283 of the U.S. Patent Act: “[Courts]... may grant injunctions in accordance with the principles of equity... on such terms as the court deems reasonable.” (35 U.S.C. § 283) In theory, a patent holder may be awarded damages from an infringer and still be denied injunctive relief.

6      35 U.S.C. § 284

7      Denise W. DeFranco, *Patent Infringement Damages: A Brief Summary*, 10 FED. CIR. B. J. 281, 281 (2001) DeFranco notes that if the patentee does not use the invention, this does not necessarily preclude him from being awarded lost profits.

8      Christina Gagnier, *Patents: A Sword or a Shield?* HUFFINGTON POST (10 Jan. 2013), [http://www.huffingtonpost.com/christina-gagnier/patent-litigation\\_b\\_2421877.html](http://www.huffingtonpost.com/christina-gagnier/patent-litigation_b_2421877.html)

the patent holder. It has been reported that PAE's accounted for over 60 percent of all patent litigation in the U.S. in 2012.<sup>9</sup> Since many of these firms are very experienced in this field, they usually demand a settlement that is just under the expected cost of litigation for the infringing firms, but still heavy.

### III. PATENT TROLLS AND THE CURRENT PATENT ECONOMY

Whether or not a PAE can legally assert its rights with regards to patent infringement is clear. In the case of *eBay Inc. v. MercExchange, L.L.C.*, it was found that infringements upon a PAE's patent holds the same weight as if were against any other non-practicing entity, such as a university or a research institute (often held in higher regard since they are not profit-seeking). Furthermore, it can be gleaned from this that the law protects the patent of any holder, regardless of their ability or intentions to effectuating the technology or process behind the patent. In the case mentioned, eBay was found to be infringing on MercExchange's patent for the "Buy it Now" feature, which MercExchange was not actively using at the time, but still owned. The ruling of the court supports the idea that companies like MercExchange are under no obligation to produce or use their own patented inventions in order to fully enforce them.<sup>10</sup>

As also demonstrated in the Supreme Court case *Continental Paper Bag Co. v. Eastern Paper Bag Co.* in 1908, the patent holder's right to exclude does not require a motive.<sup>11</sup> Though the case centered on a monopolist who wished simply to exclude potential suppliers and thereby curb competition, the principle remains that those who hold patents do not necessarily have to use them. As also demonstrated by well-known and reputable firms such as Microsoft<sup>12</sup>,

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9 Colleen V. Chien, *Patent Trolls by the Numbers*, SANTA CLARA LEGAL STUDIES RESEARCH PAPER, Mar. 13, 2013, Paper No. 08-13.

10 *eBay Inc. v. MercExchange, L.L.C.*, 547 U.S. 388 (2006)

11 *Continental Paper Bag Co. v. Eastern Paper Bag Co.*, 210 U.S. 405 (1908)

12 Paul McDougall, *Microsoft, LG Strike Android Patent Deal*, INFORMATION WEEK (Jan. 12, 2012), <http://www.informationweek.com/applications/microsoft-lg-strike-android-patent-deal/d/d-id/1102233>.

Kodak<sup>13</sup> and Nokia<sup>14</sup>, which all engage in patent assertion akin to patent trolls, patents need not simply protect a source of revenue—they can and do become that source in their own right through licensing or patent assertion suits.

Though well-regarded firms such as those named above engage in patent assertion, it is often the case that less well-known but equally present firms, such as Intellectual Ventures and Acacia, are the ones painted with the negative image of patent trolls.<sup>15</sup> Many people are uncomfortable with the idea that PAE's, which often do not manufacture any goods at all, are able to “bully” revenue out of their “victims.”<sup>16</sup> It should be noted that the ability to produce or not is not a requirement that can be feasibly enforced, as “In many cases, it would be trivial for a troll to evade this requirement by producing a token number of units of a product covered by its patent.”<sup>17</sup>

Even giant companies such as Microsoft and IBM are willing to enter the lucrative enterprise of enforcing patents. One famous incident in the 1980s involving IBM was documented by attorney Gary Reback (representing Sun Microsystems). IBM had shown up to Sun headquarters to demand royalties for seven patents it accused Sun of infringing. When challenged on the validity of their claims,

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- 13 Susan Decker, *Kodak in Crisis Mines Patents For Cash Copying Texas Instruments*, BLOOMBERG (Jan. 12, 2012), <http://www.bloomberg.com/news/2012-01-13/kodak-mines-patents-for-cash-copying-texas-instruments.html>.
  - 14 *Nokia Earnings: NSN and Patents Drive Value*, TREFIS, (Oct. 28, 2013), <http://www.nasdaq.com/article/nokia-earnings-nsn-and-patents-drive-value-cm292934>.
  - 15 Erin Fuchs, *Tech's 8 Most Fearsome 'Patent Trolls'*, BUSINESS INSIDER (Nov. 25, 2012), <http://www.businessinsider.com/biggest-patent-holding-companies-2012-11>.
  - 16 Roy Cooper, *Don't Let Patent Trolls Bully You*, NORTH CAROLINA DEPARTMENT OF JUSTICE (Jan. 6, 2014), <http://www.ncdoj.gov/News-and-Alerts/Alerts/Don't-let-patent-trolls-bully-you.aspx>.
  - 17 Timothy B. Lee, *Obama Wants to Crack Down on Patent Trolls. That's Not Enough*, THE WASHINGTON POST (Jun. 4, 2014), <http://www.washingtonpost.com/blogs/wonkblog/wp/2013/06/04/obama-wants-to-crack-down-on-patent-trolls-thats-not-enough/>.

An awkward silence ensued. The blue suits [of IBM] did not even confer among themselves. They just sat there, stone-like. Finally, the chief suit responded. “OK,” he said, “maybe you don’t infringe these seven patents. But we have 10,000 U.S. patents. Do you really want us to go back to Armonk [IBM headquarters in New York] and find seven patents you do infringe? Or do you want to make this easy and just pay us \$20 million?” After a modest bit of negotiation, Sun cut IBM a check, and the blue suits went to the next company on their hit list.<sup>18</sup>

Even in the modern industry of smartphones, Microsoft reigns not through its production capabilities, but instead through its expansive patent portfolio. Using its vast array of patents as well as its formidable legal team, Microsoft is able to extract royalties from virtually all other firms in the industry.<sup>19</sup> Evidently, it is just as Continental Paper Bag did a century earlier.

Now, it is becoming increasingly more difficult to distinguish between these well-known firms who act as PAEs and traditional PAEs that are really nothing but a patent portfolio and team of lawyers. One thing is clear: with the current patent system and legal structure in the United States, they are all here to stay.

#### IV. PATENT TROLLS AND THE PATENT ECONOMY’S WELLBEING

Though patent trolls are already deeply entrenched in our economy and are likely to remain that way, they are more than simply a necessary evil. In fact, PAE’s are necessary for the proper functioning of the patent economy. Patents, like any other right, must be enforced. Unfortunately, there is no enforcement agency in the patent economy that ensures that patents are not infringed. In fact, no such agency even exists to investigate whether or not alleged infringe-

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18 Gary L. Reback, *Patently Absurd*, FORBES (Jun. 24, 2002), <http://www.forbes.com/asap/2002/0624/044.html>.

19 Timothy B. Lee, *Microsoft’s Android Shakedown*, FORBES (Jul. 7, 2011), <http://www.forbes.com/sites/timothylee/2011/07/07/microsofts-android-shakedown/>.

ment has taken place—it is all a part of the patent holder’s duty. One remedy that patent holders pursue, whether or not they are classified as trolls, is through civil action.<sup>20</sup>

One claim that many infringers level against their patent troll accusers is that the patents being enforced are not valid anyway. The case with MPHJ, described above, seemed farfetched not because the patent troll was malignant, but instead because the very patent it was attempting to assert was questionable.<sup>21</sup> The reasonable conclusion to be drawn is not that PAE’s should not exist, but instead that the patents which they assert are sometimes flawed. There is no dispute that some patents should never have been granted in the first place, but this is a flaw of the patent system, not the PAE’s that emerge from it. In fact, in that same case, the enforcers of MPHJ’s patents ended up not bringing infringers to court since their patents were being challenged.<sup>22</sup>

With the exception of a governmental agency, no entity would have an incentive to defend the right of a patent holder except the patent holder himself.<sup>23</sup> Unfortunately, many patent holders, especially individual inventors, do not have the means to protect their patents. No matter how valuable a patent is, its value will never materialize if it is not enforced. Because of this, many inventors make the decision to sell their patents to other patent holders who are able to enforce their rights, often PAE’s. The mere presence of PAE’s causes firms to be more careful in their production so as to not infringe on any competitors’ patents.

To have a government agency do the job of PAE’s is not feasible, not simply because of the logistics behind expanding the federal government, but because such an entity would not have the legal authority to pursue offenders unless the fundamental patent right

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20 35 U.S.C. § 281

21 Edward Wyatt, *F.T.C. Settles First Case Targeting ‘Patent Troll’* N.Y. TIMES (Nov. 6, 2014), <http://www.nytimes.com/2014/11/07/business/ftc-settles-first-case-targeting-patent-troll.html>.

22 *Id.*

23 Baker Botts, *Standing To Assert A U.S. Patent - To The “Patentee” (Only) Belongs The Infringement Action.*—NEWS XCHANGE (April 2006).



be changed. Since this agency would not own any patents that are infringed, they would not possess the legal standing to defend any of the patent rights.<sup>24</sup> If somehow a government entity were in place to carry out patent enforcement, it would quickly be overburdened and become ineffective as private entities shirk off their own protection duties.

The presence of PAE's in the patent marketplace also means that there are more potential buyers for those who are selling their patents. Without the requirement of actually producing a good, many firms (including PAE's) are able to bid for patents. This drives up the price of a patent which increases inventors' returns and thus their incentive to create more innovations in the future.<sup>25</sup> Thus it is clear that not only do patent trolls function as policing entities in the patent economy, but they also increase the value of patents themselves and thereby spur innovation.

Some may still wonder what good a patent troll will do to innovation if it does not use its patents. It seems intuitive that if an invention is not being sold, then it is useless. However, this objection is flawed in many regards. First, patent assertion does not preclude the use of the invention—it only means that users have to pay the patent holder. Second, if a producer is unable to pay the patent holder, she may choose to innovate around the patent, which may bring surprising results to the market in its own way. Third, the option is always open to challenge the validity of a patent. In fact, doing so would help keep the patent system from being bloated with frivolous patents.

Unfortunately, recent rhetoric has turned many people against patent trolls and the vital function they perform for the patent system. Legislation such as the America Invents Act as well as the pending Innovation Act contains many provisions that specifically target PAE's. If successful, these will diminish the policing role of trolls as

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24 *Id.*

25 PRESIDENT'S COUNCIL OF ECON. ADVISERS AND THE NAT'L ECON. COUNCIL, AND THE OFFICE OF SCIENCE & TECH. POL'Y, EXEC. OFFICE OF THE PRESIDENT, *Patent Assertion and U.S. Innovation* (June, 2013).

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well as decrease the incentive for people to innovate—nothing short of devastating in today’s age of rapid innovation.

## V. THE AMERICA INVENTS ACT

In September 2011, Congress passed the Leahy-Smith America Invents Act (AIA), the broadest set of patent reform since the Patent Act of 1952.<sup>26</sup> One of its provisions strikes down the “joinder of parties,” stating that “accused infringers may not be joined in one action as defendants or counterclaim defendants, or have their actions consolidated for trial, based solely on allegations that they each have infringed the patent or patents in suit.”<sup>27</sup> This provision affects all patent holders whose patents have been infringed, though PAE’s were specifically targeted with this reform. Given what was stated above, namely that it is becoming increasingly difficult to distinguish between patent trolls and well-known and reputable firms, this provision would be difficult to enforce uniformly.

Before this legislation was enacted, PAE’s would usually group many defendants together (sometimes numbering in the hundreds) through joinders, done namely to save court costs. The effectiveness of such a practice may be seen in the following example: suppose that it costs a certain firm \$100,000 to litigate and assert one of its patents. Said firm will therefore not pursue any infringers that are bringing about any losses to its rivalrous profits if those losses sum to less than \$100,000. However, if the firm is able to find multiple infringers, it may join them together in a suit that is expected to at least recoup its legal fees. Thus, with the limit to joinders from the AIA, the above firm will be unable to assert its patent against multiple infringers since. Though it is losing money to the infringers, it would not want to lose even more in legal fees and other resources. The intention behind the AIA is to increase the costs for PAE’s, both in terms of time and fees. In reality, its effects are even broader: it increases the cost of all patent protection.

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26 35 U.S.C. § 102 (2011).

27 35 U.S.C. 299.

Many defenders of the AIA assert that patent trolls are bogging down the United States patent system with frivolous lawsuits.<sup>28</sup> The statistic that in 2012 PAEs brought about 62 percent of all patent lawsuits is not one to be ignored.<sup>29</sup> However, given the above argument of patent trolls' essential role as enforcers of patent rights in the economy and how they increase the incentive to innovate, a large statistic may be seen as indicative of success in those two fields. Even those who are vehemently opposed to the presence of patent trolls in our courts ought to be wary of a piece of legislation that prevents joinders—large, single cases would have to be divided into multiple cases as a result. If the desire is to decrease the number of patent cases being litigated, the AIA's provision on joinders could very well produce the opposite effect.

Supporters of the AIA provision may be shortsighted in the consequences of increasing costs for PAE's. The sharp increase in litigation costs results in PAE's having much fewer resources to devote to acquiring patents. Economics would tell us that if there are fewer buyers for patents or if buyers do not have as much to spend on patents, then the price of patents will fall. Lower prices subsequently lead to a lower "supply" of patents, in essence a fall in innovation and invention. In the age of technology in which we live, such a hindrance to would-be inventors cannot be tolerated. Inventors will be less likely to patent and sell their ideas if the returns on such great investments are diminished.

For the inventors who depend on PAE's to protect their patents, the increase in PAE's costs may simply transfer over to them—and

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28 Michael Gulliford, *If Patent Reform Is Meant to Starve Patent Trolls, Why Is It Feeding Them Instead?*, IPWATCHDOG (Sept. 8, 2014), <http://www.ipwatchdog.com/2014/09/08/if-patent-reform-is-meant-to-starve-patent-trolls-why-is-it-feeding-them-instead/id=51067>

29 Dennis Crouch, *Patent Trolls by the Numbers*, PATENTLYO (Mar. 14, 2013), <http://patentlyo.com/patent/2013/03/chien-patent-trolls.html>

even then it would be less costly than pursuing multiple infringers by themselves.<sup>30</sup>

Much of the power behind large companies such as Apple, Google and Microsoft comes from the patents they own. Indeed, it ought to be noted that these firms engage in costly patent assertion themselves, with teams of lawyers that would not be deemed much different from those of other PAE's.<sup>31</sup> Due to their size and power, they are able to maintain an artificially high price on their goods and thus hurt consumers in the technology industry. Fortunately, the presence of other PAE's provides a small but significant source of competition in terms of patents, which are quickly becoming the currency of the technology age. The provisions of the AIA reduce this much-needed source of competition and devalue the supply of innovation.

As a whole, the changes brought in by the AIA are expansive and many have long been expected and needed. However, the provision on joiners should not be supported since its effects are detrimental to our patent system.

## VI. AN UNPROMISING FUTURE: THE INNOVATION ACT

The Innovation Act, a bill introduced in October 2013, deals mainly with patent infringement, and would have drastic consequences for PAE's if passed. One of its proposed provisions states that,

The court shall award, to a prevailing party, reasonable fees and other expenses incurred by that party in connection with a civil action in which any party asserts a claim for relief arising under any Act of Congress relating to patents, unless

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30 Michael Gulliford, *If Patent Reform Is Meant to Starve Patent Trolls, Why Is It Feeding Them Instead?*, IPWATCHDOG (8 Sept. 2014), <http://www.ipwatchdog.com/2014/09/08/if-patent-reform-is-meant-to-starve-patent-trolls-why-is-it-feeding-them-instead/id=51067>

31 Klint Finley, *Google Strikes Back Against Apple and Microsoft Patent Troll*, WIRED (Dec. 26, 2013), <http://www.wired.com/2013/12/google-strikes-back/>.

the court finds that the position and conduct of the nonprevailing party or parties were reasonably justified in law and fact or that special circumstances (such as severe economic hardship to a named inventor) make an award unjust.<sup>32</sup>

There are two areas of concern in the quoted piece of legislation. First, the act of fee-shifting would all but eliminate the profitability of patent assertion, further driving PAE's out of the market. If patents no longer seem worth asserting, their value will plummet—and the incentive to innovate with it. Second, the legislation leaves open the question of what is “reasonably justified in law,” since the commercialization of patents is not required by law and patent assertion is legal. This bill, aimed directly at PAE's, would cause unprecedented harm to the current patent system.

## VII. CONCLUSION

Legislation such as the AIA and the proposed Innovation Act are successful in decreasing the effectiveness of PAE's. This means that the vital role that patent trolls play in the current patent economy is also at stake. The limiting of joinders decreases the policing ability of patent trolls and also diminishes their presence in the market for patents. Thus, the provision on joinders in the AIA should be removed. The proposed fee-shifting legislation found in the Innovation Act, though unlikely to be passed due to its extreme nature, is indicative of the hostile climate in which patent trolls find themselves.

As an economy that is becoming ever more dependent on ideas and innovation, the protection of patents is vital. Patent trolls, with their specialization in the enforcement of the rights of patent holders, fulfill this role and ensure that people will continue to have the incentive to innovate. If we are to stay competitive in this idea age, the negative image of, as well as the oppressive legislation towards patent trolls need to be lifted.