Patent Trolls and the Path to Reform

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I. Introduction

Smart Ride, a smartphone app developed by Aaron Bannert, provides real-time transportation data, which assist users with public transit systems. After several months of sustained profit and growth, Smart Ride was sued for patent infringement by a company called ArrivalStar that claimed ownership of a patent covering tracking device technology. Though Bannert was sure no infringement actually occurred, his attorneys estimated that defending this case would cost $1-2 million. This case is one notable example of an ever-growing problem in the technological industry: patent trolls. A patent troll can be defined as “a company [that] acquires a range of different patents, without ever having the intention of creating any of the products.” With these patents, trolls seek out infringers and attempt to sue for a profit. Patent trolls, or non-practicing entities (hereafter NPEs), may obtain overly broad patents to capture the widest possible range of potential infringements. While patents are generally intended to protect original and innovative ideas, the

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patent portfolios of NPEs have hindered innovation and growth in many regards.

NPEs gather a significant percentage of revenue when defendants settle. Defendants are often forced to settle because of the overwhelming amount of attorneys’ fees should lawsuits advance. As pre-trial settlement details are not often released to the public, it is difficult to determine the expenses incurred by defendant parties, yet “[a]pproximately eighty percent of patent cases settle, while only five percent of cases are terminated through a trial.”4 Even when evidence that patent infringement actually occurred is weak, small defendant companies lack the financial and legal capabilities to go forward with litigation and therefore must settle. If defendants do follow through with litigation, the suit damages at stake may be disproportionately larger than actual revenue generated by the patented technology or idea.

Recent Supreme Court cases have begun to address the issue of patent trolls on various fronts including shifting legal fees to the loser,5 specifying when to invalidate overly broad or vague patents,6 and defining what type of infringement is required to constitute a valid claim,7 among others. While these recent rulings have fueled the fight against patent trolls, abuses have continued. Legislation, rather than precedent alone, is required to combat frivolous patent lawsuits.

Legislation that is crucial to deferring NPEs from bringing harmful suits is the reversal of the American Rule. The American Rule is an established standard where legal fees are not shifted by default. Each party must pay its respective legal fees so as to encourage the filing of valid lawsuits. Theoretically, plaintiffs would

5 Octane Fitness LLC v. Icon Health & Fitness Inc., 572 U.S. ____ (2014) (slip op., at 1).
be deterred from filing suit for fear of shifting fees at the chance of loss in spite of having a legitimate claim to sue. Patent trolls were a nonissue at the conception of this standard, and current abusive trends warrant revisiting the laws and standards that allow NPEs to wield the courtroom as a weapon against profitable companies.

The current legal landscape discourages innovators by allowing patent trolls to threaten both large and small companies with litigation. Technological giants may have the legal firepower to combat frivolous suits, but small companies and startups have no choice but to settle even though their contributions to innovation may be unique. Patent trolls’ free reign has impeded technological innovation for too long. Federal legislation should prevent further extortion within and without the courtroom by abrogating the American Rule so that shifting the winner’s legal fees to the loser occurs by default.

II. BACKGROUND

The American Rule and Litigation Incentives

The shifting of attorneys’ fees to the loser of a case is a practice rarely applied. The American Rule is more of a standard based on ideology than a rule. It holds that respective litigation parties by default pay their own legal fees and has few exceptions in law and in practice. Courts have sustained the American Rule since the U.S. Supreme Court ruling in Arcambel v. Wiseman in 1796. This default is rooted in the incentives that parties have to litigate and attempts to achieve fair litigation outcomes. However, NPEs are increasingly bringing illegitimate lawsuits to court. If the American Rule is aimed at protecting the filing of valid lawsuits, a corollary objective should be to prevent the filing of invalid lawsuits. These suits are rapidly growing. “The number of firms sued by patent trolls grew nine-fold over the last decade; now a majority of patent lawsuits are filed by

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9 Id.
trolls.” A change in the American Rule, specifically relating to patent law, and the continued allowance of fee shifting will result in: 1) an increase in the perceived cost of litigation and 2) discouragement of frivolous lawsuits due to changing incentives. In light of the origins of the American Rule, plaintiffs with legitimate suits need not be concerned by shifting costs because fee shifting would be subject to the federal judge’s discretion.

Modern attempts at law revision have deterred some NPEs from frivolous litigation, yet they still run rampant. 35 U.S.C. § 285 holds that “The court in exceptional cases may award reasonable attorney fees to the prevailing party.” Fee shifting by law is allowed in “exceptional cases,” but the implications drawn from this law are not strong enough to deter NPEs nor encourage defendants to follow through with litigation. In order for this law to take hold, defendants must see the lawsuit through to the end, though many startups cannot afford litigation costs. Defendants must be sure that a baseless charge will not overburden their startup company with legal fees; otherwise, defendant parties will continue to settle at the demands of NPEs. A formal expansion of the “exceptional cases” statement will most greatly encourage legitimate lawsuits and discourage illegitimate ones.

Costs on Innovation

Patent trolls not only impose direct costs to companies, they also tax innovation and prevent market expansion. “[P]atent trolls cost defendant firms $29 billion per year in direct out-of-pocket costs; in aggregate, patent litigation destroys over $60 billion in firm wealth each year.” While large tech companies shoulder most of the aggregate cost, there is a disproportionate share placed on start-ups. “[M]ost patent trolls target firms selling less than $100 million a

12 Bessen, supra note 9.
When lawsuit costs are imposed upon startups and innovative companies, funds must be drawn from crucial areas such as research and development (R&D). Startups often do not have the funds or accumulated capital to survive even the settlement demands of NPEs, so innovation within the economy is diminished as these startups collapse from financial hardship. For publicly listed firms that had faced patent infringement suits by NPEs, researchers at Harvard and the University of Texas concluded that when suits were not dismissed, “firms reduced their R&D spending by $211 million and reduced their patenting significantly in subsequent years.” Without sustained R&D, firms face significant long-term economic risk. Money that could otherwise fuel expansion and research is instead undercut by preying NPEs through inefficiencies in current patent law.

**Government Interest in Facilitating Innovation**

The US Government has a vested interest in promoting innovation among promising startups to boost income and create jobs. In 2011, President Obama announced the Startup America Initiative, aimed at facilitating high-growth entrepreneurship in industries such as clean energy, medicine, advanced manufacturing, and information technology. Each of these industries is greatly affected by patents. One of the Initiative’s policies focuses on reducing barriers for start-up companies and entrepreneurs. Aggressive patent litigation by NPEs, particularly against small, profitable startups is a barrier to entry on its own. Specifically, this type of patent litigation limits high growth as small companies are allowed to thrive only until they become profitable to NPEs. Even if entrepreneurs gain greater access to capital and market opportunities as a result of this White House initiative, their “tax” burden from preying companies is too high to allow high growth and subsequent contribution to

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13 Id.
14 Id.
innovation and the economy. Thus government, through the proper channels, ought to have a vested interest in reforming patent law to relieve pressure on smaller firms and promote the economy at large. Doing so would keep smaller, innovative companies afloat, securing more jobs, tax revenue, and growth overall.

III. PROOF OF CLAIM

Exceptional Cases

Federal legislation as outlined in §285 of the Patent Act is prohibitively ambiguous and thus does not sufficiently protect startups and entrepreneurs from NPEs. Implementation of this law rests on whether or not a case is “exceptional,” suggesting that only unique or outstanding cases may warrant fee shifting to the prevailing party. While aggressive NPE litigation may have been unique during the time of this rule’s enactment in 1952, the problem has since become common. There are currently six times more patent lawsuits than what was filed in 1980. Fee shifting under this rule is virtually non-existent, as evidenced in recent cases brought before the Supreme Court.

In 2011, Icon Health & Fitness, Inc. sued Octane Fitness, LLC for patent infringement on various elliptical exercise machines. The court hearing the case concluded that Octane did not infringe on Icon’s patent. Octane then moved to transfer attorneys’ fees under §285 but the request was denied. The framework for this decision was based on a U.S. Court of Appeals for the Federal Circuit case in 2005. The court reasoned that:

A case may be deemed exceptional when there has been some material inappropriate conduct related to the matter in


17 Octane Fitness LLC, 572 U.S. at 5.
litigation, such as willful infringement, fraud or inequitable conduct in procuring the patent, misconduct during litigation, vexatious or unjustified litigation, conduct that violates Fed. R. Civ. P. 11, or like infractions. ... [S]anctions may be imposed against the patentee only if both (1) the litigation is brought in subjective bad faith, and (2) the litigation is objectively baseless ... There is a presumption that the assertion of infringement of a duly granted patent is made in good faith[, and] ... the underlying improper conduct and the characterization of the case as exceptional must be established by clear and convincing evidence.18

Under this reasoning, the prevailing party must bear the burden of proof and convince the court that both stipulations are met. This scenario is highly unlikely, especially if the prevailing party is a defendant startup company, for what evidence can new business owners gather that litigation is objectively baseless and brought in subjective bad faith? Such evidence is especially difficult to obtain since NPEs often operate in small offices dispersed throughout the country, far from the businesses that patent infringement suits are brought against. The Supreme Court reversed the Icon ruling on the grounds that “[t]he framework established by the Federal Circuit in Brooks Furniture is unduly rigid, and it impermissibly encumbers the statutory grant of discretion to district courts.”19 The Supreme Court supports the notion that courts ought to have more discretion in the shifting of attorneys’ fees.

Another Supreme Court case20 cites the same logic: that the Brooks Furniture framework is too rigid and district courts reserve the right to determine what is exceptional in patent infringement cases based on §285 alone. Highmark Inc. sued Allcare, a patent owner, for a declaratory judgment that their patent was invalid and


19 Octane Fitness LLC, 572 U.S. at 7.

that Highmark was not guilty of infringement; Allcare subsequently countersued. The District Court concluded noninfringement, and Highmark filed for fees under §285. The Supreme Court maintained that “[a]n ‘exceptional’ case … is simply one that stands out from others with respect to the substantive strength of a party’s litigating position (considering both the governing law and the facts of the case) or the unreasonable manner in which the case was litigated.”

The determinant of fee shifting has turned away from the prevailing party proving the case as exceptional to the court evaluating the relative substantive strength of both parties’ arguments. The increased discretion given to district courts from these Supreme Court cases ought to increase fee shifting in cases where evidence of actual patent infringement is weak.

Supreme Court precedence, however, is not enough to curb the spread of frivolous patent suits, given the persisting (and growing) problem of NPE suits after such rulings. Small and large companies alike should be able to use the court system to defend infringement claims with confidence that just and equitable decisions will be rendered. Even if district judges are granted greater discretion in fee shifting measures, small startup companies will still likely bear a significant burden of cost. Fee shifting is not assured, but merely a possibility. If fee shifting is to become the default, business owners will have more confidence that a frivolous lawsuit will not sink their business in legal fees. If a legitimate infringement case is brought to court, district judges will still hold the discretion to overturn the default of fee shifting.

Fee Shifting in Other Contexts

Fee shifting is present in other areas of federal law, including antitrust law. U.S.C. §15 states that “any person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue therefor[e] in any district court of the United States … without respect to the amount in controversy, and shall recover threefold the damages by him sustained, and the cost of suit,
including a reasonable attorney’s fee.” 22 The Civil Rights Act includes similar language: “In any action commenced pursuant to this subchapter, the court, in its discretion, may allow the prevailing party, other than the United States, a reasonable attorney’s fee as part of the costs, and the United States shall be liable for costs the same as a private person.” 23 The Copyright Act 24 provides yet further evidence of fee shifting in federal law, which counters the argument that the American Rule is the “American way” with respect to the manner in which United States courts seek to incentivize litigating parties.

The logical opposite of the American Rule is the English Rule. 25 Most legal systems in the Western world use the English rule, where the losing party pays the reasonable legal fees of the prevailing party. 26 Many parties to dispute resolution suits in American rule jurisdictions have chosen to opt out; 27 “[t]he massive opting out of the American rule suggests that this approach to attorney fees may not, in general, be the optimal arrangement.” 28 The English Rule works well as a default in most Western countries other than the United States. This suggests that its implementation, at least in US patent law specifically, would bring about equitable and just outcomes along with the benefit of protecting innovative companies that contribute to the wealth and well-being of society.

24 17 U.S.C. § 505 (2006) (stating: “In any civil action under this title, the court in its discretion may allow the recovery of full costs by or against any party other than the United States or an officer thereof. Except as otherwise provided by this title, the court may also award a reasonable attorney’s fee to the prevailing party as part of the costs.”).
25 The English Rule holds that the prevailing party’s fees shift to the loser by default.
27 See Eisenberg and Miller, id. at 331.
28 See Eisenberg and Miller, id. at 331-332.
Theoretical Justifications

Fee shifting is justified as a punitive rationale against litigation abusers when the defendant party has relatively fewer legal resources at their disposal. Thomas D. Rowe, Jr., then Duke University Professor of Law, wrote: “[W]hen a legislature perceives a regular imbalance, it can seek to match adversaries more evenly by adopting some form of fee shifting to prevent disproportionate advantage in access to and use of the legal process.” 29 Fee shifting levels the playing field and allows small companies access to court and legal avenues they could not otherwise pursue. If indeed no patent infringement occurred, the fair and equitable outcome involves no cost imposed on the defendant party.

Fee shifting may deter NPEs from bringing suit, but a client does not constitute the whole of a litigation party. Often in civil cases, lawyers, rather than their clients, ultimately decide whether a claim ought to be pursued in court. E. Donald Elliott, Yale Professor of Law, argues that, “[A] rule that creates economic incentives that affect the client but not the lawyer will not get at the actual decision-maker in that situation.” 30 If a client is to bear the full risk of fee shifting, their attorneys may still push for litigation because attorneys will collect their fees regardless of the outcome. A solution to alter attorneys’ incentives to bring frivolous lawsuits is already in place in federal law, which maintains that incurred legal fees may be transferred, in part or in whole, to the lawyer. 31 “This statute applies to all proceedings

31 28 U.S.C. § 1927 (1982) (stating: “Any attorney or other person admitted to conduct cases in any court of the United States or any Territory thereof who so multiplies the proceedings in any case unreasonably and vexatiously may be required by the court to satisfy personally the excess costs, expenses, and attorneys’ fees reasonably incurred because of such conduct.”).
in federal courts of all levels.” Patent infringement suits can only be brought before federal courts, so additional fee shifting provisions for attorneys are not necessary in legislation. However, this rule ought to be reiterated in new patent law legislation. If attorneys are also at risk when bringing frivolous cases to court, they will be less likely to represent preying NPEs. This way, the incentives of an offending party as a whole are changed, minimizing the chances that NPEs threaten small companies with baseless lawsuits.

**The Innovation Act**

The argument remains that fee shifting imposed as a default could hurt small innovative companies just as badly as NPEs. If fee shifting is made the default, small companies may fear the potential cost of two parties’ legal fees. However, the proposed legislation of the Innovation Act accounts for this possibility. § 285(a) 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 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.

The district judges would have the discretion to determine whether a case is justifiable in law and fact, bringing about just and fair outcomes for all parties involved. This encourages legitimate suits to be brought to court while discouraging those cases meant as threats for settlement earnings or other claims that are not well founded. Startup companies in financial hardship will not need to worry about

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incurring extra attorneys’ fees if the court motions in the other party’s favor.

The Innovation Act is currently in its early stages, making a second run through Congress. In 2013, the bill passed the House, but failed to pass the Senate. The current Act’s successful transition into law is debated, as many groups including NPEs have incentive to lobby politicians to reject the bill. Regardless, the bill contains relevant provisions that would greatly curb the patent troll problem, as recently noted in the Harvard Business Review by Larry Downes, an expert analyst in information technology and strategy:

The Innovation Act’s provisions would make an important dent in the worst excesses of the system. If passed, it would force plaintiffs to be more specific about the patents they are asserting as infringed. It would help unmask the true identity of companies who stand to benefit financially from the litigation of so-called non-practicing entities (NPEs), more frequently known as “patent trolls.” It would limit the extent of pre-trial discovery, which can cost millions and put pressure on innocent defendants to settle.

A prime motive of the Innovation Act is to protect innocent individuals and companies from courtroom costs and abuses. Given the reality of the growing patent troll problem, these provisions adequately fulfill this motive. Without an overturn of the American Rule with the special considerations outlined in the Innovation Act, innovative companies both small and large will continue to face a pandemic of frivolous suits. Due to sufficient funds and resources, large companies do not base decisions to litigate on incentives generated by the courtroom. With special considerations, small companies will be protected as defendant parties and still hold sufficient incentive to bring suit should infringement of intellectual property


take place. The main consequence of the Innovation Act, or at very least shifting attorneys’ fees, is that NPEs will face massive costs and lose their incentive to threaten companies with patent lawsuits.

IV. CONCLUSION

Patent trolls continue to plague the American economy by hampering its growth and development as they wield the framework of ineffective patent law. Legislation must abrogate the American Rule and enact fee shifting by default to halt the growth of preying patent trolls. Creating an environment where fee shifting is the default will alter the incentives of litigating parties so that defendants to frivolous suits may follow through with litigation rather than settling. Giving judges the discretion to withhold fee shifting will still encourage plaintiffs with legitimate claims to go to court. Current patent law is excessively ambiguous and current legal precedents do little to alter the incentives of litigating parties. New legislation is the best course of action to protect innovative companies while still upholding the legal rights of patent holders. Fee shifting is not an audacious proposal; other areas of United States federal law, as well as other Western democracies, practice it without major detriment or disadvantage. Implementing it in US patent law will allow for greater legal protection of innovative startups. The Innovation Act provides sensible language that accounts for the recent growth in patent lawsuits and provides solutions that level the legal playing field for all potential litigants. Its passage, or the passage of similar legislation, is critical to the promotion of growth and innovation in the United States economy.