

Do Patent Trolls



Allegations of inequitable conduct in patent litigation are now relatively rare. Is there a future for patent trolls—those acquiring patents for the sole purpose of extracting royalty payments?

BY JEFFREY C. MORGAN

Have a Future?

Patent litigation has certainly changed over time. For example, not long ago almost every patent litigation included a claim of “inequitable conduct”—the allegation that the patent had been procured with an intent to deceive the U.S. Patent and Trademark Office (USPTO). The practice of alleging inequitable conduct became so commonplace in the late 1980s and early 1990s that the Federal Circuit dubbed it a “plague.”¹ That was then; this is now. Allegations of inequitable conduct are now relatively rare. Today, the new plague is the advent of the patent troll and the cost-of-defense settlement.

Although the term patent troll has already entered the vernacular, we should pause to define it. When most intellectual property lawyers use the term (and the way I use it in this article), we mean an entity, other than the original inventor, who does not provide any product or service, but rather has acquired the patent for the purpose of asserting it against others (often numerous others in an entire industry), with the goal of extracting royalty payments that are less than the costs of defense. Universities and their technology transfer organizations are usually excluded from the category because although they do not practice their inventions, they are not in the business of acquiring patents solely to assert them against others.

A recent White House report states that litigation brought by patent trolls has “increased dramatically in recent years”—accounting for 62 percent of all patent litigations brought in 2012.² That figure may be inflated due in part to the antijoiner rules instituted by the America Invents Act (AIA). Beginning on Sept. 16, 2011, the AIA precluded a patent owner from joining multiple defendants in a single action unless they were accused of making, using, or

selling the same product or service or unless there were common questions of fact relating to all the defendants.³ But even before the one-defendant-per-lawsuit reforms of the AIA, patent troll litigation had been steadily rising, making up 19 percent of all patent cases in 2006, 23 percent in 2007, 26 percent in 2008, 29 percent in 2010, and 45 percent in 2011.⁴

Unique Problems for Defendants

For accused infringers, patent trolls present several unique problems. First, patent trolls and their portfolios are largely anonymous. Of course, there are some large, well-known trolls (some of whom are even publicly traded companies). But because by their nature they do not compete with those they accuse of infringement and because they exist only on paper, most trolls (and their patent holdings) are not known to the public or their targets until after they have filed suit. Further, patent owners are not currently required to disclose publicly their ownership interest to, for example, the USPTO. This makes it virtually impossible for a company to spot a patent troll in advance or take reasonable steps to avoid practicing any purportedly patented technology.

Second, patent trolls do not provide any product or service and therefore are not susceptible to countersuits for infringement. When Company A owns patents covering its products and sues Company B—a competitor—for selling infringing products, Company B may have patents of its own that it can assert against Company A. Such a level playing field serves to discourage lawsuits from being filed at the outset. When lawsuits are filed in this situation, it opens litigation up to the possibility of business resolutions that can benefit each of the litigants and the public. With patent trolls, however, the absence of exposure to countersuits (often accompanied by undercapitalization) makes them virtually lawsuit-proof (and sanction-proof).

Third, because American law generally requires a party to pay only its own litigation expenses, trolls can litigate almost for free. Trolls typically enter into contingency fee arrangements with the lawyers who represent them and therefore do not have to shoulder the cost of litigation themselves. Of course, a lawyer who represents a patent troll on a contingency must bear those

costs, but such costs are not felt by the troll. Further, litigation costs are cheaper for both trolls and their lawyers because trolls have no business (other than litigation itself) and therefore almost no documents. Conversely, a company accused of infringement must hire a lawyer (or law firm) usually on an hourly fee basis and often must produce gigabytes (if not terabytes) of documents regarding their accused products, financial records, and any other discoverable topic. If the troll loses, it has not suffered financially. The defendant, by virtue of being sued, must shoulder the costs of defense (which in itself constitutes a loss) from the outset.

Fourth, patent trolls can often delay disclosing their theories of infringement until late in the litigation. Although many district courts have local patent rules that require disclosure early in the case, many other districts do not. Sometimes, even in those districts with infringement-theory disclosure rules, a troll can make a show of disclosing their theories without any substance. Sometimes these disclosures amount to nothing more than aping the language of the claims themselves without identifying where each and every element of a patent claim is present in the accused product or service. Such failure to comply with discovery delays the case and serves to increase litigation costs for accused infringers, which makes settlement to defendants more appealing.

Fifth, patent trolls often price the cost of settlement at less than the cost of defense. This practice is obviously designed to encourage the early settlement of cases. But many defendants and commentators believe there is a darker purpose behind this tactic. By pricing settlements at less than the cost of defense, patent trolls are able to bring lawsuits that will never be tried on their merits. Many believe that trolls therefore bring meritless lawsuits solely for the purpose of extracting cost-of-defense settlements. When cases settle without any ruling on their merits, trolls can avoid the consequences for their litigation misconduct. Further, when they assert patents against small companies that cannot afford patent litigation at any cost, it is not difficult to see that this practice is ripe for potential abuse.

Judicial Checks and Balances

The above factors pose problems for district courts as much as they do for defendants. Certainly courts have the power to impose sanctions on improper litigation conduct. For example, Rule 11 imposes sanctions on litigants and their counsel for bad faith litigation conduct, and 28 U.S.C. § 1927 imposes sanctions on counsel for “vexatious” multiplication of proceedings. Further, Rule 37 imposes sanctions on litigants and/or their counsel for discovery abuses. Each of these vehicles, however, lacks the ability to completely protect accused infringers from abusive litigation tactics. The bar for proving violations of Rule 11 and § 1927, for example, is high. Further, because trolls exist only on paper, they are often undercapitalized and do not have the financial resources (without piercing the corporate veil) to satisfy a substantial sanction. In such cases, the best a defendant can hope for is that a monetary sanction will force the troll to abandon the litigation. But even in those rare instances where crippling monetary sanctions have been imposed, many thousands of dollars are likely to have been spent defending the suit before achieving a dismissal of the case.

Early claim construction and summary judgment practice can help dispose of weak patent cases. For example, claim construction of a key claim term can lead to an early motion for summary judgment of noninfringement. But, again, the expense of litigation

through summary judgment is often greater than the settlement amount demanded by the troll. Indeed, even as the patent-plaintiff popular Eastern District of Texas has stated, “The Patent Rules, with their quick discovery deadlines, may not provide the most efficient case management schedule” to protect against abuse.⁵

Ultimately, the most difficult obstacle for weeding out patent troll lawsuits that have little merit (from those that potentially do have merit) is the practice of pricing settlements at less than the cost of defending the litigation through summary judgment—let alone through trial. Currently, courts are simply not equipped to weed out frivolous cases before summary judgment.

Is There a Legislative Solution?

The above difficulties have not gone unnoticed by Washington. There are currently four bills pending in Congress designed to reign in patent troll litigation, with a fifth piece known as the Discussion Draft being circulated by House and Senate Judiciary Committee Chairman Bob Goodlatte (R-Va.) and Patrick Leahy (D-Vt.). These bills enjoy varying degrees of bipartisan support—including support from President Barack Obama. Indeed, the President has recently taken several executive actions of his own to combat patent trolls.

Although each bill (and the President’s executive actions) shares the common goal of curbing the number, influence, and expense of troll suits, each has a different focus. For example, S. 866 and the End Anonymous Patents Act make relatively minor changes to the AIA and a patent owner’s reporting obligations to the USPTO, respectively. In contrast, other bills, such as the Patent Abuse Reduction Act and the Discussion Draft circulated by Sen. Leahy and Rep. Goodlatte, propose significant changes to the way district courts conduct patent troll litigation, with significant cost-shifting provisions and penalties assessable against nonprevailing patent trolls. President Obama’s recent executive actions are directed primarily at internal USPTO procedures and outreach to the public.

S. 866 (Schumer, D-NY)

The AIA created a transitional post-grant review program in the USPTO whereby a person who is charged with infringement of a covered business method patent may petition the USPTO for review. The most modest of the pending anti-troll bills in Congress was introduced by Sen. Charles Schumer (D-N.Y.). Sen. Schumer’s bill strikes the sunset provisions of the business method patent review provisions of the AIA and changes the definition of covered business method patent from one that related only to a financial product or service to an enterprise, product, or service.⁶

The AIA excludes from post-grant review business method patents that constitute technological inventions⁷ and did not define the term. Sen. Schumer’s bill does not remedy that ambiguity.

The End Anonymous Patents Act (Deutch, D-Fla.)

The End Anonymous Patents Act, H.R. 2024, introduced by Rep. Ted Deutch (D-Fla.) requires that a patent owner and each other real party in interest disclose its identity to the USPTO at certain milestones in the life of the patent, namely when the patent issues and when maintenance fees are paid.⁸ Further, each transfer of ownership must be recorded with the USPTO by identifying the new owner and any other real party in interest. For purposes of disclosure, a real party in interest includes any entity that has the legal right to enforce the patent, any ultimate parent of a real party in interest, and any entity that has

a controlling interest in the enforcement of the patent. As an enforcement mechanism, the bill limits litigation damages to those incurred only after fully complying with the act's disclosure obligations.

The SHIELD ACT (DeFazio, D-Ore./Chaffetz R-Utah)

The Saving High-Tech Innovators from Egregious Legal Disputes (SHIELD) Act, H.R. 845, introduced by Reps. Peter DeFazio (D-Ore.) and Jason Chaffetz (R-Utah) institutes a mandatory "loser pays" regime for patent troll litigation—but only if the loser is a troll.⁹ The act permits a court to make a finding (at the request of a moving accused infringer) that the entity asserting the patent does not meet any of three conditions: (1) is the original inventor or original assignee; (2) is making or has made substantial investment toward exploiting the patent through the production or sale of a product or service covered by the patent; or (3) is an institution of higher education or its technology transfer organization.¹⁰

If none of the conditions apply, then the patent assertion entity must pay the full cost of the litigation (including reasonable attorneys' fees) in the event the defendant(s) ultimately prevails. Further, depending on when the defending party moves for such a finding that the plaintiff is a troll, the court may stay discovery until after deciding the motion. For example, if the accused infringer moves for this determination before its initial disclosures are due, the court is required to limit discovery to that which is necessary for the disposition of the motion, until the motion is decided.

There are currently four bills pending in Congress designed to reign in patent troll litigation, with a fifth piece known as the Discussion Draft being circulated.

The Patent Abuse Reduction Act (Cornyn, R-Texas)

The Patent Abuse Reduction Act, S. 1013, introduced by Sen. John Cornyn (R-Texas), makes significant changes to the litigation of patent troll suits. This bill heightens the requirements for pleading patent infringement (by requiring, for example a complaint to identify, on an element-by-element basis, why the accused product or method infringes specific claims in the patent), requires the patentee to disclose to the defendants and the court all entities with an ownership interest in the patent, permits joinder of interested persons (such as the ultimate parent of any troll litigant), limits pre-claim construction discovery to issues of claim construction, requires that the party requesting any non-core discovery (i.e., any discovery that does not go to the functionality of the accused instrumentality or the validity of the patent) to pay for such discovery, and awards attorney fees and costs to the prevailing party.¹¹

The Discussion Draft (Leahy/Goodlatte)

Perhaps the most comprehensive of any of the proposed legislations, the so-called Discussion Draft circulated by Sen. Patrick Leahy and Rep. Bob Goodlatte adopts a combination of features from the proposed Patent Abuse Reduction Act and the End Anonymous Patents Act while adding other provisions that do not

exist in any other current proposed bill.¹²

For example, the Leahy-Goodlatte Discussion Draft requires the Supreme Court to amend Form 18 by heightening the pleading requirements for patent infringement to require a patentee to plead, at least, its theory for how each accused product or service meets each limitation of each asserted claim. As in the Patent Abuse Reduction Act, it requires that the party requesting any non-core discovery pay for such discovery. It also requires a patentee who sends more than 20 demand letters to disclose to the USPTO the owner and ultimate parent of, and all exclusive licensees to, any asserted patent; requires a patentee to disclose to the USPTO, the court, and the defendants the identity of all entities who had a financial or other interest in the patent for the preceding six years; imposes monetary sanctions—and prohibits exemplary damages—if a patentee fails to comply with the disclosure requirements; stays claims in any suit against a customer of an accused product in favor of claims against the manufacturer of the product; and permits interlocutory appeal for such stays. Significantly, the Discussion Draft also creates a Rule 68–style offer of judgment for patent litigations, explicitly including an award of attorney fees and costs if the ultimate judgment awards less relief than a rejected offer.

The Discussion Draft also makes various conforming amendments to the AIA and requires multiple studies to be conducted by the Judicial Conference, the USPTO, the Government Accountability Office, and other agencies on patent trolls' impact on the courts, the economy, and society. For example it requires the Judicial Conference to study discovery burdens and potential improved case management procedures. The Departments of Commerce and Treasury and the Securities and Exchange Commission would need to study their effects on the secondary market for patent transfers. The USPTO would be required to study how to improve the quality of its examinations and the effects of the U.S. government's patent holding and transfer procedures. The Discussion Draft would also require the USPTO to create a website publishing the disclosure information required of a patentee sending more than 20 demand letters (as set forth above), which is to be searchable by patent number, prior art area, and entity. Further, it codifies the law of obviousness-type double patenting as new section 35 U.S.C. § 106.

President Obama's Executive Actions

Additionally, President Obama recently enacted several executive actions (which fall somewhat short of official executive orders). They require patentees to disclose to the USPTO all entities who have had an ownership interest, but only when they are involved in live proceedings before the USPTO; provide targeted training to USPTO examiners to improve the quality of patents using functional claiming; require the USPTO to update its website to answer common questions by those facing demands from patent trolls; expand the USPTO's public outreach to include high-profile public events to develop new ideas and consensus about patent policies and laws; and (in what could be contrary to the foregoing initiatives) strengthen the enforcement process for exclusion orders issued by the International Trade Commission, with the goal of making the exclusion order enforcement process "transparent, effective, and efficient."¹³

It remains to be seen what will become of each piece of legislation, whether and to what extent they may be consolidated or challenged, and whether there is sufficient political will to reign in patent trolls through legislative and executive actions.

Vermont's Anti-Patent Troll Law

Not to be outdone by the federal government, Vermont has taken its own aggressive stance against patent trolls. Earlier this year, the state amended its Consumer Protection Act, adding a provision that makes bad faith assertions of patent infringement illegal and actionable by either Vermont's attorney general or a private entity accused of infringement.¹⁴ Vermont's law is the first of its kind in the nation and was designed to fight what it viewed as excessive patent enforcement. The Vermont law considers various factors as evidence of bad faith patent assertion, including (1) failing to conduct an analysis "comparing the claims in the patent to the target's products, services, and technology" before sending a demand letter to an accused infringer;¹⁵ (2) sending patent assertion demand letters that do not contain "factual allegations concerning the specific areas in which the target's products, services, and technology infringe the patent or are covered by the claims in the patent";¹⁶ (3) failing to identify the foregoing "specific areas" when the accused party requests such information;¹⁷ (4) demanding "payment of a license fee or response within an unreasonably short period of time";¹⁸ or (5) where the assertion of patent infringement is deceptive.¹⁹ Shortly after the passage of this law, Vermont's attorney general filed suit against MPHJ Technology Investments LLC.²⁰ Earlier this year, the firm gained notoriety for its practice of sending, through its many subsidiaries, hundreds (if not thousands) of patent assertion demand letters to small businesses across the nation, accusing them of infringing several scan-to-email patents.²¹ To date, neither MPHJ or any of its subsidiaries has brought an infringement suit against anyone.

Predicting the Future

The various bills pending in Congress have some problems. For example, targeting a specific type of patent owner for monetary sanctions (namely, those that own a patent but do not practice the invention) may go too far and be open to attack on Constitutional grounds. Other pending bills may not go far enough. For example, extending the business method patent provisions of the AIA to an enterprise, product, or service while simultaneously carving out technological inventions (whatever that is—the law does not say) from the definition of business method patent seems to do nothing meaningful at all.

Perhaps the provisions that have the greatest likelihood of immediately and meaningfully helping accused infringers are those that heighten the pleading requirements for alleging patent infringement. A plaintiff who fails to meet those heightened requirements opens itself up to a motion to dismiss at the outset of the litigation. This would tend to reduce the number of meritless patent troll lawsuits because small business defendants would likely be able to bear the expense of an initial motion to dismiss (whereas they could not bear the expense of litigation through discovery and summary judgment). This might also enable the courts to identify meritless lawsuits at the outset, and impose appropriate sanctions on patent trolls and/or their counsel.

Despite their respective shortcomings, however, there is strong, bipartisan consensus in Washington that balance needs to be restored to patent litigation. When more than half of all patent litigations are brought by entities who do not practice their own inventions (and have no intention of ever doing so), something is clearly wrong with the system. Some of the above measures (such as heightened pleading requirements) and the imposition of sanctions

(even if trolls cannot afford to pay them), will likely apply downward pressure on the number of patent troll lawsuits filed. Still, patent trolls will likely always be with us as long as patents can be legally purchased on the open market and asserted by entities who do not practice the patented inventions. ☉

Jeffrey C. Morgan is a partner in Barnes & Thornburg LLP's Atlanta office and a member of the firm's Intellectual Property and Litigation Departments. He has a national litigation practice, focused on patent litigation and strategy. He has litigated and tried patent and trademark cases, and has represented a broad range of clients, from closely held corporations to Fortune 100 companies.



Endnotes

¹*Burlington Indus., Inc. v. Dayco Corp.*, 849 F.3d 1418, 1422 (Fed. Cir. 1988).

²Patent Assertion and U.S. Innovation, Exec. Office of the Pres., at 5 (June 2013) (hereinafter, "Patent Report"), available at www.whitehouse.gov/sites/default/files/docs/patent_report.pdf.

³See 35 U.S.C. § 299 (merely alleging that multiple defendants infringe the same patent is no longer sufficient to join multiple defendants in single suit).

⁴Patent Report, at 5.

⁵*Uniloc USA, Inc. v. Sony Corp. of America*, 2011 WL 1980214, at *1 (E.D. Tex. May 20, 2011).

⁶S. 866, available at www.gpo.gov/fdsys/pkg/BILLS-113s866is/pdf/BILLS-113s866is.pdf.

⁷H.R. 1249, 112th Cong., 1st Sess. § 18, (d)(1) (2011), available at www.uspto.gov/aia_implementation/bills-112hr1249enr.pdf.

⁸H.R. 2024, 113th Cong., 1st Sess. (2013), available at www.gpo.gov/fdsys/pkg/BILLS-113hr2024ih/pdf/BILLS-113hr2024ih.pdf.

⁹H.R. 845, 113th Cong. 1st Sess. (2013), available at www.gpo.gov/fdsys/pkg/BILLS-113hr845ih/pdf/BILLS-113hr845ih.pdf.

¹⁰*Id.*, at § 2.

¹¹S. 1013, 113th Cong., 1st Sess. (2013), available at www.gpo.gov/fdsys/pkg/BILLS-113s1013is/pdf/BILLS-113s1013is.pdf.

¹²H.R. --- "Discussion Draft," 113th Cong., 1st Sess. (2013), available at judiciary.house.gov/news/2013/05232013%20-%20Patent%20Discussion%20Draft.pdf.

¹³Fact Sheet: White House Task Force on High-Tech Patent Issues, available at www.whitehouse.gov/the-press-office/2013/06/04/fact-sheet-white-house-task-force-high-tech-patent-issues.

¹⁴See 9 V.S.A. §§ 4195-4199.

¹⁵9 V.S.A. § 4197(b)(2).

¹⁶9 V.S.A. § 4197(b)(1)(C).

¹⁷9 V.S.A. § 4197(b)(3).

¹⁸9 V.S.A. § 4197(b)(4).

¹⁹9 V.S.A. §§ 4197(b)(7).

²⁰State of Vermont, Superior Court, Washington Unit, Civil Division Docket No. 282-5-13.

²¹See Joe Mullen, *Meet the Nice-Guy Lawyers Who Want \$1,000 per Worker for Using Scanners*, ARS TECHNICA (April 7, 2013), available at arstechnica.com/tech-policy/2013/04/meet-the-nice-guy-lawyers-who-want-1000-per-worker-for-using-scanners/.