



The Honorable Dick Thornburgh Thomas L. Ewing Robin Feldman

The Issue: Trolling, Licensing & Litigating: A 21st Century Patent Paradigm?

In this edition of Washington Legal Foundation's CONVERSATIONS WITH, former Attorney General of the United States and Pennsylvania Governor Dick Thornburgh leads a discussion with Thomas L. Ewing, an attorney and patent counselor with Avancept LLC, and Professor Robin Feldman of the University of California Hastings College of the Law, on the lucrative practice of monetizing patents. Rather than utilizing patents to produce and sell products or services, an increasing number of "non-practicing entities" purchase, hold, and aggregate patents for the purpose of earning licensing fees or using the patents as weapons in litigation. Mr. Ewing and Professor Feldman discuss the positives and negatives of such activity; explain the different actors involved, from "patent trolls" to defensive patent aggregators; and assess legal policy devices which may reduce abuses that can arise from patent monetization.

Governor Thornburgh: The term "patent troll" is thrown around a lot, so much, Tom Ewing, that you've written it has become passé. Where did the term come from and how does it compare to "non-practicing entity" (NPE) or "patent assertion entity" (PAE)?

Thomas Ewing: Yes, the term has become meaningless because just about every defendant in a patent case applies it to every plaintiff. The term gained cur-

rency rapidly from a patent infringement case in which Peter Detkin, then head of Intel's patent department, accused the plaintiff and its counsel Peter Niro of being "patent extortionists." Niro then sued Detkin for libel, prompting Detkin to look for another term that wouldn't land him in hot water. The troll term had been around for nearly a decade already, but Detkin's promotion of the term significantly accelerated its use. Ironically, Detkin is now vice chairman at Intellectual Ventures, which has been described as "a troll on steroids." A non-practicing entity ("NPE") is a similar, less loaded term that describes companies that make no products of their own and earn their revenue from technology transfer, licensing, and litigation. NPEs include universities and companies that conduct their own research and/or make their own designs but don't actually make products. A patent assertion entity ("PAE") describes a particular kind of company that makes nothing at all—no designs, no research, no engineering—but instead earns all of its revenue by acquiring patents and then licensing or litigating them. PAEs have no ability to grant technology or know-how licenses because they know no more about the patents they have purchased than the words in the publicly available patent documents.

Governor Thornburgh: Professor Feldman, what do you think of these terms and their connotations?

Robin Feldman: I prefer to use the term "patent monetization entity" or "monetizer" for short. A patent monetization enti-



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ty is one whose primary focus can be described as deriving income from licensing and litigation. Although product companies do engage in licensing and litigation, when framed in terms of the primary focus of the entity, it is not difficult to separate the sheep from the goats.

The term “patent assertion entity” falls short, in my view, because it could theoretically exclude those entities who do not assert patents directly but transfer patents to third parties. A business focused on buying, selling, and licensing patents is quite different from a product company, regardless of whether the business sues people itself or merely makes money by selling to others who sue.

The picture becomes more complicated, however, by the way in which product companies are increasingly using patent bargaining in their competition strategy. As monetization activity has exploded in the last few years, product companies are spending ever increasing amounts of time and resources on acquiring, trading, and posturing with patents. This is being done in some cases to defend a company’s products and in others to attack or disadvantage competitors. One scholar estimates that in the smartphone wars alone, \$1 billion dollars has been spent on litigation and \$15-20 billion dollars on patent acquisitions so far. This is a remarkable waste of societal resources.

Governor Thornburgh: For the sake of clarity, we’ll use the term NPE here in a generic sense. Robin, a 2012 Congressional Research Service study noted that a major characteristic of NPEs is their engagement in *ex post facto* licensing and enforcement. What does that mean and do you consider it an abuse of our patent system?

Professor Feldman: I suspect the phrase “*ex post facto* licensing and enforcement” refers to the following type of activity: A company

creates a successful product. Others, then, either use patents they already have or patents they acquire to approach the successful product company and extract payment.

For example, *Wired* magazine last May interviewed a “reverse engineer” at the Rockstar Consortium. According to the engineer, his job is to take apart and examine products like routers and smartphones, looking for ways to claim that the product infringes on one of the thousands of patents in Rockstar’s portfolio. Rockstar then follows up with a license demand.

This type of activity acts as a tax on production, extracting value as part of the price of having a successful product. Fewer new products will be able to enter the market, as innovators are forced to factor in the likely cost of paying off—or fighting off—monetizers. As a result, this type of tax on production stifles innovation.

In theory, one could argue that the product company is just being forced to pay what it should already have been paying. After all, shouldn’t a company who wants to make a product just look through the PTO database to determine who has rights to various aspects of the product and acquire any necessary licenses before going into production?

This might be true in an idealized world, but the patent system is far from ideal. It is nearly impossible to identify all of the patents that might be asserted against a particular product. There are more than two million utility patents alone, each with numerous claims. Claims are often broad and vaguely worded, drafted in the hopes of going after products that have yet to be dreamed of at the time of the patent grant. In my recent book, “Rethinking Patent Law,” I describe the bargain aspect of patents and explain why it is simply not possible for a patent grant to create more than a starting place for

understanding what the patent might cover.

Modern monetization entities have developed sophisticated methods to systemize and exploit this uncertainty. This is not how the patent system was intended to function, and I believe it will operate as a serious drag on innovation.

Governor Thornburgh: Tom, you've written and spoken quite a bit about what you call "mass aggregators." Where do they fit into the NPE debate?

Mr. Ewing: Mass aggregators have resources that rival or even exceed the resources of the companies they chase down for licenses. Intellectual Ventures, for example, has a patent portfolio that matches, or nearly matches, the portfolio of IBM, which is generally considered the largest domestic portfolio. Because of their size, the mass aggregators enjoy numerous advantages in licensing and litigation over traditional patent trolls. Here's just one example: if a patent troll seeks to license just one patent, then the licensing target typically examines the patent in great detail, including a thorough review of the patent's official file history at the USPTO. This review finds every flaw and potential flaw in that one patent and often provides useful ammunition for lowering the licensing fee or even making the problem go away. But if a mass aggregator asks a company to license 250 patents, it is simply not cost effective to analyze all of them in detail, and no one does. Thus, the advantages tilt heavily in the favor of the mass aggregators in most licensing/litigation scenarios.

Governor Thornburgh: What factors have inspired the rise in patent aggregation?

Professor Feldman: Modern patent aggregation can be traced to the creation of Intellectual Ventures by former Microsoft executive Nathan Myhrvold. Intellectual

Ventures, and other mass aggregators, today operate on a scale and at a level of complexity that would have seemed unimaginable at the turn of the Millennium.

As with opening Pandora's box, once the model became known, others were quick to enter the field looking for their own tiny slice of the market and their own variation on the theme. With little formal or informal regulation, patent monetization has the feel of the Wild West, where early settlers created and enforced their own norms with little intervention from sovereign entities.

Governor Thornburgh: Why have we seen so much NPE-related litigation and licensing controversies swirling around industries like smartphones and technology-oriented companies?

Professor Feldman: With technology products such as smartphones and computers, an inordinate number of patents may relate to any individual device. These include patents on the various hardware components, patents on the software, patents on the methods of operating the phone and its network, patents on the methods of constructing the various components, and design patents. Any one of these patents can be used to demand royalties and hold up the sale of the product. I described above the tremendous uncertainty surrounding the meaning and application of each patent. Uncertainty breeds opportunity. Expand that uncertainty by increasing the number of patents that could relate to the product, and the opportunities increase exponentially.

Governor Thornburgh: NPEs and their defenders argue that the aggregation, holding, and enforcement of patents benefit the patent market and the economy. What are those asserted benefits, and do you feel they are in fact benefits?

Mr. Ewing: Patent aggregators provide an

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efficient mechanism for collection of outstanding licensing obligations. Company X may have pioneered Field Y and hold that field's fundamental patents but not be itself in a position to license or litigate those patents to the infringers. Company X may sell its patents to an aggregator who can then set about collecting the infringement "debt" owed by others. In addition, it is theoretically possible that an efficient patent market could be established such that companies would proactively seek out patent licenses in the marketplace.

It is certainly true that the historical industry practice does not facilitate serious licensing discussions outside the courtroom, which is a pity. However for the above to be true, one has to make certain assumptions about the patent system, most of which I suspect are incorrect. For instance, all patents do not have the same scope of claim coverage. Over the past 20 years many, many patents with narrow claim coverage have been granted.

The system presently regulates narrow claims by assuming that narrow claims are less likely to be infringed. This may be true, but given that some 76% of infringement litigations settle before judgment of infringement due to high litigation costs, high damages, and the threat of an injunction, then this almost certainly means that many companies have settled infringement claims in instances where no actual infringement has occurred and/or where the asserted patent is invalid.

Put another way, it is not difficult for a patent holder with a narrow patent claim to make a colorable argument for infringement such that the defendant will likely settle simply to avoid the cost and uncertainty of litigation. This scenario can occur with trolls of all sizes. But assume that the aggregators collect huge numbers of patents having merely "close enough to settle" claims—the result is

that a minor inefficiency in the system becomes highly exaggerated.

The potential harms to the innovation system are tremendous—resources are diverted from actual companies to speculators who themselves create no new innovations. The value of patents with genuinely broad claims becomes debased as well because the perceived legitimacy of the patent system sinks. I think it's highly unlikely that patent aggregation can substitute in the long run for genuine innovation and product development. Patent aggregation at best serves as a mechanism for staving off competitors while the companies supplying the mass aggregators work on restoring their competitive advantage.

Governor Thornburgh: What are the two or three major harms that patent trolling behavior causes?

Mr. Ewing: Patent litigation is extremely complicated and therefore extremely expensive. Many NPEs will settle their cases for less than the product-producing company will have to spend defending itself. So, trolling encourages certain actors to acquire patents that are "just good enough" to merit a settlement value under the cost of a good defense. The issue of whether the patent is actually valid and genuinely infringed may never be addressed in court. The practice wastes resources that could be better spent researching new products. The practice also stimulates a deep cynicism, which while not readily quantifiable, nevertheless erodes confidence in the patent system and likely harms the overall innovation system.

Governor Thornburgh: The head of one mass aggregator that you follow closely, Intellectual Ventures, has said that "we are promoting innovation by supporting inventors." Does Intellectual Ventures actually do that?

Mr. Ewing: While I admire Intellectual Ventures' (IV) business acumen, some of its claims might exist more for public relations purposes than hard reality. First, the majority of IV's patents have come from large companies and governments and not individual inventors. Second, it's somewhat unclear how much financial return small inventors receive from IV. The company is known as an arbitrage buyer, so it's not likely paying top dollar for the patents it obtains from small inventors. In those instances where the company has a revenue share with a small inventor, it's unclear to me how much the small inventor actually receives after IV removes its fees. IV is a private company so its books are not open to the public. Apart from all of this, I would be shocked to learn that any more than a tiny handful of inventors are sitting in their labs creating new inventions to slip into IV's waiting hands.

Governor Thornburgh: While often branded as a patent troll, Intellectual Ventures has brought very few lawsuits. Why has that been the case, and do you see it maintaining that stance or becoming more litigious over time?

Mr. Ewing: In recent years, IV has brought an increasing number of lawsuits against a wide array of defendants. IV spent many years carefully building up its patent portfolio and possibly didn't want to scare away potential sellers through aggressive litigation. IV seems to have moved through a phase of selling small amounts of patents to third parties who then filed infringement suits. This practice might have facilitated IV's licensing of the vast majority of retained patents. Since 2010, IV has begun filing infringement actions under its own name. The company would certainly prefer licensing over litigation due to the expense of litigation. Given all the advantages that large patent holders have over defendants, it is somewhat interesting that IV cannot

always compel potential licensees to accept its terms. IV has a horde of institutional investors who are likely expecting a very high rate of returns—so, yes, expect more lawsuits to be filed.

Governor Thornburgh: In the law review article you authored with Tom, *The Giants Among Us*, you discuss how patent aggregators often create so-called shell companies. What do aggregators gain from doing this?

Professor Feldman: Strategy is the name of the game in patent bargaining. If an entity wants to launch its patent at a company, a key strategy question will concern whether the company can launch anything in return. A shell company, which makes no products and holds no assets, is in the perfect defensive position. The company cannot threaten to counter sue with its own patents because the shell company does not make any products that could be imperiled. In the rare and unlikely event that a court were to assess fees or costs against the shell company for frivolous litigation or other bad behavior, the shell company has no assets to go after and the assets of the parent entity are protected.

Shell companies have other convenient advantages as well. They create confusion over the identity of the parties involved, which can make it difficult for a product company to know what it is defending against or how to defend. There are cases, for example, in which a product company has sued the wrong entity in the confusing mix of subs.

Most important, shell companies camouflage the overall strategy of the parent organization from the curious eyes of government regulators, antitrust lawyers, and irritating academics. This can make it difficult for authorities to spot individual behaviors, or patterns of behavior, that may be anticompetitive or otherwise inappropriate. Silence and obfuscation are excellent shields.

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Governor Thornburgh: You also discuss how some aggregators sell or license their patents to other aggregators or NPEs. What do they gain from that?

Professor Feldman: Aggregators, at certain times, have chosen not to sue anyone directly, but, as Tom stated, to transfer patents to others who will sue.

Reasons to avoid filing lawsuits directly can include avoiding the risks and costs of litigation, remaining in the shadows, and even the PR advantages of declaring that one does not assert the patents in one's portfolio. As I noted above, however, it is not clear to me that a monetizer who sues product companies directly has a different economic effect than a monetizer who simply makes money by selling to others who sue. The future value of the lawsuit presumably is included in the selling price to the third parties, and the effect in either case will be to operate as a tax on innovation. Conceivably, one might try to argue that certain aggregation approaches result in a lower tax than others. I am not certain that is accurate, but regardless, a tax on production is a tax on production. From any perspective, a tax on production is bad for innovation and bad for the consumer.

On a more complex level, transfers among patent aggregators may be part of larger business strategies that have the potential to be entirely innocent or anticompetitive. For example, transfers among patent aggregators could represent nothing more than innocent portfolio re-evaluation. On the other hand, they could represent an effort by larger players in the industry to divide up markets and maintain power. Properly evaluating such behavior will require greater disclosure and monitoring than the current system provides.

Governor Thornburgh: Aggregators like Intellectual Ventures have received investments from major corporations which rely

heavily upon patents. What function does an aggregator serve for such companies, Robin?

Professor Feldman: Patent litigation is the bane of every company's existence these days. Wouldn't it be nice if, in the middle of a litigation, a product company could search through some vast library of patents and find the perfect patent to threaten one's opponent? Some aggregators do just that, allowing their members to purchase patents from the library, which are immediately asserted as counterclaims in the member's ongoing patent litigation. We call this "Just in Time Patenting."

Patent aggregators can also serve as a form of a patent defense club by giving their members a blanket license to all of the patents in an aggregator's portfolio. With this in mind, aggregators may buy up potentially troublesome patents, putting them out of harm's way—at least from the perspective of their members.

From society's perspective, however, this aspect of the patent defense club is potentially dangerous. A club like this can be the perfect weapon to bash those who are not members. Suppose my competitors are in the patent defense club and I am not; the club can transfer its patents to a nasty third party, reserving a license for all club members. At this point, the only company the nasty third party can go after is me. Under these circumstances, my competitors will have succeeded in using their defense club as a cartel to bash the competition. Thus, patent defense clubs have the potential to allow horizontal collusion and cartel-like activity. The potential anticompetitive effects of such a structure should be enough to raise concerns from antitrust authorities.

Finally, aggregators offer the prospect of lucrative returns for their product company investors. Where else these days can one find investments for hundreds of millions of

dollars with a promised return on venture capital levels?

Someone, however, has to pay the piper. From society's perspective, the cost of these sky-high returns is likely to be paid in the form of higher consumer prices and lower innovation.

Governor Thornburgh: Tom, if the activity of mass aggregators and patent assertion entities do harm to innovation in America, how can you discourage such behavior without causing harm? Would any cures be worse than the proverbial disease?

Mr. Ewing: Yes, many of the proposed cures are likely worse than the disease. An array of quick fixes and pet solutions have been proposed and/or implemented thus far. I don't believe the solution involves changing how patents are granted apart from stopping the issuance of patents with overly narrow claims, but some significant changes to patent licensing/litigation seem warranted, especially in terms of damages calculations. It's difficult to imagine a robust system in which litigation is not quick and affordable. I have no easy silver bullet to propose, but I would suggest that the solution lies in returning to first principles—why do we have a patent system in the first place? If our nation maintains a patent system as a support to its vital innovation system, then I would suggest that therein lies the guiding principle behind the solution. I strongly doubt that the optimal solution will come from any one industry group or any group of incumbent actors. This is one area where everyone's voice needs to be heard. Among other things, today's seemingly small, insignificant voices are quite likely to be tomorrow's tech giants, and the booming voices of today's giants are just as likely to be little more than fond memories tomorrow. New competitors replacing old ones has been the nature of innovation throughout its history, and changes to the patent system probably

should not impede such transitions.

Governor Thornburgh: Federal antitrust officials have been sending signals that they may assess whether the Federal Trade Commission or the Department of Justice may have a role in addressing abuses of NPEs. Is there a role for competition law?

Mr. Ewing: Yes, there appears to be a role for antitrust jurisprudence in the patent exploitation business. Among other things, the vast majority of trolls are organized as limited liability companies, and most states provide the maximum level of privacy for LLCs. This means that the public has no idea who actually funds the majority of patent exploitations and what ties they might have to other entities. It's not hard to imagine that a god's eye view over the whole of the patent exploitation landscape would reveal some obvious antitrust issues. Apart from this funding issue, some of the patent aggregators appear to have relationships with operating companies that could similarly raise antitrust issues.

Governor Thornburgh: Robin, is there a good fit here for the business of "patent trolling" and antitrust laws and theories? For instance, what type of "markets" could antitrust officials define, which is always the first step when assessing business behavior for competitive impact?

Professor Feldman: Antitrust agencies have identified three types of market to consider in analyzing intellectual property markets—goods markets, technology markets, and innovation markets. Each of these categories, however, is grounded in the relationship between a particular piece of intellectual property and the market for the good produced with that intellectual property.

With patent rights floating unmoored from any underlying products, we are seeing the development of a different market, which

can be described as the market for patent monetization. One can acquire power within the market for patent monetization and create negative effects in various product markets without necessarily holding market power in any individual product market. To properly cabin anticompetitive behavior in this market, antitrust authorities will have to recognize the market for patent monetization as its own market, along with identifying any submarkets that may develop across time.

Federal antitrust agencies also may need to reconsider the general principal they have expressed that intellectual property licensing is procompetitive. With the market for patent monetization, patent licensing is the potential vehicle for much anticompetitive mischief, ranging from raising rivals' costs, to defensive leveraging of existing monopoly power, to horizontal collusion among competitors that can include market division and other cartel-like behavior.

Finally, antitrust authorities must think carefully about the implications of the business model encouraged by the phenomenon of patent aggregation. To put it bluntly, the most successful aggregator is likely to be the

one who frightens the greatest number of companies in the most terrifying way. When that happens, product companies may simply capitulate when the aggregator knocks on the door, regardless of the merits. Society should seriously consider whether this is the type of business model that should be nurtured in a competitive economy.

Governor Thornburgh: Tom, Robin, thank you for participating in this project.

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The Honorable Dick Thornburgh is a former Attorney General of the United States, two-term Governor of Pennsylvania, and Under-Secretary-General of the United Nations. He is currently Of Counsel to the law firm K&L Gates LLP and Chairman of Washington Legal Foundation's Legal Policy Advisory Board.

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