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Introduction

Startups are facing major challenges as a result of patent litigation. Lawsuits filed by patent assertion entities (PAEs) -- often referred to as "patent trolls" -- are increasingly targeting small, young companies. Firms with less than \$10 million in revenue have been targeted by at least 55 percent of PAE suits.¹ Patent litigation harms innovative firms that drive economic growth, keeping new products out of the hands of consumers. Engine Advocacy is encouraged by the Antitrust Division's workshop on PAE activity, and we urge the Justice Department and Federal Trade Commission to continue to seek input on the subject.

Background

Engine is a coalition that connects startups and government. Engine's mission is to create an environment where technological innovation and entrepreneurship thrive by educating and working with startups and lawmakers to construct smarter public policy. Based in San Francisco, with more than 500 members across the United States, Engine is an advocacy nonprofit whose advisory board includes early-stage investors in Silicon Valley's most successful companies, leading tech policy thinkers, and prominent startup entrepreneurs.

Discussion

Startups face unique pressure as PAE activity increases. Unlike large, established firms, young high-growth companies have fewer legal resources, limited financial flexibility, and need to move quickly. Patent litigation, and even the threat of litigation, is harming startups' short-term goals and long-term survival. This dynamic is particularly troubling for job growth and economic productivity; new and young firms are responsible for all net new job creation during the past few decades.²

Engine members, and others in the innovation community, are talking about patent litigation, and specifically the problem of PAEs. One of the biggest issues facing the community -- and one reason the agencies' inquiry is so critical -- is the lack of transparency regarding PAEs and their impact on practicing entities. While many entrepreneurs want to share their experiences, some are reluctant to speak out in fear of again becoming the target of further unwarranted legal demands from PAEs. Workshops and other channels of dialogue such as

¹ Colleen Chien, "Startups and Patent Trolls" *Santa Clara Univ. Legal Studies Research Paper No. 09-12*, September 28, 2012
<http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2146251>

² John Haltiwanger, Ron Harm, and Javier Miranda. "Business Dynamics Statistics Briefing: High Growth and Failure of Young Firms" Fourth in a series of reports using data from the U.S Census Bureau's Business Dynamics Statistics, March 2009
<http://www.kauffman.org/uploadedFiles/bds_high_growth_and_failure_4-6-09.pdf>

this may prove to be a valuable resource as businesses, academics, and advocates attempt to better understand the patent litigation landscape and its effects.

One potentially unsettling trend is the commonality of lawsuits following the startup investment and financing cycle. Many companies have seen lawsuits and demand letters in the wake of public announcements or news about the closing of a round of funding. Most startup founders devote a considerable amount of their time to fundraising. When confronted with a “pay or fight” scenario, most startups will pay to protect the funds they’ve spent months raising. In this way, predatory patent suits act as a tax on investment, with successful firms that have secured funding settling with PAEs that have no plans to develop products or contribute to economic productivity.

Another issue confronting startups faced with PAE litigation is the drag on productivity. Most startups start small and remain so through their early years. If a startup decides to fight a patent suit, a significant portion of its most productive workers (often lead engineers) are pulled away from product development for depositions and other purposes related to discovery. This disrupts the product roadmap, delays feature development, and adds pressure to meeting milestones and deadlines. This drag along with the huge cost difference between settlement and litigation lead startups to pay PAEs even when infringement claims are not valid.

The uncertainty created by the increase of PAE activity is also driving startups work proactively against potential predatory infringement claims in the patent space. While some in Washington view patents as a proxy for innovation, investing tens of thousands of dollars in patent applications presents a real drag on productivity and hiring, especially where the applications are acquired primarily for defensive purposes. This is particularly evident in the software space where 82 percent of PAE defendants have been sued on the basis of a software patent.³ Self-help initiatives like Twitter’s Innovator’s Patent Agreement and Berkeley Law professors Jason Schultz and Jennifer Urban’s Defensive Patent License further demonstrate the demand for protection against patent litigation.

Takeaways

- PAE activity is increasingly affecting startups, the net job creators in the U.S. economy
- The government should encourage further dialogue on PAEs and their practices
- PAE claims appear to be following the startup financing cycle, acting as a tax on investment
- PAE litigation is a drag on startup productivity, increasing the incentive to settle claims
- Uncertainty is driving the startup and innovation community to take defensive measures on patents, both at the company and community level

Startups’ relative size and resourcing leave them vulnerable to predatory patent litigation. This is precisely the type of extortion President Obama addressed in February when discussing patent reform and abuse of the patent system. Policymakers, the Patent and Trademark Office, and the Justice Department and Federal Trade Commission must keep startups and entrepreneurs in mind as PAE activity is discussed and scrutinized. Engine is encouraged by this opportunity to engage in dialogue with the federal government on PAE activities, but more must be done to protect the businesses of risk-taking entrepreneurs and ensure a more innovative future for the American economy.

³ Colleen Chien and Aashish Karkhanis “Software Patents and Functional Claiming” Presentation to the Feb. 12, 2013 Software PTO Roundtable at Stanford Law School <http://www.uspto.gov/patents/init_events/software_ak_cc_sw.pdf>