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## No Longer a Myth, the Emergence of the Patent Troll: Stifling Innovation, Increasing Litigation, and Extorting Billions

By **John F. Luman III** and **Christopher L. Dodson**

Patent litigation: It is infamously expensive, complex, and risky. Such characteristics are not particularly appealing to innovative, forward-looking technology companies attempting to keep pace in today's world. Studies show that defending a patent infringement claim can run into the millions of dollars. Moreover, the subject matter of today's patent cases often is very technical and complex, requiring experts to explain the technology to judge and jury. As a result, the outcome of a patent case is inherently unpredictable, and fighting a case through trial is risky for a defendant.

Enter the patent troll, a creature of opportunity. Patent trolls take full advantage of the expense facing a patent infringement defendant, the inherent unpredictability of jury outcomes and the threat of a permanent injunction if the defendant loses to extort billions of dollars from unsuspecting, risk-adverse companies through settlements or licenses. The patent troll provides no value to the patent system, other than to line its own pockets. Rather, it stifles innovation and increases frivolous litigation. Patent troll litigation is on the rise, and it is time for targeted defendants to fight back.

Patent trolls are not technology innovators. Rather, patent trolls simply acquire patents, typically from struggling companies, cash strapped inventors, or bankruptcy proceedings, with the sole intent of forcing an unsuspecting company, usually with deep pockets, to ink a license and pay a fee for the "use" of the patented technology. Patent trolls are almost always shell companies that do not make, use, or sell anything; they exist merely to acquire what they euphemistically call "undervalued patents" and then threaten to sue a company in the technological space possibly covered by the patents. The "business model" of patent trolls is specifically designed to place maximum pressure on the targeted company to extract the largest licensing fee possible. After acquiring the patent(s), the patent troll accuses the target company of infringing its patent and offers a license.<sup>1</sup> If the targeted company does not agree to a license, the target company is promptly sued for infringement, spurning high-risk, high-cost litigation.

The extortion is compounded by the fact that patent trolls lack a product of their own; therefore, the allegedly infringing company has no leverage for an infringement counterclaim of its own to assert against the troll, so the patent troll has little motivation for attempting to reach any sort of legitimate business compromise. Therefore, targeted companies have minimal leverage to do anything save for agreeing to the troll's settlement demands or litigating the matter full-tilt.

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**John F. Luman III** is a partner and **Christopher L. Dodson** is an associate in the Houston, TX, office of Bracewell & Giuliani LLP. They can be reached at [john.luman@bracewellgiuliani.com](mailto:john.luman@bracewellgiuliani.com) and [chris.dodson@bracewellgiuliani.com](mailto:chris.dodson@bracewellgiuliani.com), respectively.

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## **The Patent Troll's Leverage**

Patent trolls depend on expensive litigation costs and the threat of a permanent injunction to tilt the perceived balance of power in their favor. They rely on these predatory patent lawsuits to extort settlements and licensing payoffs. The costs of defending a patent lawsuit are astounding. It is estimated that for patent suits with less than \$1 million at risk, the median cost of discovery alone is \$290,000 and the median estimated total litigation cost is \$500,000.<sup>2</sup> For suits with between \$1 million and \$25 million at risk, the median estimated cost of discovery is \$1 million and the median estimated litigation cost is \$2 million.<sup>3</sup> For suits with more than \$25 million at risk, the estimated cost of discovery is \$2.5 million and the median estimated cost of litigation is almost \$4 million.<sup>4</sup>

Furthermore, the number of patent suits filed in the 1990s doubled, while, not surprisingly, the percent of lawsuits ending in trials declined.<sup>5</sup> In fact, the rate of patent lawsuits is increasing quicker than any other type of litigation,<sup>6</sup> and large companies are increasingly being sued by previously unknown, non-product-oriented entities.<sup>7</sup> Thus, rational defendants are quickly realizing that settling or securing licenses from patent trolls is often worth the potential cost and uncertainty of patent litigation. Conversely, the patent trolls have little to lose at all; they are not typically vulnerable to counterclaims (other than declaratory judgments of invalidity and inequitable conduct) or the threat of injunctions because they do not produce products or services. While the troll may need to be concerned that its patent could be found invalid if the case goes to trial, the troll tends to disregard that risk during the early stages of discovery and settlement negotiations. Furthermore, their patent attorneys frequently operate on a contingency basis or a blended rate basis. Thus, patent trolls are quickly becoming the new ambulance chasers by extorting enormous settlements or licensing fees, despite the questionable merits of their claims.<sup>8</sup>

## **Patent Trolls Exploit the Patent System**

While the risk and cost of patent litigation alone is usually adequate incentive for defendants to acquiesce to patent trolls, the problem is compounded by the inefficiency of the US Patent and Trademark Office (USPTO). Despite House of Representative efforts to appropriate more money to the USPTO in 2003, the Senate failed to act on the appropriations bill, and the USPTO remains largely overworked and underfunded.<sup>9</sup>

A similar bill remains pending in the 109th Congress.<sup>10</sup> In fact, the USPTO approves 85 percent to 97 percent of all patent applications filed, while spending an average of only 17 to 25 hours total per application.<sup>11</sup>

The patent trolls have learned to take advantage of the USPTO's inefficiencies. Recognizing that an increasing number of approved patents are broadly drafted, coupled with the fact that the USPTO's prior art research is often incomplete, patent trolls can assert broader claims of alleged infringement. While the validity of the trolls' patents is usually questionable to begin with, a validity challenge is typically more costly and unpredictable for the alleged infringer than a non-infringement defense.<sup>12</sup> Patent trolls therefore exploit the inefficiencies of the USPTO to target an increasing number of potential infringers.

Similarly, patent trolls, especially in the software industry, can wait in silence for the market to evolve around their broadly worded, ambiguous patents and then spring from the shadows and attempt to exploit fees and settlements from a myriad of unsuspecting companies. The ultimate result is that more companies spend more money litigating patent rights and less money on research and development of new technologies.<sup>13</sup>

Another trick of the patent trolls is the acquisition of patents that have not been enforced in the past and the aggressive enforcement of the previously unknown patents.<sup>14</sup> The software industry is particularly susceptible to this tactic for two central reasons. First, the developmental pace in the software industry is uniquely rapid.<sup>15</sup> Unlike the pharmaceutical and biotechnology industries, where developmental cycles often span decades, disclosures in the software industry that allow for detailed, lengthy development are not particularly valuable.<sup>16</sup> Second, many software patents simply cover inventions that were obvious at the time of the patent application.<sup>17</sup> Couple these two industry-specific problems with the fact that a single software product typically consists of numerous patentable inventions (unlike the pharmaceutical industry that typically requires only one patent on the final product), and this makes software developers especially susceptible to patent trolls. The differences in these intellectual property-driven industries also illustrates why effective legislative change has thus far been difficult.

## **Proposals to Combat the Patent Troll**

The effectiveness of the patent troll's business model depends on leveraging high risks and high costs in its

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favor. As a result, defeating patent trolls depends largely on cooperation by targeted companies and pooling of resources. In this regard, targeted companies are proceeding on two tracts: first, fighting back against the patent trolls in litigation so that the company does not become a perennial target for trolls, and second, lobbying Congress to reform the system. Trolls typically come calling for a license fee or settlement commiserate with what they expect the cost of litigation to be for the defendant companies. While this may sound like a good idea to remove the risk involved with the lawsuit, it has the long-term effect of making the company a target for future trolls. Trolls, and the law firms that represent them, know which potential defendants tend to settle and which defendants are more likely to battle specious claims of infringement. Companies need to make good business decisions, but must realize that the short-term gain from settling often results in long-term pain.

While litigation continues on the first front, oft-targeted companies have thus far been ineffective in effectuating legislative reform. Before addressing the proposed reforms working through Congress, it is first necessary to understand the inherent hurdles of legislative reform in this area. The central hurdle to effective patent reform is the diverse nature of the concerned parties, many with vastly different objectives.<sup>18</sup> While high-technology companies have been lobbying to reform the current patent laws related to permanent injunctions that leave them vulnerable to the threats of patent trolls, pharmaceutical and biotechnology companies do not have the same issue, and thus are reluctant to change the patent system for concern over the effect of competition.<sup>19</sup> The aggregate lobbying force of the concerned parties is likely to make measured reform difficult. Furthermore, while these large industry blocs square off against one another, smaller battles are waged between large and small inventors. Independent inventors, small businesses, and non-profits, including universities and research firms, have different concerns from companies that develop inventions for sale, and they desire to maintain their respective place among the large companies.<sup>20</sup> Given this complex environment and the myriad of powerful interests involved, the legislative results thus far have been predictable: methodical, slow-moving, and generally hesitant to reform.

### **Legislative Efforts**

On June 8, 2005, Representative Lamar Smith (R-TX), Chairman of the House Subcommittee on Courts,

the Internet, and Intellectual Property, introduced the Patent Reform Act of 2005 (PRA), trumpeting it as “the most comprehensive change to U.S. patent law since Congress passed the 1952 Patent Act.”<sup>21</sup> Rep. Smith specifically noted that the PRA was intended to “reform certain patent practices that disrupt the operations of high-tech companies and other businesses” and vowed to “eliminate legal gamesmanship from the current system that rewards lawsuit abuses over creativity . . .”<sup>22</sup> Rep. Smith was clearly making the patent trolls his target.

Though an extensive analysis of the PRA’s specific provisions is inappropriate here, it is significant that the most controversial and notable proposed change has already been removed from the PRA. The PRA as originally written would mandate that courts take into account all the facts and relevant interests before ordering injunctions against alleged infringers and encourage staying injunctions on appeal. Traditionally, 35 U.S.C. § 283 has been interpreted by the courts to dictate an extremely low bar to issuing injunctions, thus instilling significant leverage in patent troll plaintiffs. Indeed, very few published opinions ever decline to grant injunctions against patent infringers, and in practice, courts issue injunctions in favor of patent owners “virtually automatically.”<sup>23</sup> Courts are allowing too many injunctions without significant analysis into the equitable factors of the specific cases,<sup>24</sup> thus giving legitimacy to patent trolls’ behavior of using the threat of injunction to force defendants into license agreements despite the dubious nature of the patent. The proposed PRA was merely attempting to encourage the Federal Circuit to return to the expressed language of the Patent Act, which currently states that courts “may grant injunctions in accordance with the principles of equity.”<sup>25</sup> The proposed PRA would have included the following additional language:

In determining equity, the court shall consider the fairness of the remedy in light of all facts and the relevant interests of the parties associated with the invention. Unless the injunction is entered pursuant to a nonappealable judgment of infringement, a court shall stay the injunction pending appeal upon an affirmative showing that the stay would not result in irreparable harm to the owner of the patent and that the balance of the hardships from the stay does not favor the owner of the patent.<sup>26</sup>

Thus, the proposed injunction provision seems to be

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a response to the rise in patent troll litigation and the failure of the Federal Circuit to enforce the statutory language on the books by mandating that courts look at the equitable facts and circumstances of all the parties involved.<sup>27</sup>

### **Policy Recommendations**

As a general matter, patent trolls stifle innovation and divert scarce resources away from research and development. The business model of the typical patent troll ignores the fundamental principle that patents are intended to stimulate investment, aid the development of ideas, and bring those ideas to fruition. Patent rights are intended to stimulate innovation and creativity, not stifle them. Patent trolls trounce on the foundations of our intellectual property system. Intellectual property rights must, above all, be balanced to further the wide array of interests and parties involved. This is not to suggest that patent rights should be drastically shifted from their current form; rather, it suggests only that the current system has begun rewarding non-innovators and non-developers to the detriment of those entities that invest in legitimate research, development, and innovation. The delicate balance can be restored by making three minor legislative changes: (1) reinforcing the equitable nature of the injunction analysis, (2) broadening the doctrine of laches, and (3) adequately funding the USPTO so that its examiners may sufficiently examine patents and fully analyze the existence of prior art and the specificity of the claims.

First, courts should take into account the equitable circumstances of each specific case, rather than presuming immediate irreparable harm in almost all cases. Especially considering the effect of certain patent injunctions coupled with the inherent unpredictability of patent litigation results, courts should be granted more leeway in their injunction decisions.

The risk of injunction, for both large and small companies, can be the equivalent of corporate survival.<sup>28</sup> The Federal Circuit has always set a low bar for issuing patent-based injunctions by stating that, once “validity and continuing infringement have been clearly established ... immediate irreparable harm is presumed.”<sup>29</sup> Since the Federal Circuit’s inception, the number of injunctions has increased at an incredible rate.<sup>30</sup> In fact, the Federal Circuit has not refused to grant a permanent injunction based on factors of equity in the past 20 years.<sup>31</sup> District courts should return to the language of the statute and consider factors of equity when deciding whether to

grant injunctions. If this takes a more strongly worded statute, then so be it. Given the Federal Circuit’s trend to automatically grant and affirm permanent injunctions whenever infringement is found, the threat of injunction alone is usually enough for trolls to extort payments from corporate defendants. By raising the injunction bar, or at least the level of inquiry, companies will be more willing to fully assess their options and more likely to challenge the patent troll in litigation.

Second, patent litigation defendants, and legislators, should take note of the applicable defense of laches and its potential utility in defeating patent troll lawsuits.<sup>32</sup> Laches is an equitable, non-statutory defense that bars recovery from infringement when the patent owner unreasonably delays filing suit to the prejudice of the accused infringer.<sup>33</sup> Unlike a statute of limitations, laches is not based strictly on the passage of time; rather, the court attempts to balance the equities and the conduct of both parties. In *A.C. Aukerman Co. v. R.L. Chaides Construction Co.*, the Federal Circuit, sitting *en banc*, decided the seminal patent-laches case and confirmed that the laches defense was indeed an equitable defense to a claim for patent infringement.

Generally, a laches defense arises when the patent owner unreasonably and inexcusably delays filing an infringement suit to the material prejudice of the infringer. While a six-year delay is presumed unreasonable in patent infringement cases, what constitutes an unreasonable delay depends on the circumstances of the particular case.<sup>34</sup> Thus, defendants in patent litigation should always examine how long the patent has been in existence before being enforced. Furthermore, the delay does not begin only with actual knowledge of infringement, but includes constructive knowledge of infringement as well. Thus, an effective laches defense should be used to defeat patent trolls and other plaintiffs that do not enforce their patents until a case against lucrative defendants develops.

Courts should also more aggressively consider the equitable nature of a laches defense. Courts should begin to take into account the nature of the entity filing suit and consider the fact that a plaintiff’s only business may be patent acquisition, assertion, and litigation.<sup>35</sup> Furthermore, courts should take note of patent owners’ previous lack of enforcement. Unknowing innovators and developers should not be held hostage by silent, often broadly worded patents that have not been actively enforced or are simply forgotten. Courts should impose a duty on patent owners to police their patents and more

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strictly adhere to the doctrine of constructive knowledge of infringement when beginning the laches clock.

In the interest of innovation, Congress should also consider codifying the laches doctrine, applying stricter boundaries on infringement lawsuits, and placing a more onerous burden on patent owners to timely litigate infringement. The current laches doctrine is unduly narrow and should be more effectively used to defeat infringement claims, especially the claims of patent trolls that delay enforcement of patents until an industry or company advances using the covered technology.<sup>36</sup>

Last, the USPTO must be given the resources and the initiative to stop granting poor quality patents. In recent years, the USPTO has all but encouraged non-meritorious patent litigation.<sup>37</sup> Granted, the number of patent applications has increased, while the number of examiners has decreased; however, the USPTO must do a more complete and detailed job of evaluating the novelty of inventions and granting only specifically narrow patents. Poor quality patents, among other things, make it difficult to predict whether the patent is valid or not, thus increasing the uncertainty of litigation outcomes.<sup>38</sup> The broadly worded patents that have become commonplace from the USPTO are excellent fodder for manipulative patent trolls and future litigation. Too many patents are being granted to inventions that were obvious at the time of application.

That said, 3,000 examiners cannot be expected to give adequate attention to the more than 350,000 patent applications filed annually.<sup>39</sup> The result is predictable: Bad patents containing broad claims are issued, many of which most likely should not be issued over prior art. Defendants, therefore, have less effective counterclaims available for discrete claim interpretation and non-infringement. Indeed, the effectiveness of patent trolls could be decreased by improving the overall quality of issued patents.

Amidst complicated political terrain, the desire for better quality patents issued by the USPTO is a point of consensus among the varying political blocs. Examiners should be provided with improved prior art resources, and Congress should consider allowing third parties to submit prior art directly to the USPTO. By proactively providing better information to the examiners, a more efficient and complete evaluation can take place.

Aside from reforming the evaluation process, the USPTO should be appropriated more resources to match its increased case load. Unfortunately, the USPTO is largely unequipped to diligently and com-

prehensively evaluate the amount of patent applications pending. Evaluators must feel free, absent time pressure, to effectively evaluate patent applications. Dollars spent ensuring that more quality patents are issued from the USPTO will save millions in annual litigation costs, thereby freeing up valuable resources that can be used for research, development, and increased innovation and investment.

## Conclusion

Although patent trolls may be here to stay for awhile, companies should not feel the need to feed their extortionist appetite. Defendants should not succumb to the early cost of litigation settlement demand. Rather, companies should fight the troll both at the courthouse and in the legislature.

## Notes

1. Jermiah Chan & Mathew Fawcett, "Footsteps of the Patent Troll," 10 No. 1 *Intell. Prop. L. Bull.* 1, 3 (2005).
2. James Bessen & Michael J. Meurer, "Lessons for Patent Policy from Empirical Research on Patent Litigation," 9 *Lewis & Clark L. Rev.* 1, 2-3 (2005) (citing *Am. Intell. Prop. Law Ass'n.*, "Report of the Economic Survey 2003," at 22 (2003)).
3. *Id.*
4. *Id.*
5. *Id.* (citing research by Cornell law professors Theodore Eisenberg and Kevin M. Clermont).
6. Chan & Fawcett, 10 No. 1 *Intell. Prop. L. Bull.* at 3 (citing Erik Lawson, "Industry Groups Alarmed by Sharp Rise in Patent Litigation," *Intell. Prop. L. Bull.*, Aug. 1, 2005).
7. Chan & Fawcett, 10 No. 1 *Intell. Prop. L. Bull.* at 3 (citing Brenda Sandburg, "A Modest Proposal," *The Recorder*, May 9, 2005, at 4).
8. Chan & Fawcett, 10 No. 1 *Intell. Prop. L. Bull.* at 1 (referring to patent trolls as "ambulance chasers").
9. Chan & Fawcett, 10 No. 1 *Intell. Prop. L. Bull.*, n20 (citing statistics published by the PTO and that National Academies of Science, noting that, while patent applications have nearly tripled in recent years, the number of examiners has decreased by 20 percent over the past four years, leaving inexperienced examiners to handle the increasing numbers of applications).
10. H.R. 2791, 109th Congress (as reported by the H. Comm. on the Judiciary, Nov. 9, 2005).
11. *Id.*
12. *Id.* (citing Herbert F. Schwartz, *Patent Law and Practice* 52 (4th ed. 2003)).



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- 13 Steve Seidenberg, "Patent Trolls Go Mainstream with Ocean Tomo Fund: Aggressive Enforcement of IP Rights Becomes a Lucrative Business," *Corp. Legal Times*, Nov. 2005, at 28.
- 14 David G. Barker, iBrief, "Troll or No Troll? Policing Patent Usage with an Open Post-Grant Review," 2005 *Duke L. & Tech. Rev.* 9, P9 (2005).
- 15 Ronald J. Mann, "Do Patents Facilitate Financing in the Software Industry?," 83 *Tex. L. Rev.* 961, 1026 (2005).
- 16 *Id.*
- 17 *Id.*
- 18 Richard M. McDermott & Joseph Bracken, "Selected Intellectual Property Developments: The Patent Reform Act of 2005," 10 No. 5 *Elec. Banking L. & Com. Rep.* 12 (2005).
- 19 *Id.*
- 20 Michael T. Burr, "Reinventing the Patent Act," *Corp. Legal Times*, Oct. 2005, at 38.
- 21 Press Release, Congressman Smith's Office, "Smith Introduces Patent Reform Bill" (June 8, 2005).
- 22 *Id.*
- 23 W. David Westergard, "Remedying the Growing Abuse of the Patent System Through Targeted Legislation," Conf. Papers on Int'l Intell. Prop. L. & Pol'y, Fordham Law School, Mar. 31, 2005.
- 24 Equitable factors for permanent injunctions include (1) whether the plaintiff would face irreparable injury if the injunction did not issue, (2) whether the plaintiff has an adequate remedy at law, (3) whether granting the injunction is in the public interest, and (4) whether the balance of the hardships tips in the plaintiff's favor.
- 25 35 U.S.C. § 283.
- 26 H.R. 2795, 109th Cong. § 7 (as referred to the H. Subcomm. on the Courts, the Internet, and Intell. Prop., June 8, 2005).
- 27 Coincidentally, the Supreme Court has granted *certiorari* in *eBay, Inc. v. MercExchange*, 401 F.3d 1323 (Fed. Cir. 2005), to hear the following issue: "whether the Federal Circuit erred in setting forth a general rule in patent cases that a district court must, absent exceptional circumstances, issue a permanent injunction after a finding of infringement." Petition for Writ of *Certiorari*, *eBay v. MercExchange*, 74 U.S.L.W. 3371 (No. 05-130).
- 28 Chan & Fawcett, 10 No. 1 *Intell. Prop. L. Bull.* at 9.
- 29 *Id.* (quoting *Smith Int'l, Inc. v. Hughes Tool Co.*, 718 F.2d 1573, 1581 (Fed. Cir. 1983)).
- 30 Chan & Fawcett, 10 No. 1 *Intell. Prop. L. Bull.* at 9.
- 31 *Roche Products Inc. v. Bolar Pharmaceuticals Co.*, 733 F.2d 858, 866 (Fed. Cir. 1984), is the last known opinion in which the Federal Circuit refused to grant a permanent injunction based upon equitable factors.
- 32 *Symbol Technologies, Inc. v. Lemelson Med., Educ. & Research Found.*, 277 F.3d 1361, 1363 (Fed. Cir. 2002).
- 33 *See, e.g., A.C. Aukerman Co. v. R.L. Chaides Constr. Co.*, 960 F.2d 1020 (Fed. Cir. 1992) (*en banc*).
- 34 *Id.* at 1020 ("the length of time which may be deemed unreasonable has no fixed boundaries, but rather depends on the circumstances").
- 35 Jeffrey D. Sullivan & David Loretto, "Symbol Technologies v. Lemelson, Prosecution Laches, and the Still-Unmet Challenges of Junking 'Junk Patents,'" 33 *AIPLA Q.J.* 285, 320-323 (2005).
- 36 Mann, 83 *Tex. L. Rev.* at 1027-1028.
- 37 Seidenberg, *Corp. Legal Times* at 28.
- 38 Mann, 83 *Tex. L. Rev.* at 1026.
- 39 Chan & Fawcett, 10 No. 1 *Intell. Prop. L. Bull.* at 4.