Taking on the trolls

Kevin Barhydt, RPX

There are an estimated 500 non-practising entities operating in the US. As a result, companies are turning to defensive patent aggregators to seek protection from litigation. **Catherine White** speaks to RPX's **Kevin Barhydt** about such lawsuits and why the solution lies in the 'open market'

In the past, patents were left by companies to collect dust, viewed as a small and necessary asset. But during the last 10 years, they have come to the forefront of companies' minds to be monetised and exploited. As a result, patent litigation is continuously making headlines, from US Federal Judge Richard Posner attacking the US patent system in July, claiming there to be too many patents, to Apple's $1.05bn patent win over South-Korean rival Samsung in August.

Meanwhile, US inventors are adjusting to the America Invents Act ("AIA") patent reform, which came into effect on the 16 September and will see the US change from a "first-to-invent" country to a "first-to-file" country in March 2013. Additionally, the Act's 'Joinder provision', which is designed to make it more difficult to file large multi-defendant infringement cases, is an attempt to curb non-practising entities (NPEs) or 'patent trolls' from indiscriminately targeting defendants. NPEs also make popular headlines.

The term 'patent troll' was coined by former Intel assistant general counsel Peter Detkin in 2001, who attached the label to companies that buy patents solely for the purposes of licensing and litigating, but who never actually create, use or manufacture the patents themselves.

Over the years, NPE activity has received growing publicity as prolific companies sue each other, which has resulted in a steady rise in litigation. In order to address the NPE concern, US Representative Peter DeFazio (D-Oregon) and Representative Jason Chaffetz (R-Utah) introduced the Saving High-tech Innovators from Egregious Legal Disputes (SHIELD) Act[1] legislation in August. The legislation is an attempt to discourage NPEs from filing frivolous lawsuits and would require them to pay defendants' legal costs if the suit is unsuccessful. The legislation has yet to be debated, so what other avenues are there for possible NPE defendants to seek protection?

Many companies are looking beyond regulatory or legislative relief to find a market-based solution. RPX, a fast-growing provider of patent risk management services, pioneered this kind of market-driven approach to mitigating a company's exposure to NPE litigation.

RPX's 120 clients pay an annual fee, for which they receive licences or sub-licences to all of the assets in RPX's growing patent portfolio (the company is continually expanding this pool of intellectual property assets with new acquisitions of high-threat patents). Since these patents would otherwise be acquired and litigated by NPEs, members of the RPX network are actively reducing the cost and risk they face from NPEs. The company's full suite of patent risk management solutions include: defensive buying; acquisition syndication (the process of pulling together additional funding from their clients to enable them to efficiently clear risk of large portfolios); NPE litigation insurance; advisory services; and patent intelligence (providing clients with knowledge of the market place eg, data and analysis to show intelligence around NPEs and their behaviour in suits).

RPX's Kevin Barhydt, vice president and head of acquisitions and analysis, explains how the company operates and how it is arming businesses to fight litigation.

What is RPX's business model?

We identify and purchase high-risk patents and patent rights that could be used offensively in claims of infringement against members of our client network. We make acquisitions in three ways:

- In the open market from third parties;
- Directly out of active litigations from plaintiffs; and
- In larger-scale structured acquisitions that include contributions by some clients of capital above and beyond their standard subscription fees.

In all cases, RPX clients receive licences to every patent and associated right that we acquire, freeing them from the risk of an infringement assertion. All issued patents owned by RPX are also available for our members to use in a counterclaim against any non-member who initiates patent litigation against a member. We will never assert or litigate the patents in our portfolio. Our goal is to help operating companies collectively reduce the risks and costs of patent litigation.

The key to this value proposition for clients is RPX's ability to use market mechanisms to rationalise the highly inefficient, litigation-based method of patent monetisation that is commonly used.

RPX states it offers defensive patent aggregation. What is this?

Defensive patent aggregation is the practice of purchasing patents or patent rights to keep such patents out of the hands of entities that would assert them against operating companies. RPX coined this term when we founded our business in 2008.

How is the business funded and how does it raise the funds to buy patents?

RPX funds its patent acquisitions using client subscription fees, which range from $65,000 to $6.9m per year, and are based on the client's operating income. RPX's network is the largest and fastest-growing of its kind in the industry. As the RPX network grows, its buying power increases, allowing RPX to remove even more patents from the market. As of 30 June 2012, RPX had deployed more than $490m to acquire and/or sublicense approximately 2,900 patent assets.

Could you tell me who your clients are?
As of 30 June 2012, the RPX network had 120 members, operating companies that sell or use technology-based products and services. Our current clients are active in seven key sectors: consumer electronics and PCs, e-commerce and software, financial services, media content and distribution, mobile communications and devices, networking, and semiconductors.

RPX's study *The Direct Costs from NPE Disputes*[2], which was in collaboration with The Coalition for Patent Fairness (members include Dell, Symantec and Verizon Communications), highlights the impact of non-practising entities (NPEs) on operating companies. The study calls for 'open market' purchases. What is this and why does this offer a solution?
Patents are regularly sold on the open market by owners, including inventors, universities, companies, and investors. These assets can be – and frequently are – purchased by NPEs, firms that monetise the patents they own by asserting infringement against operating companies. The targeted operating companies can either pay for a licence or fight the infringement claim in court. In either scenario, they must pay significant legal fees and, unless they prevail in court, settlements to resolve the assertion.

RPX was founded on the notion that operating companies could reduce their exposure to the risk and cost of NPE patent assertion by pooling resources to acquire high-risk technology patents in the open market before they could be acquired by NPEs. In our model, we combine our own capital with capital from our clients (contributed through annual subscription fees). This model allocates risk and cost across the client network, strengthens our buying power, and enables us to compete effectively for the acquisition of key patent assets versus well-funded NPEs. We clear patent risk with every purchase and our open market purchasing power grows every time a company joins our client network.

How will open market purchases help decrease 'patent troll' behaviour?
An increase in the number of patents and patent rights purchased by RPX directly off the open market decreases the number of patents and patent rights that end up in the hands of NPEs that will assert them.

By the way, it's worth noting that we generally don't use the term 'patent troll' at RPX because it has a pejorative connotation that can oversimplify the dynamics of the patent problem. The patent market isn't irrational and wasteful because NPEs are malicious; it is irrational and wasteful because NPEs use litigation to monetise their assets. Patents are an asset class that should be traded and monetised – there is nothing wrong with that. The real problem is monetising through litigation.

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Until RPX built its network of operating companies – with attendant capital resources – litigation was the primary way to extract value from patents at an appropriate scale. As we continue to expand our client network and increase our buying power, we expect NPEs to increasingly participate in our market solution to achieve their return on investment (ROI) goals for the assets they own – we already regularly purchase patent portfolios from NPEs – rather than rely on the less efficient, costly, and more risky avenue of litigation.

What is your view on the AIA and do you think the 'Joinder provision' will increase troll practices?
The AIA includes very few elements that address the NPE problem. While the provision will reduce the number of defendants per case, we do not think it will dramatically reduce the overall number of defendants targeted by an NPE for a particular patent or portfolio campaign. We expect NPEs will simply file multiple suits over time to ensure they assert their patents against all the companies that present the greatest potential for a licence or settlement. At the same time, the Joinder provision may ultimately spur NPEs to seek to generate revenue from smaller companies through alternative, non-litigation methods of monetisation, such as aggressive assertion-letter campaigns. It remains to be seen how much impact this will actually have on the NPE business model.

As more trolls turn to the US International Trade Commission (ITC) for litigation due to the high-rate of injunctions issued, do you think the process is becoming abused?
NPEs have increasingly been bringing patent infringement actions against operating companies in the ITC. From 2010 to 2011, the number of NPE-driven investigations in the ITC grew from 4 to 16. More telling, the number of defendants in NPE patent actions in the ITC has risen tenfold in the same period, from 23 to 235. The ITC has grown in popularity for NPEs since the Commission ruled in a 2010 investigation that the "domestic industry" requirement for a complaint is met even when licensing is the sole economic activity of the plaintiff.

NPEs cannot really be characterised as "abusing" a legal avenue that has been made available, but we do think it is unfortunate that their growing access to the ITC has put added pressure on operating companies and given NPEs a higher degree of leverage to negotiate settlements.

CEO of NPE Intellectual Ventures Nathan Myhrvold said that suing to enforce patents was simply another method of capitalism working. What is your view on this?
There is truth in his comment. Capitalism is predicated on the notion that assets have value and that there be orderly systems in place to transfer that value from buyer to seller.

Patents are assets. They have value and owners should be able to realise that value. But the mechanism that NPEs use to do this – litigation – is one of the most inefficient forms of transaction ever devised.

Lawsuits are clouded in secrecy, meaning price discovery is all but impossible. Litigations are constrained unilateral transactions between two parties rather than transparent and negotiable transactions between multiple participants in an open market. And valuation decisions in a court of law are made by disinterested juries instead of by the buyer and seller of the asset. Add to this the vast amount of wasted time and money resulting from legal discovery, due diligence, court proceedings and settlements. It would be difficult to devise a less logical, less efficient way to determine and transfer the value of any asset.

We started RPX to eliminate this waste and inefficiency. We agree with NPEs that patents are assets. We completely disagree that the legal system is the appropriate way to monetise them. RPX was founded to create a rational market-based method to transact patents. Our goal is to eliminate waste (ie, legal proceedings) from the process and establish a multi-participant, open-market approach to transacting patents between owners and users (that we would argue is the appropriate "form of capitalism").

What do you think the solution to tackle the wave of patent litigation should therefore be?

In truth, NPE patent litigation is not a "wave" as much as a steadily rising tide. The number of litigations and the number of companies named as defendants in NPE assertions have been growing steadily over the past decade. It has not been a sudden or recent explosion. Our data shows that the total amount of NPE defendants in 2005 was 1,327. By 2011, this increased to 5,304, and during 2012 1H, the total rose to 1,861. The issue is now getting more attention because very large companies with highly visible products are suing each other.

The solution is a broad-based open market for patents. For such a market to be truly efficient, all participants would be on relatively equal financial footing and have relatively equal financial incentives, but historically that has not been the case. NPEs have been very well-capitalised and able to outbid individual operating companies for high-risk patent assets. While a few very large companies are able to outbid NPEs for patents, the sheer volume of patents on the market makes it a difficult and expensive task even for these industry giants to consistently identify and clear the assets of greatest risk. For smaller companies, it is financially and logistically all but impossible to individually clear patent risk. Furthermore, even those companies that have sufficient capital are generally unwilling to pay too high a price to clear a patent because doing so clears the risk not only for themselves, but also for other operating companies – often their competitors – that are also possibly infringing the patent in question.

The key to making this open market work, then, is to ensure that a handful of well-capitalised NPEs can't dominate and distort it. RPX's belief is that the collective buying power of all technology-based companies can achieve the necessary scale to operate on equal footing with NPEs in the open market for patents. By pooling capital in RPX – which employs our expertise and resources to buy on behalf of all 120 members of our network (as of the end of Q2 2012) – the participating companies are both sharing the cost of clearing patents and expanding their buying power. And because individual patents almost always are a threat to multiple companies, such cost-sharing across the network is the most logical way to buy high-risk assets and efficiently clear the risk for all companies.

You actually worked for Intellectual Ventures before joining RPX. What was behind the move?

The experience of our founders in the patent market made clear the need – and financial potential – for a business model that could rationalise a highly inefficient and wasteful ecosystem.

How does RPX analyse patent risk for companies and what solutions are there?

We have an array of proprietary methods for analysing portfolios available on the open market, NPE behaviour, litigation trends, and other contributors to patent risk. We use our analysis to work with our clients to ensure that we minimise that risk and maximise the ROI on their annual subscription fees.

RPX also uses its access to a broad set of industry and company data to provide our clients with insight on the patent market overall. We share our analysis from these kinds of broad-based projects – such as the *NPE Cost Study* we administered with The Coalition for Patent Fairness and other ongoing internal research on NPE behaviour, general litigation trends, etc, – with our clients and make our findings available through our Client Portal.

Patent trolls are quick to adapt. What advice do you have for companies to not become their next target?

Patents are becoming more relevant in the market place, so companies need to make patent strategy a key element to their business. Being proactive is the key. Waiting to receive an assertion letter from an NPE is waiting too long. Be prepared. Specifically, companies should start building a body of knowledge. What companies in your sector have been sued? What NPEs are targeting companies like yours? How aggressive are they – do they seek pre-trial settlements or do they prefer to litigate for large awards? The more you know, the better prepared you can be.

And once a company has a better understanding of the risk it faces, it should begin assessing its options to reduce that risk. So in addition to doing a better job of tracking pertinent patents as they come on the market, also consider available strategies to clear them and prevent NPEs from monetising them. Can you afford to buy high-threat patents yourself? Can you organise logical syndicates of other at-risk companies? Are there other risk-sharing mechanisms that fit your budget and strategy?

There are many possibilities. What is important is that companies recognise that the NPE threat is real and present. It is only going to grow. The time is now to start thinking about which of the possible responses makes the most sense.

Footnotes

1. https://www.eff.org/sites/default/files/SHIELD_ACT_0.pdf.
2. http://www.patentfairness.org/media/press/#2012-06-26-1.

Author

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