

THE CHANGING NPE LANDSCAPE

New Strategies & Best Practices

A White Paper published by WolfeSBMC Law Firm

By Jennifer C. Wolfe, Esq., APR, SSBB

© July, 2011

Overview

Companies large and small have, with increasing frequency, become the target of non-practicing entities (a.k.a. patent trolls, patent aggregators or privateers), offering a license to use patents they own solely for the purpose of licensing. The price – usually a little less than it would cost to litigate, sometimes even lower. Emerging technology companies backed with venture capital are usually targeted right when they are about to be acquired or register an initial public offering and the NPE knows they can leverage the company's need to close the deal. Large companies are usually targeted by industry segment en masse. Once largely reserved to the technology sector, NPEs have begun to seek licenses from consumer products, retailers and even business-to-business solution providers.

Some companies have tried to set hard line rules that they will not settle these claims and spend millions litigating to avoid becoming an easy mark. Others simply pay the fee and move on. Regardless of your company's historic position, the industry of the NPE is changing. After attending the global IP Business Congress in San Francisco in June of 2011, it is evident a clear business strategy and process to respond to these demands under the new NPE regime is essential. This is not a short term problem – it is a burgeoning industry that will not go away, but expand and evolve. There are databases, crowdsourcing tools, and yes, even the NPEs themselves are becoming resources for companies facing these demands. But to understand the best strategies, it's helpful to put the industry in context with a little history lesson. How did this all come about?

THE CHANGING NPE LANDSCAPE

New Strategies & Best Practices

By Jennifer C. Wolfe, Esq., APR, SSBB

The History of the NPE

Traditionally, companies that made products, whether consumer goods, manufacturing, pharmaceuticals, software, or hardware, would develop a patent portfolio for two to three reasons. First, to protect proprietary competitive advantages for itself (offensive); second, to build an arsenal of patents to use if sued by a competitor (defensive); and third, simply to prevent a competitor from using something they had developed and thought could have value (market domination). Companies, in this vein, would often cross-license technology when disputes arose among competitors.

In the mid-1990s (coincidentally the same time the increased USPTO maintenance fees began to kick in for patents issued in the tech boom of the 1980s), companies began to donate unused patents to universities, hospitals and research institutions, utilizing an IRS rule from 1954 which allowed for a tax write off of the value of the donation. Using creative valuations, companies leveraged this to their economic benefit through 2004. Universities and non-profit organizations benefited from the donations to further their research

activities, the corporations benefited from the tax write off, and society benefited from the development of important new technologies that would develop from this partnership. Unfortunately, Congress found this to be a loop hole for corporate taxpayers and enforced greater scrutiny under the American Jobs Creation Act of 2004 on the valuation process to avoid excessive valuations. While donations could still be made, the economics changed dramatically for large corporations.

In an overlapping trend, shortly after the dot-com bubble, in 2000, Kevin Rivette and David Line wrote *Rembrandts in the Attic*, advocating that patents were untapped valuable assets that could boost a company's shareholder value, financing power and revenue. They, along with others, launched a new industry of strategists and consultants whose sole function was maximizing value of IP for companies. Not surprisingly, rather than battle the IRS over the value of patent donations, companies began selling and licensing their patents as a source of revenue. IBM was one of the first of many to generate substantial licensing revenue from its previously unused patent portfolio. But, there wasn't exactly a marketplace or clear valuation standard for patents. In the

American way, a few entrepreneurial companies popped up to fill this need – Ocean Tomo was formed in 2003 – it is now the leading financial services companies for IP including auction and valuation services.

Intellectual Ventures, the largest NPE among

this new industry, was formed in 2000, though its business model appears to have evolved and changed over the last 11 years. Many others, some large, some small, have

continued to form over the last decade such as Webvention, Round Rock Research, and most recently Innovatio IP Ventures. Popping up overnight, a new company will form, obtain financing from investors, and then acquire large blocks of patents from companies looking to leverage their “Rembrandts.” The NPE is off and running, sending “friendly” letters inviting you to take a license for something you had no idea was patented. Most companies have received these letters sporadically and responded to them one at a time over the years, but something important is going on that will change the way you think about the NPE.

In an effort to change the public perception of as trolls or privateers, some NPEs have repositioned themselves as invention or innovation companies. They are here to help society, not hurt. They want to invest in invention and new development. Rather than build a product and sell it, they will create technology that others need and license it to them. Whether or not it will work remains to be seen. One thing is for sure – this is now an industry. An industry of invention – coined as invention capitalism – is evolving from the patent troll. The revenue model is to extract license fees from others who either willingly seek out the patented technology via a license or from those who have to be sued for infringing on it. The frequency of the letters requesting a license will increase. The quality

of the patents protecting the technology will also improve with increased funding and resources available to the NPE. Intellectual Ventures, since its founding, continues to be one of the leading filers of US patents that are invented internally – they aren’t just buying them, they are creating them for the purpose of licensing. In 2009, they filed 1,000 applications for in-house development – that number continues to increase. Further, when NPEs acquire or invent similar patents in large groupings to cover an invention or idea, in the aggregate, it can be difficult to circumvent.

It’s no longer sufficient to simply say we’re going to litigate everything to prove we’re not an easy target. You are an easy target. Litigation will only cost you more money and still doesn’t solve the problem.

So – What’s the Plan?

The NPE is now an industry – not a few rogue players in select jurisdictions. The major players are better funded and have more in-house patent attorneys than some of the Fortune 500. It’s not going away. As a law department, how will you manage this risk? How will you handle the letters and demands? It’s no longer sufficient to simply say “we’re going to litigate everything to prove we’re not an easy target.” You are an easy target. Litigation will only cost you more money and still doesn’t solve the problem. Your industry, and whether or not you are a company that is in the business of developing a patent portfolio, will drive your strategy. Regardless, a few processes will be required along with a formula for measuring risk. You need to know the tools available, how to efficiently analyze your position and strategically determine your process for responding.

Process & Risk Identification

To start, you’ll need to develop a categorization scheme to evaluate demands and letters as they come in. Every company will have a slightly different strategy based upon whether or not you are in the business of IP, but generally, you’ll want to look at the size of the NPE – is it one of the big players with lots of funding or a small garage inventor with

an attorney in the family? Is it just one patent or a family of patents? How easily detectable is infringement? Can you partner with other

It may sound crazy, and with the bad press the NPEs have received many companies might find it distasteful, but it can't be denied – it's a strategy that is available. It's the old, if you can't beat them – join them!

targets of this NPE? In a quick gut check and read of the patent, is it possible you are using it in some way? A standardized

risk assessment methodology will be needed to categorize the demands you receive.

From there, you will have different levels of investment to make in analyzing the strength of the claim. For high risk demands, you will spend more time and money. For low risk demands, less time and money – a triage of sorts for patent license demands. There are a number of tools that you can then have in your tool box to assist in cost effectively analyzing the demands and guiding decisions.

Given the likelihood that the demands you receive will increase, it's a good idea to develop a corporate policy on how to respond

to these demands that fits strategically within your risk management plan to provide some predictability in terms of budgeting. Using decision tree analysis, you can effectively build out how you make decisions on a consistent basis with a clear and well developed process and methodology.

On a long-term basis, your company can, of course, continue to lobby legislators to change the patent laws to address this problem. The likelihood of any short-term results from that effort is minimal to non-existent, but it is another option available as a long-term strategy.

Build Your Toolbox

There are tools developing that can help you in your analysis. Traditionally, hiring an outside law firm to rubber stamp an opinion of non-infringement or invalidity is in the 5-6 figures easily. With the increasing frequency of the demands, that's not realistic. Additionally, even if your company has an army of patent attorneys, they are likely busy doing other things and can't necessarily respond with diligence to each of these demands within the

Once you categorize the risk and run the analysis, you have only a few options:

1. Pay the license fee, cautious to negotiate no admission of infringement and confidentiality of your company as a licensee. You will also want to ensure you have a clause to prohibit this NPE from targeting you again in the near future – there is usually an acceptable window of time in which they will not assert another license against you.
2. Refuse a license based upon non-infringement or invalidity and then budget for litigation.
3. File a Declaratory Judgment action based upon either non-infringement and/or invalidity. If invalidity is an option, reach out to others in your industry likely to be a target to evaluate sharing costs. There are new tools to help in evaluating on a cost effective basis if this is a good option.
4. If you have it available, offer up patents in your portfolio that may be of interest to the NPE. They are in the business of invention, so if you have patents you aren't using, they may find a nice quid-pro-quo.
5. And, a new option, hire another NPE to provide a license to a patent or family of patents that can provide an argument of non-infringement.

short time frame often given to you in the demand letter.

Accordingly, the process you develop, along with finding the right law firm using the right tools can cost effectively allow you to manage these demands more effectively. Just a few of the resources and services available now include Article One Partners, Intellectual Ventures (yes, they are an NPE, but they have solutions), Chipworks, Innography, CPA Global, Minesoft, Questel, and many others. These companies are developing tools, databases and new strategies to uncover prior art, including often obscure but valuable references in a more cost effective manner. They also provide reverse engineering and access to patent licenses that may be useful in responding to NPE claims. We have developed a detailed analyst report of these service providers along with recommendations to tap into these tools with value added strategic thinking.

Stop the Problem Where it Begins

In addition to putting in place a clear strategy and process for responding to license demands, you can also try to cut off the problem where it begins – in development. If you can more effectively vet development ideas before they go live, you may be able to minimize your continual exposure to these demands. Most NPE claims are in the e-

commerce, social media or via mobile technology where infringement is easily detectable. Auditing your processes for development and implementing gates for evaluation of potential infringement in time to make a difference in the roll out can minimize the extent to which you run afoul of existing patents. Again, the tools in your toolbox may help do this more cost effectively. Further, if you use mostly outside vendors for development, you may want to require them to attend an IP certification course that educates them about how and when to check for potential infringement issues. Wolfe SBMC offers a certification course for vendors.

Join the Industry of Invention Capital

A final option is to recognize this as a new business opportunity that is critical to not only defending yourself, but potentially finding sources of new revenue and leveraging the research and development you fund within your organization. As you develop your own technologies, evaluate how you can maximize your return on them by partnering with the NPEs. Or, rather than develop on your own, simply seek out the NPEs from the outset and license the technology. It may sound crazy, and with the bad press the NPEs have received many companies might find it distasteful, but it can't be denied – it's a strategy that is available.

Jennifer C. Wolfe, Esq., APR, SSBB

Wolfe is the Co-Managing Partner of Wolfe-SBMC, an intellectual property boutique law firm with offices in New York City, Cincinnati and Spokane serving leading global companies. She is nationally accredited in public relations, a Six Sigma Black Belt in process improvement and recently named one of the world's leading intellectual property strategists by *IAM Magazine*. She is the co-author of *Brand Rewired*, a top selling product management book published by John Wiley & Sons in 2010.