Patent Trolls and the New Tort Reform: A Practitioner’s Perspective

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Abstract: Conventional wisdom holds that most software suits are being prosecuted by so-called patent trolls seeking quick, lucrative settlements on frivolous patents. But the reality is quite otherwise. Bad patents make for bad cases, and even the best lawyers lose bad cases. Given the complexity and cost of patent litigation, frivolous cases are the rarity, not the rule. The perception to the contrary reflects not the underlying reality, but rather the very effective lobbying of several larger “Patent Fairness” organizations, whose members are the very large technology companies most frequently defendants in these cases.

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I. INTRODUCTION

In the sleepy village of Santa Clara, there lived a very wealthy but very frightened giant named Intel. Intel was plagued by a fearsome band of evil trolls—patent trolls, to be exact—who wanted a glittering pot of gold in exchange for doing absolutely nothing. And they were very powerful because they said they owned the patent on some of the magic Intel used to become rich.1

So it began with a clever article in 2001 about Intel and its patent troubles in a San Francisco legal newspaper. In the years since, the existence and attributes of patent trolls have become articles of faith, the enduring stuff of urban legend.2

We are told these trolls “coerce law-abiding companies to pay large licensing fees” by filing frivolous suits.3 Honorable companies are “being held ransom by tiny outfits whose only assets are ‘kooky and vague’ patents.”4 Frivolous patent suits are described as a tax on the system, even a serious threat to innovation itself.5 Patent litigation is seen as “basically mugging someone,”6 and patent

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2 And the subject of legislative “reform,” currently underway.


plaintiffs "modern day highway robbers." It is "patent terrorism," a "cottage industry of extortion."8

Come, now—gold may be good, but extort money from the likes of Microsoft and Google by filing frivolous patent suits? These companies are many things, but stupid is not one of them. Of course there are bad patents. But bad patents make for bad cases, and even the best lawyers lose bad cases. Far from being a "simple and effective source of illegitimate profit," filing frivolous patent suits is a fast track to a Chapter 11 filing.

The proof lies in the numbers. Take Acacia Research Corporation, perhaps the patent troll poster child. This intellectual property holding company reported gross revenues of just $34 million in calendar year 2006, about what IBM makes in a week licensing IBM patents. Yet, Acacia is an extortionist and IBM an icon. What gives?

Large technology companies devote sizeable sums of money to innocuously named lobbying groups seeking "patent reform," like the "Coalition for Patent Fairness," (is anyone really for patent unfairness?) and the Orwellian "Business Software Alliance" or "BSA." These organizations have done an extraordinary job building the perception that the patent system is broken, the economy is clogged with bad patents, and that something desperately needs to be done right now. In terms of the calculated misimpression created, a more accurate name for these organizations would be the "Coalition to Immunize Large Infringers from Pesky Patent Suits."10

These efforts may still prove successful in reshaping patent law since that process is yet underway. But the attacks and mischaracterizations have already been successful in a subtle, but important way: in shaping the way federal district court judges view patent cases, especially software cases. This outcome may have been the real object of the exercise all along.


10 And their motto could be, "Hey! We could have invented that."
Consider this: if a federal judge believes that the patent system is broken and most software patents suspect, that judge is likely to approach patent cases with considerable skepticism. Such skepticism can change the way the court thereafter views claim construction, enablement, invalidity, and now—importantly—obviousness. A judge who believes that the patent system is broken may be significantly more inclined to grant an obviousness summary judgment motion than one who believes the patent system basically valid, with a few aberrant patents on the margin. In patent cases, judges are becoming powerful gatekeepers, just as they did in antitrust cases post-Matshushita. Tort reform has now settled on patent law.

In short, perception matters. But, unhappily (at least for some), perception about patent trolls specifically, and patent litigation generally, just does not accord with reality. From the perspective of an intellectual property plaintiff’s lawyer, the view from the trenches is much different. Here’s why.

II. MYTH ONE: PLAINTIFFS WILL BRING FRIVOLOUS PATENT CASES

Perhaps the most common refrain in the patent debate is that plaintiffs will bring frivolous cases to extort unjustified settlements. The following over-heated quotes are quite typical:

- "[F]rivolous patent holders . . . intimidate true innovators into paying protection money."  
- The "unpredictable legal environment has encouraged legitimate companies threatened by patent trolls to pay large settlements . . ."  

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11 A monkey with a typewriter can get a patent. Look at 6,368,227 (swinging technique) and 6,004,596 (sealed, crustless, peanut butter sandwich). See U.S. Patent No. 6,368,227 (filed Nov. 17, 2000) and U.S. Patent No. 6,004,596 (filed Dec. 12, 1999).


15 Patent Quality Improvement, supra note 9, at 5.
The present patent law is subject to abuse by patent holders who go fishing for infringers, or worse, coerce law-abiding companies to pay large licensing fees."  

"Google and other technology companies increasingly face mounting legal costs to defend against frivolous patent claims from parties gaming the system to forestall competition or reap windfall profits."  

"Patent trolls invent nothing and produce nothing. They do not contribute innovation to society. Rather, they exploit flaws in the patent system by purchasing excessively broad and questionable patents on ubiquitous software and e-commerce technologies, and demanding payment from many who use them. They give nothing to the economy or society; they only take for themselves."  

"Technology companies are often subject to suits by persons more interested in reaping a quick buck through settling the suit rather than exercising their patent."  

These perceptions are all terribly naive. A frivolous patent case remains just a frivolous case. Smart companies, particularly those frequently sued, do not settle frivolous cases. While doing so might save money against defense costs in one case, the cost of being seen as a soft settlement touch will be brutally expensive across the entire

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16 Patent Law Reform, supra note 3, at 3.


litigation portfolio, reaching ever into the future. A big technology company simply cannot afford cheap settlements.

Take Microsoft, for example: at any given time, Microsoft is defending literally scores of patent cases. Invariably, the company will conduct a pragmatic litigation risk assessment of the claim, determine the claim's real value, and settle for that much and no more. If a claim is truly frivolous, Microsoft will not settle, period. If the plaintiff does not understand that, or wants more than a non-frivolous claim is worth, Microsoft will pay several of its hundreds of retained lawyers to try the case; it does so frequently all over the country. This is just good business.

Now, what does this mean to the aspiring plaintiff's lawyer? The cost of building and trying a patent case can easily exceed $4 million. No sane plaintiff's lawyer would spend this kind of money on a frivolous case. Even if the plaintiff had a good claims construction; survived repeated invalidity, anticipation, and obviousness summary judgment motions; prevailed at trial; and persuaded the trial judge not to take away the verdict post-trial, there remains the Federal Circuit. A frivolous patent claim will fair poorly in that court, especially today. Frivolous cases simply do not pay. To assert otherwise is to say that Microsoft, Google, Intel and others are irrational, which is, as the engineers would say, counterfactual.

Now it is one thing for Microsoft to spend $3 to $4 million defending a case—it can afford it. But it is quite another for a small intellectual property holding company and/or its counsel to spend $4 million and then lose—do that once or twice and the defense side starts to look very appealing.

For these reasons, a plaintiff's IP practice tends to be self-regulating and disciplined by self-interested economic rationality. A plaintiff's lawyer simply does not have the power to extort unwarranted settlements in weak cases. To the contrary, a company that carefully invests in its reputation as being slow to settle and expensive to sue may well have the ability to settle claims at a discount relative to the risk-weighted litigation value. These practical realities mean the central premise of the pro-patent reformers—that weak cases lead to extortionate settlements—is just flat wrong.20

20 Though there are silly cases. For example, a 2001 declaratory judgment complaint testing the fairly notorious PB&J patent spouted off a multiyear fight that has yet to be resolved. See, e.g., Albie's Foods, Inc. v. Menusaver, Inc., 170 F. Supp. 2d 736 (E.D. Mich. 2001). The case involved U.S. patent 6,004,596, "Sealed Crustless Sandwich," which was really a simple peanut butter and jelly sandwich, owned by a unit of jam giant, Smuckers. This is a ridiculous patent—and a profoundly silly legal proceeding—but one hopes the
But what of injunctive relief and the specter of shutting down a defendant’s business? “The trolls can use these patents to threaten to shut down the entire computing industry with a court order injunction, no matter how minor the feature that has been patented is.”21 Typical of the criticism is the following from a CNET article captioned “The Shakedown Is On”:

[T]rolls can seek an injunction on a company’s product shipments even though the trolls have no customers or market share to lose. This unfair and ethically questionable advantage is rapidly emerging as one of the biggest threats corporations face today and could radically hamper the very nature of innovation.22

Hardly. Getting an injunction on behalf of a perceived troll on a minor feature incorporated into an important software product is somewhat like trying to teach a dodo to fly: the bird was flightless and is now extinct. It just will not happen. Given all the hysteria about injunctive relief and consequent settlement leverage, how often has a court actually entered an injunction on behalf of a perceived troll to shut down an ongoing business? I know of no case, though perhaps the now-notorious RIM case came closest (injunction threatened but not in place).23 One case out of thousands hardly constitutes a litigation crisis.

To put it differently, to secure an injunction, the plaintiff will have to persuade a district court judge that the patent is strong, the likelihood of prevailing great, and the injunction necessary, fair, and just (and, as a practical matter, not sought to leverage a quick settlement). If the plaintiff makes this showing, why should the injunction not be issued?

Another frequent anti-patent criticism rests on the notion that a portfolio owner can readily spew out scores of infringement notice letters and demand modest sums for a license, which the recipients will pay given inherent litigation cost and uncertainty. The articulated point here is that it is sensible, from the would-be defendant’s

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21 Shiels, supra note 7.

22 Beyers, supra note 5.

23 NTP, Inc. v. Research in Motion, Ltd., 418 F.3d 1282 (Fed. Cir. 2005).

patent holder and its lawyers make this kind of mistake only once. See U.S. Patent No. 6,004,596 (filed Dec. 12, 1999).
perspective, to pay a several hundred thousand dollar troll toll to avoid more expensive litigation, even if the patent claim is weak.

Once again the reality is otherwise. If the patent claim is weak, and if the patent holder is looking for a modest license, this means that the claim organically has little value. While the defendant may not want to spend significant sums on lawyers defending the case, why would the defendant think that the plaintiff is willing to make an irrational decision and spend millions of dollars prosecuting a weak claim against an individual defendant or defendants? If the patent holder sues numerous defendants together, there is strength in numbers, and great economy of scale, and the joined case can be defended economically. In fact an often smart defense that moves on receipt of such a shakedown letter would be to immediately file a declaratory relief action in a remote jurisdiction of the defendant's choice. It is one thing to write blustering letters but quite another to spend money on counsel defending a declaratory relief action far, far away.

At the end of the day, it is simply wrong to say, as the patent critics do, that the area is rife with silly suits that somehow, paradoxically, produce rich returns. It is just not so, which brings us to myth two.

III. Myth Two: Patent Trolling is a "Very, Very Profitable Business Model."24

Another firmly held belief is that the patent trolling and litigation business is fabulously profitable. For example:

- "Several problems contribute to making this 'patent troll' business model a simple and effective source of illegitimate profit irrespective of the quality of the patent."25

- "The key to the new industry's success has been a small, yet aggressive, army of lawyers who help enforcers hammer companies with infringement claims. And the attorneys, like the

24 Shiels, supra note 7.

25 Patent Quality Improvement, supra note 9, at 3.
patent enforcement shops they represent, are getting rich—very rich."26

Well, this too is more myth than reality. While there are outliers, the patent trolling business is just not that lucrative. Take Acacia Research as an example—here are the numbers: in fiscal year ("FY") 2006, Acacia recognized license revenue of $34.8 million. This compares with FY05 revenue of $19.6 million, and FY04 revenue of $4.3 million. All-in, over the last three years (which represents the most fevered part of the patent troll debate), this leading patent troll grossed just $58.7 million, less than $20 million a year in gross revenue enforcing a patent portfolio covering thousands of patents held by 39 separate Acacia companies.27 It would be interesting to compare this sum to what the members of the BSA spent on that organization and related lobbying efforts over the same period.

Acacia’s revenues did not come cheaply. The company’s 2006 annual SEC Form 10-K filing notes an “increase in patent related legal expenses in 2006, as compared to 2005 ....”28 This increase reflected two underlying factors: (1) a “net increase in the number of ongoing patent enforcement litigations in 2006 compared to 2005”; and (2) an increase in the number of outside law firms engaged on “an hourly or discounted hourly basis.”29

These trends are revealing and likely bode poorly for Acacia. Fewer defendants are settling, litigation is growing more commonplace and expensive, and likely more risky (note the increase in lawyers who insist on at least an hourly component: one test of the validity of a patent claim is whether IP counsel are willing to take the case on a pure contingency basis). Some of this undoubtedly reflects the pillorying Acacia received in the press as a patent troll.

Acacia’s legal expenses are also increasing. In 2006 it spent about $7.5 million on contingency counsel, and another $4.5 million on hourly counsel and case costs. After paying the lawyers and the inventors (often on a royalty revenue share basis30), there just is not

26 Sandburg, supra note 1, at 1.

27 Acacia Research Co., Annual Report (Form 10-K), at 1, 2 (Mar. 16, 2006).

28 Id. at 70.

29 Id.

30 And one would assume that the inventors are demanding higher royalty share percentages, given all of the press about lucrative troll activity, thereby squeezing Acacia between the lawyers and the patent owners.
much left for this troll. Over the five year period 2002–06, Acacia Technologies Group lost close to $35 million. This is hardly a "very, very profitable business model."\(^{31}\)

At the end of the day, Acacia's principal victims are likely to be its shareholders. As technology essayist Paul Graham\(^{32}\) notes, the way to make money in technology business is to sell products, not license patents.\(^{33}\)

The reality of patent trial verdicts also far favors the defense side. Of the patent verdicts available in trials to verdict in calendar years 2005 and 2006, the medium verdict was just shy of $4 million.\(^{34}\) Based on the statistics, in 2005 and 2006, a patent holder who survived summary judgment and won at trial, recovered just about what the case cost to prosecute and try.\(^{35}\) This is very much a pets.com model for making money in the litigation business. The remarkable thing is that plaintiffs' lawyers are even willing to take on patent cases.

There are, of course, some rather notable exceptions, most notably aggressive litigants who do make huge sums of money enforcing IP portfolios. But these are not the Acacia's of the world; they are companies like IBM and Texas Instruments, which brings us to myth three.

IV. MYTH THREE: PATENT PLAINTIFFS ARE SMALL, OPPORTUNISTIC SPECULATORS

Another firmly-held belief is that patent trolls are small, opportunistic speculators who buy portfolios of patents for modest sums, and then use them as litigation fodder. Once again the reality is otherwise. As many have observed, IBM's patent licensing revenue is stupendously large: does a troll cease to be a troll when it grows to be a giant?

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\(^{31}\) Sheils, supra note 7.

\(^{32}\) Paul Graham's technology essays are well worth reading. He is often right and always lucid.


\(^{35}\) Id. at 19.
Consider, too, Texas Instruments ("TI"). This company is one of the first to see the wisdom in enforcing its patents by filing infringement cases in the Eastern District of Texas, which sits in Marshall, Texas. And this strategy worked; for example, TI won significant cases and closed very large licensing agreements in 1999 and after.\textsuperscript{36} Was TI acting immorally by filing suit to enforce its intellectual property rights? If not, then why was Burst.com acting immorally when it sued Microsoft (and now Apple) to enforce its IP rights?

For that matter, even Microsoft—a charter member of the BSA—has been making noises about suing the open source community, alleging that Linux violates "more than 200 of Microsoft's patents."\textsuperscript{37} Microsoft evidently sees nothing inconsistent in complaining about patent trolls on the one hand while threatening to sue the open source community on the other. To Microsoft, as a plaintiff, it is a matter of principle and honor: "We live in a world where we honor, and support the honoring of, intellectual property . . . . [Others] have to 'play by the same rules as the rest of the business' . . . . 'What's fair is fair.'"\textsuperscript{38} One problem here is that "fair" is entirely situational. To Microsoft as plaintiff, it is about honoring intellectual property; to Microsoft as defendant, it is about patent trolls and shakedown litigation.

All of this leads to a fairly profound point: a patent troll is always just "the other guy." It is noble to sue and ignoble to be sued.

V. MYTH FOUR: PATENT TROLLS EXPLOIT "RENEGADE" JURISDICTIONS

This myth is at least partially true. Without question, plaintiffs have been flocking to the Eastern District of Texas (Marshall) since 1999. Texas Instruments started this trend by filing significant patent

\textsuperscript{36} See Texas Instruments: Cross-license Agreement Expected to Bring More Than $1 Billion to TI Over Next 10 yrs., M2 PRESSWIRE, May 25, 1999, http://findarticles.com/p/articles/mi_hb5243/is_199905/ai_n20210692 (a license agreement projected to produce royalty payments of $1 billion following a jury trial in the U.S. District Court for the Eastern District of Texas, concluded in March 1999 in TI’s favor).


\textsuperscript{38} Id. Along the same lines, Toshiba recently filed suit against numerous companies, alleging DVD patent infringement and seeking damages and injunctive relief. A troll too?
cases concerning semiconductor chips, which resulted in very substantial settlements.\textsuperscript{39}

There were very real reasons to file in Marshall. First, Judge Ward had established a binding set of patent rules that moved cases toward trial quickly; some (defendants) would say too quickly. Second, juries in Marshall (and in nearby Tyler, Texas) proved receptive to plaintiff patent cases, presumably believing in the sanctity of private property and the inherent value of a blue ribbon patent. Statistics show a significantly higher plaintiff win rate in Marshall, although defendants do prevail at trial there, especially lately.

But all good things come to an end, and so too for the Eastern District of Texas. The district has been too successful in attracting patent cases, and the rocket docket is beginning to slow, markedly. For example, in the last twelve calendar months, Judge Ward received 140 new patent cases. These are in addition to his existing docket. With 144 new cases alone, one wonders how the court can manage the docket, run claims construction hearings, issue thoughtful opinions, and conduct trials.

In short, filing in Marshall is very much like buying Google stock—perhaps a better idea three years ago.

\section*{VI. Myth Five: There Has Been a Flood of New Patent Cases}

Another article of faith is that the bankrupt patent system has resulted in a flood of new patent cases. But this too is not exactly right. In the past 30 years, the number of patent cases filed has approximately tripled. Given the ever increasing importance of intellectual property in today’s economy, a tripling of cases over 30 years hardly seems a flood of new litigation.

Perhaps more importantly, however, any “flood” has now begun to recede. The number of patent cases filed increased every year from 1991 to 2004 (beginning with 1,171 cases per year in 1991, and topping at 3,075 per year in 2004). But, in 2005, the number of patent filings fell almost 10%. That is, after 15 years of year-after-year increases, the number of patent cases actually declined in 2005.

Were the central tenants of the anti-patent lobby true, that is that weak cases produce lucrative returns, patent filings presumably would continue to increase. Instead, the drop in 2005 seems evidence that the demonization of the patent system has begun to dissuade would-be plaintiffs.

\textsuperscript{39} Texas Instruments, supra note 36.
VII. MYTH-MAKING: THE BSA AND THE COALITION FOR PATENT FAIRNESS

The current misperceptions about “patent abuse,” and the reciprocal need for “patent reform,” did not spring into being unbidden. To the contrary, these myths have been carefully inculcated by the BSA and its companion organization, The Coalition for Patent Fairness. Beginning many years ago, both organizations lobbied to create the impression that patent abuse warrants reform. Typical is the following: “One of the top legislative priorities for BSA is patent reform. . . . Reforming the existing patent system will also alleviate troublesome elements from patent litigation, resulting in a reduction of the costly and disruptive effects of abusive patent practices.”40 “Troublesome elements”? This McCarthyesque vernacular is significant. Time and again, the anti-patent organizations have heralded the “fact” of abuse and reciprocal need for reform. After years of repetition, many accept both assertions as true.

At bottom, what is really at stake here is the integrity of the software patent system generally. The twin anti-patent organizations are just that: anti-patent. Their goal is not to somehow winnow out good from bad cases early on, nor ride herd on over-zealous plaintiff’s lawyers. Instead, they intended to eliminate software patents themselves. The first phase has been the attack on abusive patent suits; the second phase will be an attack on bad patents (already underway); and the third phase will be a legislative or judicial rejection of patents in the software area entirely. This is, without question, the goal.

VIII. CONCLUSION

Recognizing a job well done, Google, Microsoft, Intel and their ilk have demonized the patent system extraordinarily well. But what is good for these large technology companies is, in this instance at least, not good for America. When investing in innovation is bad business, businesses will not invest in innovation. And that is bad for us all.