The patent plot thickens

Tam Harbert - June 29, 2010

To hear some high-tech companies talk, patent trolls are dirty and evil. They hide under bridges, coming out only to attack innocent victims. Even the less colorful and more politically correct term - non-practicing entities (NPE) - conjures an image of an office full of bums who do nothing constructive for society.

It's a moniker that small patent holders don't like. "Since when does practicing anything have anything to do with your property rights? It's like saying you're not using your car, so I'm free to use it," said Dennis Fernandez, managing partner of Fernandez & Associates, an IP law firm that represents small inventors such as universities and early-stage venture capital funds. "You may have a piece of beachfront property you're not developing, but that doesn't mean Hilton can come in and build a resort on it."

But in the last couple of years, some in the high-tech industry have co-opted the NPE model. Organizations like RPX and Allied Security Trust (AST) have emerged as defensive patent aggregators. They are trying to protect their members, which are primarily large high-tech companies, by buying patents that they think NPEs might use to assert against the tech titans and thus squeeze them for money. This type of defense has proven to be an attractive alternative. AST, a non-profit consortium that started in 2007 with approximately six members, now has 18. RPX, a for-profit company, was started in September of 2008 and in early 2009 had just five members. Now it has more than 40 clients and has purchased more than $200 million in patent rights.

And yet these efforts don't seem to have made a dent in the number of NPE-related patent litigations. Indeed, RPX did a recent study of 60 top technology companies, and found that 80 to 85% of all patent litigation at these companies was NPE-related, said John Amster, co-founder and CEO of RPX. That compares to about 16% in general industry. In looking specifically at semiconductor companies, RPX said that 57% of all semiconductor patent suits in the last five years were filed by NPEs. And it's getting worse. The number of NPE cases filed against semiconductor companies increased 59% from 2008 to 2009, according to RPX, and already in the first quarter of 2010 there were more than half as many cases as in all of 2009.

Why the huge increase? If the patent aggregators were successful, shouldn't we be seeing fewer lawsuits? It seems that the more attention paid to the value of patents as assets, the more investment money is flowing into buying patents and litigating them. In fact, these defensive aggregators have simply joined a growing number of entities that are experimenting with different ways to profit from patent assets.

"It's become a very attractive area for investment," said Amster. "There is a fairly regular supply of patents available, the pricing for patents is good in light of the potential returns you can get if you're willing to take on the risks of suing." And in downturns like we've just gone through, it can become even more attractive. "It's an uncorrelated investment type," he said. "It's not correlated to the
general market risk."

Nobody seems to be tracking exactly how much money is flowing into this market, but everybody agrees it's a lot. RPX estimates that investment has totaled $8 billion to $10 billion over the last five to six years.

Just how that money flows is also hard to track, probably because many of the organizations involved don't want it publicized. Several of the NPEs are backed by major financial institutions, according to Bruce Berman, CEO of Brody Berman Associates Inc, a management consulting and communications firm that focuses on the IP market. But they don't want it known because of the bad connotation associated with NPEs. In addition, major technology companies sometimes use NPEs themselves, said Berman. They have a shareholder obligation to get as much value from their patents as possible, and yet they aren't inclined to sue their customers or business partners. So in some cases, they sell those patents to NPEs, and then the NPE can then pursue alleged infringers.

Meanwhile, a one-man patent holding company called SITI-Sites has filed suit against AST and member companies Verizon, Cisco, and Ericsson, accusing them of conspiring to drive down the cost of buying and licensing patents in order to force small patent owners and licensors out of business.

Dan McCurdy, CEO of AST, said that the suit is "completely baseless. At best, the plaintiff is badly misinformed about the trust and our activities."

But Robert Aronoff, managing director of Pluritas LLC, an IP broker and management consultant, said he sees a need to broaden the number of patent buyers on the market beyond what he calls "corporate interests." He noted that some large companies are members of both RPX and AST, plus they might be participating with financial groups that are shopping the market. That way they could conceivably be bidding for the same patents from within several different groups, and thus could pick the best deal. "There are only a few groups that are out there buying these patents," which means they have a lot of market power, said Aronoff. "If the patent sellers are limited to the established buyers, then that discourages competition and the sellers are going to get subpar outcomes."

Aronoff sees this as an opportunity for his company to move from being an IP broker to becoming an "IP merchant bank." In addition to offering patents for sale on the market, his firm packages the patents in ways that make them more attractive to traditional financial investors, including having the patents vetted by a law firm. "There are large private sources of capital that will invest in litigation," he said. "They understand the investment opportunity."

Berman thinks all this activity is good for innovation in general. "Companies steal a lot," he said. "Some of it is unwitting. Much of it is not. But you have to catch them, and until recently the capital wasn't there, and the law firms were not interested. Now they can hold big companies' feet to the fire."