

How Sun Tzu Would Outflank Patent Trolls

Much has been written about strategies employed by patent trolls. Many have opined about the tax they represent to operating companies. Others have lauded trolls for providing markets where inventors can sell their patents for reasonable returns. This article will focus on strategies—many from Sun Tzu, the ancient Chinese military strategist—that operating companies can utilize to outflank patent trolls.

Threat Assessment PatentFreedom reports that as of December 1, 2009, there were over 315 distinct patent trolls lurking around the world. Since 1985, these trolls have been involved in litigation with nearly 4,500 different operating companies in over 3,100 distinct actions.

Much of this litigation is taking place before juries—who are generally sympathetic to patentees—rather than before judges. According to research conducted by PricewaterhouseCoopers, where juries decided 22% of the patent cases with damages awards in the 1990s, the 2000s have seen juries decide 43% of the patent cases with damages awards. The success rates for plaintiffs in jury trials have consistently and significantly outperformed plaintiff success rates in bench trials every year from 1997 until at least 2007.

Furthermore, the median jury award has been shown to be significantly greater than the median bench award. In the 1990s, the median damage award by juries was \$2.6 million as compared to \$8.6 million in the 2000s. Finally, as jury awards have risen, the composition of damages has also changed. Over the last decade, reasonable royalties have overtaken lost profits as the basis of damages awards in patent cases.

Two-Pronged Master Strategy In assessing the factors underlying the success of the surge in Iraq, Generals David Petraeus and Raymond Odierno point to kinetic operations (in which the enemy was engaged) and non-kinetic missions (which were undertaken with the aim of shifting the fealty of the local populace from the insurgents to coalition forces). So too in tackling patent trolls, operating companies must be prepared to engage kinetically and non-kinetically.

Kinetic operations include preemptive strikes, deflecting attacks, conducting counter-intelligence, probing missions and selecting the battlefield. Non-kinetic activities include employing the media, industry associations, legislators and the judiciary to promulgate legislation and issue rulings aimed at defanging patent trolls.

Launch a Preemptive Strike Sun Tsu wrote, “The supreme art of war is to subdue the enemy without fighting.” Individual companies or patent purchasing groups such as Allied Security Trust (AST) acquire patents so that they will not fall into the hands of a patent troll. Highest on the patent purchasing groups’ target list are patents that have the potential to be widely asserted against members of the patent purchasing group. The Achilles Heel of such preemptive purchasing strategies is that it is prohibitively expensive for operating companies to acquire all of the patents that could be asserted against them. Also, the fees for induction into AST are outside the range of affordability for many companies: Allied Security Trust charges a membership fee of \$250,000 and requires members to deposit \$5 million in escrow to fund patent purchases.

Deflect the Attack This tactic entails shifting the threat of patent assertion upstream. This permutation of preemptive action calls for the operating companies to secure an indemnification provision in the licensing agreement from the technology vendor. Alternatively, licensing agreements can be drafted to stipulate that the vendor will take the lead in litigating on behalf of its customers.

Another variation of deflecting the attack is to convince the patent troll that your firm does not represent a high value target. This may be because little revenue is being generated from products in question, their claims do not read on the technology you practice, or your ease of designing around contentious technologies. Alleged infringers can also argue that under the principle of apportionment in damages assessments, theasserter would only receive royalties based on a fraction of the revenues generated by the product in question. Moreover, Matthew Fawcett, SVP and General Counsel of JDS Uniphase, believes that such arguments are more likely to persuade trolls to cease an assertion than arguing that the troll's patents are invalid or not infringed.

Rapid Force Mobilization Companies should establish practices and procedures for quickly responding to threats from patent trolls. For instance, demand letters addressed to division leaders or licensing professionals should be immediately forwarded to the firm's chief patent counsel. While there is an argument for ignoring demand letters (see below), companies should not stumble upon this stance as a matter of negligence.

There is a debate as to whether the leaders of the business unit accused of infringement or the corporate counsel should lead the organization's response. Knowing that litigation costs and settlement payments will be charged to their units, business division leaders may refuse to settle. However, once litigation gets underway, they and their colleagues often despise the time and annoyance associated with depositions and discovery. The related aggravation often causes division leaders to moderate their intransigence and become more dilatory in handling the related legal intricacies. Therefore, there is merit in establishing a policy whereby infringement issues are managed by a centralized corporate legal team.

While corporate counselors should realize that business people and research professionals were not hired (and are not compensated) for their ability to participate in legal processes, the corporate lawyers can better establish a consistent firm-wide policy of contending with patent trolls. Such policy should be designed to minimize the incidence of stranded litigation expenditures.

Minimize Collateral Damage Forward thinking organizations should take measures that would—at a minimum—reduce the risk of sustaining tremble damage. Being able to demonstrate that a rigorous survey of the landscape—conducted before encountering charges of infringement—revealed no risk of patent infringement should reduce the risk of incurring treble damages. It is thus advisable for companies to conduct reasonable searches when patents are to be incorporated into commercial ready products.

Opinions letters from outside lawyers are another shield that can protect a firm from treble damages. Despite the protective layer that opinion letters provide, there are two caveats. First, while failing to obtain an opinion letter could expose a company to shareholder lawsuits if its infringement was proved, the *Seagate* case holds that there should be no adverse inferences if a company elected not to obtain an opinion letter. Second, if companies choose to brandish opinion letters while defending their contention of no infringing behavior, they must waive attorney client privilege with respect to that issue. Thus, practices of shopping around for favorable opinion letters would be revealed.

Counterintelligence Activities Sun Tzu teaches us that, "If you know the enemy and know yourself you need not fear the results of a hundred battles." In the early days of trolling, information was asymmetric: the trolls had far more intel on the operating companies they targeted than the operating companies gathered on the trolls. Today, information can be much more symmetrical. When served with a demand letter, operating companies should conduct a threat assessment by learning as much as possible about their opponents.

The first step is to review the demand letter to determine the degree of the troll's professionalism and

investment in their assertion. Demand letters that reference which of the operating company's products are believed to be violating which of the troll's claims accompanied by a DVD demonstrating such contentions are more convincing than demand letters that contain a variety of alleged infringers sprinkled throughout as a result of sloppy cutting and pasting. A similar analysis should be conducted with regard to the level of granularity associated with trolls' complaints.

By relying on sources such as PatentFreedom and IP Law 360 targeted companies can piece together answers to questions such as those below to determine the lethality of the trolls.

- Is the target company the sole target of a specific troll, or one of a thousand?
- What are the sources of—and the extent of—funding the trolls receive?
- Which patents are owned or controlled by the trolls?
- How often have the trolls asserted their patents and against whom?
- What percentage of the troll's complaints proceeded to trial? What is their settlement history? How long, on average, do trolls pursue infringers before reaching settlement?
- Is the troll a rational or irrational actor?
- Which law firms are retained?

Joseph O'Shea, Director of Open Innovation at Danaher Corporation, points out that latent semantic filtering searches are much more effective in detecting prior art than traditional bullion (keyword) searches. The former technology was developed in the aftermath of the terror of September 11, 2001 to detect coded threats that exist in electronic communications. Latent semantic filtering is designed to read on the some 300 methods that the brain uses to make associations. The importance of latent semantic filtering for purposes of digging up prior art is that a patentee may use one word (kettle) in some cases and (teapot) in other cases to mean the same thing. Or a given word could be defined to mean one thing in that patent while it has a different meaning in every other context.

Coalition Defense Companies accused of patent infringement do not have to defend themselves individually. Rather they can participate in a collective defense via coalitions. Benefits of coalitions include work can be consolidated, prior art shared and costs reduced. Some joint defense groups use one law firm for an entire litigation effort which results in tremendous costs savings compared to each of 30 or 40 defendants using their own litigation firms.

Ron Laurie, CEO of Inflection Point Strategy, points out that joint defense agreements work best when they are trying to invalidate a patent as opposed to proving non-infringement. The reason is that non-infringement addresses a wide array of products which the members of the joint defense often do not feel comfortable discussing in the presence of their competitors as a host of trade secret and anti-trust issues are at risk of arising.

A crucial determinant of joint defense groups' success is their cohesiveness. Among the common denominators shared by the more enduring joint defense groups are:

- Members are from the same industry.
- The members have large stakes in the relevant businesses.
- The participants share similar exposures.
- The business profiles of the members are relatively homogenous.

- The industry is relatively concentrated.
- They are managed by steering committees.
- Timothy R. Croll, Division IP Counsel at LSI Corporation, indicated that another important factor is the involvement of CEOs who are adamant about defeating the trolls. Furthermore, CEOs who are also founders of the member companies take personal umbrage at the accusations lobbed by patent trolls and thus become highly dedicated to defeating the patent trolls.

In addition to the difficulty associated with herding any group of companies into one amalgamated force, the risks associated with joint defense groups are that all of the players must agree on one invalidity argument. This itself can cause friction within the group and represents significant risk of misidentifying the most promising invalidity claims. A further concern is that one of the members may elect to settle early.

A new permutation of patent defense coalitions is a company called RPX. RPX will buy (or license in) patents that are being asserted against its members and then sub-licenses the patents back to its members. Finally, while not formal joint defense groups, standards setting bodies raise the level of difficulty for trolls to exert patents against their standards since it becomes nearly impossible to have claims that read on such expansive standards.

Foment Internal Unrest As all insurrectionists know, there are advantages in fomenting tension among members of the target entity. One means of accomplishing this is to marginalize a troll's in-house lawyers by attacking their attorney-client privilege. Shredding an in-house lawyer's attorney-client privilege would emasculate these lawyers and call into question their value to the organization, not to mention the percentage of any settlements they would be rightfully entitled to.

As far as piercing in-house lawyers' attorney-client privilege, one can make the argument that the advice that the lawyer is rendering is business advice, not legal advice. An aftershock of punching through the attorney-client privilege is that discovery may reveal that the troll was talking down the licensing potential in its discussions to acquire the patent so as to pay less. Such disclosures would be damaging in future litigation.

It is important to realize that there is an excessive amount of ego resident at multi-member trolling organizations. Each partner believes that he contributes far more to the troll than the other partners. This seems to be one root cause of the internecine dissention currently plaguing iPotential. Thus, when communicating with trolls, operating companies should ask questions revolving around the roles and responsibilities of the players on the trolling organization. Comments such as, "So you do all of the heavy lifting and John just collects the royalty checks" can begin to create fissures within the enemy. (Never underestimate the power of verbal slights: The Shin Bet, Israel's internal security organization, is said to have spread jokes about Yasser Arafat to trivialize him.)

Divide and Conquer Napoleon once said, "God is on the side of the heaviest artillery." Therefore, operating companies should try to reduce patent trolls' access to outside legal counsel while ensuring that the operating companies can procure more legal services in a cost-effective manner.

Patent assertion has been a nearly cost-free, zero-risk exercise for patent trolls. Outside lawyers who represent trolls on a contingency basis are accessories to trolls' aggressive behavior. Thus, one strategy would be to sever the ties between contingency fee law firms and patent trolls. This strategy is reminiscent of General Colin Powell's "First you cut it off. Then you kill it." remarks about Iraqi forces at the outset of the first Persian Gulf War.

An initiative aimed at cutting the trolls' supply lines to their lawyers is for operating companies to cease

doing any business with law firms that represent trolls. Law firms are impacted by the recession and are sensitive to losing any sizable clients. The potential conflicts that could arise with a lawyer asserting patents that he owns has resulted in the dismissal of such lawyers from their firms.

I believe the domino theory applies to law firm economics: A law firm loses a few clients which results in a few key partners leaving the firm. Then a few more partners leave a firm. Some law firms have covenants with their banks requiring law firms to retain a certain percentage of their partners as a condition for maintaining their credit lines. Should law firms lose too many partners, their credit lines could be frozen and the entire firm could implode. (Should banks and professional liability insurers restrict credit and raise premiums on law firms that expect to receive a high percentage of their revenues from contingency fees, access to contingency lawyers by patent trolls could be further limited.)

While the above measures could make it more costly for patent trolls to retain law firms, operating companies should benefit from lower legal defense expenditures. As law firms are pinched, they are more willing to serve clients on a fixed fee basis or through another alternative fee structure. They are also more inclined to offer volume discounts in return for becoming a preferred provider.

Operating companies can launch psychological warfare—perhaps by proxy—by planting seeds of distrust in the minds of trolls about their relationships with contingency law firms by broaching the following scenarios:

- Not all law firms are financially strong enough to fund years of patent litigation on a contingency basis. Trolls' litigation efforts could be jeopardized if their law firm implodes a few years into the trial.
- Patent holders should evaluate the law firm's partner compensation structure. Contingency fee lawyers may not produce billable hours for extended periods of time. However, these lawyers will need to earn some income during this time and their partners must be willing to pay them salaries. On the other hand, when the contingency fee lawyers win a large case and bring tens of millions of dollars to the firm, there should be an understanding as to how such enormous fees should be shared among the partners. If these understandings are not pre-ordained, the law firm could blow apart during the patent litigation.
- The scope of the representation. For example, it must be determined at the outset how settlements achieved by litigating counterclaims will be allocated.
- There could be discrepancies relative to how the legal fees will be calculated. Should they be calculated based on the gross or net verdicts? How are legal fees to be determined if business opportunities—such as an acquisition—arise out of the litigation? As per litigation between Patriot Scientific and its law firms, disputes between trolls and their lawyers arise when the case is thrown out of court or a law firm has been disqualified from representing a client in a specific jurisdiction.

The Silent Treatment Sun Tzu counsels us, “Be extremely subtle, even to the point of formlessness. Be extremely mysterious, even to the point of soundlessness. Thereby you can be the director of the opponent's fate.” Indeed, there are merits with ignoring demand letters from trolls. A troll that lacks experience or resources may implode before litigation can be initiated. Further, the silent treatment may be an effective strategy if you believe your firm is at end of a long list of targets. If a company at the front of the list invalidates the patent or acquires it, they would remove the threat.

However, Anthony K. Sebro, Jr. of PCT Companies points out that stalling is risky because it increases the licensor's investment in their assertion efforts. Costs expended in patent assertion demark a troll's minimum acceptable level of recovery. Also, should the case proceed to trial, initial stonewalling on the part of a defendant could annoy a jury.

Walled City Defense As Karl von Clausewitz, a more recent disciple of Sun Tsu, teaches us, “If you entrench yourself behind strong fortifications, you compel the enemy seek a solution elsewhere.” The Walled City Defense occurs when a company—as a matter of firm-wide policy—refuses to settle with patent trolls. For very large companies this could be a sound policy as failure to mount a strident defense would result in such firms being targeted for stick licensing agreements in an ever-growing number of cases.

Probing Mission An operating company accused of infringing a troll’s patent can embark on a probing mission by initiating litigation until Markman hearings occur. As these hearings usually occur about one year into the litigation, the majority of a defendant’s resources can be preserved. If the judge favors the operating company’s claims construction, the settlement value of the case is reduced.

Trench Warfare This all-out litigation strategy is extremely expensive and will typically last several years. It occurs when both parties are certain of their claims analysis, optimistic about eventual damages awards, and are convinced that they hold the moral high ground. Much of the proceedings revolve around invalidating the patent or proving non-infringement (discussed elsewhere in this article).

Sun Tzu said, “What is of supreme importance in war is to attack the enemy’s strategy.” Non-conventional weapons that can be unsheathed during trench warfare to derail the trolls’ strategy include:

- Raising the issue of champerty to create a wedge between the actual patent owner and mercenary trolls. Champerty holds that parties are prohibited from entering into a contract that requires them to litigate. (However, many states do not recognize champerty.)
- Request the court to sanction the troll under Federal Rule of Civil Procedure 11, which prohibits filing claims that are “frivolous.” John M. Caracappa and Grace Parke Fremlin, Partners with Steptoe & Johnson, wrote in a memo that in *Eon-Net L.P. v. Flagstar Bancorp Inc.*, the court reasoned that more substantive evidence or argument is needed.
- Mr. Fawcett believes that in addition to Rule 11 sanctions, there is merit in considering affirmative tort-based claims (such as malicious prosecution or tortious interference) against patent trolls in some circumstances.
- One final measure that has been taken to combat the patent trolls occurred when IBM and Halliburton filled separate business methods patents on the business of running patent trolls.

Scorched Earth Campaign This form of trench warfare consists of trying to invalidate the patent which is the source of the assertion. Standard mechanisms for achieving this objective include:

- Producing prior art, perhaps by unearthing defensive publications.
- Pointing to chinks in the chain of ownership (such as discovering that a previous Board of Directors did not approve the sale of a patent) and deficiencies in assignments.
- Proving that non-essential inventors were listed as inventors on the patent.
- Providing evidence that there were premature discussions of—and efforts to derive commercial benefits from—the invention.

- Demonstrating inequitable conduct such as intent to deceive, failure to disclose interests and inconsistent positions with co-pending applications.
- Illustrating how the best mode disclosures were insufficient.
- Petition for a re-examination hearing with the U.S. Patent Office. Organizations supportive of filing such requests include the Electronic Frontier Foundation and the Public Patent Foundation. The major advantages of re-exams are that these procedures are much less expensive than litigation. According to Eric Kirsch, a Partner with Cooper & Dunham, “in only 25% of *ex-parte* re-exams are all claims confirmed valid; in 64% of *ex-parte* re-exams, one or more claims are amended; and, in 11% of *ex-parte* re-exams all claims are cancelled as invalid. The risk with re-exams is that the US Patent Office only gives you one bullet to try to shoot down the patent. Moreover, if the elite patent examiners in the re-exam division can not find prior art, most judges will doubt that they will uncover additional prior art.

Agent Provocateur a.k.a. Black Ops Defendants in patent litigation may be tempted to hire a private investigator to search for dirt that would discredit members of a trolling organization. (Indeed, Karl von Clausewitz said, “Principles and rules are only intended to provide a thinking man with a frame of reference.”) However, this is not a judicious course of action. First, any dirt that is discovered is often not admissible in court. Second, even if such dirt were admissible, the presentation of it could backfire. The troll would have a good chance of engendering sympathy with the jury as the narrative would become “not only does this large company refuse to pay the patent owner but they are digging for irrelevant information in his garbage”. (The adverse publicity is so potentially damaging that some of the largest companies in the US require the approval of the firm’s chief counsel to authorize the retention of private investigators.)

In *i4i v. Microsoft*, Judge Davis assessed Microsoft with a \$40 million penalty which was, in part, due to Microsoft’s counsel acting improperly. One of the offending comments arose when Microsoft’s outside defense counsel equated i4i’s infringement case with the national banking crisis implying that i4i was a banker seeking a “bailout”.

Selecting the Battlefield Sun Tzu emphasized never to fight on the enemy’s chosen ground. Ira Levy, Partner with Goodwin Procter, reports that the Federal Circuit is more receptive to petitions of *forum non conveniens* which are granted when the court believes there is a more appropriate forum to hear the case. Under this legal doctrine, at least three cases have been transferred out of the Eastern District Court of Texas over the past 6 months. (However, when trolls file against a large number of defendants, the Federal Circuit often takes the position that the Eastern District Court of Texas is as good a venue as any.)

Mr. Levy explains that another method to exert some control over the venue is to file a declaratory judgment (DJ) in a venue that is favorable to the potential licensee. These DJ actions can be filed as soon as an operating company believes it is being targeted by a patent troll. Even third party reports that a given troll may target a particular industry may be sufficient grounds to file a DJ action. In addition to enabling the operating company to have its case tried in a more favorable forum, DJ actions enable the operating company to select the timing of the court proceedings. Accordingly, DJ actions allow the petitioner to orchestrate the legal strategy.

Directing litigation between an operating company and a patent troll to the International Trade Commission (ITC) is a double-edged sword. Trolls may not have standing before the ITC if they have no licensing agreements in place. Litigation before the ITC is often expensive and the agency only has the

power to award an exclusion order on the importation of infringing goods into the U.S., not the monetary damages that non-practicing entities typically seek.

However, trolls can obtain injunctions quickly at the ITC. Companies that file complaints at the ITC see 85% of their cases go to trial and 15% settling. Complainants tend to have a higher success rate before the ITC than district courts. When cases were adjudicated, complainants at the ITC won cases 58% of the time, whereas plaintiffs in district court only won 35% of the time, according to research by Colleen V. Chien, an assistant professor at Santa Clara University Law School.

A respondent also has a more difficult time trying to stay an ITC case while a patent is being re-examined compared to a district court case. Trolls may be attracted to the ITC because they can have resolution of a case long before the re-exam is concluded.

Battle for Hearts and Minds Trying to win the hearts and minds of key figures in legislatures and on benches is a form of non-kinetic activity. Operating companies should actively file *amicus curiae* briefs in court cases that could have a material impact on their businesses. Much is already being done in this regard: there were 24 amicus briefs—some filed by multiple parties—in connection with the *Bilski* case. Indeed, cases such as *eBay v. Mercexchange* and *Medimmune v. Genentech* have done quite a bit in terms of declawing patent trolls.

Operating companies concerned about their vulnerability to patent trolls should participate in lobbying efforts in support of issues such as having the US Patent and Trademark Office hire more examiners and adopt policies that prevent granting patents with overly broad claims. Some have suggested that the American Bar Association and the American Intellectual Property Lawyers Association should take an official stance against their members accepting trolls' cases. Adopting the European practice of the losing party paying at least some of the winning party's legal fees could retard the proliferation of trolls.

Another approach is for intellectual property insurance, and certainly general liability policies, to expressly exclude coverage for the defense of troll-like litigation. The intent is to prevent trolls from pursuing deep insurance pockets and thereby deter the behavior. (This idea will be hard to jump start as the initial defendants would be highly exposed to claims of infringement.)

Mr. Fawcett believes that the power imbalance can be re-set by making these thousands of private disputes more public. The largest victims of patent trolls could lead the way by publishing all of the demand letters they receive in public forums. This in turn may increase pressure for legislation anathema to the interests of patent trolls.

Détente Israeli President Shimon Peres rhetorically pondered, "If we make friends with our enemies, have we not thereby eliminated our foes?" As bewildering as it may seem, many in-house patent lawyers harbor deep-seeded admiration for patent trolls. Some corporate lawyers respect the trolls' pluck. Others realize that large operating companies assert patents that they do not practice. Many others understand that they owe their jobs in no small part to patent trolls. For these reasons, operating companies are increasingly willing to more amiably settle disputes with trolls.

Patent trolls are overwhelmingly interested in capturing licensing revenues. Nevertheless, in some cases, operating companies can reduce their payments to trolls by providing validation of the troll's patents, for instance through the issuance of a press release. If you believe the troll has a target rich licensee list, you can generate momentum for the troll by settling quickly. In this scenario, the operating company would in essence be a willing accelerant of the trolls' future cash flow streams and should be rewarded for that by receiving a lower royalty rate. (The first companies to settle could request a most favored nation provision in their license agreement with the troll but such MFN clauses are easy to draft around.)

However, the patent validation for reduced royalty rate gambit doesn't always work out for either party. The operating company might value not receiving publicity for its settlement so as to avoid marking itself as easy prey for further assertion. The troll may make the determination that the patent validation for reduced royalty rate gambit runs the risk of backfiring since a discounted royalty would be disclosed in litigation and factored into future damages calculations.

Another potential bargaining chip is rapid settlement in return for a broad covenant not to sue and/or grant-back rights for the operating company.

Collaboration Politics is not the only place where strange bedfellows are made. Several companies are coming to the realization that patent trolls can be used as revenue enhancement vehicles. Thus, some operating companies are selling patents—or licensing art—to trolls. Others are participating in recoveries that trolls generate from assertion.

About the Author: David Wanetick is a Managing Director at IncreMental Advantage, a business valuation firm with an expertise in valuing emerging technologies, based in Princeton, NJ. He teaches Valuation of Emerging Technologies and Negotiating Licensing Agreements at The Business Development Academy. He may be reached at dwanetick@incrementaladvantage.com.