

**Maastricht University**

---

**From the Selected Works of Severin de Wit**

---

Fall October, 2011

# The Case eBay Inc. vs. MercExchange LLC, It's Impact on NPEs and Patent Enforcement

Severin de Wit



This work is licensed under a [Creative Commons CC\\_BY-SA International License](https://creativecommons.org/licenses/by-sa/4.0/).



Available at: [https://works.bepress.com/severin\\_dewit/1/](https://works.bepress.com/severin_dewit/1/)

## **The Case *eBay Inc. v. MercExchange LLC*, it's Impact on NPE's and Patent Enforcement**<sup>1 2</sup>

Undoubtedly one of the most important cases adjudicated by the US Supreme Court for the last ten years is the 2006 *eBay vs. MercExchange* case. It not only dramatically reshaped the US patent landscape but its consequences were equally felt outside the US. The case dealt with an important question of patent enforcement. Should patent owners in patent infringement cases be entitled, virtually “automatically”, to an injunction once the patent is being held valid and infringed? Or should judges have discretion to decide what remedies fits the infringement, taking into account the harm caused and the larger public interest into the equation? *eBay* was found by lower courts to have infringed two e-commerce patents owned by MercExchange, a small technology company related to the so called “buy it now”-feature on its website. This feature allows users who do not want to take part in an auction to buy an item at a static, fixed price.

MercExchange owns a patent that broadly covers the creation of an online marketplace where items can be offered under live auction conditions and at fixed prices for immediate purchase. MercExchange claimed that eBay was infringing upon this patent. Although the district court jury verdict favored MercExchange, and found that eBay was infringing the patent, the court did not grant an injunction against eBay because it found that MercExchange's

*“willingness to license its patents [and] its lack of commercial activity in practicing its patents . . . are sufficient to rebut the presumption that it will suffer irreparable harm if an injunction does not issue.”*

The Federal Circuit did not find the case to be “*sufficiently exceptional to justify the denial of a permanent injunction*,” and it reversed the district court's denial of injunctive relief.

The Supreme Court overturned the Federal Circuit's approval of the injunction, holding that nothing in the Patent Act eliminated the traditional reliance on weighing the “equitable” factors considered in determining whether an injunction should issue. The Court departed, by doing so, from *Continental Paper Bag Co v. Eastern Paper*

---

<sup>1</sup> This article is an adaptation of a presentation given on June 26, 2009 at the Institute of European Studies at Macao University, Macao, P.R.C.

<sup>2</sup> by Severin de Wit, Intellectual Property Expert Group (IPEG) and managing director of OTB IP management B.V., The Hague, Netherlands.

*Bag Co*<sup>3</sup> which confirmed the right of a patentee to an injunction as a equitable remedy<sup>4</sup> once the patent is held valid and infringed.

The Supreme Court in the *eBay* case however requires a court to use a four prong test requiring a plaintiff to demonstrate (1) that it has suffered an irreparable injury; (2) that remedies available at law are inadequate to compensate for that injury; (3) that considering the balance of hardships between the plaintiff and defendant, a remedy in equity (injunctive relief, *SdW*) is warranted; and (4) that the public interest would not be disserved by a permanent injunction.

The decision to grant or deny such relief is an act of equitable discretion<sup>5</sup> by the district court, reviewable on appeal for abuse of discretion. These principles apply with equal force to Patent Act disputes. The Supreme Court held that "*neither the District Court nor the Court of Appeals fairly applied these principles*", adding

*"(...) Although the District Court recited the traditional four-factor test, (...) it appeared to adopt certain expansive principles suggesting that injunctive relief could not issue in a broad swath of cases. Most notably, it concluded that a "plaintiff's willingness to license its patents" and "its lack of commercial activity in practicing the patents" would be sufficient to establish that the patent holder would not suffer irreparable harm if an injunction did not issue."*

*(...)*

*"But traditional equitable principles do not permit such broad classifications. For example, some patent holders, such as university researchers or self-made inventors, might reasonably prefer to license their patents, rather than undertake efforts to secure the financing necessary to bring their works to market themselves. Such patent holders may be able to satisfy the traditional four-factor test, and we see no basis for categorically denying them the opportunity to do so."*

The court noted that it had consistently rejected invitations to replace traditional equitable considerations with a rule allowing automatic injunctions in its copyright law cases<sup>6</sup>.

*Thomas, J.*, delivered the opinion for a unanimous Court. While all eight justices joined the majority opinion by Justice Thomas which stated that there should be no

---

<sup>3</sup> 210 U.S. 405, 423 (1908) (citing U.S.Comp. Stat. 1901, p.3395).

<sup>4</sup> A remedy may be classified as "legal", "equitable", or "declaratory". If a remedy is *declaratory*, the plaintiff obtains a court ruling about his or her status, but does not recover tangible relief. *Legal* remedies usually involve an award of monetary damages to substitute for what the plaintiff lost (in case of patent infringement, lost damages for the unauthorized use of the patent, or missed royalties). *Equitable* remedies are court orders to a person or company to do or not do something e.g. not to infringe the patent in suit. Injunctions are therefore called equitable remedies under US law. John Schaeffer, *Equitable Disgorgement: An Unused Power That Courts Retain to Make Willful Patent Infringement Unprofitable*, Intellectual Property & Technology Law Journal, volume 222 Number 1 (January, 2010) mentions yet another equitable remedy in patent infringement, "*Equitable disgorgement*" (taking away profits gained with patent infringement).

<sup>5</sup> see footnote 3.

<sup>6</sup> *Johnson Controls, Inc. v. Phoenix Control Sys., Inc.*, 886 F.2d 1173, 1174 (9th Cir. 1998) and *New York Times Co. v. Tasini*, 533 U.S. 483 (2001). See also Nimmer on Copyright, § 14.06- §14.153

general rule as to when an injunction should issue in a patent case, there were two concurring opinions with three and four justices respectively, setting out suggested guidelines for granting injunctions. One concurring opinion pointed out that from "*at least the early 19th century, courts have granted injunctive relief upon a finding of infringement in the vast majority of patent cases,*" by applying the four-prong test.

In a separate concurring opinion it was stated:

*"In cases now arising trial courts should bear in mind that in many instances the nature of the patent being enforced and the economic function of the patent holder present considerations quite unlike earlier cases. An industry has developed in which firms use patents not as a basis for producing and selling goods but, instead, primarily for obtaining licensing fees. ... For these firms, an injunction, and the potentially serious sanctions arising from its violation, can be employed as a bargaining tool to charge exorbitant fees to companies that seek to buy licenses to practice the patent". (...)*

*"When the patented invention is but a small component of the product the companies seek to produce and the threat of an injunction is employed simply for undue leverage in negotiations, legal damages may well be sufficient to compensate for the infringement and an injunction may not serve the public interest. In addition injunctive relief may have different consequences for the burgeoning number of patents over business methods, which were not of much economic and legal significance in earlier times. The potential vagueness and suspect validity of some of these patents may affect the calculus under the four-factor test."*

Until 2006, it was rare for the Supreme Court to accept for review *any* patent case. For example, in the case of the bread and butter issue of the standard of obviousness under what is today 35 USC § 103(a), it was only in 1965 that *certiorari*<sup>7</sup> was granted to review this "new" patent law from 1952 – thirteen years earlier. The latest review of the obviousness standard for patentability from the Court was in *Sakraida v. Ag Pro, Inc.*<sup>8</sup>, which is thirty (30) years ago, and six (6) years *before* the creation of the Federal Circuit.

The last major eruption of patent activity at the Court took place in 1965 – over forty (40) years ago. In that year, stimulated by both a patent antitrust and patent misuse case as well as two patent preemption cases in the previous two years – all with rulings against the intellectual property rights holder – the Court granted *certiorari* in seven (7) patent cases, including the *Walker Process* patent fraud case as well as a number of cases involving interpretation of the 1952 Patent Act (*Adams Battery*<sup>9</sup>, *Graham v. Deere*<sup>10</sup>, *Calmar v. Cook*<sup>11</sup>, *Hazeltine v. Brenner*<sup>12</sup> and

---

<sup>7</sup> the system in the US whereby the US Supreme Court has to accept to hear a case under appeal

<sup>8</sup> 425 U.S. 273 (1976)

<sup>9</sup> *United States v. Adams*, 383 U.S. 39 (1966)

<sup>10</sup> 383 U.S. 1 (1966)

<sup>11</sup> 336 F.2d 110 (CA8 1964)

<sup>12</sup> 382 U.S. 252 (1965)

*Brenner v. Manson* <sup>13</sup>) <sup>14</sup>. Since 2006, quite unexpectedly, much more patent cases were heard by the Supreme Court in a sign of discontent with CAFC patent decisions. *MedImmune, Inc. v. Genentech, Inc.* <sup>15</sup>, *Quanta Computer, Inc. v. LG Electronics, Inc.* <sup>16</sup> and *KSR Int'l Co. v. Teleflex Inc.* <sup>17</sup> were further proof that the court was dissatisfied with the course the CAFC took in patent cases that stirred business communities, innovation debates and radical anti-patent proponents. Another factor that clearly played a dominant role in the discussion about patent quality were the increasing numbers of patent trolls <sup>18</sup> taking injunctive relief action against operating companies. This "patent unrest" in the business community in the US - allegedly caused by patent trolls seeking injunctive relief <sup>19</sup> against patent infringements - led undoubtedly to the Supreme Court's firm hand in giving a more critical look at the patent cases coming from lower courts and the CAFC.

The *eBay* case impassionedly divided the patent community. Technology companies supported eBay's case before the Supreme Court arguing that patent cases - and more importantly the companies asserting patents, known as Non Practicing Entities ("NPEs") or "Patent Trolls" <sup>20</sup> - were stifling innovation. Other views, among others advocated by some pharmaceutical companies, argued the opposite. In an "amicus brief" <sup>21</sup> to the court, those companies stated that limiting injunctions and weakening patent laws would drive up the cost of innovation <sup>22</sup>.

---

<sup>13</sup> 383 U.S. 519 (1966)

<sup>14</sup> <http://www.patentlyo.com/patent/2005/05/post.html>

<sup>15</sup> 549 U. S. 118 (2007)

<sup>16</sup> 553 U. S. 617 (2008)

<sup>17</sup> 550 U. S. 398 (2007)

<sup>18</sup> Under many definitions of "patent trolls" the "King of Trolls" would be Thomas Edison, owning over a 1,000 patents, many of them he never practiced, see Andre Millard, *"Edison and the Business of Innovation"*, Johns Hopkins Studies in the History of Technology, p. 43-44.

<sup>19</sup> See Steve Seidenberg, *Troll Control, The Supreme Court's eBay Decision Sets Back Pesky 'Patent Trolls' or American Innovation, Depending upon Which Side You're on*, A.B.A. J., Sept. 2006, p. 51, 53.

<sup>20</sup> owners of patents that do not have any business other than to assert it against users of the patent to extract royalties). Originally meaning of "troll" - according to Scandinavian Mythology - repulsive dwarfs who lived in caves or other hidden places. They would steal children and property but hated noise, see e.d. Hirsch, Jr. et al., *The new dictionary of cultural literacy* (2002).

Peter Detkin, formerly Intel, now with Intellectual Ventures, who used the word, as is believed, for the first time in relation to patent enforcement, states (now) that the term "patent troll" should apply only to one who "must own no more than a few patents of questionable merit and is not in any business related to the patents." The quote is a paraphrase appearing in Brenda Sandburg, *"A Modest Proposal"* The Recorder, May 9, 2005, reproduced at [www.law.com/jsp/article.jsp?id=1115370308794](http://www.law.com/jsp/article.jsp?id=1115370308794), which in turn is cited by Bruce Sunstein, *"Funding Patent Assertion Litigation"*.

<sup>21</sup> An amicus brief or also called "amicus curiae" brief (literally "friend of the court") is filed by someone not a party to the case but interested in the legal doctrine to be developed there because of the relevance of that doctrine for their own preferred policy or later litigation. Amicus curiae almost invariably align themselves with one of the parties, making them primarily friends of the parties despite the "friend of the court" label. Amicus briefs are potentially important because they can bring to the court's attention legal arguments and perspectives different from the parties' views. Such briefs may, for example, help the justices see the effects of potential rulings. An amicus curiae is usually an organization, although it may be an individual.

<sup>22</sup> see the Amicus brief No. 05-130 (most briefs can be found at Dennis Crouch, *Review: eBay v. MercExchange Amici Briefs*, Patently-O, January 30, 2006, at <http://www.patentlyo.com>) filed on behalf of the Biotechnology Industry, which argued: "New inventions and discoveries drive the biotechnology industry. Millions of people worldwide benefit daily from biotechnology-derived medicines and products. The right to exclude others from practicing a validly patented invention provides the investment incentive that is essential for high-risk, high-

The case attracted large attention both from inside and outside the legal profession, not least because eBay spared no effort nor money to make its case both in publicity as well as within legal circles. A record number of 37 amicus briefs were filed, ranging from IP practitioner groups, industry associations, numerous law professors (on either side of the arguments), IT and Pharma & biotech companies and of course also “patent trolls”. *Financial Times* editorial comments at the time called upon the Supreme Court to “*restore some sanity to the system*” referring to the Blackberry case where an owner of a single patent, with no business of himself, almost shut down the successful Blackberry wireless email handheld business. The newspaper went as far as saying that the case could be “*crucial to the future of US innovation: the near-automatic right to an injunction creates a severe imbalance of power within the patent system*”, obviously referring to patent trolls as a major problem in the US patent system. This is nothing but short of gross exaggeration and is certainly not true for all industries. In the pharmaceutical and biotech industry a patent protects the vast sums of that went into innovative R&D. New therapies are not introduced to patients until the often several hundred million dollar regulatory process has confirmed that a new chemotherapy or antibiotic is both effective and will not harm the patient. As Hal Wegner <sup>23</sup> points out, absent an iron-clad exclusive right guaranteed by the patent, new drug development by the private sector would wither as the grant of a compulsory license would destroy the profit incentive so vital to induce pharmaceutical concerns to invest the vast sums needed for regulatory approval.

Soon after *eBay v. MercExchange*, it was argued, there would be an increase in denials of requests for permanent injunctive relief, essentially awarding compulsory licenses to the infringers. Many argued that some industries would be hurt more than others by the ruling. For the biopharmaceutical industry for whom patents constitute its life blood, the consequences could be mixed at best. Smaller biotech companies with patented technology were supposed not to fare as well after *eBay*. Without the threat of an automatic permanent injunction, those companies would lose significant leverage in negotiations to license their patented technology, was the often heard argument.

---

*cost biotechnology research and development. Increased unpredictability with respect to the availability of exclusive rights will greatly diminish the value of patent rights, weaken the hand of patent owners in negotiations to determine the value of a patent, shift such value determinations to the courts, reduce inventors' desire to promptly disclose inventions to the public, and discourage the investment required to research and discover innovative technologies."*

<sup>23</sup> Harold S. Wegner, "Injunctive Relief: A Charming Betsy Boomerang", paper for the 1st Annual Northwestern Journal of Technology and Intellectual Property Symposium: IP Litigation in the 21st Century, Northwestern University, February 24, 2006, Chicago, Illinois.

Let us first make a short side step to see how all this plays out in Europe. Most European patent laws are based on the understanding that the right to exclude others is the fundamental right of a patentee. A patent right provides its owner an exclusive right to an invention he made. If this invention for which a patent has been granted is being infringed, an injunction against the party infringing the patent owner's exclusive right to manufacture and dispose of a patent is the only effective remedy to restore exclusivity. Exclusivity is what the party who innovated requires to earn back his R&D investment. An exclusive right would be meaningless without the right to exclude. Injunction and exclusivity go therefore hand in hand. This is not to say injunctions in patent cases are granted "automatically" without a *balance of convenience* test. In fact in many European jurisdictions such a test will be undertaken by a court, where all factors are assessed <sup>24</sup>.

In most patent countries of the EU a court ordered injunction is granted unless specific circumstances are shown that do not justify an injunction, like public health. Many EU countries give the patent owner the choice either to go for an injunction per se, an injunction as well as an order to pay damages, or, alternatively, only for damages. Refusal to injunction amounts to a compulsory license, which can only be granted in exceptional circumstances, according to most current European patent laws. It was widely thought after *eBay* that the current critical approach to intellectual property rights may spark a similar debate in Europe as in the US. This materialized only sporadically, and then mainly in relation to the role of patent trolls, or NPE's in European patent litigation<sup>25</sup>. Unlike in the US there has been no academic empirical research on the effects of patent litigation by patent trolls in Europe. Most publications provide broad conceptual opinions on whether a troll is preventing or even destroying innovation, rather than substantive, empirical evidence. Unlike in the US and typical for the political climate in Europe, the tone is often much more confrontational and some authors take a preoccupied and bellicose stance against patent assertion by NPEs <sup>26</sup>.

---

<sup>24</sup> e.g. a "preliminary injunction" will not be granted where the patentee has delayed, or, in the UK for example, where the patentee has a track record of licensing the patent in question. In that case a court will normally take the view that a royalty payment in respect of past sales would adequately compensate the patentee. For a summary of requirements to get a preliminary injunction in the UK, Germany, France and The Netherlands, see "*Patent Injunctions in Main European Jurisdictions*", ipeg, see <http://www.ipeg.com/blog>, under "IP Presentations".

<sup>25</sup> Andri Hess-Blumer, "*Patent Trolls - eine Analyse nach Schweizer Recht*", *Zeitschrift für Immaterialgüter-, Informations- und Wettbewerbsrecht*, 12/2009, p. 851-865, Willi Schickedanz, "*Patentverletzung durch Einsatz von Geschützten Bauteilen in komplexen Vorrichtungen und die Rolle der Patent-Trolle*", *GRUR Int.* 2009, Heft 11, 901-908,

<sup>26</sup> a good example of poor understanding of patent litigation, the nature of patenting and what patent trolls are, combined with an offensive and rather "unacademic" attitude towards NPE's, see two European authors, Henkel, Reitzig, "*Patent sharks and the sustainability of value destruction strategies*" (2007). The two economists start their "research" paper by stating: "(...) we denote patent sharks as 'individuals or firms that seek to generate profits mainly or exclusively from licensing or selling their (often simplistic) patented technology to a

For more empirical studies on the effect patent litigation by NPEs we need to look at the US. So what happened with the possibility of obtaining injunctive relief after *eBay*? A recent survey of post-*eBay* cases indicates that the denial of injunctive relief currently occurs in about 30 percent of patent cases <sup>27</sup>. The author, J. Scott Larson <sup>28</sup>, maintains that as a result of allowing district courts so much discretion unpredictability occurs, thereby promoting forum shopping and increased litigation in patent cases. This is a remarkable perception as the quintessential idea of *eBay* was to *lower* the amount of injunctive relief cases, due to tightened criteria, *not* to increase the number of patent cases.

More than anything else the aftermath of *eBay* concentrated on whether patent trolls are indeed stifling innovation and how these "patent aggregators" could be stopped. *eBay* was just a precursor to a much larger debate on patent trolls and their effect on patent enforcement, that is still going on till date. Debates about Patent Reform have a tendency to evolve also around the issue of patent trolls and whether they constitute a threat to the patent system or to innovation (or both). As patent trolls produce no goods, nor do they "practice" the patented invention themselves, trolls have been labeled a "threat" to operating companies and therefore stifle innovative work by those companies, who "independently invent <sup>29</sup>". These stories, routinely invoked by the press, advocates, and academics, shape, according to Colleen V. Chien<sup>30</sup>, public understanding of the patent system. In her 2009 publication, Chien describes and matches these stories <sup>31</sup> to empirical data on patent litigations to determine which types of suits are most prevalent. Chien's publication is among the first systematic attempts to place the various types of patent litigation within context. The author focuses exclusively on the litigation of high-tech patents, covering hardware, software, and financial inventions, using data from the Stanford Intellectual Property Clearinghouse <sup>32</sup> for cases initiated in U.S. District Courts from January 2000 through March 2008. Chien's data show that the reality is more complicated than the

---

*manufacturing firm that, at the point in time when fees are claimed, already infringes on the shark's patent and is therefore under particular pressure to reach an agreement with the shark."*

<sup>27</sup> J. Scott Larson, "The Unsettled Aftereffects of *eBay* and Survey of its Continued Impact upon U.S. Patent Litigation", 2010 Intellectual Property & Technology Law Review (IPTLRev), volume 22, nr. 3 (March 2010).

<sup>28</sup> Larson, *ibid.* p.5

<sup>29</sup> <http://www.ipeg.eu/blog/?p=921>

<sup>30</sup> "Of Trolls, Davids, Goliaths, and Kings: Narratives and Evidence in the Litigation of High-Tech Patents", Santa Clara University School of Law Legal Studies Research Papers Series Working Paper No. 09-13, April 2009.

<sup>31</sup> Chien, *ibid.* p. 105

<sup>32</sup> The Intellectual Property Litigation Clearinghouse (IPLC) was originally created by the Stanford Program in Law, Science and Technology under the combined leadership of faculty director Mark Lemley and Joshua Walker (who served as the IPLC executive director) in collaboration with the Stanford Department of Computer Science. The IPLC has been designed to make IP litigation more transparent, covering all (1) patent infringement, (2) manifest copyright, (3) manifest trademark, (4) manifest antitrust, and (5) certain trade secret lawsuits filed in the U.S. District Court from January 1, 2000 to the present.



rhetoric regarding patent litigation. For instance, NPEs <sup>33</sup> bring only a minority of patent suits: 17% of high-tech patent suits in the last eight years (28% of all high-tech patent suits if one includes suits with multiple defendants and those that seek declaratory judgment ("DJ"). This average reflects an increase in NPE suits as a proportion of all suits over an eight-year period, from 22% in 2000-2001 to 36% from 2006 to March 2008, counting defendants, or from 10% to 20%, counting cases <sup>34</sup>. Although an overall increase is seen in the number of patent litigations, data do not support the view that this increase is *solely* due to NPEs. In terms of numbers NPE's do not qualify as the prevalent patent litigators, although, admittedly, NPE's main object and goal is to enforce patents they acquired. Enforcement by litigation is part of their business.

According to several studies, individuals and small companies are more likely than large companies to sue on their patents <sup>35</sup>. Although there might be a difference between small companies, individual patent owners and NPEs, all have one thing in common, they seek remuneration for their inventions. Some have argued that NPE's do not "invent" anything themselves. Even is this true, what difference does when looking into enforcement of rights acquired? Whether it is a right acquired as result of an own invention or a right that has been identified as a valuable one, analyzed, checked by engineers as well as patent lawyers, prior art searched and thoroughly prepared for EOU <sup>36</sup>.

PricewaterhouseCoopers (PwC) has compiled a thorough database of patent damages awards (from 1980 through 2008), collecting information about patent holder success rates, appellate reversals and modifications, time-to-trial statistics (from 1995 through 2008), and practicing versus NPE statistics (from 1995 through 2008). Based on this study, they made several observations that are illustrative for assessing the impact of NPEs <sup>37</sup>.

Their findings, in a nutshell:

- Annual median damages award has ranged from \$2.2 to \$10.6 million, with no discernible trend since 1995

---

<sup>33</sup> Chien refers to NPEs as a corporate patent enforcement entity that neither practices nor seeks to commercialize its inventions. This definition excludes inventors whom others have called trolls, in particular, individual inventors who initiate suits, *ibid.* p. 108.

<sup>34</sup> Chien, *ibid.*, p. 129-130

<sup>35</sup> Chien, *ibid.*, p. 115

<sup>36</sup> Evidence of Use, as a precursor to a patent infringement action

<sup>37</sup> "A closer Look, Patent litigation trends and the increasing impact of non practicing entities", PricewaterhouseCoopers, 2009.

- Damages awards for NPEs have averaged more than double those for practicing entities since 1995
- NPEs have been successful 29 percent of the time overall versus 41 percent for practicing entities, due to the relative lack of success for NPEs at summary judgment; however, both have roughly a 2/3 win rate at trial
- The disparity between jury and bench awards has widened and is likely the contributing factor in the significant increase in use of juries since 1995
- Reasonable royalties continue to be the predominant measure of damages awards
- Alleged infringers increase their trial success rates slightly as plaintiffs seeking declaratory judgment
- While the median time-to-trial has remained fairly constant since 1995, significant variations exist between jurisdictions
- Certain federal district courts (particularly Virginia Eastern and Texas Eastern) continue to be more favorable to patent holders, with shorter time-to-trial, higher success rates, and higher median damages awards
- Five federal district courts accounted for 33 percent of all identified decisions involving an NPE as the patent holder.

So is the NPE business model contemptible? We full heartedly disagree. One can have *ethical* oppositions against a company whose only task it is to make money out of patents. If this is because one despises capitalistic behavior in order to maximize profits, one can say it's just a logical result of this political view to also denounce NPE's acquisition of IP to gain profits. However many embrace IP as means to protect value in (some) inventions but then subsequently denounce NPE's strive for gain by enforcing that same IP. This is nothing less than hypocritical. Compare this with other parties that "play" the market. If hedge funds gain from debt-laden countries like Greece by arranging currency-swaps to masquerade losses or financial distress, the financial world is heralding the players as "*financial innovators*". If the use of market mechanisms is used to profit from Intellectual Property the players are called "extortionists"<sup>38</sup>.

Investors who buy and develop real (immovable) property are often denounced as "property *speculators*" only by those who have no idea what risks are involved in assessing, valuating and subsequently developing such property. Is this in fact the location for the property? Will eventually buyers take the offering or even like what

---

<sup>38</sup> Brenda Sandburg, "*Trolling for Dollars*", Recorder (S.F. Cal.), July 30, 2001 at 1.

the developer presents as an "unique opportunity"? Are investors willing to take the risk that the property, once renovated and assessed, will turn out to find no buyers? Those business risks are commonly accepted and rewarded by paying upgraded and sometimes inflated property prices. So why would an investor in intangible assets be judged any different <sup>39</sup>?

In this regard, one aspect of NPE's has remained underexposed in literature, namely that NPEs have gone through considerable effort to locate and acquire patents that remain undervalued, unused or overlooked by industry, or "operating" companies. One way of looking to this is that NPE's acquire patents that "operating companies" have either missed, ignored, dismissed or simply overlooked, despite sophisticated databases offering all the opportunity to explore what is being patented in a certain technical area. In fact, can *anyone* maintain that "*he was not aware of a certain patent*"? That seems possible only if he did not look for the patent nor searched the databases publicly and freely available from all major Patent Offices around the world. Many patent professionals and information companies offer extensive search tools. For a relatively low amounts anyone can find out "patented prior art" or which (an how many) patents are granted prior to their own "independent" invention. But that is only the easy part. When a new consumer electronics product is being developed, many patented technologies are being licensed in from third parties. Apple's iPod for example has hundreds of patented technologies, ranging from wireless LAN facilities, to touch screen, motion controls (for shuffling), battery power, etc. Existing technologies, not developed by others, in many cases patented, are then either bought from the owners (by taking a license) or are being circumvented by "designing around". A major task of any patent department e.g. of a consumer electronics company, is to find out whether a product design that comes from their in-house R&D group, is not touched upon by third party patents <sup>40</sup>. Surely it is, caused by the sheer number of patents, frequently impossible to weigh whether some patents are indeed infringed by one's own product, or even to read all the patents that seem relevant for the searched technology. When NPEs subsequently reach a better result or a different opinion and buy that patent that was initially discarded as irrelevant (e.g. because it was wrongfully held to be invalid) or overlooked by the operating company, the company occasionally has to face litigation. If not settled the operating company has then to accept the consequences

---

<sup>39</sup> for a more elaborated example of real property investors as "trolls", see James F. McDonough III, "*The Myth of the Patent Troll: An Alternative View of the Function of Patent Dealers in an Idea Economy*", Vol. 56 Emory Law Journal, 2006, § 3, p.199-200.

<sup>40</sup> a common misunderstanding is that once a patent application is being filed and a patent issued for an in-house invention the product that resulted from own development, is free of infringing other rights. IN other words: even if you get a patent of your one, this can still infringe third party right under an older patent for the same technology.

by paying damages as a result of its wrong infringement or incomplete database analysis.

However, the reality is that many "operating" companies simply *ignore* patented inventions by third parties, either willingly or unwillingly (meaning they do not check any database prior to developing or researching their new product or process). From a 2003 study by Motivaction, commissioned by the European Patent Office <sup>41</sup>, it appeared that while the EPO (as an institution) is well known, the EPO's patent information services are not as 50% to 70% of the companies surveyed are not aware of the EPO's patent information services. Even more troublesome is that a vast majority of European companies simply do not recognize the relevance of patent information for their own R&D efforts. A striking 31% of "EPC10" <sup>42</sup> - companies disagreed with the statement *"Information contained in patents is of commercial advantage to my company"*, for only 14% of their US companies. 55% of EPC10 companies disagreed with: *"I have used patent information in the past to solve technical or engineering problems"*, against 36% in the US. 52% of EPC10 companies disagreed with: *"I have used patent information in the past to find out if someone else has independently arrived at the same idea as mine"*, against 22% in the US.

So who is there to blame? Certainly not NPEs. They only expose widespread *patent ignoramus*. In doing so most NPEs focus on high-tech patents for obvious reasons. First they acquire patents from distressed or bankrupt companies <sup>43</sup>, from companies that have gone out of a certain business or from smaller SMEs that have neither the expertise nor the money to enforce their patent rights. NPE's have to operate in an imperfect market, contributing to their high risk strategies. Many even doubt that there is such a thing as a "patent market" where demand and supply provide for a fair price, rather than a very expensive lottery <sup>44</sup>. As McDonough rightly points out, patents are "illiquid commodities <sup>45</sup>" because they are not "readily convertible into cash <sup>46</sup>". Without the presence of parties that have full faith and credit in the "patent market", NPEs fulfill the role of "market makers", as they discover and extract the value of a patent, be it in licensing negotiations or in enforcement strategies. Some have taken the view that "patent value" maybe a illusive concept, because of the

---

<sup>41</sup> "Usage Profiles Of Patent Information Among Current And Potential Users", Report on the main results of the survey, commissioned by the European Patent Office (2003), Motivaction, Amsterdam

<sup>42</sup> the original European members of the European Patent Convention plus Eastern European countries like Estonia, Poland, Czech Republic, Romania, Bulgaria, Slovenia, Slovakia, Latvia, Hungary and Lithuania.

<sup>43</sup> Chien, *ibid.*, p. 110

<sup>44</sup> Kimberly A. Moore, "Worthless Patents", Law and Economics Working Papers Series, George Mason University School of Law, p.2

<sup>45</sup> McDonough, *ibid.*, p. 213

<sup>46</sup> Current assets of a business, excluding inventories, that could be converted into cash if necessary within a short period, usually one year or less. Also known as *liquid assets*.

impossibility of obtaining sufficient empirical data on each, patent "worthlessness"<sup>47</sup> is prevalent, which only adds to the impossible task for NPE's to identify those "value" patents that are valid, used and infringed by parties without being reasonably compensated.

In that sense there is nothing wrong with most NPE's. The opposite is true if one sees this phenomenon as a result of insufficient "*patent mining*"<sup>48</sup> as the process of seeking relevant patents is often called. If the patents are the result of in house innovative R&D output, asserting them against alleged infringers who use these intangible assets in their own products in order to recoup investments in their R&D is commonly regarded a smart business to maintain competitiveness or market share. However, if these patents have been bought from a third party - either defunct or bankrupt or from sellers of unused IP for a profit - with the purpose of enforcing it against companies *using* the patented technology is then seen as "extortion" of ethically behavior. Seldom is this seen as a smart policy and a sign of shrewd entrepreneurship. What difference is there with other examples of buying assets with an intention to "work" the asset for onward sales with a profit?

Obviously these patents have been bought by a party that decided to make value of patents where the seller did not an opportunity to extract the full value, e..g because they did not see the opportunities, or simply do not have the resources in manpower or money to do it themselves. These companies have valid and sound reasons to sell their patents. The price the buyer normally is willing to pay (having made the analysis that they would be in a better position to make even more money of those patents, backed by investors, than the original owner) reflects the potential and true value of the patents. This is what NPEs regularly do and what we will increasingly see happening. Many companies have an inventory of unused patents<sup>49</sup> that is not subject to active value creating strategies, but rather used as defensive (and passive) "freedom-to-operate" operations. One can hardly blame parties for looking to find "Rembrandts in the attic" and come up with a viable value extracting enforcement strategy for pursuing financial rewards from intangible assets, where the original owners did not.

---

<sup>47</sup> Moore, *ibid.*, p. 5-7.

<sup>48</sup> Patent mining is one of the center pieces of intellectual property management and *either* form part of normal risk management policies by technology companies or - as Edward Kahn, in "*Patent Mining in a Changing World*" (IPFrontline, June 2005) expressed it - "seems to promise untold riches generated from rights portfolios that would otherwise lie dormant".

<sup>49</sup> majority of patents are never used in any product or process. estimations are given that this number may reach of 95% of all patents granted worldwide. No exact figures are known, as companies do not know, nor publish them if they would, which patents are covered by their product design.

So, is this reason for European companies to grumble? If one reads commentaries and listens to the comments made in boardrooms of many companies, they certainly do. We would argue that this is not the way this phenomenon should be addressed. Rather than complaining, companies should more actively seek active strategies to extract value out of their own patent portfolios, or- depending on where they stand at the equation – hire expertise to pursue a more active IP strategy. Whether that is to engage arm's length companies to license out their non used IP, or buy defensive IP positions on the market before NPEs doing just that. The point we would like to make is: get rid of that grinded and often wrong idea that patents are just to create freedom to operate. NPEs have stirred a more active debate about the need to get a more transparent IP market <sup>50</sup>. As there is no real and open "market" for IP – in the economic sense – where buyers and sellers can meet supply and demand, based on generally accepted value propositions, the call for improvement of the market conditions for IP will increase. The actions by NPEs will therefore have two positive outcomes. Firstly companies are forced to critically evaluate and reform their IP strategies and secondly, there will be a innovative push to create new market mechanisms for IP to be more easily change hands. In that sense, NPE's rather promote the advancement of innovation rather than stifle it. The presence of NPE's - or "patent dealers <sup>51</sup>" - in the market allow small entities and individual inventors to gain access to the patent market.

The Hague, Netherlands, March 2010

(c) Severin de Wit

---

<sup>50</sup> supportive of this view: James F. McDonough III, *"The Myth of the Patent Troll: An Alternative View of the Function of Patent Dealers in an Idea Economy"*, Vol. 56 Emory Law Journal, 2006, p.216-218.

<sup>51</sup> McDonough, *ibid.*, p. 223