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The Ignominious Patent Troll

By **Dayrel S. Sewell**

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NPEs, PAEs, and Trolls....Oh my

Non-Practicing Entities (NPEs), also interchangeably known as Patent Assertion Entities (PAEs) and "Patent Trolls", are firmly a part of the lexicon, and are making for boisterous jurisprudence, political banter, and corrective legislative action. NPEs are typically understood as entities that primarily do not develop products based on their patents and attempt to derive disproportionate value from those patents via questionable litigation. The recent increase in patent litigation by NPEs raises concern amongst technology companies and legal commentators alike because of the asymmetric economic leverage that NPEs exert being that—as non-practicing entities—NPEs often incur less discovery costs in patent litigation and are not exposed to counterclaims.

PAE activity has increased dramatically in recent years (see *infra*, Figure 1). Last year, PAEs brought over 2,500 lawsuits — 62% of all patent suits. That compares to 1,500 in 2011 (45% of all cases), and 731 in 2010 (accounting for 29%). See http://www.whitehouse.gov/sites/default/files/docs/patent_report.pdf. James Bessen and Michael Meurer find that defendants and licensees paid PAE's \$29 billion in 2011, a 400% increase from 2005; they estimate that less than 25% of this money flowed back to innovation. In addition, in the majority of PAE cases, the legal cost of the defense exceeds this settlement or judgment amount. See *id.*

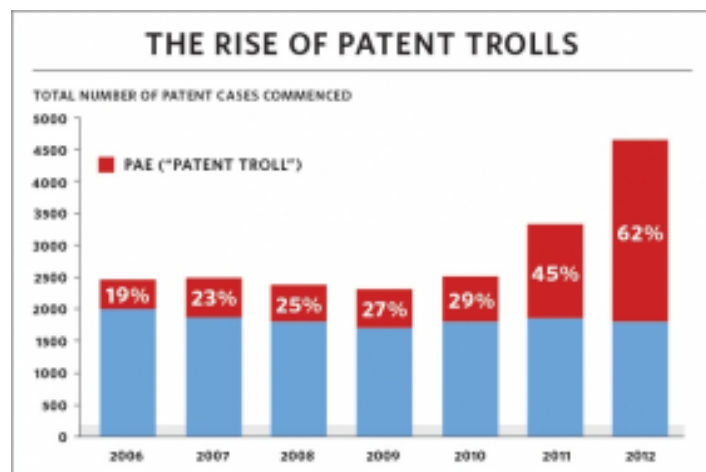


Figure 1: The Rise of Patent Trolls: Total Number of Patent Cases Commenced, 2006-2012

Federal Circuit Chief Judge Randall R. Rader on Patent Trolls

In 2011, at the E.D. Texas Judicial Conference, Chief Judge Rader emphatically stated that the state of patent litigation needs improvement. Chief Judge Rader listed curtailing the abusive practices—as well as the influence—of patent trolls as one of the six primary ways to improve the U.S. patent system and decrease litigation expense. See 2011 E.D. Texas Judicial Conference Chief Judge Rader Speech Transcript, at <http://memberconnections.com/olc/filelib/LVFC/cpages/9008/Library/The%20State%20of%20Patent%20Litigation%20w%20Ediscovery%20Model%20Order.pdf>.

Chief Judge Rader defines 'troll' as "any party that attempts to enforce a patent far beyond its actual value or contribution to the prior art." See *id.* Chief Judge Rader acknowledges that the exorbitant cost of patent litigation is, at times, responsible for non-meritorious claims by PAEs to rule the day as a result of acquiescence to the steep cost of discovery. After final disposition, he posits that reversing costs and fees is a strong recommendation to quell the swell of the PAE tide by discouraging cases that are brought only to obtain revenue from litigation avoidance instincts. See *id.*

In a recent op-ed, Federal Circuit Chief Judge Randall Rader along with Professors Colleen Chien and David Hricik stated:

FROM an early age we are taught the importance of fighting fairly. But as the vast number of frivolous patent lawsuits have shown, too many people are rewarded for doing just the opposite.

The onslaught of litigation brought by "patent trolls" — who typically buy up a slew of patents, then sue anyone and everyone who might be using or selling the claimed inventions — has slowed the development of new products, increased costs for

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who might be using or selling the claimed inventions — has slowed the development of new products, increased costs for businesses and consumers, and clogged our judicial system.

* * *

With huge advantages in cost and risk, trolls can afford to file patent-infringement lawsuits that have just a slim chance of success. When they lose a case, after all, they are typically out little more than their own court-filing fees. Defendants, on the other hand, have much more to lose from a protracted legal fight and so they often end up settling.

Lost in the debate, however, is that judges already have the authority to curtail these practices: they can make trolls pay for abusive litigation.

Section 285 of the Patent Act, as well as Rule 11 of the Federal Rules of Civil Procedure, give judges the authority they need to shift the cost burden of litigation abuse from the defendant to the troll. . . . [E]ven though many cases settle, the prospect of paying fees will discourage aggressive suits and frivolous demands.

* * *

Judges know the routine all too well, and the law gives them the authority to stop it. We urge them to do so.

See Randall R. Rader, Colleen V. Chien & David Hricik, Make Trolls Pay in Court, N.Y.TIMES, June 5, 2013, at A5.

May 2013: H.R., Patent Discussion Draft

On May 23, 2013, House Judiciary Committee Chairman Bob Goodlatte (R-Va.) released a discussion draft of legislation designed to address the ever increasing problem of abusive patent litigation. This Patent Discussion Draft is aimed at stymieing patent troll-type behavior that affects business operation and development, and seeks to resolve the asymmetries surrounding abusive patent litigation.

For the federal court system, the Bill would, *inter alia*,: 1) further incentivize patent settlement; 2) **raise the pleading requirements for allegations of patent infringement from the Federal Circuit's minimal pleading, FRCP Civil Form 18 standard, to be comparable to the Supreme Court's pleading standards set forth in *Iqbal* and *Twombly***; 3) *reduce abusive discovery tactics and discovery excesses by limiting and streamlining discovery (i.e., E-Discovery Model Order)*; 4) *generally create a presumption in favor of granting the prevailing party's petition for payment of costs and expenses, including attorney's fees*; 5) provide for "customer-suit exception", wherein courts would stay actions against customers pending resolution of the infringement case against the manufacturer; and, 6) to continue the practice, for IP licenses in bankruptcy proceedings, that bankruptcy trustees are barred from terminating licenses to patents and other IP of the debtor.

In the interest of brevity, visit the following URL to view and analyze the draft H.R. Bill with respect to the United States Patent and Trademark Office recommendations as well as improvements to the 2011 Leahy-Smith America Invents Act. See <http://judiciary.house.gov/news/2013/052013%20-%20Patent%20Discussion%20Draft%201%20pager.pdf>.

Executive Office and Congressional Responses to PAEs

On June 4, 2013, the White House issued five executive actions and seven legislative recommendations designed to stem the tides of frivolous litigation by NPEs with the focus on ensuring higher quality patents. See <http://www.whitehouse.gov/the-press-office/2013/06/04/fact-sheet-white-house-task-force-high-tech-patent-issues>.

- Executive Actions

1. **Making "Real Party-in-Interest" the New Default.** Patent trolls often set up shell companies to hide their activities and enable their abusive litigation and extraction of settlements. This tactic prevents those facing litigation from knowing the full extent of the patents that their adversaries hold when negotiating settlements, or even knowing connections between multiple trolls. The PTO will begin a rulemaking process to require patent applicants and owners to regularly update ownership information when they are involved in proceedings before the PTO, specifically designating the "ultimate parent entity" in control of the patent or application.
2. **Tightening Functional Claiming.** The AIA made important improvements to the examination process and overall patent quality, but stakeholders remain concerned about patents with overly broad claims — particularly in the context of software. The PTO will provide new targeted training to its examiners on scrutiny of functional claims and will, over the next six months develop strategies to improve claim clarity, such as by use of glossaries in patent specifications to assist examiners in the software field.
3. **Empowering Downstream Users.** Patent trolls are increasingly targeting Main Street retailers, consumers and other end-users of products containing patented technology — for instance, for using point-of-sale software or a particular business method. End-users should not be subject to lawsuits for simply using a product as intended, and need an easier way to know their rights before entering into costly litigation or settlement. The PTO will publish new education and outreach materials, including an accessible, plain-English web site offering answers to common questions by those facing demands from a possible troll.
4. **Expanding Dedicated Outreach and Study.** Challenges to U.S. innovation using tools available in the patent space are particularly dynamic, and require both dedicated attention and meaningful data. Engagement with stakeholders — including patent holders, research institutions, consumer advocates, public interest groups, and the general public — is also an important part of our work moving forward. Roundtables and workshops that the PTO, DOJ, and FTC have held in 2012 have offered invaluable input to this process. We are announcing an expansion of our outreach efforts, including six months of high-profile events across the country to develop new ideas and consensus around updates to patent policies and laws. We are also announcing an expansion of the PTO Edison Scholars Program, which will bring distinguished academic experts to the PTO to develop — and make available to the public — more robust data and research on the issues bearing on abusive litigation.
5. **Strengthen Enforcement Process of Exclusion Orders.** Once the U.S. International Trade Commission (ITC) finds a violation of Section 337 and issues an exclusion order barring the importation of infringing goods, Customs and Border Protection (CBP) and the ITC are responsible for determining whether imported articles fall within the scope of the exclusion order. Implementing these orders present unique challenges given these shared responsibilities and the complexity of making this determination, particularly in cases in which a technologically sophisticated product such as a smartphone has been successfully redesigned to not fall within the scope of the exclusion order. To address this concern, the U.S. Intellectual Property Enforcement Coordinator will launch an interagency review of existing procedures that CBP and the ITC use to evaluate the scope of exclusion orders and work to ensure the process and standards utilized during exclusion order enforcement activities are transparent, effective, and efficient.

- Legislative Recommendations

1. **Require patentees and applicants to disclose the "Real Party-in-Interest,"** by requiring that any party sending demand letters, filing an

infringement suit or seeking PTO review of a patent to file updated ownership information, and enabling the PTO or district courts to impose sanctions for non-compliance.

2. **Permit more discretion in awarding fees to prevailing parties in patent cases**, providing district courts with more discretion to award attorney's fees under 35 USC 285 as a sanction for abusive court filings (similar to the legal standard that applies in copyright infringement cases).
3. **Expand the PTO's transitional program** for covered business method patents to include a broader category of computer-enabled patents and permit a wider range of challengers to petition for review of issued patents before the Patent Trial and Appeals Board (PTAB).
4. **Protect off-the-shelf use by consumers and businesses** by providing them with better legal protection against liability for a product being used off-the-shelf and solely for its intended use. Also, stay judicial proceedings against such consumers when an infringement suit has also been brought against a vendor, retailer, or manufacturer.
5. **Change the ITC standard for obtaining an injunction** to better align it with the traditional four-factor test in *eBay Inc. v. MercExchange*, to enhance consistency in the standards applied at the ITC and district courts.
6. **Use demand letter transparency to help curb abusive suits**, incentivizing public filing of demand letters in a way that makes them accessible and searchable to the public.
7. **Ensure the ITC has adequate flexibility in hiring** qualified Administrative Law Judges.

The U.S. Government Accountability Office (GAO)

On August 22, 2013, the GAO released its report, *Assessing Factors That Affect Patent Infringement Litigation Could Help Improve Patent Quality*, in response to Section 34 of America Invents Act that mandated that GAO conduct a study on the consequences of patent litigation by NPEs. See <http://www.gao.gov/assets/660/657103.pdf>. To combat perceived patent system abuse, the GAO recommends that U.S. Patent and Trademark Office consider examining trends in patent infringement litigation and consider linking this information to internal patent examination data to improve patent quality and examination. The U.S. Patent and Trademark Office commented on a draft of this GAO-13-465 report and agreed with key findings and this recommendation.

The National Economic Council and the Council of Economic Advisers

The National Economic Council and the Council of Economic Advisers report concludes that the gold-standard approach is to greatly diminish the extent to which legal rules allow patent owners to capture a disproportionate share of returns to investment. The National Economic Council and the Council of Economic Advisers see three main areas for improvement: 1) clearer patents with a high standard of novelty and non-obviousness; 2) reduced disparity of litigation costs between patent owners and technology users; and, 3) greater adaptability of the innovation system to challenges posed by new technologies and new business models. See http://www.whitehouse.gov/sites/default/files/docs/patent_report.pdf.

Federal Trade Commission (FTC) on PAEs

The discourse that I engaged in while at the recent Federal Circuit Bar Association's International Series Conference in Toronto over PAEs astutely foreshadowed the next wave of government action on the matter. On September 30, 2013, the FTC announced its proposal to seek information from approximately 25 companies that are in the business of buying and asserting patents information to examine how PAEs do business and develop a better understanding of how they impact innovation and competition to further effectuate sound policy decisions. See <http://ftc.gov/opa/2013/09/paestudy.shtm>. The proposal is expected to be published in the Federal Register shortly. [Public comments on the proposal can be submitted electronically](#) and will be accepted until 60 days after the Notice is published. All interested parties are encouraged to make their position(s) heard.

Discussion

- Case Study: Response to the PAE Uprising

In the matter of *Network Protection Sciences, LLC v. Fortinet, Inc.*, 3:12-cv-01106-WHA (N.D. Cal.), U.S. District Judge William Alsup made clear that the court would not tolerate abusive litigation tactics.

Network Protection Sciences, LLC (NPS) initially filed this patent infringement suit against Fortinet and four unaffiliated defendants in the Eastern District of Texas on July 6, 2010. Defendant Fortinet manufactures and sells network security products. The other four defendants were also manufacturers of network security products.

In January 2012, Judge Rodney Gilstrap granted defendants' motion to transfer venue, unconvinced that NPS' Texas presence, after being scrutinized, should be given much weight. Plaintiff NPS is one of 22 companies set up by Innovation Management Sciences, LLC ("IMS"). NPS appears to have virtually no assets apart from U.S. Patent No. 5,623,601 (the '601 patent) and conducts minimal, if any, business activities aside from asserting the '601 patent against firms engaged in designing, manufacturing, and selling software products. The '601 patent, titled "Apparatus and method for providing a secure gateway for communication and data exchanges between networks," was issued to inventor Hung T. Vu in April 1997 and was subsequently assigned to NPS.

Since 2010, the founders of NPS and IMS, Rakesh Ramde and William Lam (via various entities they control) have been involved in at least a dozen patent lawsuits against at least 40 defendants. It should be noted that both Ramde and Lam are listed as active-status attorneys.

The record was replete with Plaintiff's litigation misconduct. In his Order denying Fortinet's Motion to Dismiss, Judge Alsup held that Ramde and Lam (and thus NPS) were aware that NPS might not own the '601 patent back in 2010. Moreover, NPS attempted to conceal evidence of the incomplete transfer through discovery stonewalling and obfuscation. See *Network Protection Sciences, LLC*, Order Denying Motion to Dismiss, Dkt. 246, p. 11, Ins. 19-21. Judge Alsup further held that "NPS manufactured venue in Texas via a sham... no litigant should be allowed to manufacture sham venue in that district in order to take advantage of that district's receptiveness to processing patent cases" See *id.* at p. 12, Ins. 7, 24-25. More specifically, Judge Alsup stated that "[t]o create the impression that NPS is something other than a patent troll, NPS and its principals have repeatedly made misleading statements to Fortinet and to the Court." *Id.* at p. 12, Ins. 12-13. Lastly, Judge Alsup held that "two prior orders herein have already found that NPS has engaged in unreasonable and improper litigation behavior." *Id.* at p. 13, Ins. 1-2.

Indisputably, this case is the poster-child for patent trolls because of the litany of NPS' litigation misconduct. In lieu of dismissal for litigation misconduct, which Judge Alsup said is a severe sanction, Judge Alsup ordered that the case to proceed to a jury trial. At trial, NPS would have to justify to the jury its sham employees and a sham file-cabinet office in Texas, and that expert testimony was necessary to establish that this was a legitimate business practice under Texas law.

• Oral Argument Excerpt

THE COURT: You're on the verge of losing this entire motion, and going to the Federal Circuit, with a lot of money against you. So if you want this to live to fight another day, you ought to listen to me for a moment. The best you can hope for is that the jury's going to decide this; but for

the jury to decide the sham nature of this closet in Texas, they're going to have to understand why somebody would want to do this. So an expert is somebody you need to have explain it. This is going to be part of your case.

[COUNSEL]: No, Your Honor, it's not.

THE COURT: Well, then, it will be part of their case.

[COUNSEL]: Why is that relevant to the issue of patent infringement?

THE COURT: If we're going to try ownership here, and all of these issues about whether or not this guy was a sham, or not, the jury's got to understand the background of why it was or was not a sham.

[COUNSEL]: Well, Your Honor -

THE COURT: You're not going to be able to skate by, with -- beat this motion, and then get it somehow excluded at trial. For goodness' sakes.

[COUNSEL]: Well, how is it relevant to the issues that are at trial?

THE COURT: You've got to prove ownership. It's your burden.

[COUNSEL]: And you prove ownership by an assignment; not by -- not by showing -

THE COURT: It may not be valid, Counsel.

[COUNSEL]: But that will be resolved.

THE COURT: No, it's not going to be resolved. You're asking that it be resolved by the jury. I heard you say it a moment ago.

[COUNSEL]: No, Your Honor. I'm sorry.

THE COURT: Well, maybe now you're taking it back. It's on the record. I heard it. So on appeal you can make that point; but this jury is going to hear all of this stuff about the closet. And you're going to have to explain why "Mr. Sham" was signing these documents.

See *Patent Troll Required to Explain "Sham Venue" and "Sham Employees" to the Jury*, at http://www.jdsupra.com/legalnews/patent-troll-required-to-explain-sham-v-20454/?utm_source=jds&utm_medium=twitter&utm_campaign=bizlaw (Sept. 24, 2013).

Not surprisingly, just before the trial was set to begin on October 1, 2013, he issued an Order for dismissal with prejudice wherein each party bore their own costs and fees. See *Network Protection Sciences, LLC*, Joint Stipulated Dismissal With Prejudice, Dkt. 356. The case was then referred to a magistrate judge for settlement talks. Attorneys for both NPS and Fortinet declined comment.

Conclusion

In *Network Protection Sciences, LLC*, and similar cases, courts ought to be more willing to utilize sanctions as well as the other methods discussed herein to shutter the courthouse doors to abusive litigation. It is incomprehensible to have these abusive litigation deterrents and not utilize them when the record screams otherwise. Rule 11(c) of the Federal Rules of Civil Procedure offers sanctions for litigation abuses and indicates that reasonable attorney fees can serve as one form of sanctions. Additionally, the Patent Act provides that a "court in exceptional cases may award reasonable attorney fees to the prevailing party." See 35 U.S.C. § 285. Section 285's language was first included in the 1946 statutory revision of damage calculations. However, rather than limiting the award to "exceptional cases", the 1946 statute provided that "[t]he court may in its discretion award reasonable attorney's fees to the prevailing party." See 35 U.S.C. § 70 (1946 ed.).

It is understood that there is discretion involved in the sanction-worthy, decision-making process. Nevertheless, if rules that are available are not justly applied to appropriate situations, then there is little speculation that abusive litigation tactics will continue. As Federal Circuit Chief Judge Rader says, "[j]udges know the routine all too well, and the law gives them the authority to stop it. We urge them to do so." See Randall R. Rader, Colleen V. Chien & David Hricik, *Make Trolls Pay in Court*, N.Y. TIMES, June 5, 2013, at A5.

It is critical to maintain objective analysis when it comes to the PAEs. The focus on this topic must remain on the substance of stamping out abusive litigation that lack merit and not just the elimination of patent trolls. Remember, substance over form.

The issues posed by PAEs and the intellectual property industry clamor for successful and timely oversight, legislation, and enforcement to address this proverbial 'cat and mouse' game. If the litigation tactics pursued by PAEs did not yield lucrative outcomes, PAEs would likely have never existed to this degree, entered the lexicon, and drew so much ire. Patents are no exception to the doctrine that there is often a 'system' and there are those intent on 'gaming' the system. Therefore, continuous, purposeful, and calculated measures must be taken to eradicate the practices of those who exert undue tactics to effectuate financial gain and antithetically stifle innovation. It is incumbent upon all interested parties to continue to advocate and implement sound policy against abuse of our judicial system. Moreover, there is ever-present need to remain watchful for future harms and be well-prepared to take remedial action-steps prior to a burgeoning issue becoming another grotesque black-eye on the face of an already over-taxed judicial system.

