Tech | August 24, 2012 | CFO.com | US

What You Need to Know About Patent Trolls

The Apple-Samsung courtroom clash is a magnified version of the intellectual-property battles currently roiling smaller companies in the tech space.

David Rosenbaum

While Apple and Samsung duke it out in federal court for billions in damages and control over the global smartphone and tablet market, 01 Communique, a Mississauga, Ontario-based software firm with 15 full-time employees and annual revenues of less than $1 million, is waiting to hear from the U.S. Court of Appeals on a patent infringement suit it brought against LogMeIn, a remote access software company with 482 full-time employees and $119.5 million in 2011 revenues.

01 Communique, which specializes in remote access software, has also sued Citrix Systems, a multinational cloud-computing company with more than 6,000 employees and $2.1 billion in 2011 revenues, again for patent infringement. Last June, 01 Communique settled a suit against Bomgar, a private-company provider of remote computer support. As a result of the litigation, Bomgar entered into a licensing agreement with 01 Communique and, according to a company statement, 01 Communique received "a set series of payments."

"We like to think we're what the patent system is all about," says 01 Communique CFO Brian Stringer. 01 Communique applied for its first patent in 2000 and it was granted in 2005. The company now has five patents, with two more under consideration. "We spent a lot of money trying to develop not just products, but product awareness," Stringer says. "We've spent about $25 million developing and competing. But we were very naïve. We didn't realize how difficult it is to protect your intellectual property. We learned quickly. And we made a conscious decision that since we were competing against bigger companies — and lost a number of large accounts — we were going to protect our IP rights."

To help protect its rights, in 2011 01 Communique partnered with WiLAN. WiLAN's business is based on acquiring patents or partnering with companies like 01 Communique to assert their IP rights, either through negotiation or litigation. WiLAN offers its services for free, and in return takes a portion of the licensing fees it gets other companies to pay, or a piece of a settlement or court award.

According to WiLAN CEO Jim Skippen, 100% of WiLAN's $106 million annual revenue comes from licensing patents. "We think we're a growth company," he says. "Double, triple revenue: we're working toward that."

Other, larger IP licensing companies include Acacia Research, which has sued Red Hat, Novel, and Apple. Digitude Innnovations, which bought patents from Apple and filed suit against a number of software companies, and Intellectual Ventures, founded by former Microsoft chief technology officer Nathan Myhrvold, are two others.

Because WiLAN and the other IP companies own and assert rights over IP (Skippen says WiLAN has acquired more than 3,000 patents in the past six years) but don't make anything or use those patents to provide any service, they're defined by the U.S. International Trade Commission (USITC) as Non-Practicing Entities.

There's another appellation that's used to describe NPEs: patent trolls. They're called that because they didn't build the bridge; they don't maintain the bridge; they just collect a fee for allowing you to cross the bridge.

The name implies that they're ugly, doing ugly business.

But to some CFOs, like Stringer, they're beautiful.

Patent Wars and Patent Trolls

The argument between Apple, which this month became the most valuable publicly traded company in the world with a market capitalization north of $620 billion, and South Korean multinational Samsung, with over 20% of the global handset market and a market cap of about $182 billion, went to the jury Wednesday.

Yesterday, a South Korean court ruled that Apple and Samsung had infringed each other's patents, awarded damages to both, and ordered them to stop selling certain phones and tablets in South Korea. But while the disputes between these colossi get gallons of ink, far smaller, far less-publicized skirmishes, such as 01 Communique's various lawsuits, are increasingly breaking out.

In fact, the USITC is increasing its staff and building a new courtroom slated to be finished this fall. It needs a new courtroom, it says in a June report, because the numbers of investigations under Section 337 of the Tariff Act of 1930 that involve "allegations of infringement of patents or other IP rights" have increased by more than 530% from 2000 to 2011. In other words, the USITC needs a bigger boat because the IP waters are filled with patent sharks.

Some people have argued that these sharks, or trolls, stifle innovation. As patent lawsuits and the cost of defending them increase, capital that would be invested in research and development, the argument goes, dries up. A recent Boston University study on the cost of nonpracticing entity disputes puts the 2011 price tag of NPE lawsuits at about $29 billion.

The largest driver of all this litigious activity, the USITC report says, is technology, specifically "high tech products such as smartphones and tablet computers." That's because literally hundreds of thousands of patents are expressed in every single device. However, another critical driver is that businesses and CFOs are awakening to the idea that, as Kimberly Klein Cauthorn, director of insurance operations for RPX, a provider of patent risk solutions, says, "People are seeing patents as assets."

Before businesses started paying huge amounts for, and litigating over, patents, they were commonly viewed as obscure legal rights that were warehoused rather than managed, and when used, were used defensively to discourage competition in the marketplace. Now, thanks to the enormous, highly publicized sums being spent to buy portfolios of patents, they're beginning to be viewed as valuable assets. Consequently, it's inevitable, says Cauthorn, that "people will spend time trying to figure out how to make money on them" and, she adds, a new secondary market is emerging based on buying and selling patents.

To which Erich Spangenberg, CEO of IP Navigation Group, which offers "full service patent monetization," would shout, Amen. "We've gotten more calls this year than in the previous 10," he says. "CFOs are beginning to realize that patents represent real value independent of the product associated with it.

"Any CFO," Spangenberg says, "should want to make money with his patents. It's incremental working capital. They already have the asset. Why not make money on it?"

What Spangenberg says he does for small and midsize businesses is to analyze their patents and figure out who might be infringing on them. He then "marches [the patent] to, say, an Internet commerce company and I encourage them to license it. If they don't, there's the option to go to court. Our job is to educate the licensee to take on the license without litigation.

"Look," Spangenberg concludes, "for a small business, you won't make it if you can't protect what you're doing. You'll go out of business."

As for the accusation that he's a troll, Spangenberg argues that the phrase shows bias. "It's a derogatory term for someone who owns a patent. I just try to take [the word troll] out of the mix," he says. "I prefer patent owner. A patent is not a right to produce; it's a right to exclude. You get the right to exclude someone else from using an idea for a period of time. Some people truly go out to create a better world and they don't care about money. But a majority of companies, especially small companies, need some way to protect their innovation."

WiLAN's Skippen echoes Spangenberg. "I personally think that the term patent troll has come out of the large entities that have the impunity to take other people's IP. Companies like ours help small patent owners get value from their IP and large companies don't like it. Why don't we have a term like patent thief for companies that take IP and don't pay for it?"

Anne Culotta, a patent attorney at Culotta Law Firm, believes that the "asymmetry" in patent law — wherein a troll bringing suit against an entity using the patent has nothing to lose (other than time and money), whereas if the patent user loses in court it can be enjoined from making a product or delivering a service — is being addressed via fines for bringing bad suits to even the playing field. Still, says Culotta, there's need for more reform while the "ways of extracting value from IP are continuing to evolve."

But even with a more even playing field, going into court is something most companies and their CFOs try to avoid. Once a letter of complaint is received by a business, Culotta says, "the cash register starts to roll. In many cases, the calculus [for the CFO] is: 'I need this uncertainty to go away,' and not bother with the protracted expenses of litigating a patent suit." In other words, it's easier to settle, which is what patent trolls bank on.

CFOs and Patent Litigation

Asked about patent trolls, Ryan Goepel, CFO of Zeitecs, a private oil field technology company, asks, "Aren't those guys who make life miserable for people?"

But Goepel admits that, as a former finance executive at Halliburton, he was thinking "as a big-company guy." Zeitecs, considerably smaller, has from 10 to 20 patents "in various stages" in its portfolio. Goepel has not employed the services of an NPE nor has he licensed any of Zeitecs's patents, but says he's open to it. "With any decisions we make [about IP]," he says, "licensing is one of the things you evaluate."

Zeitecs has one specific patented technology that its leadership believes is a competitive differentiator. If someone infringed

on that, says Goepel, “We’d raise holy hell, because that’s core. We’d definitely send a letter and if they said go pound sand, we’d definitely have to look at [litigation].”

One of Goepel’s problems with trolls is that his company operates in a small space. If he believes anyone in that space is violating one of Zeitecs’s patents, “We would negotiate directly. I’d be uncomfortable with a third party because of our relationships with our competitors. We don’t want to burn bridges. You don’t know how a third party will act. The third party might not care about those relationships. I think when you go down the litigation route, you’ve done a risk-reward assessment and you’ve decided you can’t beat the competition in the market. Suing always takes way longer than you expect and costs more than you expect: it becomes all-consuming. Your business model becomes litigation.”

01 Communique’s Stringer believes he’s protecting his company by leveraging WiLAN’s expertise to enforce the patents — the assets — that his company has spent “a lot of time and work developing.”

Generally accepted accounting principles and international financial reporting standards “don’t provide for capitalization of IP,” Stringer says. “It’s carried on your books for next to nothing. So the IP is difficult to value. But if someone is infringing rights, taking away market share, well, it’s not a simple spreadsheet question, but it goes to the core of your business, the heart and soul of our company.

“I’ve been here 14 years. We believe very strongly that this is our technology; we invented it; we expect to win the battle against Citrix. If you believe you’re justified, you continue to fight. And we will. Damages keep accruing, and we’re entitled to compensation for that.

“David beat Goliath, didn’t he?”