

You may not have a choice. Trolling for Dollars

Patent enforcers are scaring corporate America, and they're getting rich — very rich — doing it

By Brenda Sandburg
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Peter Detkin's spin sounds surprisingly like something out of the Brothers Grimm.

In the sleepy village of Santa Clara, there lived a very wealthy but very frightened giant named Intel. Intel was plagued by a fearsome band of evil trolls -- patent trolls, to be exact -- who wanted a glittering pot of gold in exchange for doing absolutely nothing. And they were very powerful because they said they owned the patent on some of the magic Intel used to become rich.

The true story behind the fairy tale, at least Detkin's version of it, unfolds like a case study on a patent system run amok. The assistant general counsel at semiconductor titan Intel Corp., Detkin spends much of his time these days fighting off claims of patent infringement by companies that have never made a semiconductor device. In 1999 alone, the claims topped \$15 billion, Detkin said, and he hurls the epithet "patent trolls" at the companies that want Intel to pay up. He even keeps a couple of troll dolls on his desk in the gray warren of buildings at Intel's Santa Clara headquarters just as a reminder of his company's legal enemies.

"We were sued for libel for the use of the term 'patent extortionists' so I came up with 'patent trolls,'" Detkin said. "A patent troll is somebody who tries to make a lot of money off a patent that they are not practicing and have no intention of practicing and in most cases never practiced."

The companies Detkin calls trolls relate a much different version of the fairy tale. In their story, Intel is a crafty colossus who stomped on their rights and brazenly stole the all-important magic that helped spin the semiconductor into gold. They're just getting a fair share for themselves and their clients and contend this is why the patent system is in place: to protect the small from manipulative mammoths like Intel.

And more and more, they are the ones who get to write the happy ending for the story.

In the last decade, patent enforcement has grown into a multibillion shadow industry that is transforming America's patent system from a security fence protecting inventors

from exploitation into a money-minting machine for a few patent holders.

The key to the new industry's success has been a small, yet aggressive, army of lawyers who help enforcers hammer companies with infringement claims. And the attorneys, like the patent enforcement shops they represent, are getting rich very rich. By the most conservative estimates, the best-known lawyer in the patent-enforcement industry, Gerald Hosier, has pulled in at least \$400 million in fees. But even smaller players are seeing spectacular returns. Lawyers in the field routinely charge contingency fees as high as 45 percent, and suits can settle for as much as \$50 million.

Despite the big settlements, the industry's growth has been largely under the radar. Not even the enforcers themselves know how many companies have been formed in recent years to tap into the lucrative power of the patent.

And though companies that specialize in buying and enforcing patents have earned the unending enmity of corporate executives, that hasn't stopped major corporations from doing exactly the same thing -- using claims of patent infringement as an extremely lucrative new way of generating revenue.

"In the last three to five years, the business has been growing exponentially because everybody is getting into the act," said David Braunstein, vice president of the intellectual property consulting firm Fairfield Resources International Inc. of Stamford, Conn.

Braunstein said that from 1980 to 1999 royalties on patents in the United States grew from \$3 billion to nearly \$110 billion. IBM alone generates \$1 billion in income from patent royalties -- a figure 2,000 percent higher than in 1988.

Patent enforcers and their lawyers have used the simple, yet effective, power of financial threat to persuade companies to settle. Companies fear the expense of patent litigation -- which can run as high as \$2 million per patent and often would rather settle with a patent enforcer than mount an expensive fight. If they do make it to the courtroom, there's no guarantee they'll win, and an injunction to stop a company from manufacturing an infringing product would create the financial equivalent of nuclear winter.

As Detkin puts it: "I'm so afraid of that happening, I'm almost forced to the settlement table."

A Chief Exponent

The fear Detkin describes can come from anywhere - even the quiet, well-heeled suburbs north of Chicago. There, in an unremarkable office building it shares with a bank branch, is TechSearch LLC, one of the chief exponents of new-style patent enforcement.

In the last three years, TechSearch has made millions of dollars -- primarily from a patent it acquired on a method of transmitting data between computers. Close to 100 companies -- including UAL Corp., Sears, Roebuck and Co. and Hyatt Corp. -- have opted to pay TechSearch to license the technology rather than take the fight to court.

Not that the settlements have earned TechSearch much respect: "I have mixed feelings about those organizations. From an ethical standpoint, they're almost like ambulance chasers," said Andy Gibbs, CEO of PatentCafe.com Inc., a Web site that focuses on intellectual property issues.

TechSearch embodies the criticism leveled most against patent enforcement specialists: It is not the inventor who sought the patent, it produces nothing, it sells nothing. It simply makes money by exploiting broad patents that have never really been enforced. It lives, primarily, to sue.

"At one end of the scale is a professional group that makes good, sound legal arguments," said Stephen Fox, associate general counsel and director of IP at Hewlett-Packard Co. "At the other end of the spectrum are outright extortionists."

As one might expect, the term "extortion" gets under the skin of TechSearch's executives and lawyers. TechSearch was the company that hit Intel with a libel suit when a spokesman called the company a patent extortionist, and Anthony Brown, TechSearch's top executive, makes no apologies for the company's aggressive approach.

Brown has reason to feel protective -- TechSearch is his baby, after all. A former partner at Chicago's Jenner & Block, Brown founded the company three years ago without the key ingredient to build a successful enforcement business -- a patent. So he began a long search of the Patent and Trademark Office's list of issued patents. The goal: to find one that wasn't being enforced and that could ring the bells on the company cash register.

"The needle-in-the-haystack approach," as Brown calls it, struck gold when he found the patent on transferring data between computers. It's a patent so broad that Brown acknowledges anyone with a Web server could be sued for infringement.

The company now owns about two dozen patents, buying the rights from inventors and splitting licensing proceeds with them. The company won't disclose revenues, but has already pulled in at least \$3 million on the Internet patent alone.

"If it weren't for companies like TechSearch the small inventor or small company would be deprived of their rights," Brown said. "Should big companies have a free ride because they are dealing with small companies or inventors?"

The Lawyer

Of course, sometimes TechSearch has to follow through with its threat of a suit. That's where Raymond Niro Sr. comes in.

Niro's 26-attorney, Chicago firm, Niro, Scavone, Haller & Niro, is devoted exclusively to plaintiffs intellectual property litigation. His clients include big companies, such as Black & Decker, but he said he tends to represent the little guys who can't afford to litigate against major corporations. He puts TechSearch in that category.

He also represents another pair of prominent players in patent enforcement: Fort Worth-based PhoneTel Communications Inc. and IMS Technology Inc. in Alexandria, Va. Both have been immensely successful. PhoneTel, which enforces the patents of the inventor of the answering machine, has secured more than 50 licenses worth \$55.5 million in royalties. IMS, which enforces a patent on interactive control of machine tools, has collected more than \$50 million in licensing fees, and is in the process of acquiring additional patents.

The fact the companies don't make a product doesn't phase Niro, and he bristles at critics who brand his clients extortionists. They, he contends, are doing nothing different from large corporations that defend their patents.

"It's not extortion when the money is coming to them," Niro said. "Then it's the exercise of their constitutional right."

Chance Encounter

Niro got into the patent enforcement business by chance. He had been a partner at a Chicago litigation boutique when in 1976 he and Gerald Hosier split off to start their own firm.

One of their early clients was George Richards, the inventor of the automatic shut-off nozzle used on gas station pumps. Richards didn't have money to go after a pump manufacturer using his invention, so he begged Niro and Hosier to take his case on a contingency fee basis, offering to pay them half of whatever award they negotiated.

The deal changed their lives.

"We won \$200,000 without a trial," Niro said. "The two of us were ecstatic. We got \$50,000 each and all we did was file a complaint and take discovery."

Hosier left the partnership in 1983 to form a solo practice. "Jerry wanted to do contingency fee work exclusively," Niro said. About 60 percent of Niro's business is in contingency fees.

Five years later, Hosier began representing Jerome Lemelson -- the late inventor whose pursuit of licensing fees for his controversial patents on machine vision and bar code technologies has sparked the dreams of many of the newly minted patent enforcers. With Hosier's help, Lemelson collected more than \$1 billion in revenue. And Hosier himself made hundreds of millions in attorneys fees.

Niro hasn't fared badly himself. Since April 1994 he has won 20 multimillion-dollar jury verdicts in a row on behalf of his clients. The string of wins has garnered "in excess of \$400 million," Niro said. His fee generally ranges from 35 percent to 45 percent of the gross revenues.

The Big Score?

But the big score could come with TechSearch. In 1998 the company acquired a microprocessor patent from International Meta Systems Inc., a defunct computer chip designer. TechSearch promptly sued Intel for infringement.

The suit is an example of just how high the stakes have become for patent enforcers and their corporate foes. TechSearch is seeking \$2 billion to \$7 billion in damages and an injunction against Intel to stop production of its Pentium processors.

Intel has fought back with every weapon in its arsenal: It has used a Cayman Islands-based shell company, Maelen Ltd., to try to take the patent away from TechSearch. Maelen, which is owned by Intel, asked a Texas bankruptcy court to void TechSearch's purchase of the patent, arguing the company had paid too little for it. The judge denied the request.

A company spokesman downplayed the use of a shell company: "We use unnamed companies when we're buying assets in a competitive environment and the Intel name might drive up the price," said company spokesman Chuck Mulloy.

A federal court subsequently rejected TechSearch's infringement claims against Intel, but an appeal is pending with the Federal Circuit U.S. Court of Appeals. Niro contends that IMS should be reimbursed for use of its patented technology, which he said makes Intel's Pentium processors compatible with earlier chip designs.

"It's like Robin Hood," Niro said. "We take from the rich and give to the poor."

Joining In

As gag-inducing as the Robin Hood analogy may be to a corporate executive in a patent enforcer's crosshairs, many are delighted by the thought of making a lot of money on an idea that's free of production, marketing and most other overhead costs. Although they may deride purchasing patents simply to license them for cash, a number of corporations are doing exactly what TechSearch and its fellow licensing shops do.

Take, for instance, Pitney Bowes Inc. Pitney Bowes makes postage meters. Yet it has amassed patents on technology for everything from cellular phones to word processors. The company doesn't make laser printers, yet it obtained a patent for improving print resolution. Pitney then sued Hewlett-Packard for infringement, and last month HP agreed to pay \$400 million in cash to settle the dispute.

Many corporations and universities have established licensing departments only in the last few years, Fairfield Resources' Braunstein said. Corporations also are now pursuing a "patent factory" approach where they obtain patents to cover future developments in their industry. Companies "don't do experimental work" to support these patents but simply put the invention on paper, he said.

While corporations may bemoan the patent enforcement

boutiques, the small shops like TechSearch are doing the same thing as a Lucent or Texas Instrument, Braunstein said. "Don't pick on little consultants that do this," he said. "It's part and parcel of licensing as a business."

Until about 15 years ago companies didn't pay much attention to their patent portfolios. AT&T, IBM and Fairchild Camera and Instrument Corp. (which was acquired by National Semiconductor Corp.) were the first to license their patents in significant numbers. However, they charged a relatively small fee.

It wasn't until the late 1980s when Texas Instrument started suing companies for infringing its semiconductor patents that the licensing business took off. The company has made an estimated \$3 billion through patent licensing.

T.J. Rodgers, president and CEO of Cypress Semiconductor Corp., is critical of companies that make a business out of enforcing patents. But he makes a distinction based on their motivation. "They fall into three categories," Rodgers said, "the good, the bad and the ugly." The good companies don't go on the offensive unless a patent critical to their business is being infringed, he said.

The bad companies have a structure in place whereby they actively seek out people who might be using their intellectual property, and the ugly are "intellectually empty companies like Rambus who are basically in the business of suing people for money." Los Altos-based Rambus Inc. licenses rights to computer memory technology to about 30 companies. Several companies have litigated over the validity of Rambus' patents.

The distinction, however, seems a stretch to Brobeck, Phleger & Harrison partner Daniel Harris.

"Some companies will get a bad rap for licensing their technology in lieu of creating products themselves," Harris said. "But if you look at it from the perspective of someone holding physical property, most people would not begrudge them the right to rent or sell it."

Harris said value judgments should be based on the patent

at issue rather than the practice of enforcement. "There's nothing untoward in exploiting IP," he said. "It's a question of the strength of the patent. Some are not worth the paper they are written on."

Companies with overly broad patents sought to capitalize on their position last year. During the IPO frenzy, Harris said, these companies threatened to sue start-ups for infringement just as they were about to go public. "It's a difficult decision whether to pay a modest license fee to make this go away or fight it" and have to disclose the threat of litigation as a material event, he said. "The road show turns into 'What's going on with this?'"

Companies that buy up patents and see how much money they can rake in from licensing them are "far removed from the benevolent vision of the inventor creating [something] in his garage and trying to nurture it," said Guy Chambers, a partner at Townsend and Townsend and Crew. He said he represented such a company in a suit against a Japanese firm. "I didn't get very much respect from the judge," Chambers said, adding that he would have some reluctance to take such a case again.

"It's important to have a case that evokes sympathy from the judge and jury," he said.

Sympathy is a tough sell for Intel's Detkin. He's more prone to derision when it comes to the fable he says patent trolls have created about Intel. In their story, the trolls were the masterminds behind the company's signature product, the Pentium processor. Intel's engineers simply stole their work.

"I guess our guys just sit around and read patents," Detkin said.

The red-nosed, gap-toothed mug of a plastic troll a colleague gave him isn't far away as Detkin ponders the patent enforcers' claims.

This time he evokes Mel Brooks rather than the Brothers Grimm: "It's like in *The Producers*. They all claim they're entitled to a percentage."

See Related Chart — The Enforcers

The Enforcers

A selection of companies in the patent licensing business and their estimated revenues

\$1.2 billion in company revenues since 1988

Lemelson Medical, Education & Research Foundation
(Incline Village, Nev.)

Clients/Litigation:

Jerome Lemelson and his estate have filed about 15 lawsuits against nearly 800 companies, most of which have agreed to license Lemelson's patents.

\$700 million for clients since founding in 1988

Mahr-Leonard Management Co.
(Dallas)

Clients/Litigation:

Clients include Harris Corp., National Semiconductor, EMI, Gilbert Hyatt.

\$500 million for clients since 1995

André-Troner Ltd. Co.
(Melbourne, Fla.)

Clients/Litigation:

Clients include Stanford University, Kodak Digital Camera, Lockheed Martin.

\$350 million to \$450 million in licensing fees since 1994

Ronald A. Katz Technology Licensing L.P.
(Los Angeles)

Clients/Litigation:

Sued AT&T Corp., Microsoft Corp., IBM Corp., Intel Corp. and Sprint Corp.

\$65 million in company revenues in 2000

BTG plc
(London)

Clients/Litigation:

Manages about 10,000 patents.

\$55.5 million in royalties since 1996

PhoneTel Communications Inc.
(Fort Worth, Texas)

Clients/Litigation:

Sued AT&T Corp., Lucent Technologies, Southwestern Bell, Sprint and others.

\$50 million + in licensing fees since 1996

IMS Technology Inc.
(Alexandria, Va.)

Clients/Litigation:

Sued Mitsubishi Electric Corp. and Haas Automation Inc.

\$17 million in company revenues in 2000

Refac
(Edgewater, N.J.)
Clients/Litigation:
Sued Lotus Development Corp., Hitachi Ltd. and IBM Corp.

\$4.1 million in company revenues in 2000

Competitive Technologies Inc.
(Fairfield, Conn.)
Clients/Litigation:
Clients include Sony, Lucent, Bell Atlantic.

\$3 million estimated on single computer technology patent

TechSearch LLC
(Northbrook, Ill.)
Clients/Litigation:
Suits pending against Intel Corp., online education company UNext, and the Green Bay Packers.

\$1 million + in licensing fees since 1995

General Patent Corp.
(Suffern, N.Y.)
Clients/Litigation:
Has sued IBM Corp., Motorola Inc. and U.S. Robotics Corp.

\$202,000 from a \$575,000 settlement

Patent Enforcement and Royalties Ltd.
(Toronto)
Clients/Litigation:
Has supported six lawsuits, including a German inventor's suit against hair dryer manufacturer Conair Corp. and a doctor's suit against Land O' Lakes Inc.

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Source: Patent enforcement companies; Securities and Exchange Commission