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# Startups and Patent Trolls



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SUMMARY			
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## Abstract

This article estimates the impact of Patent Assertion Entities (PAE) on small companies based on an analysis of patent litigation data regarding the period 2006 – 2012. A non-random survey of 223 tech company start-ups was conducted (79 of which had received a demand from a PAE), as well as interviews with relevant stakeholders. The authors propose reforms and highlight methods that would help small companies dealing with PAEs.

## Keywords

Patent Assertion Entities; small companies; patent strategy; startups; technology.

## Summary

Patent assertion entities (PAEs) use various strategies with respect to their disputes with small companies. Sometimes their strategy is to raise demands against many companies at once, in order to achieve more settlements.<sup>1</sup> Alternatively, they seek to secure a royalty rate or venue, suing small companies together with larger ones, so the small companies would submit themselves to an agreement of high royalty rates, due to a number of different reasons, such as the cost of patent disputes. Another strategy adopted is to go after small companies for their usage or implementation of existing technology rather than technology that was developed by them. The fact is that many fundamental parts of commerce are patented, having a consequence of a broad usage for different agents, creating a large number of targets. Lastly, small companies that serve a large number of clients are chased, because PAEs aim at their clients.<sup>2</sup>

During the research period, around 60% of the demands raised involved software or high-tech patents. 40% of the survey respondents were being targeted because of the

<sup>1</sup> CHIEN, COLLEN V: Startups and Patent Trolls [2012], 2

<sup>2</sup> *Ibid*, 16

implementation of a widely available technology.<sup>3</sup> According to the RPX Database, most of the unique defendants of these legal disputes are small companies (66% of the unique defendant companies have less than \$100M annual revenue, of which at least 55% have revenues of \$10M per year.)<sup>4</sup> Based on unique defendants, suing small companies distinguishes PAE's from operating companies, because the latter sued companies with less than \$10M of annual revenue only 16% of the time.<sup>5</sup>

The costs of these disputes were higher when the primary response was to fight in court, delivering an average expenditure of \$857K, followed by the settling cost that had an average of \$340K. Lastly, using alternative dispute resolution methods and fighting outside of court had average costs of \$168K.<sup>6</sup>

When analyzing the impact of PAEs on small companies, the study has shown that due to the characteristics of these companies, a PAE demand resulted in one or more significant operational impacts for 40% of them.<sup>7</sup> 18% reported product change, 15% delay in non-headcount milestone, 13% resulted in exit of business/line or pivot business strategy, 10% had issues with delay in hiring and 4% was impacted in fundraising.<sup>8</sup>

However, operational changes were not the only implication of demands raised by PAEs: 22% of the respondents reported that firstly they did nothing about litigation, while 35% fought the demand and 18% settled it.<sup>9</sup> The study has also shown that beside the economic impacts, small companies usually take litigation more personally, resulting in considerable emotional distress.

Yet, PAEs also deliver positive effects on small companies. Strategically developing a patent portfolio can help young operating businesses by providing new sources of economic return. However, only 4% of the survey respondents were monetizing their patents. A company that possesses patents is able to dissolve rather than go bankrupt or delay the death of a seller by selling (even if the broker fees vary from 15-25%) the patent to a PAE.<sup>10</sup> According to the author's view, if a company is able to identify the right patentable invention, it is rewarded with a range of options, which can even include becoming a PAE or just holding the patent.

Based on its research, the author highlights some of the current reforms that can reduce the harms of patent assertion and increase the benefits of a broad patent market for small companies.<sup>11</sup>

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<sup>3</sup> *Ibid*

<sup>4</sup> *Ibid*, 10

<sup>5</sup> *Ibid*

<sup>6</sup> *Ibid*, 2

<sup>7</sup> *Ibid*, 12

<sup>8</sup> CHIEN, COLLEN V: Startups and Patent Trolls [2012], Fig 1

<sup>9</sup> *Ibid*, 2

<sup>10</sup> *Ibid*, 19

<sup>11</sup> *Ibid*, 21

- The current efforts, like the e-discovery reforms or the decrease on litigation fees, are reported as advantageous for big companies but have small effects for medium and small sized companies, because the costs are still high.<sup>12</sup>
- SHIELD Act would require PAEs to pay the defendant's fees if the patent was invalid or non-infringed.<sup>13</sup> However, small companies would still have to go through the procedure to invalidate or prove the non-infringement and that still requires expenses and time that maybe are not available to these companies.

Taking the specific needs of small companies when being targeted by PAEs into account, the author makes three proposals:

- Setting collective, self-help-based solutions, such as joint defense efforts and industry association groups that would disseminate best practices and information about the disputes. In addition, guidance on not settling and on how to manage insurance and other issues could be added.<sup>14</sup>
- Expanding existing limits of liability or a congress adoption of a version of "innocent use defense" (due to the fact that 40% of the survey participants argued that they were targeted for the innocent usage of wide available technologies and at least 60% of those cases involved software or high-tech patents.)<sup>15</sup> These measures could discourage those practices.<sup>16</sup>
- Reducing the return of patent assertion by not validating patents held by PAEs through royalty-based settlements. Courts could increase the standards for providing damages.

The author provides a list of best practices for start-ups dealing with these issues that consists of 11 suggestions:

1. **Don't Panic** – Remaining calm and remembering that patent demands are common in business will help to control the situation.
2. **Keep a low profile** – If there is a strong belief that a license is not needed, doing nothing sometimes is the best option possible, since it will save the business resources.<sup>17</sup>
3. **Find a lawyer with a long-term view and business savvy** – The author's advice is to find a lawyer that understands the business and your intentions and strategy.<sup>18</sup>
4. **Know yourself** – Understanding if the patent really concerns the business will provide an easier way out, and this should be a priority, unless the business has its own unique prior art.<sup>19</sup>

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<sup>12</sup> *Ibid*

<sup>13</sup> *Ibid*, 22

<sup>14</sup> *Ibid*, 23

<sup>15</sup> *Ibid*

<sup>16</sup> *Ibid*, A9

<sup>17</sup> *Ibid*

<sup>18</sup> *Ibid*

<sup>19</sup> *Ibid*

5. **Check out the people, not just the patent** - Do some background research on who is holding the patent and who is representing them, in order to visualize the true reasons why they are chasing your business.<sup>20</sup>
6. **Poverty defense** - PAEs are mainly interested about money, so being clear about the financial situation of the business and asking how much it will take to discontinue the litigation is a clever strategy.<sup>21</sup>
7. **Team up** - Seek out joint defense with the certainty that the other defendants are not opting for an aggressive approach.
8. **Life Support** - In order to reduce expenses, offer help with the defense, e.g., by having an engineer assessing non-infringement defenses or search for prior art.<sup>22</sup>
9. **Pick battles carefully** - Prioritize the right lawsuits and pick the right strategy analyzing case by case, e.g., by being aggressive when it costs more.<sup>23</sup>
10. **Advice for all times:** Don't be an easy target. PAEs study their targets, so make it difficult to access detailed documents or video tutorials that provide too much information.<sup>24</sup>
11. **If you are looking to sell your patents** - The author's advice is to work with a broker due to the risk of the patent not being on the radar.<sup>25</sup>

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<sup>20</sup> *Ibid*

<sup>21</sup> *Ibid*

<sup>22</sup> *Ibid*

<sup>23</sup> *Ibid*

<sup>24</sup> *Ibid*

<sup>25</sup> *Ibid*