

## PATENT LICENSING AND THE EMERGENCE OF A NEW PATENT MARKET

I.	INTRODUCTION .....	446
II.	BACKGROUND.....	448
	A. <i>Economic Landscape of the United States: The Shift to a New Idea Economy</i> .....	448
	B. <i>Current Outlook of the U.S. Patent Licensing Market</i> .....	449
	C. <i>The Patent Portfolio and Traditional Business Models in Patent Licensing</i> .....	451
	1. Broad Portfolio Model.....	452
	2. Deep Portfolio Model .....	452
	3. Patent Pool Model.....	452
	D. <i>Patent Trolls</i> .....	453
III.	ANALYZING THE ACTIVITIES OF THE PATENT LICENSING FIRMS FROM AN ECONOMIC VIEWPOINT .....	455
	A. <i>How Does the Patent Licensing Market Operate? A Closer Look</i> .....	455
	1. The “Patent Market” .....	455
	2. Inherent Problems in the Patent Market .....	456
	3. The Real Victims of the Troll Problem .....	458
	B. <i>Patent Licensing Firms</i> .....	459
	1. Patent Dealers Encourage Exchange .....	460
	2. Patent Dealers Make Patents More Liquid .....	460
	3. Patent Dealers Clear the Market .....	461
	4. Pressing Questions About Patent Licensing Firms .....	462
	C. <i>Criticisms Against Patent Licensing Firms</i> .....	463
	1. Do Patent Licensing Firms Hinder the Progress of Useful Arts? .....	463
	2. Do Patent Licensing Firms Spur Vexatious Litigation? ....	465
	3. Do Patent Licensing Firms Encourage Low Quality Patents? .....	466
IV.	JUDICIAL AND CONGRESSIONAL RESPONSE .....	466
	A. <i>The Magnitude of the Troll Problem</i> .....	467
	B. <i>Recent Supreme Court Cases</i> .....	468
	1. <i>MedImmune, Inc. v. Genentech, Inc.</i> .....	468
	2. <i>KSR Int’l Co. v. Teleflex Inc.</i> .....	470
	3. <i>eBay Inc. v. MercExchange L.L.C.</i> .....	472
	C. <i>Patent Reform Act of 2007</i> .....	475

446      *HOUSTON BUSINESS AND TAX LAW JOURNAL*      [Vol. IX

1. Invention Date Finally Eliminated From US Law .....475

2. Post-Grant Review .....476

3. Apportionment of Damages.....476

D. *Overall Impact of the Cases and Proposed Legislative Reforms*.....477

V. CONCLUSION.....479

I. INTRODUCTION

It should come as no surprise that the patent licensing market in the U.S., like most other technologically advanced nations today, is skewed heavily in favor of large corporations with massive patent portfolios.<sup>1</sup> The current patent system provides very few opportunities for smaller patentees<sup>2</sup> and severely undercuts their ability to operate in the licensing market.<sup>3</sup> Even if they somehow obtain access to licensing opportunities, they still face significant barriers in negotiating favorable licensing terms with potential licensees.<sup>4</sup> Unable to earn their fair share of compensation for their patents through licensing, some small patentees who lack the means to commercialize their patents have resorted to litigation or threat of litigation as a way to assert their rights and seek monetary reward for their patents.<sup>5</sup>

Because the current patent system does not provide a viable solution to this problem, patent licensing firms have recently emerged to provide novel business models for struggling smaller patentees.<sup>6</sup> According to some practitioners, the variety of market-based strategies and resources that these licensing firms offer to small patentees could help improve overall market efficiency by enabling smaller patentees to play a more prominent role in the patent licensing market.<sup>7</sup> The idea is that, with a better

1. Peter N. Detkin, *Leveling the Patent Playing Field*, 6 J. Marshall Rev. Intell. Prop. L. 636, 636 (2007).

2. A patentee is “[o]ne who either has been granted a patent or has succeeded in title to a patent.” BLACK’S LAW DICTIONARY 1162 (8th ed. 2004). Inventors are presumed to be the patentees unless there is an assignment of ownership. See John A. O’Brien, *Taking Invention Disclosures: Practical and Ethical Considerations*, in FUNDAMENTALS OF PATENT PROSECUTION 2008: A BOOT CAMP FOR CLAIM DRAFTING & AMENDMENT WRITING 11, 43 (2008), available at 936 PLI/Pat 11 (Westlaw).

3. Detkin, *supra* note 1, at 636.

4. *Id.* at 637-39.

5. See *id.* at 640.

6. See *id.* at 637; see also Joff Wild, *IV’s Detkin Explores the Role of Aggregators in a Changing Patent World*, IAM MAGAZINE, Sept. 22, 2007, available at <http://www.iam-magazine.com/blog/detail.aspx?g=6514d2f4-5426-4ab9-9864-071ef26c87b9> (critiquing Detkin, *supra* note 1).

7. See Detkin, *supra* note 1, at 637 (describing how the patent commercialization strategies deployed by patent licensing firms can “marshal capital, expertise, connections, and economies of scale to knock down the barriers that have thwarted small inventors and offer alternatives to litigation, with all its expenses, delays, and uncertainties”).

representation in the market, smaller patentees would no longer need to resort to litigation to solve their problems.<sup>8</sup> Some critics, however, believe patents are valuable only so long as they are commercialized into useful products, and have accused nonpracticing patentees<sup>9</sup> and their licensing firms of abusing the patent system and impeding the progress of useful arts.<sup>10</sup> Others, contrarily, argue the problems are actually caused by fundamental deficiencies in the patent system itself.<sup>11</sup>

At this time, courts and lawmakers are not particularly concerned with the lack of opportunities accorded to smaller patentees in the patent licensing market.<sup>12</sup> In fact, some scholars and practitioners predict that recent United States Supreme Court decisions and legislative reforms will exacerbate the situation for smaller patentees.<sup>13</sup> Hence, patent licensing firms believe what is necessary is a fundamental transformation in the way smaller patentees operate in the licensing market.<sup>14</sup> For instance, Peter Detkin, co-founder and managing director at Intellectual Ventures, L.L.C., asserts that Intellectual Venture's novel market-based solutions "offer great promise to solve some of those systematic failures, and so present a complement — and in certain cases an alternative — to the legislative reform that the Congress has been deliberating."<sup>15</sup>

This Comment studies the role of such patent licensing firms in today's U.S. patent licensing market, analyzes various arguments concerning whether the licensing firms facilitate or impede market efficiency, and analyzes whether they promote or hinder the progress of useful arts. Part II of this comment provides basic background knowledge on patents and patent licensing, and examines the economic landscape of the U.S. economy in the intellectual property age. Part III discusses the current condition of the patent market and analyzes the role of the licensing firms and emerging business models in the patent licensing market.

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8. *See id.*

9. *See infra* Part II.D.

10. Detkin, *supra* note 1, at 637.

11. *See Survey - Patents & Technology: Voracious Venture*, ECONOMIST, Oct. 22, 2005, available at 2005 WLNR 17008347 (founder of Intellectual Ventures, Nathan Myhrvold, stating that the traditional view of patents is "archaic"); *see also* John M. Golden, "Patent Trolls" and Patent Remedies, 85 TEX. L. REV. 2111, 2112 (2007) ("Academics, policymakers, and even sitting judges have suggested that patent law may have overleaped its proper bounds, or at least become too likely to frustrate, rather than to fulfill, its constitutional purpose of 'promot[ing] the Progress of Science and useful Arts.'").

12. *See* Detkin, *supra* note 1, at 636.

13. *See, e.g., id.* at 636-37. ("Many of the patent law reforms under consideration would tilt an already unbalanced playing field to further benefit larger corporations in the information technology industries."); *see also* Sara M. King, *Clearing the Patent Thicket: The Supreme Court and Congress Undertake Patent Reform*, 19 NO. 9 INTEL. PROP. & TECH. L.J. 13, 13 (2007) ("Current patent reform efforts, however, are spurred by the perception that the US patent system is in danger of becoming a drag on, rather than an impetus to, innovation and the development of useful products.").

14. *See, e.g.,* Detkin, *supra* note 1, at 637-38.

15. *Id.* at 636.

Finally, Part IV identifies significant judicial and congressional reforms that have become sources of heated debate in the industry and analyzes their potential impact.

## II. BACKGROUND

In order to appreciate the recent developments in the patent licensing market and the potential impact of newly emerging business models, it is helpful to understand how intellectual property has evolved in the U.S. economy. Today's economy can be described as "knowledge-based" in that knowledge of new technology and products is becoming a crucial asset for corporations.

### A. *Economic Landscape of the United States: The Shift to a New Idea Economy*

Over the last 35 years, intellectual property has played an increasingly important role in shaping the U.S. economic landscape.<sup>16</sup> The value and importance of intellectual property in the modern global economy cannot be overstated.<sup>17</sup> Preservation of intellectual property rights is imperative to provide creators with an incentive for innovation,<sup>18</sup> and much of the value of the world's leading companies resides in their intangible assets.<sup>19</sup>

Today, intellectual property "has become one of the most important assets of both traditional 'brick and mortar' and technology-driven businesses."<sup>20</sup> Throughout this economic evolution, patents have shown a

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16. James F. McDonough III, Comment, *The Myth of the Patent Troll: An Alternative View of the Function of Patent Dealers in an Idea Economy*, 56 EMORY L.J. 189, 190-91 (2006). Intellectual property is "[a] category of intangible rights protecting commercially valuable products of the human intellect." BLACK'S LAW DICTIONARY 824 (8th ed. 2004).

17. See, e.g., Miranda Jones, Case Note, *Permanent Injunction, A Remedy By Any Other Name Is Patently Not the Same: How eBay v. MercExchange Affects the Patent Right of Non-Practicing Entities*, 14 GEO. MASON L. REV. 1035, 1035 (2007) (noting that the value of U.S. intellectual property today exceeds \$5 trillion, slightly less than half of U.S. gross domestic product).

18. See, e.g., *Image Tech. Servs., Inc. v. Eastman Kodak Co.*, 125 F.3d 1195, 1218 (9th Cir. 1997) (noting that the purpose of intellectual property rights is to "encourage innovation, industry, and competition") (quoting *Atari Games Corp. v. Nintendo of Am., Inc.*, 897 F.2d 1572, 1576 (Fed. Cir. 1990)).

19. Peter S. Menell, *Bankruptcy Treatment of Intellectual Property Assets: An Economic Analysis*, 22 BERKELEY TECH. L.J. 733, 735 (2007). "In 2000, intangible assets and intellectual property values are clearly the most important assets of most industrial companies given the increased intensity of competition, increased rapidity of technological growth and innovation, increased reliance on legal protection of rights in intellectual property and increased enforcement of ownership rights, and increasingly sharp liability standards for infringement and misappropriation." *Id.* at 735 (quoting William J. Murphy, *Proposal for a Centralized and Integrated Registry for Security Interests in Intellectual Property*, 41 IDEA 297, 301 (2002)).

20. Teresa L. Johnson & Bryce R. Giddens, *The Treatment of Intellectual Property Licenses in Bankruptcy and Secured Transactions*, in PATENT AND HIGH TECHNOLOGY LICENSING 2006, at 447, 455 (2006), available at 831 PLI/Pat 447 (Westlaw).

particularly remarkable growth.<sup>21</sup> Between 1970 and 2007, the annual number of utility patent applications rose from 103,175 to 456,154, and the annual number of utility patents issued by the U.S. Patent and Trademark Office (“USPTO”) rose from 64,429 to 157,283.<sup>22</sup> Just within the past decade, fee revenues paid to the USPTO for patent products and services have more than doubled.<sup>23</sup> More recently, in 2006, the annual revenues generated by patent licensing in the U.S. alone were estimated to be over a staggering \$150 billion.<sup>24</sup> These numbers suggest, in compelling fashion, that patents have carved their niche in the U.S. economic landscape.

### B. Current Outlook of the U.S. Patent Licensing Market

In light of the above, U.S. businesses will likely continue to heighten their focus on the development and amplification of their patent portfolios so as to broaden the coverage of technologies and compete more effectively in the increasingly knowledge-based economy. This section discusses the current outlook of the patent licensing market in this economic landscape and explains how patentees and businesses operate in the market. In a perfectly efficient market, patentees, businesses, and the public would all benefit from each other’s success in the market.<sup>25</sup> Specifically, patentees, big or small, would receive just compensation for their useful innovations, manufacturers would have access to new technologies that enhance their business, and the public would benefit from better products and services.<sup>26</sup>

The actual market, however, does not function so efficiently.<sup>27</sup> The current state of affairs shows that the patent licensing market strongly favors larger corporations over smaller ones, enabling the larger

21. See, e.g., McDonough, *supra* note 16, at 191 (“Over the last twenty years, technology firms have been patenting more, increasing patent scope, licensing more frequently, and revamping their business strategies in an effort to prioritize intellectual property.”).

22. See U.S. Patent and Trademark Office, U.S. Patent Statistics Chart Calendar Years 1963-2006, [http://www.uspto.gov/web/offices/ac/ido/oeip/taf/us\\_stat.htm](http://www.uspto.gov/web/offices/ac/ido/oeip/taf/us_stat.htm) (last visited Jan. 9, 2009).

23. In fiscal year 1998, the USPTO had revenues of \$712.9 million from patent-related fees. U.S. Patent and Trademark Office, Long Description for Earned Revenue for Patents and Trademarks Graph, [http://www.uspto.gov/go/com/annual/2001/earnedrev\\_desc.htm](http://www.uspto.gov/go/com/annual/2001/earnedrev_desc.htm) (last visited Feb. 11, 2008). In fiscal year 2008, that value increased to \$1.625 billion. U.S. Patent and Trademark Office, Performance and Accountability Report Fiscal Year 2008, Management’s Discussion and Analysis, [http://www.uspto.gov/web/offices/com/annual/2008/mda\\_07\\_02\\_04.html](http://www.uspto.gov/web/offices/com/annual/2008/mda_07_02_04.html) (last visited Apr. 17, 2009). This represents an increase in earned revenue of approximately 128%.

24. John A. Dondrea, AIPLA 2006 Annual Meeting, [http://www.aipla.org/Content/ContentGroups/Speaker\\_Papers/Annual\\_Meeting\\_Speaker\\_Papers/200618/DondreaDOC.pdf](http://www.aipla.org/Content/ContentGroups/Speaker_Papers/Annual_Meeting_Speaker_Papers/200618/DondreaDOC.pdf) (last visited Jan. 9, 2009). See also Bruce Burton, Michael Bredahl, & Brian Napper, *Strategic Role of Intellectual Property in Company Valuation and Financing*, in HANDLING INTELLECTUAL PROPERTY ISSUES IN BUSINESS TRANSACTIONS 2002, at 9, 20 (2002), available at 690 PLI/Pat 9 (Westlaw) (“Patent licensing revenues up 700% from 1990 to 1999, from \$15 billion in 1990 to well over \$120 billion in 1999”). It is noted, however, that the accuracy of licensing statistics is difficult to substantiate because details of most licenses are kept undisclosed.

25. See Detkin, *supra* note 1, at 639.

26. *Id.*

27. See *id.*

corporations to reap much of the market opportunities and benefits while limiting them to smaller patentees.<sup>28</sup> Even though a significant number of the most important and cutting-edge inventions come from individual inventors, small companies, and nonprofit research groups, such small-scale patentees are often unable to monetize their inventions for several reasons.<sup>29</sup>

First, because most small patentees do not have the financial resources to practice their inventions commercially, they have little access to license negotiators representing potential licensees.<sup>30</sup> Second, even if they somehow succeed in getting that first meeting, they usually do not have the budget or time to engage in lengthy negotiations.<sup>31</sup> As a result, corporate license negotiators, whose main objective is to limit the licensing fees that their corporations must pay, may use this to their advantage, e.g., employing delay tactics to “whittle down an inventor’s patience and his price.”<sup>32</sup> Even if the small patentees expend considerable time and money to withstand these lengthy discussions, they often lack the experience and bargaining power to negotiate a favorable licensing deal.<sup>33</sup> Furthermore, many small patentees, especially individual inventors, are usually at a significant “informational disadvantage” due to their unfamiliarity with the nature of the business.<sup>34</sup> Put another way, license negotiators will rarely license the patents under reasonable terms if the small patentees have little knowledge regarding the commercial value of their patents or the possibility of design-arounds,<sup>35</sup> or cannot make any educated guesses about the corporation’s cost-benefit analysis.<sup>36</sup> Further still, the apprehension of potential costs in case of negotiation failure could force the patentee to accept licensing fees substantially less than the true commercial value of patented invention.<sup>37</sup> As a result, despite all their efforts, small patentees

28. *See id.* at 637-38; *see also* Wild, *supra* note 6.

29. *See* Detkin, *supra* note 1, at 637 (noting that during the 1990s, 43% of all patent applications filed in the U.S. originated from individual inventors, small businesses, and research institutes); Chris Sommers, *Actively Manage Patents for Better ROI*, in *PATENT STRATEGY & MANAGEMENT* 4, 4 (2007) (noting that patents by small companies represent 20-30% of all active high technology U.S. patents).

30. Detkin, *supra* note 1, at 639 (“[S]ome licensing staff tends to regard solitary inventors as crackpots or trolls until proven otherwise.”).

31. *See id.*

32. *Id.*

33. *See id.*

34. Golden, *supra* note 11, at 2132. Because small patentees do not possess the resources necessary to commercialize their patents into marketable products, it is difficult for them to make reasonable estimates on the value of their patents. *See* Oren Bracha, *How Patents Became Rights and Why We Should Care*, 38 *LOY. L.A. L. REV.* 177, 208 (2004) (noting Adam Smith’s opinion that “the market . . . determine[s] the inventor’s compensation”).

35. A design-around is an attempt to improve or imitate the patented invention without actually infringing it. *See* Tanya Mazur, *Free for the “Taking”: Why States Should Not Be Able to Invoke Sovereign Immunity in Patent Infringement Disputes*, 75 *GEO. WASH. L. REV.* 398, 402 (2007).

36. Golden, *supra* note 11, at 2132-33.

37. *See id.* at 2135.

are ultimately left in frustration and denied fair compensation for their patented inventions.<sup>38</sup>

C. *The Patent Portfolio and Traditional Business Models in Patent Licensing*

Another factor that leads to smaller patentees being disadvantaged in the market pertains to patent portfolios (i.e., collection of patents under common ownership) and available business models in the patent licensing market. A strong patent portfolio is a powerful tool in today's business, as a corporation's negotiating strengths during licensing often directly depend on the size and depth of the corporation's portfolio.<sup>39</sup> Although a significant number of all issued patents originate from small-scale patentees, the bulk of licensing revenues generated by manufacturers' portfolios is collected by large corporations.<sup>40</sup> One reason small patentees get shut out of the manufacturers' portfolio pool is that, with the increasing cost of patent litigation through judgment running around \$5 million per side, no one fears a small patentee because it poses no threat of litigation (unless the patentee can hire a contingent-fee law firm).<sup>41</sup> Another reason is that, no matter how prolific a small patentee may be, the number of patents it has is far too few to compete with bigger tech corporations.<sup>42</sup> In other words, a small patentee's portfolio cannot match the vast breadth and depth of portfolios developed by giant corporations.<sup>43</sup> As a result, smaller patentees cannot set up an effective licensing operation using conventional business models that are utilized by the bigger corporations.<sup>44</sup> Even if they are able to collect sufficient resources to set up a portfolio licensing operation, small patentees generally have a much more difficult time

38. See Detkin, *supra* note 1, at 640.

39. *Id.* at 641. A healthy patent portfolio is a valuable asset to any company. See, e.g., Rajiv P. Patel, A Patent Portfolio Development Strategy for Start-Up Companies, Fenwick & West L.L.P. at 1 (Nov. 1, 2002), [http://www.fenwick.com/docstore/Publications/IP/IP\\_Articles/Patent\\_Portfolio\\_Dev.pdf](http://www.fenwick.com/docstore/Publications/IP/IP_Articles/Patent_Portfolio_Dev.pdf), (“[A] well-crafted patent portfolio may be used for a variety of business objectives, such as bolstering market position, protecting research and development efforts, generating revenue, and encouraging favorable cross-licensing or settlement agreements.”); see also Rich Tehrani, Vonage Loses to Sprint Nextel, TMC (Sept. 25, 2007), <http://voipservices.tmcnet.com/feature/articles/11384-vonage-loses-sprint-nextel.htm> (“A broad portfolio is a shield against patent lawsuits.”); Schox, P.L.C., Avoid a patent infringement lawsuit, <http://www.schoxplc.com/notes/avoid-a-patent-infringement-lawsuit.html> (last visited Apr. 5th, 2009) (“A strong patent portfolio is a powerful deterrent against patent infringement lawsuits brought by a competitor.”)

40. Detkin, *supra* note 1, at 641 (citing E-mail from Jim Hirabayashi and Paul Harrison, U.S. Patent and Trademark Office, Patent Technology Monitoring Division (Feb. 2, 2005)).

41. See Joseph N. Hosteny, *Litigators Corner: Stanford University - A Patent Troll?*, INTELL. PROP. TODAY, Apr. 2006, at 14, available at <http://www.hosteny.com/archive/Hosteny%2004-06.pdf>.

42. See Detkin, *supra* note 1, at 640-41.

43. *Id.* at 641; R. Polk Wagner & Gideon Parchomovsky, *Patent Portfolios*, 154 U. PA. L. REV. 1, 10 (2005) (“Companies with small patent portfolios will find it difficult to compete against firms with large patent holdings”); *id.* at 65 (“[H]olders of strong patent portfolios have an inherent advantage over competitors that hold a small number of individual patents.”)

44. Detkin, *supra* note 1, at 640-41.

negotiating licensing deals because they lack the credibility that established companies have.<sup>45</sup>

Historically, business models in the patent licensing market have operated in a way that strongly favors larger corporations.<sup>46</sup> According to Detkin, for example, large corporations usually follow one or more of a small number of well-established business models, which may be categorized as (1) the broad portfolio model, (2) the deep portfolio model, and (3) the patent pool model.<sup>47</sup> Each of these traditional business models is designed to cater mainly for the needs of large corporations, effectively shutting out smaller patentees from the market.<sup>48</sup>

### 1. Broad Portfolio Model

Companies that employ the broad portfolio model, including IBM and Thomson, exploit their massive patent portfolios and dominant market presence to execute their licensing operations.<sup>49</sup> These operations are quite vast in scope — they involve thousands of licensees and hundreds of millions of dollars in revenue.<sup>50</sup> Obviously, small patentees do not have the necessary capital or portfolio size to follow such an extensive approach.

### 2. Deep Portfolio Model

The deep portfolio model, which exploits portfolios that are not so broad but extremely deep, has been utilized by companies that boast a portfolio containing a large number of patents in a specific field, such as Qualcomm (wireless technology), Rambus (memory chip technology), and Texas Instruments (semiconductor technology).<sup>51</sup> Like the broad portfolio model, this model could account for thousands of licensees for millions of dollars in revenue.<sup>52</sup> For substantially the same reasons as the broad portfolio approach, then, this model is unfit for small patentees.

### 3. Patent pool model

The third successful business model is the corporate patent pool model. A patent pool may be described as “a collection of patents drawn from a group of big companies, usually in support of a technology

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45. *Id.* at 641.

46. *Id.* at 640-41.

47. *Id.*; Wagner & Parchomovsky, *supra* note 43, at 31.

48. Detkin, *supra* note 1, at 640-41.

49. *Id.* at 640.

50. *Id.*

51. *Id.* at 641. For example, Qualcomm has over 6,000 patents and patent applications in wireless cellular technologies. *Id.* at 641 n.18.

52. Detkin, *supra* note 1, at 641. For example, in 2006, semiconductors accounted for \$13.7 billion out of a total of \$14.3 billion in Texas Instrument's total revenue. *Id.* at 641 n.18.

standard.”<sup>53</sup> Large corporations with vast portfolios have the option of entering into agreements to join a patent pool and cross-license each other’s patents.<sup>54</sup> Once again, small patentees usually do not have access to these pools because establishing patent pools is prohibitively expensive for patentees with limited financial resources.<sup>55</sup>

#### D. Patent Trolls<sup>56</sup>

What options, then, are small patentees left with? Notwithstanding good-faith negotiation attempts, the door to the patent licensing market appears to have been shut against them.<sup>57</sup> Without any reasonable means to receive fair compensation for their patents, some of these patentees feel that they have no choice but to file or threaten lawsuits against possible infringers and collect settlement fees.<sup>58</sup> Those who resort to this approach have been referred in the industry as “patent trolls.”<sup>59</sup>

The term “patent troll,” however, has been used rather carelessly to describe a myriad of patentee classes and, consequently, is difficult to define.<sup>60</sup> According to Detkin, who coined the term, 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.”<sup>61</sup> Due to the sharply critical and derogatory connotation now associated with the term,<sup>62</sup> however, Detkin now refrains from using it.<sup>63</sup>

53. *Id.* at 641; see also Birgit Verbeure, Esther van Zimmeren, Gert Matthijs & Geertrui Van Overwalle, *Patent Pools and Diagnostic Testing*, 24 TRENDS IN BIOTECHNOLOGY NO.3, March 2006, at 115, available at <http://www.epip.eu/conferences/epip02/lectures/Verbeureetal-2006-TIB-Publication.pdf> (defining a patent pool as “agreements between two or more patent owners to license one or more of their patents as a package to one another, and to third parties willing to pay the associated royalties”).

54. Detkin, *supra* note 1, at 641.

55. *Id.*

56. The term “patent troll” was coined by Detkin in 2001. See Detkin, *supra* note 1, at 636 (citing Brenda Sandburg, *Trolling for Dollars: Patent Enforcers Are Scaring Corporate America, and They’re Getting Rich—Very Rich—Doing It*, RECORDER, July 30, 2001, at 1, available at <http://www.phonetel.com/pdfs/LWTrolls.pdf>; see also Keith L. Slenkovich, *U.S. Supreme Court Decisions in eBay, Medimmune, and KSR Deliver Triple Dose of Bad News to Nonpracticing Patent Holders (aka “Patent Trolls”)*, THELEN L.L.P., Sep. 7, 2007, at n.1., <http://www.mondaq.com/article.asp?articleid=52066>).

57. Detkin, *supra* note 1, at 641.

58. *Id.* at 640 (citing ROBERT P. MERGES ET AL., *INTELLECTUAL PROPERTY IN THE NEW TECHNOLOGICAL AGE* 163-64 (4th ed. 2006)).

59. *Id.*

60. See *id.* at 642.

61. Jennifer Kahualelio Gregory, Comment, *The Troll Next Door*, 6 J. MARSHALL REV. INTELL. PROP. L. 292, 292, nn.6-7 (2007) (citing Sandburg, *supra* note 56, at 1).

62. See, e.g., *id.* at 293 (“When used as a label, Patent Troll conjures images of an archaic ogre-like monster and vilifies a type of patent enforcer that threatens businesses with unfounded patent infringement litigation solely for the purpose of monetary gain.”); McDonough, *supra* note 16, at 197-98 (explaining that the label “patent troll” is damaging to the discussion of the U.S. patent system because it is simplistic, derogatory, and overly broad); Slenkovich, *supra* note 56, at n.1 (expressing

Though the term “troll” has been used generically to describe and denounce entities that do not commercialize their patents, many observers now recognize that a patentee does not become a “troll” simply because the patentee does not, or in many cases cannot, commercialize the patented invention.<sup>64</sup> To more accurately identify the parties who exemplify the negative connotations behind the term, some have suggested that the perception of “trolls” should be based on bad faith.<sup>65</sup> Under a bad faith definition, for example, a patentee could legitimately be labeled a troll if the patentee knows of a corporation infringing its patent but intentionally (1) waits to send a cease-and-desist letter until that corporation has expended significant resources so as to extract exorbitant settlement fees,<sup>66</sup> (2) acquires a large patent portfolio for the sole purpose of putting competitors out of business, or (3) games the patent system to intentionally acquire patents of questionable value<sup>67</sup> and enforces them against corporations.<sup>68</sup> To effectuate a more balanced discussion, “patent trolls” as used in this Comment will refer to “bad-faith” patent holders as those described above, and “nonpracticing patentees” will refer to non-profit enterprises, such as research institutes and universities and other classes of patentees who do not commercially practice their patented inventions but nevertheless seek to enforce their rights in good faith.<sup>69</sup> Finally, “patent licensing firms” will refer to those firms that utilize business methods to promote licensing transactions for nonpracticing patentees who do not have

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concern that the use of the pejorative term “patent troll” may not be justified and that “nonpracticing patent holders” may be a more proper way to refer to such individuals and entities).

63. Detkin, *supra* note 1, at 642 (“[The term] has become too emotionally charged and too often hurled carelessly as an epithet to disparage just about every kind of plaintiff in a patent suit.”).

64. See, e.g., Rebecca A. Hand, Note, *Ebay v. MercExchange: Looking at the Cause and Effect of a Shift in the Standard for Issuing Patent Injunctions*, 25 *CARDOZO ARTS & ENT. L.J.* 461, 475 (2007) (“It is unclear to what extent [nonpracticing patentees] should be included under the category of Patent Trolls, which hinder technological and industrial growth.”).

65. See Marc Morgan, Comment, *Stop Looking Under the Bridge for Imaginary Creatures: A Comment Examining Who Really Deserves the Title Patent Troll*, 17 *FED. CIR. B.J.* 165, 178 (2007).

66. It is noted that, although patents are published for public viewing pursuant to the publication requirement under 35 U.S.C. § 122(b), that does not ensure corporations are aware of the patents or any potential infringement thereof.

67. There is no universal consensus on what exactly defines the “quality” of a patent. See Lois Matelan, *The Continuing Controversy over Business Methods Patents*, 90 *J. PAT. & TRADEMARK OFF. SOC’Y* 125, 137. Patent quality may be defined in terms of the “likelihood that it is truly novel and nonobvious” over the prior art and the difficulty of designing around the patent. See *id.* at 137 n.108. For a more detailed discussion of evaluating the quality of a patent, see generally Sivaramjani Thambisetty, *Patents as Credence Goods*, 27 *OXFORD J. LEGAL STUD.* 707, 720-26 (2007).

68. See Morgan, *supra* note 65, at 178. See also Christopher A. Harkins, *Fending off Paper Patents and Patent Trolls: A Novel “Cold Fusion” Defense Because Changing Times Demand It*, 17 *ALB. L.J. SCI. & TECH.* 407, 411 (2007) (noting there are patents “devoid of any commercial value by the patent owner except as a ‘holdup’ device for extorting money”).

69. See, e.g., Gerard N. Magliocca, *Blackberries and Barnyards: Patent Trolls and the Perils of Innovation*, 82 *NOTRE DAME L. REV.* 1809, 1810 n.3 (2007); Steve M. Cohen, *Patent Law—Patented System Infringes Under 35 U.S.C. § 271 when Control and Beneficial Use Occurs Within United States—NTP, Inc. v. Research in Motion, Ltd.*, 418 *F.3d 1282 (Fed. Cir. 2005)*, 40 *SUFFOLK U. L. REV.* 269, 270 n.11.

the means to develop and enforce their patents on their own.<sup>70</sup> Clearly defining and distinguishing the various classes of patentees at issue will facilitate the discussion that follows.

### III. ANALYZING THE ACTIVITIES OF THE PATENT LICENSING FIRMS FROM AN ECONOMIC VIEWPOINT

#### A. *How Does the Patent Licensing Market Operate? A Closer Look*

Before analyzing the role of patent licensing firms in the patent licensing market in today's technology-driven economy, it is helpful to first understand the anatomy of the patent market and how it operates in the framework of the U.S. patent system.

##### 1. The "Patent Market"

A market is defined as "an institution that exists to facilitate exchange . . . [and] to reduce the costs of carrying out exchange transactions."<sup>71</sup> By statute, a patent is a form of property transferable in commercial exchange,<sup>72</sup> and a legitimate market exists in which patentees license and sell their patents.<sup>73</sup> The sale of patents and the issuance of immunities through licenses, therefore, may be said to constitute the "patent market."

A market depends on the legal system in order to operate,<sup>74</sup> and the patent market is no exception — its performance and efficiency are contingent on the federal government's ability to provide a properly functioning patent system.<sup>75</sup> This is particularly important with respect to intellectual property such as patents because they are intangible, nonrival commodities<sup>76</sup> and because the intellectual property market is a market for ideas and innovation.<sup>77</sup> Unlike tangible property, ideas (e.g., patented

70. According to Detkin, examples of patent licensing firms include "patent aggregators" who enter the market to offer small patentees better commercial access and more bargaining power in negotiating licensing deals, and "patent market makers" who give smaller patentees a better chance at landing licensing deals by reducing the time and expense of licensing transactions. *See* Detkin, *supra* note 1, at 637.

71. McDonough, *supra* note 16, at 205.

72. *Id.* at 207. "Applications for patent, patents, or any interest therein, shall be assignable in law." 35 U.S.C. § 261 (2000).

73. *See* McDonough, *supra* note 16, at 207.

74. *Id.* at 205.

75. *See id.* at 205-06. In the U.S., the legal system that controls patents is the federal government because the federal government controls the patent law, which arises under the Constitution. *Id.* at 205 n.148 (citing U.S. CONST. art. I, § 8, cl. 8; 35 U.S.C. §§ 102, 103 (2000)).

76. McDonough, *supra* note 16, at 205-06. Nonrival goods are "goods that can be used by more than one person at the same time without reducing the marginal value of the good to concurrent users." *Id.* at 206 n.149.

77. *Id.* at 204.

subject matter) can be utilized concurrently by numerous entities without depleting the value of the original.<sup>78</sup> This makes patents more vulnerable to expropriation, and the purpose of the U.S. patent system is aimed specifically to deter such expropriation and protect patent rights by granting property entitlements in the innovation through the right of exclusion (i.e., the right granted to a patentee under 35 U.S.C. § 271(a) to exclude others from using, making, or selling the patented invention).<sup>79</sup>

The failure of the patent system to provide this protection leads to patent devaluation, licensing difficulties, and ultimately market failure.<sup>80</sup> Unfortunately, the inherent nature of the patent market makes it extremely difficult for the system to serve its protective function effectively.

## 2. Inherent Problems in the Patent Market

In a patent market, the most basic market exchange involves an exchange between a patentee and a buyer or licensee.<sup>81</sup> As explained above, however, patents can easily be expropriated because subject matter of issued patents is made publicly available on the USPTO website,<sup>82</sup> and the ease of expropriation has the effect of discouraging exchange in the market.<sup>83</sup> The only way patentees can enforce their rights under the patent system is through civil litigation,<sup>84</sup> but the USPTO does not provide any

78. *Id.* at 206 (explaining how another person can easily take advantage of an invention without the patentee knowing); Joshua S. Gans & Scott Stern, *The Product Market and the Market for Ideas: Commercialization Strategies for Technology Entrepreneurs*, 32 RES. POL'Y 333, 338 (2003). It is noted, however, corporations patent inventions in classes of things, not just the examples the inventors have worked up. McDonough is silent regarding the critical point of overlapping patents, but it is important to consider its significance because patents (and patent rights) frequently overlap as new patents are obtained on small improvements over preexisting patents within that technology. *See, e.g.*, John B. Sganga, Jr., *Presenting the Witnesses Special to a Patent Trial*, in PATENT LITIGATION 1999 95, 99 (1999), available at 572 PLI/Pat 95 (Westlaw) ("patents are often obtained on small improvements over the prior art"). Hence, saying that a patent is "keyed to innovation" may be misleading to some experts. It is noted that innovation usually occurs in frequent but small increments — it is the cumulative contribution of generations of inventors that drives innovation in the patent context. *See* Oren Bar-Gill & Gideon Parchomovsky, *The Value of Giving Away Secrets*, 89 VA. L. REV. 1857, 1867-68 (2003).

79. *See* McDonough, *supra* note 16, at 206; 35 U.S.C. § 271(a) (2003).

80. "Market failure may be defined as a condition in which economically rational transactions do not take place," which leads to "inefficient or unfavorable allocation of resources." Adam F. Scales, *A Nation of Policyholders: Governmental and Market Failure in Flood Insurance*, 26 MISS. C. L. REV. 3, 7 (2006-2007); Andrew Hysell, *Are Property Owners Constitutionally Entitled to Compensation for Environmental Remediation Funds?*, 13 BUFF. ENVTL. L.J. 1, 11 n.71 (2005) (citing Marlies Wierenga, *A Brief Introduction to Environmental Economics*, ENVIRONMENTAL LAW ALLIANCE WORLDWIDE, Aug. 2003, <http://www.elaw.org/system/files/What+is+environmental+economics++2.doc>).

81. *See* McDonough, *supra* note 16, at 207 (citing ROBIN PAUL MALLOY, LAW IN A MARKET CONTEXT 115 (2004)).

82. The potential licensor can also obtain knowledge on patented technology from information disclosed by the licensor during negotiation. McDonough, *supra* note 16, at 209.

83. *Id.* at 209-10 (citing Kimberly A. Moore, *Xenophobia in American Courts*, 97 NW. U. L. REV. 1497, 1532 (2003)).

84. *Id.*

aid in the enforcement.<sup>85</sup> In other words, a patentee can only enforce its patents if it has the resources to litigate.<sup>86</sup> This is not a trivial matter considering that the average patent infringement case in the United States today costs over \$5 million per side.<sup>87</sup>

Another option for the patentee is to negotiate a licensing agreement with the infringer (or potential infringer). Where the patentee lacks the resources to litigate, however, it is difficult for the patentee to negotiate any reasonable licensing terms because the infringer knows the patentee has no means to enforce its patents.<sup>88</sup> In other words, potential licensees have less incentive to enter into licensing negotiations with patentees who have no means to enforce their patents, because they pose no threat of financial liability for the infringement.<sup>89</sup> Ultimately, the larger corporations may choose to operate within the patent and attempt to produce the technology internally rather than paying licensing royalties.<sup>90</sup> The patent licensing market obviously cannot function efficiently when corporations are not willing to enter into licensing deals.<sup>91</sup> Furthermore, when no one is willing to take a license under a patent and the patentee cannot prevent others from infringing activities, the patent becomes essentially worthless, which in turn discourages innovation because patentees are denied economic compensation for their inventions.<sup>92</sup>

85. USPTO website, General Information Concerning Patents, <http://www.uspto.gov/go/pac/doc/general/> (last visited Apr. 19, 2009) (“Once a patent is issued, the patentee must enforce the patent without aid of the USPTO.”).

86. McDonough, *supra* note 16, at 206 (citing Jeff A. Ronspies, *Does David Need a New Sling? Small Entities Face a Costly Barrier to Patent Protection*, 4 J. MARSHALL REV. INTELL. PROP. L. 184, 211 (2004)).

87. Bart Showalter, *Costs of Patent Litigation*, AIPLA, Jan. 2008, [http://www.aipla.org/Content/ContentGroups/Speaker\\_Papers/Mid-Winter1/20083/Showalter-slides.pdf](http://www.aipla.org/Content/ContentGroups/Speaker_Papers/Mid-Winter1/20083/Showalter-slides.pdf).

88. See McDonough, *supra* note 16, at 206 (citing Posting of Patent Hawk to The Patent Prospector (Oct. 3, 2005), [http://www.patenthawk.com/blog/2005/10/patent\\_liquidity.html#more](http://www.patenthawk.com/blog/2005/10/patent_liquidity.html#more) (discussing the unwillingness of some companies to negotiate with small patentees)). On the other hand, when a credible threat of litigation exists, the infringer will be forced to enter into licensing negotiations due to the high cost of patent litigation and potential damages. In this scenario, the infringer is faced with two options: agree to pay for a license or defend itself against the infringement claim. Golden, *supra* note 11, at 2126. As long as the cost of licensing is less than the cost of litigation, which is almost always the case, the infringer will agree to a licensing deal. *Id.*

89. The argument of potential licensees is “why pay and use the patented technology when you can use it for free and get away with it?”

90. McDonough, *supra* note 16, at 210-11. “A firm maximizes profits and minimizes costs when it provides something for itself that it otherwise would seek through exchange on the market. The choice is dictated by cost. Although the firm in this case is minimizing cost through expropriation, the situation is analogous to Coase’s theorem regarding cost internalization and outsourcing.” *Id.* at 211 n.203.

91. See, e.g., Erik Belt & Keith Toms, *The Price of Admission: Licensee Challenges to Patents After MedImmune v. Genentech*, BOSTON B.J., May/June 2007, at 10, 11, available at 51-JUN B. BJ 10 (Westlaw) (“[p]atent licensing is a major contributor to the U.S. economy”).

92. See B. Zorina Khan, *Property Rights and Patent Litigation in Early Nineteenth-Century America*, 55 J. ECON. HIST. 58, 93 (1995) (stating that property rights in inventions that are properly enforced “promote[] market exchange and technological progress”).

### 3. The Real Victims of the Troll Problem

Large corporations, however, may argue that they are the real victims of the troll problem, not the small patentees.<sup>93</sup> For example, when Research in Motion Ltd. (one of the leading U.S. manufacturers of wireless communication devices) was forced to pay \$612 million<sup>94</sup> to settle infringement claims filed by NTP, Inc. (a small company that does not produce goods and services), Computer & Communications Industry Association (“CCIA”) President and CEO Ed Black exclaimed, “NTP has exploited the nation’s courts to threaten the operation of the federal government and extract more than a half billion dollars from one of the world’s finest communications companies.”<sup>95</sup>

A victory for small patentees in such high-stakes litigation, in addition to vehement lobbying efforts by larger companies, may give the impression that small patentees frequently win in infringement lawsuits and haul in big corporations to court whenever they get a chance. In reality, however, such a decisive victory for small patentees in an infringement case is uncommon, not to mention litigation is almost never a desirable process for them.<sup>96</sup> This is because, unlike bigger corporations, smaller patentees cannot afford the excessive legal fees for a lawsuit that could run for years before judgment is rendered on the merits.<sup>97</sup> Moreover, lawsuits may distract inventors and take their time away from working on new inventions, which is also undesirable.<sup>98</sup> Such consequences are counterintuitive to the purpose of the patent system to promote innovation, and could lead to significant inefficiencies in the patent licensing market.<sup>99</sup>

Who the actual victims are may depend on one’s perspective, but the U.S. patent system has not been able to ameliorate the dire situation for small patentees.<sup>100</sup> Some observers, including Detkin, go as far as saying that the current system rewards unscrupulous patent trolls and cripples the information technology sector at all levels.<sup>101</sup> In the lower sector, patent infringement lawsuits imperil the financial stability of smaller patentees that produce a significant number of patents on which the technology

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93. See Will Rodger & Matt Schruers, *RIM Settlement Shows Patent System Broken, CCIA Says*, COMPUTER & COMM’N INDUS. ASS’N, Mar. 6, 2006, [http://www.ccianet.org/artmanager/publish/2006/RIM\\_Settlement\\_Shows\\_Patent\\_System\\_Broken\\_CCIA\\_Says.shtml](http://www.ccianet.org/artmanager/publish/2006/RIM_Settlement_Shows_Patent_System_Broken_CCIA_Says.shtml); see also Ben Charny, *Patent Trolls Lurk in Supreme Court Cases*, EWEEK, March 29, 2006, <http://www.eweek.com/article2/0,1895,1943958,00.asp> (“[Patent trolls] exist[] solely to sue other companies that mistakenly use the technology in their products or services.”).

94. See, e.g., *Tavory v. NTP, Inc.*, 297 F. App’x 986, 988 (Fed. Cir. 2008).

95. Rodger & Schruers, *supra* note 93.

96. See *id.*

97. Detkin, *supra* note 1, at 640.

98. *Id.*

99. See Rodger & Schruers, *supra* note 93.

100. See Detkin, *supra* note 1, at 638-42.

101. See *id.* at 640-42.

industry depends; in the upper sector, large corporations that drive the information technology economy are compelled to negotiate licensing deals under the threat of frivolous lawsuits.<sup>102</sup> The U.S. Constitution makes it clear that the objective of the patent system is to “promote the [p]rogress of . . . useful arts.”<sup>103</sup> The current state of affairs as described above seems to give rise to an age-old question: does the current patent system effectively promote research and innovation and facilitate the progress of useful arts?<sup>104</sup>

### B. Patent Licensing Firms

In recent years, patent licensing firms have emerged with the realization that a potential market exists for small patentees disgruntled by the current system.<sup>105</sup> As explained earlier, patent licensing firms have employed novel business methods to assist smaller patentees to operate effectively in the patent licensing market, e.g., by aggregating patents held by those patentees and licensing them to large tech corporations that are either infringing or willing to utilize the patented technologies.<sup>106</sup> Equipped with adequate resources to work productively with large corporations, licensing firms enable smaller patentees to play a more prominent role in the patent market, and, theoretically, improve market efficiency.<sup>107</sup>

One observer, James McDonough, has referred to such licensing firms as “patent dealers,” and analogized them to securities dealers who operate as market makers by buying and selling stocks on their own account, thereby providing liquidity and making the market more efficient.<sup>108</sup> McDonough concluded that patent dealers can make the patent licensing market more efficient by promoting the licensing of patents.<sup>109</sup> Specifically, he suggested that patent dealers benefit the market by (1) encouraging exchange, (2) making patents more liquid, and (3) facilitating market clearing through price equalization.<sup>110</sup> Each will be analyzed briefly below.

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102. See *id.* at 638-42.

103. U.S. CONST. art. I, § 8.

104. See, e.g., Rodger & Schruers, *supra* note 93 (explaining that the question has long been the subject of debate, and there is no easy answer).

105. McDonough, *supra* note 16, at 211.

106. See Detkin, *supra* note 1, at 643.

107. See *id.* at 643-44.

108. McDonough, *supra* note 16, at 211. See also Lawrence E. Mitchell, *Structure as an Independent Variable in Assessing Stock Market Failures*, 72 GEO. WASH. L. REV. 547, 578 (2004) (explaining the concept of securities dealers).

109. McDonough, *supra* note 16, at 211.

110. *Id.*

### 1. Patent Dealers Encourage Exchange

Potential licensees will not be motivated to enter the market unless they are faced with a “credible threat of litigation.”<sup>111</sup> Patent dealers are equipped with sufficient resources to present that threat.<sup>112</sup> The threat of litigation has the effect of facilitating market exchange, for instance, encouraging potential infringers and licensees to enter into licensing negotiations because the potential costs of the infringement lawsuit and resulting damages could be far greater than licensing fees.<sup>113</sup> Without patent dealers, most individual inventors or small entities have no feasible means to lure potential licensees to the bargaining table. Creating opportunities for such exchange promotes economic growth in the patent licensing market.

### 2. Patent Dealers Make Patents More Liquid

Patents are generally regarded as illiquid assets.<sup>114</sup> Without a centralized price setting in the markets, patentees must expend a great deal of time and funds to find potential licensees and negotiate a successful licensing deal with them.<sup>115</sup> The same burden falls upon the potential licensee — companies looking to benefit from promising technology will incur substantial costs to discover the patentee and discuss product details as well as pricing.<sup>116</sup> Because a good deal of travel and research is necessary to learn about the products and compare prices of similar products, which is particularly difficult and time-consuming in a decentralized market, both sides incur heavy costs even before they commence negotiation.<sup>117</sup> Hence, the patent cannot be liquidated in a timely manner, and both the patentee and the licensee company may suffer significant and unnecessary transaction costs.<sup>118</sup> What is needed is an entity to bring the two sides together and coordinate the exchange.<sup>119</sup>

Patent dealers assume the role as that exchange coordinator, the intermediary between the patentee and the licensee company.<sup>120</sup> By

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111. *Id.* at 206.

112. *Id.* at 212. *See also* Tomas Kellner, *Perot Backs \$200 Million Bet on Patents*, FORBES, Aug. 9, 2005, [http://www.forbes.com/2005/08/09/perot-patents-fund-cz\\_tk\\_0809patents.html](http://www.forbes.com/2005/08/09/perot-patents-fund-cz_tk_0809patents.html).

113. *See id.*

114. *Id.* at 213. *See* Michael Kanellos, *Patent Auction Pays More in the End*, CNET NEWS, May 10, 2006, [http://www.news.com/Patent-auction-pays-more-in-the-end/2100-1014\\_3-6070799.html](http://www.news.com/Patent-auction-pays-more-in-the-end/2100-1014_3-6070799.html) (noting that patents were historically an illiquid asset); *see also* BLACK'S LAW DICTIONARY 126 (8th ed. 2004) (defining an illiquid asset as “[a]n asset that is not readily convertible into cash.”).

115. *See* McDonough, *supra* note 16, at 213 (Explaining that the patent market is a “search” market that does not have a centralized price setting. In such a decentralized market, sellers and buyers meet by conducting an extensive search.).

116. *Id.*

117. *See id.*

118. *Id.*

119. *See id.*

120. *See id.*

matching the patentees with companies looking to commercialize the patentees' patents or in need of immunity therefrom, patent dealers can promote a more centralized patent licensing market.<sup>121</sup>

In other words, by managing the transactions themselves, they provide a "central place of exchange" for the patentees and potential licensees.<sup>122</sup> They accomplish this by publicly advertising themselves as dealers, purchasing patents from the original inventors, and then presenting corporate license negotiators with a pre-screened inventory of patents that are relevant to the corporations' operations.<sup>123</sup> The overall process and benefits of centralizing a decentralized market may be summed up as follows:

The central place of exchange greatly reduces the search costs of buyers and sellers who must only find the dealer, and not each other. The management of transactions by the dealer reduces the costs of buying and selling and helps the market to operate smoothly. By buying when suppliers are ready to sell and selling when customers are ready to buy, the dealer provides immediacy to the marketplace.<sup>124</sup>

By coordinating exchange in this way, patent dealers provide liquidity in the patent licensing market.

### 3. Patent Dealers Clear the Market

By providing market liquidity, patent dealers can also help "clear the market."<sup>125</sup> Clearing the market describes "an economic process of seller price adjustment until supply equals demand and the market is 'cleared' of all surpluses and shortages."<sup>126</sup> This process is the key to an efficient market, and serves a particularly important function in the patent market due to the illiquid nature of patents.<sup>127</sup> Without anyone to equalize prices in the market, both patentees and companies incur unnecessary costs for searching patents and evaluating their quality.<sup>128</sup> The inevitable result of

121. McDonough, *supra* note 16, at 213.

122. *Id.* (analogizing patent licensing firms to NASDAQ securities dealers who match investors with companies seeking owners and vice-versa).

123. *See id.*; *see also* Detkin, *supra* note 1, at 643-44.

124. McDonough, *supra* note 16, at 214.

125. *Id.*

126. Richard A. Epstein, *Behavioral Economics: Human Errors and Market Corrections*, 73 U. CHI. L. REV. 111, 121 n.29 (2006) (defining "market-clearing" as a price equilibrium at which "everyone who wants to buy at that price can obtain the product and everyone who wants to sell at that price can find a buyer"); *see also* McDonough, *supra* note 16, at 214 n.242 ("Clearing in an equity market also concentrates the risks to all participants within a single organization.").

127. *See* McDonough, *supra* note 16, at 215.

128. *See id.* at 214-15 (explaining that search costs include "time, money, and effort spent learning what is available where for how much," and evaluation costs arise from assessing the quality of

this is inconsistent pricing and mismatched exchanges, which could ultimately lead to market failure.<sup>129</sup>

Patent dealers, however, undertake these risks which are normally assumed by the market participants.<sup>130</sup> As explained above, patent dealers purchase the patents from the inventor, place them in their inventory, and find a potential licensee interested in licensing the technology. As part of this process, patent dealers collect and supply information as well as assess the quality of patents by “evaluat[ing] the risk of patent invalidation, the breadth of the patent scope, the prior art, and the attractiveness of the industry.”<sup>131</sup> Hence, patent dealers bear the search costs and patent valuation costs which would otherwise be shouldered by the patentees and licensees.<sup>132</sup> If patent dealers can capably manage these tasks, the market can also operate more efficiently because the risks are concentrated on the dealers rather than the parties to the potential license.<sup>133</sup> Through effective risk-management and patent valuation, patent dealers can effectively set market clearing prices for patents.<sup>134</sup>

#### 4. Pressing Questions About Patent Licensing Firms

Despite the above arguments, questions remain as to how the patent licensing firms (i.e., patent dealers) can realistically achieve these results. For example, although it is well-known that patent validity and the scope of its claims determine the ability of the patentee to exclude others from making, using, or selling the claimed subject matter, are patent licensing firms capable of accurately analyzing these crucial factors in determining the value of patents as exclusionary property rights? It still remains to be seen how effectively these licensing firms can assess the value of patents, which are notoriously difficult to measure. At the least, licensing firms must be able to assess the availability and cost of implementing design-arounds, which could significantly affect patent valuation.<sup>135</sup> Further, unlike most other assets, the value of a patent is in the preclusive power of

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patents (quoting JOHN MCMILLAN, *REINVENTING THE BAZAAR: A NATURAL HISTORY OF MARKETS* 44 (2002)).

129. *See id.* at 215 (describing how market friction is caused by “asymmetrically informed” market participants).

130. *See id.* (explaining that this is similar to how securities dealers undertake the risks normally assumed by buyers and sellers in capital markets).

131. *Id.*

132. *See id.*

133. *See* McDonough, *supra* note 16, at 215 (explaining that dealers are better suited to manage market risks because they deal with multiple parties, have better access to information, and gain specialization through knowledge of technology).

134. *See id.*

135. *See, e.g.,* Merritt R. Blakeslee & Christopher V. Meservy, *Seeking Adjudication of a Design-Around in Section 337 Patent Infringement Investigations: Procedural Context and Strategic Considerations*, 35 *AIPLA Q.J.* 385, 409 (2007) (explaining that a design-around could substantially reduce the value of the patent).

the claimed invention, and depends heavily on the identity of the patent owner at a given time. If no one fears being sued, the patent has little value, and vice-versa. This may also raise some doubts as to the viability of patent licensing firms.

If patent licensing firms can overcome these obstacles, they can indeed promote a more efficient market. By creating a credible threat of litigation, making patents more liquid, and setting market clearing prices, patent licensing firms can theoretically benefit all parties in transaction: the patentees are able to monetize their patents, the licensing firms gain the value of facilitating the transaction and the value of information it collects through the transaction, and corporate licensees are able to reach fair licensing terms based on information provided by the licensing firms.<sup>136</sup>

### C. Criticisms Against Patent Licensing Firms

McDonough also noted some of the criticisms against nonpracticing patentees and the licensing firms that give them access to the patent licensing market. The three main arguments are that they (1) abuse the patent system by hindering the progress of useful arts, (2) spur vexatious litigation, and (3) exploit low-quality patents.<sup>137</sup> Each will be discussed below.

#### 1. Do Patent Licensing Firms Hinder the Progress of Useful Arts?

The U.S. Constitution states “Congress shall have the power . . . [t]o promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries.”<sup>138</sup> This exclusive right gives the inventor or assignee a monopoly over the things defined by the patent claim during the term of the granted patent.<sup>139</sup> Until the patent expires, the patentee has the right to exclude others from making, using, or selling any form of the claimed subject matter.<sup>140</sup> The right of exclusion applies even if the infringer developed its product independently and without knowledge of the patent.<sup>141</sup> In exchange, the patentee is required under statute to disclose the invention to the public in sufficient detail so that others could make, use, and sell at least the preferred embodiment after the patent term

136. See McDonough, *supra* note 16, at 217.

137. See *id.* at 201.

138. U.S. CONST. art. I, § 8, cl. 8.

139. 35 U.S.C. § 154(a)(2) (2000); see also USPTO website, <http://www.uspto.gov/web/offices/pac/doc/general/index.html#ptsc> (last visited Feb. 26, 2008) (stating that the term of a patent is generally 20 years from its U.S. filing date, or in some cases from the filing date of an earlier related application).

140. See 35 U.S.C. § 271(a).

141. See Mazur, *supra* note 35, at 401.

expires.<sup>142</sup> During the term of the patent, the patentee may choose to forgo the granted exclusivity in exchange for a license fee.<sup>143</sup>

The main contention against patent licensing firms is that they engage in aggressive tactics to threaten the operation of other companies, thereby interfering with the constitutional goal of promoting the progress of useful science and arts.<sup>144</sup> This allegation is unjustified because it is based on the false notion that all nonpracticing patentees operate as patent trolls. Predatory nonpracticing patentees who game the system indeed exist, but blame should not be placed on other patentees who legitimately seek compensation for their patents or on patent licensing firms that assist them in that process. Further, there is no constitutional or statutory requirement for a patentee to practice or commercialize the patented invention.<sup>145</sup> In fact, the patentee may choose to withhold the invention from use by others throughout the term of the patent because the Patent Act makes clear that the patentee may refuse “to grant a license or use any rights to the patent.”<sup>146</sup> Therefore, the public has no positive right to access the invention until the patent expires. In fact, with the telescoping scopes of patents, expiration may not assure anything — at expiration time, if the patentee has improved embodiments within the expiring patents as well as later-issued patents, the patentee’s right of exclusion may last much longer. Accordingly, despite the criticisms, the bottom line is that nonpracticing entities are operating within the law to protect their exclusive right to their patented invention.<sup>147</sup> Patent licensing firms, who help them protect that right, also operate within legal bounds.

McDonough goes as far as to argue that patent licensing firms actually advance the constitutional purpose of promoting the progress of science

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142. See 35 U.S.C. § 112; see also MANUAL OF PATENT EXAMINING PROCEDURE § 2164 (8th ed., Rev. 4, Sep. 2007) (explaining the purpose of the requirement that the inventor “describe the invention in such terms that one skilled in the art can make and use the claimed invention” is to “ensure that the invention is communicated to the interested public in a meaningful way”). The enablement requirement is designed to provide an incentive toward innovation. See Mazur, *supra* note 35, at 402 (noting “the benefits from conveying the knowledge associated with new inventions include incentives for others to design around or improve the invention, thereby generating further innovation”).

143. See McDonough, *supra* note 16, at 221 (citing *United States v. Radio Corp. of Am.*, 117 F. Supp. 449, 454 (D. Del. 1954)).

144. Xuan-Thao Nguyen & Jeffrey A. Maine, *A Review of Recent Decisions of the United States Court of Appeals for the Federal Circuit*, 57 AM. U.L. REV. 775, 776 (2008).

145. McDonough, *supra* note 16, at 221.

146. “No patent owner . . . shall be . . . deemed guilty of misuse or illegal extension of the patent right by reason of . . . refus[ing] to license or use any rights to the patent.” Mazur, *supra* note 35, at 402. A patentee can reserve the exclusive right of the invention to himself and is “neither bound to use his discovery himself or permit others to use it.” *Id.* at 402 n.31 (quoting *Cont’l Paper Bag Co. v. E. Paper Bag Co.*, 210 U.S. 405, 425 (1908)). See also *id.* at 403 n.32 (“the long term gains of securing a greater market share, or even of driving a competitor out of business, might well be of far greater benefit to the patent holder”) (quoting Paul Gormley, Comment, *Compulsory Patent Licenses and Environmental Protection*, 7 TUL. ENVTL. L.J. 131, 135 (1993)).

147. McDonough, *supra* note 16, at 222.

and useful arts.<sup>148</sup> First, patent licensing firms can give incentive to individual inventors and small entities to invent, thereby advancing innovation and providing the public with useful technology.<sup>149</sup> Second, patent licensing firms can help promote productive relationships between small patentees and bigger corporations that are capable of commercializing patented technologies, which in turn makes it easier for the public to gain access to those technologies.<sup>150</sup> Third, patent licensing firms, armed with the financial resources to enforce the patents in court, can encourage potential infringers either to license or design around the patents.<sup>151</sup> This is beneficial because licensing broadens public access to the patented subject matter, and because research and development efforts to design around the invention advance innovation and, if successful, provide the public with a new or improved technology.<sup>152</sup> Finally, because patent licensing firms increase patent liquidity and reduce market risks for patentees, they provide inventors with incentive to invent.<sup>153</sup>

## 2. Do Patent Licensing Firms Spur Vexatious Litigation?

Patent licensing firms provide smaller patentees with a mechanism to enforce their patents through litigation, which inevitably increases the number of litigations.<sup>154</sup> Though an increase in litigation is never desirable, that does not necessarily support the conclusion that the litigations are frivolous. As explained above, it is the legal status of patentees that enables them to enforce their right to exclude others from their patented invention.<sup>155</sup> They do not violate the law by suing infringers who are violating that right.<sup>156</sup> Moreover, increase in litigation is no evidence that patent licensing firms cause vexatious litigation, because the underlying infringement could have existed well before the emergence of patent licensing firms — had the small patentees known about the infringement and possessed the necessary resources to litigate, they probably would have pursued the litigations themselves.

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148. *Id.*

149. *Id.* at 223.

150. *Id.*

151. *Id.*

152. *See id.*

153. *See McDonough, supra* note 16, at 223.

154. *See id.* at 224.

155. *See id.* at 221.

156. *See id.* at 227.

### 3. Do Patent Licensing Firms Encourage Low Quality Patents?

Hardly anyone can dispute there has been a growing concern over the quality of patents being issued in recent years.<sup>157</sup> Many believe the USPTO examiners are underfunded and understaffed, which in turn leads to faulty or incomplete examinations.<sup>158</sup> Some also believe the increasing number of business method and software patents is problematic because the exact parameters of such subject matters are still vague and ill-defined, resulting in a high percentage of patents with unreasonable overlap.<sup>159</sup> The result is an increasing number of litigations against large corporations and manufacturers whose complex products contain various bits of technology patented by others.<sup>160</sup> Litigation abuses committed by patent trolls who thrive on questionable patents have likewise increased, but many nonpracticing patentees rely on patent licensing firms to legitimately enforce their patents from infringers and receive just compensation for their inventions.<sup>161</sup>

## IV. JUDICIAL AND CONGRESSIONAL RESPONSE

Despite the optimistic arguments in support of patent licensing firms, Congress is not particularly sympathetic and has been more concerned with stopping the harmful activities of patent trolls.<sup>162</sup> Recent U.S. Supreme Court decisions,<sup>163</sup> while not directly addressing any particular troll, also suggest that courts are concerned over the debilitating effects of trolling activities on corporations.<sup>164</sup> At first glance, the patent troll issue seems to

157. See, e.g., Lorraine Woellert, *Look Who's Fighting Patent Reform - VCs, Trade Groups, and Universities have taken up the Fight Against Big Tech*, BUS. WK., July 9, 2007, available at 2007 WLNR 12731271.

158. See, e.g., Parchomovsky & Wagner, *supra* note 43, at 61 (noting that lately, the quality of the patent review process is being called into question due in part to insufficient resources, and asserting that the quality of review will remain poor unless and until there is a major reform in the USPTO examination procedure); Cheryl Lee Johnson, *The False Premise and Promises of Markman's Decision to Task Judges with Claim Construction and the Judicial Scorecard*, in HOW TO PREPARE & CONDUCT MARKMAN HEARINGS 2005, at 9, 70 (2005), available at 837 PLI/Pat 9 (Westlaw) (“[O]ver the last few years, the rumblings of a few critics have become an avalanche of denunciations of poor ‘quality’ patents and flawed Patent Office examination.”).

159. See Hand, *supra* note 64, at 463-64.

160. See Woellert, *supra* note 157.

161. See *id.*

162. See, e.g., *Patent Trolls: Fact or Fiction?: Hearing Before the Subcomm. on Courts, the Internet, & Intellectual Property of the H. Comm. on the Judiciary*, 109th Cong. 4-5 (2006) (statements of Lamar Smith, Chairman, Subcomm. on Courts, the Internet, and Intellectual Property & Howard L. Berman, Ranking Member, Subcomm. on Courts, the Internet, and Intellectual Property).

163. See *infra* Part IV.B.

164. See, e.g., *eBay Inc. v. MercExchange L.L.C.*, 547 U.S. 388, 395-97 (2006) (Kennedy, J., concurring) (“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.” (citing FTC, TO PROMOTE INNOVATION: THE PROPER BALANCE OF COMPETITION AND PATENT LAW AND POLICY, ch. 3,

be nothing more than a scuffle between large and small corporations. Upon closer scrutiny, however, patent trolls shed light onto a more fundamental issue concerning the integrity of the U.S. patent system.<sup>165</sup>

#### A. *The Magnitude of the Troll Problem*

Patent trolls have exposed serious defects in the patent system, and reform efforts are being undertaken by both Congress and the U.S. Supreme Court. Recent legislative and court activities show that the problems of the current patent system are not going unnoticed. For example, Congress is currently considering patent reform for the third straight year, and the Supreme Court has granted certiorari in more patent cases in the past two years than the last forty years combined.<sup>166</sup> Courts and Congress have focused their reform efforts on two main issues — improving the quality of patents and preventing vexatious litigation.<sup>167</sup>

In their attempt to limit the effects of troll activity, however, courts and legislators are also limiting legitimate patentees' ability to stop the infringing activity. This is problematic because a patent is supposed to "exclude others from making, using, offering for sale, or selling the invention throughout the United States or importing the invention into the United States," and anyone who engages in these activities during the term of the patent is an infringer of the patent.<sup>168</sup> Further, a patent is a negative right which gives its owner the right of exclusion, not an active right to make, use, or sell the invention.<sup>169</sup> Because this right of exclusion is the only right the Patent Statute confers to the patentee, the value of the patent is in its ability to exclude.<sup>170</sup> Reform efforts that end up limiting this ability would undermine the value of patents, which in turn weakens the patent system, diminishes incentives for innovation, and discourages exchange in the patent licensing market.<sup>171</sup> Such reform efforts could essentially allow the nation's most dominant high-tech companies to

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38-39 (Oct. 2003), <http://www.ftc.gov/os/2003/10/innovationrpt.pdf>). See also King, *supra* note 13, at 13.

165. See McDonough, *supra* note 16, at 197.

166. King, *supra* note 13, at 13.

167. *Id.*

168. 35 U.S.C. §§ 154(a)(1), 271(a) (2000).

169. See *id.* § 154(a)(1). The Code does not confer the owner any positive rights to use the invention. See BLACK'S LAW DICTIONARY 1156 (8th ed. 2004) ("The holding of a patent does not by itself grant any right to make, use, or sell anything.").

170. See Hand, *supra* note 64, at 481; McDonough, *supra* note 16, at 197.

171. See McDonough, *supra* note 16, at 197; see also Slenkovich, *supra* note 56 (noting that "the practical effect of each of these decisions has been to erode the legal arsenal available to those who seek to hold and enforce patent rights"); *Through a Goose*, THE PAT. PROSPECTOR, Sept. 7, 2007, [http://www.patenthawk.com/blog/2007/09/through\\_a\\_goose.html](http://www.patenthawk.com/blog/2007/09/through_a_goose.html) ("Rep. Dana Rohrabacher . . . forewarned that the bill would 'dramatically weaken the patent rights of ordinary Americans and make us even more vulnerable to the outright theft of American-created technology and innovation.'").

control the market and pace of innovation while crippling smaller patentees.<sup>172</sup>

B. *Recent Supreme Court Cases*

Although the Supreme Court is certainly aware of the troll problem, the Court has not made life easier for small patentees. In fact, three recent Supreme Court cases could have debilitating consequences for small patentees: (1) *MedImmune, Inc. v. Genentech, Inc.*, (2) *KSR Int'l Co. v. Teleflex Inc.*, and (3) *eBay Inc. v. MercExchange L.L.C.*<sup>173</sup> The practical effect of the decisions have been to further limit the legal options available to small patentees who seek to hold and enforce patent rights.<sup>174</sup>

1. *MedImmune, Inc. v. Genentech, Inc.*

**Facts:**

MedImmune (licensee) entered into a license agreement with Genentech (licensor) in which MedImmune was to pay royalties on sales of licensed products in exchange for the right to make, use, and sell those products.<sup>175</sup> Subsequently, one of Genentech's products, which was pending at the time of the licensing agreement, matured into a patent, and Genentech informed MedImmune that the new patent covered MedImmune's product and that royalties were consequently due.<sup>176</sup> MedImmune, however, asserted that they did not owe any royalties under the licensing agreement because Genentech's patent was invalid, unenforceable, and not infringed by its product.<sup>177</sup> MedImmune nevertheless paid the demanded royalties so as to avoid the risk of a patent infringement action, but filed a declaratory-judgment action to have the patent claims invalidated.<sup>178</sup>

**Holding:**

In *Medimmune*, the Supreme Court determined that a patent licensee can seek a declaratory judgment that the patent covered in the licensing agreement is invalid or not infringed, even while the licensing agreement is

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172. See Kevin Kearns, *Patent Nonsense*, WASH. TIMES, June 21, 2007, <http://www.washingtontimes.com/news/2007/jun/21/patent-nonsense/>.

173. Slenkovich, *supra* note 56; see also *MedImmune, Inc. v. Genentech, Inc.*, 549 U.S. 118, 127 S. Ct. 764 (2007); *KSR Int'l Co. v. Teleflex Inc.*, 550 U.S. 398, 127 S.Ct. 1727 (2007); *eBay Inc. v. MercExchange, L.L.C.*, 547 U.S. 388, 126 S. Ct. 1837 (2006).

174. Slenkovich, *supra* note 56.

175. *MedImmune*, 549 U.S. at 121.

176. *Id.*

177. *Id.* at 121-22.

178. *Id.* at 122. The court noted "[i]f [Genentech] were to prevail in a patent infringement action, [MedImmune] could be ordered to pay treble damages and attorney's fees, and could be enjoined from selling . . . a product that has accounted for more than 80 percent of its revenue from sales since 1999." *Id.*

still in effect.<sup>179</sup> Put another way, the Court held that a patent licensee is not required to terminate or breach its licensing agreement before challenging the validity of the underlying patent.<sup>180</sup>

**Discussion:**

The only issue before the Court was whether a licensee's continuance of royalty payments precludes a justiciable controversy by means of which the licensee could dispute the patent's validity.<sup>181</sup> The Court held it does not.<sup>182</sup> In doing so, the Court rejected Genentech's appeal to the common-law rule that forbids a party to a contract to challenge the validity of the contract while simultaneously reaping its benefits.<sup>183</sup> The Court specified that MedImmune was not reaping the benefits of the license, but simply asserting that the licensing agreement did not prevent it from challenging the underlying patent or refusing to pay royalties because the patent did not cover its products or was invalid.<sup>184</sup>

**Impact:**

Prior to the *MedImmune* holding, those who had taken a license to the patent and remained in good standing under the license could not seek a declaratory judgment contesting the enforceability of the underlying patent.<sup>185</sup> This would effectively allow patent trolls to allege infringement and aggressively pursue licensing agreements without subjecting themselves to declaratory judgment actions.<sup>186</sup> The Supreme Court, however, overruled the Federal Circuit's general rule by holding that a licensee need not "expose itself" to a potential injunction or "treble damages" before it can challenge the validity of the underlying patent or its own product's infringement status.<sup>187</sup> As a result, licensees can now contest the enforceability of the underlying patents without fear of breaching the license.<sup>188</sup>

The *MedImmune* decision will enable corporate licensees to protect themselves against patent trolls who allege infringement based on weak patents, as it enables them to challenge the validity of the trolls' patents through declaratory judgment actions filed in their forum of choice.<sup>189</sup> The decision is not specifically directed at patent trolls, but the likely impact is

179. *Id.* at 137.

180. *Id.*

181. *See MedImmune*, 549 U.S. at 120-21. The Court did not rule on whether to grant or deny the declaratory relief, and remanded the case to have the lower court decide the merits of the claim. *See id.* at 136-37.

182. *See id.* at 135.

183. *See id.*

184. *Id.* at 135.

185. *Id.* at 122.

186. Irfan A. Lateef & Joshua Stowell, *A Supreme End to Patent Trolls?*, 49 AUG ORANGE COUNTY LAW. 18, 22 (2007).

187. Slenkovich, *supra* note 56.

188. *See id.*

189. Lateef & Stowell, *supra* note 186, at 22.

that licensing schemes by patent licensing firms will be less potent for generating revenue because entering into a license agreement no longer assures the patent will go unchallenged.<sup>190</sup> The holding not only allows licensees to bring suit to invalidate the patents and avoid royalties, but may even encourage them to use the threat of litigation as leverage to negotiate favorable terms under the licensing agreement.<sup>191</sup>

Furthermore, even though small inventors can hire contingent fee lawyers to represent them as plaintiffs, if a license results from their patents, the licensees can now file a declaratory judgment action against the small inventors without breaching the license; in such a case, the small inventors, with their limited resources, cannot pay for a lawyer to defend (because a contingent fee arrangement is unavailable to defendants). This makes it easier for corporate licensees to “renegotiate” running royalty licenses through declaratory judgment actions or threats thereof. Therefore, *MedImmune* is ultimately an unfavorable decision for nonpracticing patentees and patent licensing firms, and “furthers the Supreme Court’s patent reform agenda by facilitating invalidation and dampening somewhat the potency of the patent monopoly.”<sup>192</sup>

## 2. *KSR Int’l Co. v. Teleflex Inc.*

### **Facts:**

Teleflex, an exclusive licensee to a patent for a position-adjustable vehicle pedal, sued KSR for infringement.<sup>193</sup> Teleflex’s invention integrated into the pedal assembly an electronic pedal-position sensor and a fixed pivot point of the pedal, which resulted in a more compact design and permitted adjustment of the pedal height without moving the sensor.<sup>194</sup> KSR countered by arguing that the patent in question is invalid under 35 U.S.C. § 103 as being obvious over prior art.<sup>195</sup>

### **Holding:**

In *KSR*, the Supreme Court made what some have called a landmark decision in reevaluating the central requirement to obtain and sustain a valid patent, namely that the claimed invention must not be “obvious” in light of the prior art.<sup>196</sup> Ultimately, the Court found for KSR, holding that

190. Slenkovich, *supra* note 56.

191. *See id.*

192. King, *supra* note 13, at 15.

193. *KSR Int’l Co. v. Teleflex Inc.*, 550 U.S. 398, 405-06, 127 S.Ct. 1727, 1734 (2007).

194. *Id.* at 411.

195. *Id.* at 406.

196. *See* Olivia Clarke, *Supreme Court Decision Could Impact Future of Patent Law*, CHI. LAW., July 2007, available at 7/07 CHIL 21 (Westlaw). There is no easy definition of “obviousness,” but the framework for analyzing whether an invention satisfies the obviousness test was set out in *Graham v. John Deere Co. of Kansas City*, 383 U.S. 1, 86 S. Ct. 684 (1966). *See* King, *supra* note 13, at 14. The obviousness test “forbids issuance of a patent when ‘the differences between the subject matter sought to be patented and the prior art are such that the subject matter as a whole would have been obvious at

Teleflex's patent was an obvious combination of elements from the prior art and was therefore invalid as being obvious.<sup>197</sup>

**Discussion:**

Under § 103 of the Patent Act, a patent claim is invalid if any embodiment within the claim would have been obvious to one of ordinary skill in the art at the time the invention was made.<sup>198</sup> In determining whether an invention was obvious, the Federal Circuit for many years applied a rigid test, known as the TSM test, that no patent could be invalidated for obviousness unless there was some prior "teaching, suggestion, or motivation" indicating how the prior art could point to the claimed invention.<sup>199</sup> In *KSR*, the Supreme Court rejected the approach taken by the Federal Circuit and reversed the holding, concluding that Teleflex's invention was invalid due to obviousness.<sup>200</sup> In so holding, the Court deemed that the test for obviousness as applied by the Federal Circuit was too "rigid" for determining the validity of the patent.<sup>201</sup> The Court explained that the TSM is still a viable test, but that its analysis must be more flexible and expansive in testing obviousness.<sup>202</sup>

**Impact:**

Thomas Goldstein, who represented Teleflex in the case, stated that "[t]he stakes [of the case] couldn't possibly be higher because obviousness is the most important legal gateway to patenting . . . ."<sup>203</sup> The significance of the decision lies in the fact that the Court in effect made it easier to invalidate patents on obviousness grounds by clarifying the factors to be used to determine obviousness, but at the same time not explaining how to combine, weigh, or use those factors.<sup>204</sup> Though courts and USPTO examiners have always applied their subjective insights in determining obviousness, the *KSR* decision gives them even more leeway for subjective

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the time the invention was made to a person having ordinary skill in the art to which said subject matter pertains." *KSR*, 550 U.S. at 406 (quoting 35 U.S.C. § 103).

197. See *KSR*, 550 U.S. at 427 ("KSR provided convincing evidence that mounting a modular sensor on a fixed pivot point of the Asano pedal was a design step well within the grasp of a person of ordinary skill in the relevant art.").

198. 35 U.S.C. § 103(a) (2004). A "person having ordinary skill in the art" is a hypothetical person presumed to have "the capability of understanding the scientific and engineering principles applicable to the pertinent art" at the time of the invention. UNITED STATES PATENT & TRADEMARK OFFICE, MANUAL OF PATENT EXAMINING PROCEDURE § 2141.03 (8th ed. 2001, rev. 2008), <http://www.uspto.gov/web/offices/pac/mpep/index.htm>.

199. Slenkovich, *supra* note 56.

200. *KSR Int'l Co. v. Teleflex Inc.*, 550 U.S. 398, 427, 127 S.Ct. 1727, 1746 (2007).

201. *Id.* at 415.

202. *Id.* at 418 (explaining that "[t]he obviousness analysis cannot be confined by a formalistic conception of the words teaching, suggestion, and motivation, or by overemphasis on the importance of published articles and the explicit content of issued patents").

203. Peter Lattman, *KSR v. Teleflex: The Supreme Court's Big Patent Ruling*, WALL ST. J., May 1, 2007, <http://blogs.wsj.com/law/2007/05/01/ksr-v-teleflex-the-supreme-courts-big-patent-ruling/>.

204. Clarke, *supra* note 196.

scrutiny.<sup>205</sup> Any time a subjective component of an analysis is given more weight, the results become less predictable and more inconsistent.<sup>206</sup> Courts and examiners can now look for obviousness in more creative ways, and may reject or invalidate patents based on grounds that were never raised before.<sup>207</sup>

Moreover, the *KSR* decision has lowered the bar for parties charged with infringement to invalidate patents based on obviousness.<sup>208</sup> The decision provides a stronger legal basis for corporate licensees to counter threats of litigation by patent trolls, particularly when weak patents are involved.<sup>209</sup> Nonpracticing patentees with strong patents have less to fear because of the presumption, under 35 U.S.C. § 282, that issued patents shall be deemed valid, but the *KSR* holding will undoubtedly give litigants more room to argue over the obviousness issue.<sup>210</sup> This inevitably increases litigation costs as well as unpredictability. Practically speaking, it follows that the *KSR* decision may have severe consequences for nonpracticing patentees who lack the financial resources to withstand a long trial.<sup>211</sup>

### 3. *eBay Inc. v. MercExchange L.L.C.*

#### **Facts:**

MercExchange, the owner of a business method patent for conducting online sales on an electronic market, sought to license its patent to eBay, an operator of an online auction.<sup>212</sup> The parties, however, failed to reach an agreement and MercExchange filed an infringement suit against eBay. MercExchange won the case and sought injunctive relief against future infringements.<sup>213</sup>

#### **Holding:**

The Court ultimately reversed the Federal Circuit's decision to grant MercExchange's motion for a permanent injunction against future infringements. In reaching its decision, the Court reversed the Federal Circuit's long-held, bright-line rule that, absent exceptional circumstances, courts will automatically issue permanent injunctions against patent

205. *See id.*

206. *Id.*

207. *Id.*

208. Lateef & Stowell, *supra* note 186, at 22.

209. *Id.*

210. *See* Clarke, *supra* note 196; *see also* Kearns, *supra* note 172 (explaining that, when the validity of issued patents are less certain, the benefits to patentees become less certain, which consequently weakens the inventors' incentives to seek patents and pose higher risks for venture capitalists backing new inventions).

211. Slenkovich, *supra* note 56.

212. *eBay Inc. v. MercExchange, L.L.C.*, 547 U.S. 388, 390, 126 S. Ct. 1837, 1839 (2006).

213. *Id.* at 390-91.

infringement once validity and infringement are decided in the patentee's favor.<sup>214</sup>

**Discussion:**

In *eBay*, the Supreme Court was asked to determine the proper test for granting or denying injunctive relief in a suit arising under the Patent Act.<sup>215</sup> Rejecting the Federal Circuit's general rule as conflicting with the equitable principles stated by Congress, the Court instead held that the decision to grant or deny injunctive relief is an act of discretion governed by the traditional four-factor test, which applies with equal force to disputes arising under the Patent Act.<sup>216</sup>

**Impact:**

The significance of the *eBay* decision is the Supreme Court's denial of a long-held presumption that favored the grant of an injunction against a patent infringer.<sup>217</sup> By reversing this longstanding tradition of the Federal Circuit, the Court made it considerably more difficult for patentees to enforce their right of exclusion.<sup>218</sup> Because a value of a patent lies in the ability to exclude others from the patented technology, curtailing this right could significantly undermine the value of the patent.<sup>219</sup>

Further, the *eBay* holding marked a significant victory for corporate licensees and potential infringers and a major setback for patent licensing firms and nonpracticing patentees.<sup>220</sup> Large technological and software companies are content with the holding because their products often make use of hundreds if not thousands of patents, which makes them more vulnerable to infringement action.<sup>221</sup> On the other hand, nonpracticing patentees trying to establish themselves in the marketplace have lost a powerful remedy to enforce their rights with respect to the only asset they

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214. *Id.* at 393-94 (quoting *MercExchange L.L.C. v. eBay Inc.*, 401 F.3d 1323, 1339 (2005)). "Because the 'right to exclude recognized in a patent is but the essence of the concept of property,' the general rule is that a permanent injunction will issue once infringement and validity have been adjudged." *MercExchange*, 401 F.3d at 1338 (quoting *Richardson v. Suzuki Motor Co.*, 868 F.2d 1226, 1246-47 (Fed. Cir. 1989)). The Federal Circuit has historically applied this special rule for injunctive relief in patent disputes and consistently held that patents are unique in that "this statutory right to exclude alone justifies its general rule in favor of permanent injunctive relief." *eBay*, 547 U.S. at 392 (citing *MercExchange*, 401 F.3d at 1338). The Supreme Court, however, disagreed with this argument and ruled that "the creation of a right is distinct from the provision of remedies for violations of that right." *Id.*

215. *eBay*, 547 U.S. at 391.

216. *Id.* ("[A] plaintiff seeking a permanent injunction . . . must demonstrate: (1) that it has suffered an irreparable injury; (2) that remedies available at law, such as monetary damages, are inadequate to compensate for that injury; (3) that, considering the balance of hardships between the plaintiff and defendant, a remedy in equity is warranted; and (4) that the public interest would not be disserved by a permanent injunction.").

217. Hand, *supra* note 64, at 463.

218. See *eBay*, 547 U.S. at 393-94.

219. Hand, *supra* note 64, at 463.

220. King, *supra* note 13, at 14.

221. *Id.* at 14-15. See also Hand, *supra* note 64, at 470.

really have: innovative ideas.<sup>222</sup> These entities rely on their patents for attracting initial investment and “carving out their own protected industry niche.”<sup>223</sup> Even if they intend to manufacture products and commercialize their inventions in the future, they need to rely on licensing to generate startup revenue.<sup>224</sup> Larger corporations, who have already established their presence in the market, are not as dependent on the monopoly that patents provide.<sup>225</sup> For nonpracticing entities, however, a presumption of injunctive relief for patent infringement provides invaluable bargaining leverage during licensing negotiation.<sup>226</sup> Without the necessary bargaining power, it will be significantly more difficult for the patent licensing firms to obtain a favorable licensing deal for the nonpracticing patentees.

A denial of an injunction would leave the patentee with monetary compensation. Assessing a reasonable royalty, however, is tremendously difficult even from a retrospective viewpoint.<sup>227</sup> Even if damages are calculated accurately, monetary compensation is still an inadequate remedy for most patentees in the sense that it does not assure their right to protect their patents against continuing infringement.<sup>228</sup>

Federal district courts, in response to the Supreme Court’s decision in *eBay*, appear to be consistently denying injunctions in cases where the patentee and accused infringer were not direct competitors.<sup>229</sup> Hence, one can argue that, post-*eBay*, the patentee’s fate depends almost solely on the commercial activities of the patentee and infringer, i.e., permanent injunctions will be granted if there is direct competition, but denied otherwise.<sup>230</sup> Under such a rule, nonpracticing patentees lose every time because, by definition, they are not direct competitors.<sup>231</sup> Consistent with this analysis, after the *eBay* decision district courts have, in the majority of cases, denied a permanent injunction in patent infringement suits where the

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222. Woellert, *supra* note 157.

223. Golden, *supra* note 11, at 2157.

224. *Id.*

225. Woellert, *supra* note 157.

226. Golden, *supra* note 11, at 2157.

227. *Id.* at 2150-51. A royalty rate is difficult to determine because it is theoretically tied to patent value, which is “almost impossible to determine, apart from such an obvious case as an improved process that reduces everyone’s production costs by, say, 10 percent.” *Id.* at 2150 n.143 (quoting 3 PHILIP E. AREEDA & HERBERT HOVENKAMP, *ANTITRUST LAW: AN ANALYSIS OF ANTITRUST PRINCIPLES AND THEIR APPLICATION* § 707, at 209 (2d ed. 2002)). Patents are difficult to value as business assets and there is currently no appropriate method by which to value them. *Id.*

228. Golden, *supra* note 11, at 2152 (emphasizing that courts are unlikely to be able to determine damages accurately when a unique set of rights are threatened with continued infringement).

229. *Id.* at 2113; *see id.* at 2148 (explaining that whether a patent holder obtains the benefits of a presumption of injunctive relief depends on the patent holder’s business model).

230. Hand, *supra* note 64, at 484.

231. Andrew Beckerman-Rodau, *The Aftermath of eBay v. MercExchange*, 126 *S. Ct.* 1837 (2006); A Review of Subsequent Judicial Decisions, 89 *J. PAT. & TRADEMARK OFF. SOC’Y* 631, 654-55 (2007).

patentee was a nonpracticing patentee.<sup>232</sup> The Supreme Court may have created a sweeping rule that categorically discriminates against patent licensing firms and nonpracticing patentees.<sup>233</sup>

### C. Patent Reform Act of 2007

Congress is also taking steps to ameliorate the troll problem. The Patent Reform Act of 2007 was introduced by members of both the House and the Senate in an effort to address recent trends that have generated concern over the integrity and effectiveness of the U.S. patent system.<sup>234</sup> If signed into law, some observers say it would bring “the biggest, most sweeping changes to U.S. patent law in over 50 years.”<sup>235</sup>

The proposed reforms contain various provisions that are perceived to favor larger corporations such as Microsoft, Intel, Hewlett-Packard, and IBM, who have supported the Act as a way to limit the leverage of patent trolls.<sup>236</sup> On the other hand, nonpracticing patentees as well as entrepreneurs, venture capitalists, trade groups, drug and medical manufacturers, and engineering societies have strongly opposed the act because such reforms “[run] the risk of throttling the little guy.”<sup>237</sup> Some of the most highly debated proposals include the first-to-file system, post-grant review, and apportionment of damages.

#### 1. Invention Date Finally Eliminated From US Law

Currently, the U.S. is the only country in the world having a “first-to-invent” provision where, when there are competing applicants for the same claim, the first person who invented the subject matter in a WTO country, and who did not abandon, suppress, or conceal it, is awarded the claim.<sup>238</sup> In contrast, under the “first-to-file” provision in force in other countries, the patent is awarded to the first person who has filed the application to the

232. *Id.*

233. See Golden, *supra* note 11, at 2117 (“A per se rule of discrimination based on a patent holder’s business model could act as an undesirable drag on the efficiency and competitiveness of markets for innovation.”).

234. See King, *supra* note 13, at 15-16 (describing how the reforms aimed “to reverse recent trends by making it easier to invalidate patents [and] curtailing remedies for infringement”); Sheila Riley, *Proposed Bill to Stop ‘Patent Trolls’ Supported by Big Tech Companies*, INVESTOR’S BUS. DAILY, May 29, 2008, available at 2008 WLNR 10075009.

235. Harkins, *supra* note 68, at 422. See also John Markoff, *Two Views of Innovation, Colliding in Washington*, N.Y. TIMES, Jan. 13, 2008, [http://www.nytimes.com/2008/01/13/business/13stream.html?\\_r=1](http://www.nytimes.com/2008/01/13/business/13stream.html?_r=1).

236. See King, *supra* note 13, at 16.

237. Markoff, *supra* note 235; Woellert, *supra* note 157.

238. Judy Newman, *Bill to Reform Patent System Seen as Threat—Small Businesses Fear They Won’t Be Able to Protect and Defend Their Intellectual Property*, WIS. ST. J., June 18, 2007, available at 2007 WLNR 11466461; 35 U.S.C. § 102(g)(1).

patent office.<sup>239</sup> The main argument against the proposed “first-to-file” system is that it inevitably gives an edge to larger corporations over smaller entities because larger corporations have better means and resources to file patent applications as quickly as possible.<sup>240</sup> A foreseeable result of this change is smaller patentees rushing to file their patent applications just to beat competitors to the filing office, even if their research is far from complete.<sup>241</sup>

## 2. Post-Grant Review

The Patent Reform Act would allow anyone to request cancellation of an issued patent if it is within 12 months of issuance or notice of infringement, or if a likelihood of “significant economic harm” is shown.<sup>242</sup> The post-grant review would make it easier for anyone to challenge patents during the entire life of the patent.<sup>243</sup> Though invalidating poor-quality patents is a desirable process, this provision may end up slowing down the patent licensing market because potential licensees may be unwilling to negotiate a license for something that could be endlessly challenged throughout the term of the patent.<sup>244</sup>

## 3. Apportionment of Damages

This provision was proposed in response to the increasing magnitude of patent damage awards in recent years and addresses the situation in which the patented technology represents only part of the infringing product.<sup>245</sup> If a corporation’s product is found to violate another’s patent, damages are to be assessed based on the contribution of just the patented feature, not the whole product.<sup>246</sup> Opponents argue that this provision is unnecessary because the courts already have discretion to limit damages,

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239. Newman, *supra* note 238. The competing “first-to-invent” and “first-to-file” rules apply only where there are two roughly contemporaneous applicants for the same subject matter, which happens very rarely.

240. *Id.* (statement of William Tucker, Executive Director for Research Administration and Technology Transfer in the University of California’s Office of the President). See also Tom Ramstack, *Patent Bill Seen Hurting the Little Guy*, WASH. TIMES, July 19, 2007, available at 2007 WLNR 13775696 (explaining that the first-to-file system is beneficial to larger corporations that have large research and development budgets as well as a better team of lawyers who can help file patent applications as quickly as possible); *Globalists plan to give away U.S. patents*, INTELLIGENCER, Aug. 1, 2007, available at 2007 WLNR 15128989 (“First-to-file would be a windfall to megacorporations and a bid disadvantage to the small-entity inventor. First-to-file would invite an avalanche of applications from the big companies . . . and the small inventors would be lost in the shuffle.”).

241. Ramstack, *supra* note 240.

242. King, *supra* note 13, at 16.

243. *Globalists plan to give away U.S. patents*, *supra* note 240.

244. Newman, *supra* note 238.

245. King, *supra* note 13, at 16. The idea behind this provision is that it is unfair to calculate damages based on the entire market value of the infringing product in cases where the patented technology is relatively modest compared to the value of the infringing product as a whole. *Id.*

246. Newman, *supra* note 238.

and that it will only add another twist to the already expensive and complex phase of determining damages at trial.<sup>247</sup> This could delay court rulings on patent challenges for years, which could be devastating for small patentees in need of immediate financial relief.<sup>248</sup>

#### D. Overall Impact of the Cases and Proposed Legislative Reforms

The reform efforts by courts and Congress will most likely be an effective deterrence against bad-faith patent trolls. However, these reform efforts, just like the “troll” term itself, seem over-expansive in that they curtail not only the trolls but also patentees who have been wrongly associated with them, i.e., nonpracticing patentees.<sup>249</sup> In other words, the reform efforts are not narrowly tailored, but rather target a large class that encompasses not only patent trolls but a vast number of innocent nonpracticing patentees.

Federal district courts, in response to the Supreme Court’s decision in *eBay*, appear to be consistently denying injunctions in cases where the patentee and accused infringer were not direct competitors.<sup>250</sup> Hence, one can argue that, post-*eBay*, the patentee’s fate depends almost solely on the commercial activities of the patentee and infringer, i.e., permanent injunctions will be granted if there is direct competition, but denied otherwise.<sup>251</sup> Under such a rule, nonpracticing patentees lose every single time because they, by definition, are not direct competitors.<sup>252</sup> Consistent with this analysis, district courts after the *eBay* decision have, in the majority of cases, denied a permanent injunction in patent infringement suits where the patentee was a nonpracticing patentee.<sup>253</sup> The Supreme Court may have created a sweeping rule that categorically discriminates against patent licensing firms and nonpracticing patentees.<sup>254</sup>

The Court’s position seems to prioritize the prevention of troll activity and protection of potential licensees, regardless of how nonpracticing patentees may be affected. For example, although the Court in *eBay*

247. King, *supra* note 13, at 16.

248. Newman, *supra* note 238. Opponents also contend that the sale of a whole product often depends on the presence of a minor patented improvement. *Id.*

249. See, e.g., Jon Van, *Proposals for Patent Reforms Raising Fears*, CHI. TRIB., September 7, 2007, available at 2007 WLNR 17475378 (explaining how many business executives are concerned about the unintended consequences that lurk in the complex reform proposals, which are likely to make it more difficult not only for trolls but also for innovative start-up companies to get financing).

250. Golden, *supra* note 11, at 2113; see *id.* at 2148 (explaining that whether a patent holder obtains the benefits of a presumption of injunctive relief depends on the patent holder’s business model).

251. Hand, *supra* note 64, at 484.

252. Beckerman-Rodau, *supra* note 231, at 654-55.

253. *Id.*

254. See Golden, *supra* note 11, at 2117 (“A per se rule of discrimination based on a patent holder’s business model could act as an undesirable drag on the efficiency and competitiveness of markets for innovation.”).

acknowledged the inadequacy of monetary damages and the importance of injunctive relief in an infringement suit,<sup>255</sup> it decided injunctions may be too powerful a remedy considering the potent presence of patent trolls in the market. Rather than leaving trolls with the opportunity to use the threat of injunction as a way to unfairly extort favorable terms in a licensing deal, the Court apparently favored protection for potential licensees at the expense of nonpracticing patentees who rightfully rely on the availability of injunctions to negotiate a fair license or protect its patent rights.<sup>256</sup>

Nonpracticing patentees have become involuntarily caught in the battle between the patent trolls and corporate licensees and find themselves in the unfortunate position of having their patent rights circumscribed as a consequence of the trolls' activities. This also makes it difficult for patent licensing firms to serve their function of market facilitators because their effectiveness hinges on the viability of the patent rights of the patentees they represent. No one can reasonably argue that the reform efforts can protect potential licensees from predatory patent trolls. The problem, however, is that they could possibly cause more harm to innocent nonpracticing patentees than good to potential licensees.<sup>257</sup>

Though it is still too early to predict the full impact of the proposed reforms and the Supreme Court decisions, many observers believe that they will deliver a big blow to the smaller patentees.<sup>258</sup> The reform efforts could diminish the strength of the patent, facilitate invalidation of patents, increase litigation, and limit the ability of small patentees to enforce their rights against infringers.<sup>259</sup> They could also make new patents harder to obtain, and enable large companies with large budgets to infringe others' patented technology without hesitation.<sup>260</sup> Because intellectual property

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255. *eBay Inc. v. MercExchange, L.L.C.*, 547 U.S. 388, 395, 126 S. Ct. 1837, 1841 (2006) (Roberts, J., concurring) (noting that there is no reasonable way a patentee could "protect[] . . . a right to exclude through monetary remedies that would allow an infringer to use an invention against the patentee's wishes . . .").

256. *See Hand, supra* note 64, at 470.

257. *See, e.g., Newman, supra* note 238 (statement of John Neis, managing director of Venture Investors, Madison) ("While we all agree that there are abuses to the patent system and improvements could and should be made, other provisions 'could be unintentionally devastating for small venture (capital)-backed [sic] companies at a critical time in their existence[.]").

258. *See, e.g., Globalists plan to give away U.S. patents, supra* note 240 ("[T]he new patent bill is a big attack on the constitutional property rights of individual inventors and small enterprises, the very kind of entrepreneurs who give us our most important innovations . . . . The common thread in the changes to be made by the new patent bill is that they favor big companies like Microsoft and hurt individual and small-entity inventors."); *Van, supra* note 249 ("There'd be more uncertainty for a little company, making it more difficult to attract investors.").

259. *See King, supra* note 13, at 13-17; *see also Globalists plan to give away U.S. patents, supra* note 240 ("[The reforms] would increase litigation and limit the ability of independent inventors and small companies to enforce their rights or to win just compensation from those who infringe their rights.").

260. *See Markoff, supra* note 235; *see also Van, supra* note 249 ("[R]eform legislation would enable large companies with deep pockets to use patented technology as they pleased, knowing it would be cheaper to fight in court than to negotiate royalties with patent holders.").

has become such a key component of the global economy, courts and legislators are likely to show continued interest in the field of patent law.<sup>261</sup>

By encouraging exchange of technologies between small patentees and large corporations, patent licensing firms can promote efficiency in the patent licensing market. In light of recent reform efforts, however, they must overcome a number of challenges. They must first and foremost earn a more positive reputation in the tech industry. In the midst of the intensifying debate over the legitimacy of their business models, they must disassociate themselves from the “troll” label by demonstrating that they are not oppressive opportunists but legitimate entrepreneurs who invest only in patentees justifiably seeking enforcement of their legal rights. Further, the patent licensing firms must reevaluate their clients’ patent portfolios and stop marketing those patents that may not be patentable under the new patentability standards. It remains to be seen how the patent licensing firms will respond to these challenges.

#### V. CONCLUSION

The emergence of patent licensing firms demonstrates a positive progression in response to the demands of the patent licensing market, which historically has been dominated by large corporations. Novel business models offered by these licensing firms give hope to smaller patentees who struggle to survive in the patent licensing market and obtain just compensation for their inventions. These licensing firms have departed with the old notion that patents are valuable only when they are commercialized into useful products. Instead, they have embraced those who do not practice their patents, and offer them market-based solutions which could eventually lead to a more balanced and stable patent licensing market.

However, electronic commerce, overlapping and poorly-defined patents, and rapid technological progress have enabled opportunistic patent trolls to exploit the patent system and employ avaricious tactics against corporations. Congressional and judicial reform efforts have been made to eliminate trolling activities, but in the process they have also impaired the ability of legitimate patentees and businesses to compete in the patent licensing market. Therefore, while patent licensing firms have great potential, their ultimate survival will depend on how well they can adjust to the major changes that lie ahead.

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261. Clarke, *supra* note 196.

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