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## Starving the Troll: Using the Customer Suit Exception to Deter Abusive Patent Litigation

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# STARVING THE TROLL: USING THE CUSTOMER SUIT EXCEPTION TO DETER ABUSIVE PATENT LITIGATION

*“This business is not based on what’s right or what’s wrong . . . . It’s based on fear. Nobody would pay you for a patent unless they feared that the consequences of not paying you vastly exceed the consequences of paying.”<sup>1</sup>*

## INTRODUCTION

Many scholars and practitioners agree that non-practicing entities (NPEs), patent holders who do not use their patent but for filing infringement lawsuits, are increasingly burdening the patent system. While there are many different types of NPEs, pejoratively known as “patent trolls,” those that target end users<sup>2</sup> to obtain licensing fees are seen as the most nefarious.<sup>3</sup> These NPEs use the threat of expensive litigation as leverage for extorting a licensing fee for what are usually weak patents. Often, the manufacturer of the product is procedurally unable to protect its customers from these actions and is forced to watch as the customers acquiesce to the frivolous licensing demands.

Congress and the judiciary have attempted to solve this problem,<sup>4</sup> mostly in the form of diminishing the leverage patent trolls have in litigation. However, each enacted solution has merely resulted in the NPE adapting its strategy. There has yet to be a significant decline in the number of NPE filings. Therefore, another round of patent reform is necessary to give the entities opposing the patent trolls—not just the ones who have lawsuits filed against them, but also the small retailer who is one of thousands to receive a letter demanding licensing fees—tools to combat the problem. This Note argues that an expansion of the customer suit exception<sup>5</sup> is the only viable option available at the moment to protect both classes of non-manufacturer NPE victims. Part I gives a brief background on the NPEs position in the patent landscape. Part II discusses how the current options available to customers for patent infringement lawsuits fail to deter

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1. *The Symbol/Cognex-Lemelson Patent Battle*, GROKLAW (Aug. 22, 2005, 11:05 AM), <http://www.groklaw.net/articlebasic.php?story=20050822040508297> (quoting Gerald Hosier, attorney for Jerome Lemelson, a patent troll that received \$1.5 billion in license agreements).

2. End users are entities at the end of a product supply chain.

3. For purposes of this Note, NPE and patent troll will be used interchangeably.

4. See Tracie L. Bryant, *The America Invents Act: Slaying Trolls, Limiting Joinder*, 25 HARV. J.L. & TECH. 687, 694 (2012). “[NPEs] are generally viewed as a problem that plagues the patent system . . . .” *Id.* at 692.

5. When a manufacturer’s customer is defending a patent infringement claim based on the manufacturer’s product, the customer suit exception allows the manufacturer to file a declaratory judgment action against the plaintiff seeking a finding of noninfringement. The lawsuit against the customer would then be stayed pending conclusion of the manufacturer’s declaratory judgment action.

patent troll activities. Part III shows that the heightened pleading standards and fee shifting options from the most current reform proposal will not diminish trivial NPE lawsuit filings. Finally, Part IV explains why an expansion of the customer suit exception is the best option for protecting customer defendants from patent trolls.

## I. BACKGROUND

Patent infringement is statutorily defined as “whoever without authority makes, uses, offers to sell, or sells any patented invention, within the United States . . . .”<sup>6</sup> The purpose of a patent is to promote innovation.<sup>7</sup> The temporary monopoly a patent provides gives the inventor a chance to exploit the market and recover its investment; thus, there is more incentive for innovative activities.<sup>8</sup> However, recent trends in patent litigation have led to patents being used as tools for litigation rather than mechanisms to promote innovation.<sup>9</sup> NPEs neither develop new technologies nor participate directly in the market, but instead acquire patents for the purpose of extracting license fees by making threats of litigation.<sup>10</sup>

Patent trolls entered the intellectual property law spotlight in *NTP, Inc. v. Research in Motion, Ltd.*<sup>11</sup> NTP, Inc.’s (NTP) primary assets were a collection of patents. It had no employees and was operated from an attorney’s home.<sup>12</sup> NTP sued Research in Motion, Ltd. (RIM), alleging its BlackBerry email integration technology infringed NTP patents.<sup>13</sup> The litigation resulted in a jury finding that RIM had infringed NTP’s patents, an award of \$54 million in damages to NTP, and most importantly, a permanent injunction enjoining RIM from further manufacture, use, importation, or sale of all accused BlackBerry systems.<sup>14</sup> During the appeal, the U.S. Patent and Trademark Office (USPTO) re-examined NTP’s patents and ultimately found that all were invalid, a finding that would have prevented NTP from obtaining any remedy for infringement of the patents.<sup>15</sup> However, the fear that an injunction would stop service to BlackBerrys worldwide forced RIM into a \$612.5 million settlement prior to the USPTO’s invalidity findings.<sup>16</sup> The NTP case is exemplary of the

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6. 35 U.S.C. § 271(a) (2012).

7. See WILLIAM J. WATKINS, JR., PATENT TROLLS: PREDATORY LITIGATION AND THE SMOTHERING OF INNOVATION 2 (2013).

8. See *id.*

9. See *id.*

10. Gregory d’Incelli, *Has Ebay Spelled the End of Patent Troll Abuses? Paying the Toll: The Rise (and Fall?) of the Patent Troll*, 17 U. MIAMI BUS. L. REV. 343, 346 (2009).

11. See *NTP, Inc. v. Research in Motion, Ltd.*, 418 F.3d 1282 (Fed. Cir. 2005).

12. See WATKINS, *supra* note 7, at 21.

13. See *id.*

14. Incelli, *supra* note 10, at 345. The injunction was stayed pending appeal. *Id.* at 345 n.7.

15. See WATKINS, *supra* note 7, at 21.

16. See *id.* (the settlement included licensing fees for past and future use of the NTP technology).

major criticisms of patent trolls, including their practice of extorting settlements, asserting weak patents, and enjoying significant leverage.

First, trolls obtain patents primarily to extort settlements and license fees.<sup>17</sup> The NTP case shows how one type of troll—the “lottery-ticket” troll—makes its money.<sup>18</sup> Lottery-ticket trolls hold patents they hope are valid and infringed, and are interested in jury awards against big players in the industry.<sup>19</sup> In the past, a permanent injunction would be awarded alongside any jury damages in patent cases.<sup>20</sup> The injunction became a very powerful tool for the patent troll, allowing them to charge exorbitant licensing fees.<sup>21</sup> However, in *eBay v. MercExchange*, the United States Supreme Court held that patent cases were subject to the traditional four-factor test for the granting of an injunction.<sup>22</sup> One such factor being that the party seeking injunctive relief had to be a market competitor. Because most patent trolls do not manufacture or sell anything related to the patent, plaintiffs’ requests for injunctive relief began to get systematically denied.<sup>23</sup> This helped level the litigation playing field.<sup>24</sup>

However, there is another type of troll that the injunctive relief holding did not have much of an effect on. This group—labeled as “bottom-feeder” or “nuisance-value”—is interested in quick, low-value settlements or license fees.<sup>25</sup> These types rely on the high cost of litigation to compel parties they sue to settle, rather than pay millions in attorney fees.<sup>26</sup> This business model usually involves acquiring many questionable patents<sup>27</sup> and asserting them against large numbers of “unsophisticated purchasers,” rather than manufacturers.<sup>28</sup>

17. Robert P. Merges, *The Trouble with Trolls: Innovation, Rent-Seeking, and Patent Law Reform*, 24 BERKELEY TECH. L.J. 1583, 1588 (2009).

18. See Mark A. Lemley & A. Douglas Melamed, *Missing the Forest for the Trolls*, 113 COLUM. L. REV. 2117, 2126 (2013).

19. *Id.*

20. See Incelli, *supra* note 10, at 352 (“[A]bsent an unusual case . . . ‘a permanent injunction will issue once infringement and validity have been adjudged.’”) (citing *MercExchange, L.L.C. v. eBay, Inc.*, 401 F.3d 1323, 1338 (Fed. Cir. 2005)).

21. *Id.* at 353 n.55.

22. See WATKINS, *supra* note 7, at 25 (“A plaintiff must demonstrate: (1) that it has suffered an irreparable injury; (2) that the 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) the public interest would not be disserved by a permanent injunction.”) (quoting *eBay Inc. v. MercExchange, L.L.C.*, 547 U.S. 388, 391 (2006)).

23. Incelli, *supra* note 10, at 360–61.

24. See WATKINS, *supra* note 7, at 26.

25. Lemley, *supra* note 18.

26. *Id.*

27. See, e.g., Peter S. Menell, *A Method for Reforming the Patent System*, 13 MICH. TELECOMM. & TECH. L. REV. 487, 507 (2007) (stating that these types of trolls will acquire their patents at bankruptcy sales and on the open-market).

28. Brian J. Love & James C. Yoon, *Expanding Patent Law’s Customer Suit Exception*, 93 B.U. L. REV. 1605, 1609–10 (2013).

Certain aspects of the patent system have contributed to the viability of nuisance-value trolls. The patent system ensures that there is a large supply of patents, both high and low quality, and potential defendants to assert them against. In recent years, the USPTO has been understaffed, leading to a less rigorous examination of patent applications.<sup>29</sup> This has led to a culture where USPTO examiners approve most applications and shift the burden of resolving infringement disputes onto the patent holders.<sup>30</sup> Further, the Patent Act<sup>31</sup> supplies a large population of defendants. Specifically, section 271 of the Patent Act<sup>32</sup> gives patent holders the option to sue almost any entity that comes in contact with the patented item along the stream of commerce, from the original manufacturer down to the retailer or end user.<sup>33</sup> For example, Innovatio IP Ventures, LLC, a well-known NPE, exploited the nuisance-value model rather recently. After obtaining patents related to wireless technology, Innovatio mailed over 8,000 letters alleging patent infringement to coffee shops, restaurants and the like that offered Wi-Fi services to their customers.<sup>34</sup> Innovatio demanded each merchant pay it several thousand dollars, a fraction of what attorney fees would be, to license the technology or Innovatio would bring a lawsuit.<sup>35</sup> These trolls take advantage of the asymmetric cost in patent litigation to extort settlements.<sup>36</sup>

A second criticism of patent trolls, particularly the nuisance-value trolls, is that they primarily assert weak patents.<sup>37</sup> Since their goal is to settle long before validity and infringement are determined, they have the freedom to use lower quality patents.<sup>38</sup> They understand, however, that not every letter they send out will result in acquiescence to the licensing terms they offer.<sup>39</sup> When this happens, the trolls are not afraid to commence litigation even though they know the patent is weak.<sup>40</sup> The theory behind this strategy has been called “predatory patent litigation” and relies on the

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29. See WATKINS, *supra* note 7, at 7 (citations omitted) (noting that it has “not been uncommon for 3,000 patent examiners to handle over 350,000 patent applications annually”).

30. William F. Shughart II, *Foreword* to WILLIAM J. WATKINS, JR., PATENT TROLLS: PREDATORY LITIGATION AND THE SMOTHERING OF INNOVATION, at xii (2013).

31. 35 U.S.C. §§ 1–376 (2012).

32. *Id.* § 271(a).

33. See Love, *supra* note 28, at 1612–13.

34. See WATKINS, *supra* note 7, at 18.

35. See *id.* at 19.

36. See *Businesses and Promoting Innovation by Limiting Patent Troll Abuse: Hearing Before the S. Comm. on the Judiciary*, 113th Cong. (2013) (statement of Dana Rao, Vice President and Associate General Counsel for Intellectual Property Litigation, Adobe Systems, Inc.).

37. *Id.* at 2128.

38. *Id.*

39. See Erik Hovenkamp, *Predatory Patent Litigation: How Patent Assertion Entities Use Reputation to Monetize Bad Patents 2* (Aug. 5, 2013) (unpublished manuscript), <http://papers.ssrn.com/abstract=2308115> (explaining that some licensing demands will be ignored or rejected based on a belief that the litigation threat is non-credible).

40. *Id.* at 3.

NPE gaining a litigious reputation.<sup>41</sup> Since an overwhelming majority of patent infringement litigation gets settled, these cases based on weak patents do not get to the judicial stage of validity determination.<sup>42</sup> However, the litigation still imposes significant costs on both sides.<sup>43</sup> All this is observed by the other potential defendants, who view the troll's threat as more credible, and are thus more amenable to the NPE's licensing terms.<sup>44</sup> In the end, the short financial loss suffered in the beginning is recouped over time through the subsequent licensing agreements.<sup>45</sup>

The final criticism is that NPEs have significant leverage with very little to lose.<sup>46</sup> Since patent trolls, by definition, do not actually practice their patents within the industry, they are essentially invulnerable to countersuit from an alleged infringer.<sup>47</sup> In non-NPE patent litigation, involving two opposing competitors each with its own patent portfolio, the result is often a reasonable cross-licensing arrangement.<sup>48</sup> These arrangements arise because it is likely that each side owns patents used by the other. Therefore, litigation in these circumstances would result in a degree of mutually assured destruction.<sup>49</sup> NPEs, on the other hand, do not participate in the market and thus have no interest in these cooperative arrangements.<sup>50</sup>

Furthermore, recipients of letters from the nuisance-value trolls demanding licensing fees have a limited choice of judicial forums if they want to pursue a declaratory judgment of invalidity or infringement.<sup>51</sup> In determining what forum is appropriate for such an action, the Court of Appeals for the Federal Circuit (the Federal Circuit)<sup>52</sup> does not allow district courts to consider where the allegedly infringing items are produced.<sup>53</sup> If the alleged infringer cannot meet the personal jurisdiction

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41. *Id.* at 2.

42. *See id.* at 2–3.

43. *Id.* at 3.

44. *Id.*

45. *Id.* at 2.

46. Incelli, *supra* note 10, at 347.

47. *Id.* at 348 n.22.

48. Donald S. Chisum, *Reforming Patent Law Reform*, 4 J. MARSHALL REV. INTELL. PROP. L. 336, 340 (2005).

49. Incelli, *supra* note 10, at 348–49.

50. *Id.*

51. *See* WATKINS, *supra* note 7, at 23 (explaining that under 28 U.S.C. § 2201, a federal district court may declare the rights or legal relations of an interested party about whether or not further relief could be sought).

52. The Federal Circuit, created by Congress in 1982 as part of the Federal Courts Improvement Act, has a “unique jurisdictional structure: its appellate jurisdiction is defined by subject matter rather than geography, and it has exclusive appellate jurisdiction over patent claims.” Matthew R. Huppert, Note, *Commercial Purpose: Reevaluating Asahi Through the Lens of International Patent Litigation*, 111 COLUM. L. REV. 624 (2011).

53. *See id.* at 24 (“To determine [where a] declaratory judgment action can be filed . . . the court will ask whether (1) the troll purposefully availed its activities at residents of the forum, (2) the claim arises out of or relates to those activities, and (3) the assertion of personal jurisdiction is

requirements, they must either wait for the NPE to bring suit or file the declaratory judgment action where the NPE is located, which is often a NPE friendly district.<sup>54</sup>

Nevertheless, efforts have been made to tame the trolls. One of the first major attempts to curtail the negative effect of trolls was the passage of the Patent Act of 1999.<sup>55</sup> Trolls were manipulating the USPTO's application procedures to create "submarine patents"—patents that remained hidden until a large company spent significant sums of money developing a technology that infringed upon the patent.<sup>56</sup> The troll would then quickly attempt to get the patent issued and "hold up" the company for exorbitant royalties.<sup>57</sup> The Patent Act of 1999 attempted to address this problem by requiring patent applications to be published eighteen months after filing.<sup>58</sup> However, patent trolls can easily get around this publication requirement by certifying that they will not file a patent in another country.<sup>59</sup>

The judicial branch responded with its decision in *eBay Inc. v. MercExchange, L.L.C.*<sup>60</sup> In *eBay*, the Supreme Court put an end to the automatic issuance of permanent injunctions in patent cases after infringement and validity were established.<sup>61</sup> This decision extinguished a component of the lottery-ticket troll's business method. However, this holding did not affect the nuisance-value troll,<sup>62</sup> leaving them free to continue sending mass amounts of licensing demands.<sup>63</sup>

Soon thereafter, Congress passed the America Invents Act (AIA).<sup>64</sup> Prior to enactment of the AIA, NPEs would bring a single infringement suit

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reasonable and fair. . . . [A declaratory judgment action] 'neither directly arises out of nor relates to the making, using, offering to sell, selling, or importing of arguably infringing products . . . but instead arises out of or relates to the activities of the [troll] in enforcing the patent.'" (citing *Avocent Huntsville, Corp. v. Aten Int'l Co.*, 552 F.3d 1324, 1332 (Fed. Cir. 2008)).

54. *See id.* at 29–30 (explaining that the Eastern District of Texas leads the United States in patent cases because it is notoriously friendly to plaintiffs, who win 78% of the time—likely a result of complicated cases presented in front of uneducated juries).

55. *See* Brief of Amicus Curiae Yahoo! Inc. In Support of Petitioner at 9, *eBay Inc. v. MercExchange, L.L.C.*, 547 U.S. 288 (2006) (No. 05-130).

56. *Id.*

57. *Id.*

58. 35 U.S.C. § 122(b)(1)(A) (2012).

59. *See id.* § 122(b)(2)(B)(i) ("If an applicant makes a request upon filing, certifying that the invention disclosed in the application has not and will not be the subject of an application filed in another country . . . that requires publication of applications 18 months after filing, the application shall not be published as provided in paragraph (1).").

60. *eBay Inc. v. MercExchange, L.L.C.*, 547 U.S. 388 (2006).

61. *See* WATKINS, *supra* note 7, at 25.

62. *See* Todd Klein, *Ebay v. Mercexchange and KSR Int'l Co. v. Teleflex, Inc.: The Supreme Court Wages War Against Patent Trolls*, 112 PENN ST. L. REV. 295, 308 (2007) (stating that the main result of the shift away from near automatic permanent injunctions is that companies accused of infringing a patent will be more likely to litigate to judgment).

63. This is because the nuisance-value troll targets groups that would rather pay cheap licensing fees than partake in any litigation.

64. Leahy-Smith America Invents Act, Pub. L. No. 112-129, 125 Stat. 284 (2011) (codified in scattered sections of 35 U.S.C. (2012)).

against a large number of defendants from many different forums.<sup>65</sup> This strategy gave NPEs at least two distinct advantages. First, it decreased the trolls' litigation costs by allowing them to only litigate common issues once, rather than putting on the same evidence at multiple trials in multiple forums.<sup>66</sup> Second, and more importantly, the trolls were practically guaranteed a favorable venue.<sup>67</sup> By cherry-picking defendants that were either located in the NPE's venue, or who sold the infringing product there, the NPEs were able to establish personal jurisdiction.<sup>68</sup> A defendant could ask the district court to transfer the case to another district as long as it is "[f]or the convenience of parties and witnesses, in the interest of justice."<sup>69</sup> However, with a large number of geographically diverse defendants, it is almost impossible to win such a motion because there is no district clearly more convenient for all the defendants.<sup>70</sup> Therefore, if the action was brought in the NPE friendly Eastern District of Texas, where patent plaintiffs win 78% of the time,<sup>71</sup> the NPE could obtain an early advantage. The AIA changed this.

When President Obama signed the AIA on September 16, 2011 it was the first major reform of U.S. patent law in over half a century.<sup>72</sup> An important section of this Act set a much more rigorous standard for plaintiffs to join defendants in the same suit.<sup>73</sup> This provision demanded more of a connection between defendants than infringement of the same patent. Rather, their cases had to arise out of the same transaction.<sup>74</sup> The ideal result would have been an increase in the number of cases filed by NPEs,<sup>75</sup> but a net decrease in the number of defendants being sued.<sup>76</sup> However, while this was the effect initially, as there was a decrease in the number of defendants being sued by patent trolls from 4,889 in 2011 to 3,696 in 2012, the trolls have since begun to rebound and the number of defendants in patent troll litigations increased to 4,123 in 2013.<sup>77</sup> Furthermore, the AIA has little to no effect on nuisance-value NPEs that send out thousands of letters merely threatening litigation.

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65. Bryant, *supra* note 4, at 688.

66. *Id.* at 691.

67. *Id.*

68. *Id.* at 691–92. A patent infringement defendant is subject to personal jurisdiction within the location of its principal place of business and anywhere the patent is infringed, (i.e. sold, offered for sale, used, or imported). Furthermore, it only takes a single instance of infringement within the state to establish personal jurisdiction.

69. *Id.* at 692 (citing 28 U.S.C. § 1404(a) (2006)).

70. *Id.*

71. See WATKINS, *supra* note 7, at 29.

72. Bryant, *supra* note 4, at 694.

73. *Id.* at 695.

74. *Id.*

75. Because the NPEs would have to file a suit for each defendant.

76. Bryant, *supra* note 4, at 703.

77. See RPX CORP., 2013 NPE LITIGATION REPORT, at 14 (2014), <https://www.rpxcorp.com/wp-content/uploads/2014/01/RPX-2013-NPE-Litigation-Report.pdf>.



## II. CURRENT CONTRACTUAL PROTECTION FOR BUYERS

Current contract law has two protective measures for customers<sup>78</sup> who purchase a product which is later alleged to infringe a patent. First, the Uniform Commercial Code (UCC) provides protection for all purchase agreements. Second, more sophisticated customers can request explicit indemnification clauses in their contracts for the sale of goods. While both of these offer valuable protection to the downstream user of a product, who does not and should not know they may be infringing a patent, they do little to deter patent troll activity and merely shift the costs to the manufacturers.

### A. THE UNIFORM COMMERCIAL CODE

In UCC section 2-312(3),<sup>79</sup> the UCC grants a warranty against claims of patent infringement by a third party.<sup>80</sup> To be protected by this provision, a customer needs to purchase the item from a “merchant regularly dealing in goods of the kind” and be subject to a “rightful claim” of infringement.<sup>81</sup> The first qualification, “merchant,” has been interpreted quite broadly,<sup>82</sup> but the second, “rightful claim,” has no set definition, which has led to inconsistent rulings in the courts.<sup>83</sup>

The term “merchant” is defined by the UCC as “a person who . . . holds himself out as having knowledge or skill peculiar to the practices or goods involved.”<sup>84</sup> Most sellers will fall under the “merchant” category because most businesses regularly deal the goods in question and an individual inventor would likely be considered to have special knowledge.<sup>85</sup> While this interpretation is quite broad, there are limitations. If a buyer purchases noninfringing components and assembles them into an infringing product, they cannot seek indemnification from the manufacturer of the component

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78. The importance of speaking about protections provided to customers is that all end users are, in their nature, customers—they purchase the product they are using from some entity. Therefore, any protection provided to customers for purchases made would also, theoretically, apply to end users. However, it should be noted that not all customers are end users. For example, in a supply chain where a manufacturer sells widgets to a retailer who in turn sells a widget to a person both the retailer and person are customers, but only the person would be an end user.

79. U.C.C. § 2-312(3) (AM. LAW INST. & UNIF. LAW COMM’N 2012) (“Unless otherwise agreed a seller who is a merchant regularly dealing in goods of the kind warrants that the good shall be delivered free of the rightful claim of any third person by way of infringement or the like . . .”).

80. Bradley W. Scheer, *Indemnification for Patent Infringement Under the Uniform Commercial Code*, 34 LINCOLN L. REV. 1, 7 (2006–2007).

81. U.C.C. § 2-312(3).

82. See Scheer, *supra* note 80, at 7–8.

83. See Karen E. Sandrik, *Warranting Rightful Claims*, 72 LA. L. REV. 873, 877 (2012) (explaining that there is no definition for “rightful claim” in the UCC and since few claims seeking warranty for infringement lawsuits were brought in the past scholars did not put much thought into defining it).

84. U.C.C. § 2-104(1).

85. See Scheer, *supra* note 80, at 8 n.25.

parts.<sup>86</sup> Also, if a buyer gives the seller specifications for a product, then the seller is not liable to the buyer for infringement claims.<sup>87</sup>

However, the UCC gives no definition for rightful claim and the statutory language offers little help in constructing a definition.<sup>88</sup> The only insight can be found in Comment 4 of section 2-312 of the UCC, which states that “eviction” is not necessary to the buyer’s remedy.<sup>89</sup> In other words, a buyer is not required to prove they were precluded from using the purchased good to be covered by the provision.<sup>90</sup> The UCC drafters further state that “a buyer’s remedy arises immediately upon receipt of notice of infringement.”<sup>91</sup> Although this may be a low standard, the judiciary has struggled to uniformly agree on the definition of “rightful claim.”<sup>92</sup>

Prior to 1996, there was little discussion of what constituted a rightful claim.<sup>93</sup> In 1996, the Federal Circuit created some boundaries in *Cover v. Hydramatic Packing Corporation*.<sup>94</sup> Although the court did not give a definition of rightful claim, it did find that a rightful claim did not require a showing of liability for patent infringement.<sup>95</sup> In 2001, a Pennsylvania district court attempted to define “rightful claim” in *84 Lumber Co. v. MRK Technologies, Ltd.*<sup>96</sup> The *84 Lumber* court found that an analysis of what was a rightful claim entailed a comparison between the scope of the patents at issue and the allegedly infringing products.<sup>97</sup> The federal court gave a very vague indication of how to carry out such a comparison,<sup>98</sup> but did hold that it required an analysis of patent liability.<sup>99</sup> Thus, federal courts seemed to recognize the need for patent-specific analysis.

State courts, on the other hand, have failed to follow the path lit by the federal courts.<sup>100</sup> A series of decisions shows a clear departure from the

86. See *Chemtron Inc. v. Aqua Products, Inc.*, 830 F. Supp. 314, 315 (E.D. Va. 1993).

87. See *Bonneau Co. v. AG Indus., Inc.*, 116 F.3d 155, 155 (5th Cir. 1997).

88. Sandrik, *supra* note 83, at 891.

89. U.C.C. § 2-312 cmt. 4. Comment 4 of this provision was the drafters’ response to a strongly supported proposal from the New York Patent Law Association to have “rightful claims” replaced with “valid claims.” See Sandrik, *supra* note 83, at 891.

90. See Sandrik, *supra* note 83, at 891.

91. U.C.C. § 2-312 cmt. 4.

92. Sandrik, *supra* note 83, at 892.

93. *Id.* at 892.

94. See *Cover v. Hydramatic Packing Corp.*, 83 F.3d 1390, 1393 (Fed. Cir. 1996).

95. *Id.* at 1394 (explaining that equating “rightful claim” with “patent liability” would not promote judicial economy because parties would be forced to forego settlement and go to trial to determine whether a rightful claim existed under federal law).

96. *84 Lumber Co. v. MRK Technologies, Ltd.*, 145 F. Supp. 2d 675 (W.D. Pa. 2001).

97. *Id.* at 680.

98. *Id.* (stating that “[i]f claims of patent infringement are seen as marks on a continuum, whatever a ‘rightful claim’ is would fall somewhere between purely frivolous claims, at one end, and claims where liability has been proven, at the other”).

99. *Id.* (holding that “[a determination of rightful claim] cannot be resolved without also deciding a substantial issue of federal patent law, namely, that there was an adequate basis for [the third party’s] assertion that defendants’ products infringed [their] patents”).

100. See Sandrik, *supra* note 83, at 894.

patent-specific analysis in *84 Lumber*.<sup>101</sup> First, in *Sun Coast Merchandise Corp. v. Myron Corp.*,<sup>102</sup> the New Jersey Superior Court held that valid infringement was not required for a rightful claim. Rather, the third-party's claim merely had to be of a substantial nature and unduly disturb the buyer's ownership of the goods in question.<sup>103</sup> In *Pacific Sunwear of California, Inc. v. Olaes Enterprises, Inc.*,<sup>104</sup> the California Court of Appeal lowered the bar even further. The California court found that "substantial nature" could be confusing and held that the standard is whether the claim was nonfrivolous.<sup>105</sup> Moreover, the court stated that the existence of litigation is not necessary to establish that a claim is nonfrivolous.<sup>106</sup> Since patents are presumed valid, almost every claim of infringement would likely meet the nonfrivolous standard.<sup>107</sup>

Comparing the federal and state approaches, two opposing definitions of what constitutes a rightful claim can be seen. The federal courts lean towards requiring the buyer to prove that the patent being asserted has some validity.<sup>108</sup> State courts, on the other hand, require little more than proof that the buyer's ownership of the infringing product was disturbed.<sup>109</sup> However, the low standard used in state courts has gained traction on the federal level.<sup>110</sup>

The unclear body of law surrounding rightful claim disputes is problematic to both parties involved in the original sale of goods. Without a uniform standard, neither party can make an educated decision on when they are—or are not—protected. For example, if the buyer gets a demand letter from a patent troll and decides to pay the license fee, its next step would be to file a claim against the seller for indemnification. If the buyer files in a court that requires the troll to have initiated litigation as a necessary condition to coverage under UCC section 2-312, the buyer will lose. Furthermore, the buyer would also be estopped from bringing suits in other, more favorable jurisdictions.<sup>111</sup> This leaves the buyer having to pay

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101. *See id.* at 894–95.

102. *Sun Coast Merch. Corp. v. Myron Corp.*, 922 A.2d 782, 788 (N.J. Super. Ct. App. Div. 2007).

103. *See id.* at 797.

104. *Pac. Sunwear of Cal., Inc. v. Olaes Enters., Inc.*, 84 Cal. Rptr. 3d 182 (Cal. Ct. App. 2008).

105. *See id.* at 194 (explaining that nonfrivolous is well defined in the legal context and can therefore be more readily applied than substantial nature).

106. *See id.*

107. *See Sandrik, supra* note 83, at 897.

108. *See 84 Lumber Co. v. MRK Technologies, Ltd.*, 145 F. Supp. 2d 675, 680 (W.D. Pa. 2001).

109. *See Sun Coast Merch. Corp. v. Myron Corp.*, 922 A.2d 782, 797 (N.J. Super. Ct. App. Div. 2007).

110. In *Phoenix Solutions, Inc. v. Sony Elecs., Inc.*, 637 F. Supp. 2d 683 (N.D. Cal. 2009), a California District Court adopted the low standard set forth in *Pacific Sunwear*. *See Sandrik, supra* note 83, at 897.

111. "The preclusive effect of a judgment is defined by claim preclusion and issue preclusion . . ." *Taylor v. Sturgell*, 553 U.S. 880, 892 (2008). Issue preclusion is operative where an issue was:

for something that it had no reason to believe would occur. On the other hand, if the suit is brought in a jurisdiction with a lower standard of rightful claim and the buyer wins the indemnification suit, the seller is on the hook for a licensing fee they took no part in negotiating.

Outside of the problems that arise due to the confusion in determining what standard to apply, problems associated with the use of UCC section 2-312 in the context of patent infringement have been recognized. First, when a buyer believes it is covered by the warranty against infringement it has a stronger incentive to settle a claim than to defend a possibly frivolous suit.<sup>112</sup> This in turn incentivizes the nuisance-value trolls that are interested in mass, low-value settlements.<sup>113</sup> Second, in patent infringement scenarios, the normal justifications for warranty law are often not present.<sup>114</sup> Warranty law is understood as a risk allocation device.<sup>115</sup> For the warranty against infringement, the risk is allocated to the seller on the assumption that it has superior knowledge about the quality or title of goods.<sup>116</sup> However, in many intellectual property infringement cases this asymmetry of information is not present.<sup>117</sup> Third, the warranty against infringement not only does little to minimize litigation, but actually requires more litigation. In order to obtain coverage under this warranty the buyer would need to file a lawsuit against the seller. Therefore, in addition to any infringement lawsuits filed against a buyer, there will also be an indemnification suit filed by the buyer against the seller. This adds to the judicial economy problem that the patent trolls have already exacerbated.

## B. CONTRACTUAL INDEMNITY

In response to some of the concerns seen with leaving infringement protection up to warranty clauses, some sellers began to add indemnity

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(1) actually litigated, (2) determined by a valid and final judgment, and (3) the determination was essential to the judgment. *See* RESTATEMENT (SECOND) OF JUDGMENTS: ISSUE PRECLUSION-GEN. RULE § 27 (1982). Therefore, a “rightful claim” determination based on a motion from one of the parties, satisfies the three issue preclusion factors. *See id.* § 27 cmt. d, cmt. h, illus 13.

112. Sandrik, *supra* note 83, at 889.

113. *See id.*

114. *See id.* at 880.

115. CLAYTON P. GILLETTE & STEVEN D. WALT, SALES LAW: DOMESTIC AND INTERNATIONAL 316–17 (2d ed. 2009).

116. *See id.* (explaining that the superior knowledge is due to the seller’s position in the market as one who regularly deals with the goods and who has ownership and oversight over them).

117. *See* William F. Dudine, Jr., *Warranties Against Infringement Under the Uniform Commercial Code*, 36 N.Y. ST. B.J. 214, 215 (1964); *see also* Sandrik, *supra* note 83, at 902 (giving an example of a buyer who pays a license fee to a patent troll and then successfully seeks indemnification from the seller). Another interesting feature of the warranty against infringement is that it requires a relation between the allegedly infringing party and the seller. Imagine a three-step supply chain where a manufacturer sells to a retailer who sells to a buyer. The retailer may have to indemnify the buyer for an infringement action but since the retailer was not the subject of an infringement action they cannot then seek indemnification from the manufacturer.

provisions in their sales contracts.<sup>118</sup> The standard indemnity provision would require prompt notice to the seller (licensor) of any infringement claim and full authority to defend the case on behalf of the licensee.<sup>119</sup> Licensors would limit their obligation to three options: (a) obtain the rights to use the licensed product, (b) modify the product so it was non-infringing, or (c) terminate the license and refund a pro-rated portion of the purchase price.<sup>120</sup> These standard clauses persisted for many years even though they had problems of their own.<sup>121</sup> In the years following the creation of the Federal Circuit and subsequent reforms in the patent system,<sup>122</sup> more problems arose that plagued modern usage of patent infringement indemnity clauses in sales contracts.

The changes that the creation of the Federal Circuit imposed upon the patent system ultimately resulted in an increase in patent infringement claims and much higher damage awards for those that were successful.<sup>123</sup> This led to buyers (licensees) and sellers (licensors) demanding extra protection in the indemnity clauses with the resulting clause often reflecting bargaining power rather than a rational distribution of risk and reward between buyer and seller.<sup>124</sup> For example, it is common for a large enterprise with substantial leverage that is buying products to insist on full indemnity with no restrictions.<sup>125</sup> However, if the licensor has inadequate resources to defend a claim or pay an adverse judgment, the buyer's insistence on full indemnity does little to shift their risk.<sup>126</sup>

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118. See Thomas M.S. Hemnes, *Intellectual Property Indemnity Clauses*, B.C. INTELL. PROP. & TECH. F., 2013, at 1, 2.

119. See *id.*

120. See *id.*

121. *Id.* (explaining that option (c) could be detrimental if the product in question was critical to a business because even if a comparable non-infringing product was available, the buyer would have to find, implement, and migrate all data to the new system, which would be expensive, time-consuming, and risky).

122. Prior to the creation of the Federal Circuit, circuit courts were relatively hostile to patents, resulting in a small percentage of litigated patents being enforced upon appeal, and when a patent was found valid, the damages were generally measured as a reasonable royalty, which were usually in the "low single digits." *Id.* The Federal Circuit was given exclusive jurisdiction over patent appeals. As the Circuit is primarily populated by patent practitioners, it casts a kinder eye on patents, holding them valid two-thirds of the time. *Id.* The Federal Circuit also expanded the scope of damages by allowing claims for potential profit, lost profit, and treble damages where there was willful infringement and expanded the range of patentable things to include computer software, forms of life, and business methods. *Id.* In some cases, damage awards skyrocketed to millions of dollars due to the volume of business that was dependent on the allegedly infringing product. *Id.* Patentees realized the potential for financial gain and began filing more infringement claims. *Id.*

123. See *id.* at 3.

124. *Id.*

125. *Id.*

126. See *id.* The buyer is only protected for as much money as the seller is worth. Therefore, in the situations where the buyer is much larger than the seller, the indemnity clause "create[s] the appearance, but not the reality, of a transfer of infringement risk." *Id.* at 4. The buyer has the

On the other side of the spectrum, sellers with more power than buyers will add exceptions to the indemnity clauses that make them all but illusory.<sup>127</sup> For example, a common exception would be to “technology already in use at the time the patent is issued” and “patents known to the licensee.”<sup>128</sup> The “already in use” clause basically states that if the licensor’s product already infringes at the time of licensing then the buyer cannot seek indemnity.<sup>129</sup> This is a necessary requirement for a patent infringement claim and essentially shifts the burden of determining whether the product infringes any patents to the buyer.<sup>130</sup> Another common exception is to only provide indemnity for final judgments of infringement.<sup>131</sup> This leaves the buyer with deciding whether to take the substantial risk and expense of ongoing litigation or to settle and pay to make the claim go away.<sup>132</sup> A final typical exclusion exists when the licensed technology is combined with other technology not supplied by the seller.<sup>133</sup> In much of the technology world, products are sold with the intention of being combined with others so virtually every infringement claim will have a combination that is excluded from indemnification.<sup>134</sup>

Current patent warranty and indemnification practices advance an effective appearance, but in reality, are flawed. Whether it is the uncertainty of the warranty against infringement in the UCC or unfair indemnification clauses in sales contracts, purchasers of goods are not adequately protected against patent infringement claims for which they should have little to no obligation. A new approach should not only protect innocent purchasers of goods, but also help minimize the incentives that patent trolls have in targeting them.

### III. THE CURRENT PATENT REFORM PROPOSAL

Recent patent reform proposals in both the House of Representatives and the Senate have many commonalities. The two discussed in this section are fee shifting and a set of interconnected reforms that this Article calls heightened pleading requirements.<sup>135</sup>

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power to bankrupt the seller, but this may not be in the buyer’s interest if the seller provides a product that is important to the buyer’s business and hard to replace. *Id.*

127. *See id.*

128. *Id.*

129. *Id.*

130. *Id.*

131. *Id.*

132. *Id.*

133. *Id.*

134. *Id.*

135. These pleading requirements are aimed at limiting early discovery. While not technically in the pleading phase of litigation, these discovery reforms would become an important factor in deciding whether or not to continue with litigation during its early stages. Accordingly, this Note groups such discovery reforms with the other pleading reforms.

### A. FEE SHIFTING

The “American Rule” of litigation is that each party is only obligated to pay their own attorney’s fees, regardless of the outcome.<sup>136</sup> Nonetheless, there are many federal and state statutes in the United States that authorize some version of fee shifting.<sup>137</sup> On the opposite end of the spectrum lies the “English Rule,” where the losing party pays a substantial portion, if not all, of the winner’s attorney’s fees.<sup>138</sup> Arguments have been made that exceptions to the American Rule are made in an effort to deter lawsuits that use abusive litigation practices or have questionable merit.<sup>139</sup> Fee shifting statutes can be one-way or two-way.<sup>140</sup> Two-way fee shifting allows attorney fees to be shifted regardless of which party wins.<sup>141</sup> One-way fee shifting only allows attorney fees to be shifted when a predetermined party, either plaintiff or defendant, wins.<sup>142</sup> Within those categories, fee shifting can either be mandatory or discretionary, each variation having different effects on litigation.<sup>143</sup> As explained in Part I, patent trolls use the American Rule and fear of the costs of litigation to coerce defendants into paying licensing fees. The argument made by scholars is that a more liberal approach to fee shifting in patent infringement cases would help curb patent troll behavior.<sup>144</sup>

There has been substantial discussion on the effects an adoption of fee shifting would have on civil litigation.<sup>145</sup> One of the main arguments from proponents of the English Rule is that it discourages speculative litigation

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136. John F. Vargo, *The American Rule on Attorney Fee Allocation: The Injured Person’s Access to Justice*, 42 AM. U. L. REV. 1567, 1569 (1993). There is also the “English Rule” whereby the nonprevailing party must pay the prevailing party’s attorneys’ fees. Douglas C. Rennie, *Rule 82 and Tort Reform: An Empirical Study of the Impact of Alaska’s English Rule on Federal Civil Case Filings*, 29 ALASKA L. REV. 1, 1–2 (2012).

137. See Colleen V. Chien, *Reforming Software Patents*, 50 HOUS. L. REV. 325, 370 (2012) (“[C]lose to 200 federal statutes and 4,000 state statutes authorize attorney’s fees.”).

138. Thomas D. Rowe, Jr., *Predicting the Effects of Attorney Fee Shifting*, 47 LAW & CONTEMP. PROBS. 139, 140 (2012).

139. Emily H. Chen, *Making Abusers Pay: Deterring Patent Litigation by Shifting Attorney’s Fees*, 28 BERKELEY TECH. L.J. 351, 351 (2013) (citing Jane P. Mallor, *Punitive Attorneys’ Fees for Abuses of the Judicial System*, 61 N.C. L. REV. 613, 619 (1983)).

140. See Rowe, *supra* note 138, at 140–41 (explaining that two-way fee shifting allows attorney fees to be shifted regardless of which party wins and that one-way fee shifting only allows attorney fees to be shifted when a predetermined party wins).

141. See *id.* at 141.

142. See *id.*

143. Discretionary fee shifting requires the court to determine whether one party should pay the fees of the other, whereas mandatory fee shifting requires the losing party to pay automatically upon judgment. See Chien, *supra* note 137, at 370–71 (explaining that the “English Rule” is a two-way mandatory shift and most United States fee shifting statutes are discretionary).

144. *Protecting Small Businesses and Promoting Innovation by Limiting Patent Troll Abuse: Hearing Before the S. Comm. on the Judiciary*, 113th Cong. 3 (2013) [hereinafter *Protecting Small Business Hearing*] (record submission of Sen. Patrick Leahy) (statement of Starwood Hotels & Resorts Worldwide).

145. Edward A. Snyder & James W. Hughes, *The English Rule for Allocating Legal Costs: Evidence Confronts Theory*, 6 J.L. ECON. & ORG. 345, 345 (1990).

and limits the leverage weak cases have when threatening to inflict the cost of litigation.<sup>146</sup> Theoretically, a plaintiff will forego filing “long-shot cases,” which are only attractive for the high potential payoff, and “imposition-based cases,” whose value arises solely due to litigation cost, if he is responsible for defendant’s reasonable legal costs.<sup>147</sup> Furthermore, supporters of the current system will admit that “well-meaning persons placed in danger of open-ended legal jeopardy may suspend activities that are privately profitable and sometimes socially useful.”<sup>148</sup> This is exactly the type of behavior and negative effect exhibited by patent trolls, which is why improved fee shifting regimes have been included in almost every patent reform bill recently introduced in the United States Congress.<sup>149</sup>

Fee shifting in patent litigation is controlled by 35 U.S.C. §285.<sup>150</sup> It states that “[t]he court in exceptional cases may award reasonable attorney fees to the prevailing party.”<sup>151</sup> The meaning of “exceptionable” had, until recently, made it nearly impossible for a judge to shift fees in a patent litigation case.<sup>152</sup> However, on April 29, 2014, the Supreme Court’s ruling in *Octane Fitness, LLC v. ICON Health & Fitness, Inc.* marked the beginning of a new era in fee shifting for patent lawsuits.<sup>153</sup>

Prior to the ruling in *Octane Fitness*, the controlling precedent on what constituted an “exceptional” case came from *Brooks Furniture Manufacturing v. Dutailier International, Inc.*<sup>154</sup> In *Brooks Furniture*, the Federal Circuit held that a case is exceptional only when there has been material inappropriate conduct.<sup>155</sup> Absent misconduct, the Federal Circuit

146. Walter Olson & David Bernstein, *Loser-Pays: Where Next?*, 55 MD. L. REV. 1161, 1161 (1996).

147. *Id.*

148. *Id.* at 1189.

149. See Saving High-Tech Innovators from Egregious Legal Disputes Act of 2013, H.R. 845, 113th Cong. § 2 (2013) (“[N]otwithstanding [35 U.S.C.] section 285, the Court shall award the recovery of full costs to any prevailing party asserting invalidity or noninfringement, including reasonable attorney’s fees . . . upon the entry of a final judgment . . . .”); Patent Abuse Reduction Act, S. 1013, 113th Cong. § 5 (2013) (“Section 285 of title 35, United States Code, is amended to read as follows . . . ‘[t]he court shall award to the prevailing party reasonable costs and expenses, including attorney’s fees . . . .’”); Innovation Act, H.R. 3309, 113th Cong. § 3 (2013) (“Section 285 of title 35, United States Code, is amended to read as follows . . . . ‘The court shall award, to a prevailing party, reasonable fees and other expenses incurred by that party in connection with a civil action . . . relating to patents . . . .’”).

150. 35 U.S.C. § 285 (2012).

151. *Id.* This is a two-way discretionary fee shifting regime.

152. John F. O’Rourke, Patrick Soon & Rebecca Bellow, *Silver, Garlic and Attorney’s Fees*, 56 ORANGE CTY. LAW. 28, 29 (2014).

153. See Martin E. Hsia, *The Supreme Court’s Intellectual (Property) Year: A Whirlwind Tour*, 18 HAW. B.J. 26, 27–28 (2014) (summarizing the Supreme Court’s ruling in *Octane Fitness*); see also *Octane Fitness, LLC v. ICON Health & Fitness, Inc.*, 134 S. Ct. 1749 (2014).

154. *Brooks Furniture Mfg. v. Dutailier Int’l, Inc.*, 393 F.3d 1378, 1381–82 (2005).

155. *Id.* at 1381 (explaining that material inappropriate conduct would be “willful infringement, fraud or inequitable conduct in procuring the patent, misconduct during litigation, vexatious or unjustified litigation, conduct that violates Fed. R. Civ. P. 11, or like infractions”).



held that fees may only be assessed when the litigation is brought in subjective bad faith and is objectively baseless.<sup>156</sup> However, the Federal Circuit continued, there is a presumption of good faith in asserting a patent, therefore, the improper conduct must be established by “clear and convincing evidence.”<sup>157</sup> In practice, this standard was insurmountable, making fee shifting in patent cases all but illusory.<sup>158</sup> *Octane Fitness* changed this.

In *Octane Fitness*, the Supreme Court decided that “[t]he framework established by the Federal Circuit in *Brooks Furniture* is unduly rigid, and it impermissibly encumbers the statutory grant of discretion to district courts.”<sup>159</sup> The Supreme Court went on to hold that “an ‘exceptional case’ is simply one that stands out from others with respect to the substantive strength of a party’s litigating position . . . or the unreasonable manner in which the case was litigated.”<sup>160</sup> The Supreme Court also changed the evidentiary requirement from the “clear and convincing evidence” standard espoused in *Brooks Furniture* to a “simple discretionary inquiry” with no specific evidentiary burden.<sup>161</sup>

On the same day *Octane Fitness* was decided, the Supreme Court also decided *Highmark Inc. v. Allcare Health Management Systems*.<sup>162</sup> In *Highmark*, the Supreme Court held that the decision to award attorney’s fees is a matter of discretion given to the district court, and that decision is to be reviewed on appeal for abuse of discretion.<sup>163</sup> The practical effect of these two decisions is to give district courts wide latitude in deciding whether to issue fees and to make that decision much less likely to be overturned.<sup>164</sup>

Many believed that the *Octane Fitness* and *Highmark* decisions leveled the playing field by giving alleged infringers an “additional tool . . . to fight back against plaintiffs [asserting] meritless claims . . . in hopes of a quick payoff.”<sup>165</sup> Although *Octane Fitness* is a relatively new decision, making it

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156. *Id.*

157. *Id.* at 1382.

158. Chien, *supra* note 137, at 377 n.330, n.331 (explaining that there are around 3000 patent case filings on average per year and in 2011 there were only 21 awards of attorney’s fees with only half of those going to defendants); *Octane Fitness*, 134 S. Ct. at 1752 (“[*Brooks Furniture*] is so demanding that it would appear to render [35 U.S.C.] § 285 largely superfluous.”).

159. *Octane Fitness*, 134 S. Ct. at 1755. In general, there are two ways that fee shifting regimes impose fees: mandatory or discretionary. See Chien, *supra* note 137, at 370. Section 285 of the Patent Act was intended to be used in a discretionary nature and the Federal Circuit’s formulation in *Brooks Furniture* “superimposes an inflexible framework onto statutory text that is inherently flexible.” *Octane Fitness*, 134 S. Ct. at 1753, 1756.

160. *Octane Fitness*, 134 S. Ct. at 1756.

161. *Id.* at 1758.

162. *Highmark Inc. v. Allcare Health Mgmt. Sys.*, 134 S. Ct. 1744 (2014).

163. *Id.* at 1748.

164. O’Rourke, *supra* note 152, at 30.

165. Bijal V. Vakil, Thomas Flynn & Nathan Zhang, *Supreme Court Issues Two “High-Octane” Decisions to Address Abusive Patent Litigation Practices*, WHITE & CASE PUBLS. (Apr.

difficult to accurately determine the effects it has on patent litigation, early statistical analysis indicates that they are minimal.<sup>166</sup> Glaser Weil surveyed the seventy-five district court decisions involving fee awards that arose between the decision in *Octane Fitness* on April 29, 2014, and October 28, 2014.<sup>167</sup> They found that 18% of motions for fee awards were granted and another 13% of motions were granted in part, totaling about 29% of motions resulting in an award.<sup>168</sup> While Glaser Weil admitted they did not have pre-*Octane* statistics to determine whether this grant rate was a significant change, the most interesting finding had to do with which party was awarded the fees.<sup>169</sup> Of the twenty-three cases where fees were granted in full or in part, thirteen were granted in the plaintiffs' favor and ten in defendants' favor.<sup>170</sup>

The research indicates that the lowered standard set in *Octane Fitness* affects both sides of litigation, helping both plaintiffs, including patent trolls, and defendants get their fees awarded.<sup>171</sup> Therefore, a patent litigation fee shifting regime intended to help protect defendants from patent trolls needs a structural change that does more than merely alter the legal standard required to trigger it. Two-way fee shifting regimes, like the one currently used in patent litigation, are generally meant to discourage nuisance suits<sup>172</sup> and have been criticized for not having a uniform effect.<sup>173</sup> Conversely, one-way fee shifting regimes are instituted to achieve a specific policy objective.<sup>174</sup> Here, the policy objective is to minimize the abusive litigation tactics used by patent trolls. In furtherance of this objective, members of Congress have been attempting to get a bill enacted that would turn section 285 of Title 35 of the United States Code into a one-way fee shifting statute.

The Saving High-Tech Innovators from Egregious Legal Disputes (SHIELD) Act was introduced on February 27, 2013<sup>175</sup> with its main goal to

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29, 2014), <http://www.whitecase.com/articles/042014/supreme-court-issues-two-high-octane-decisions-to-address-abusive-patent-litigation-practices/#.VG0SJYfSoSd>.

166. See Andrew Choung, *Half a Year Since Octane*, GLASER WEIL IP FILE (Nov. 3, 2014), <http://www.intellectualpropertyfilegw.com/?p=385> (conducting a study on fee awards in district court patent cases in the six months following *Octane Fitness, LLC v. ICON Health & Fitness, Inc.*, 134 S. Ct. 1749 (2014)).

167. See *id.*

168. See *id.* (finding that of the seventy-five motions for fee awards, fifty were denied, thirteen were granted, ten were granted in part, and two were still pending additional briefing).

169. See *id.*

170. See *id.*

171. See *id.*

172. Rowe, *supra* note 138, at 147.

173. See Chien, *supra* note 137, at 373 (explaining that empirical evidence undercuts the assumption that a two-way fee shifting regime lowers the amount of litigation, and further, that "the task of assessing whether they worked to deter frivolous suits was impossible.").

174. *Id.* at 375–76.

175. Saving High-Tech Innovators from Egregious Legal Disputes Act, H.R. 845, 113th Cong. (2013).

make patent trolls take financial responsibility for their actions.<sup>176</sup> The SHIELD Act would award a prevailing defendant full costs if the plaintiff did not meet at least one set of conditions.<sup>177</sup> The conditions exempt from the mandatory one-way shift include a plaintiff that is the original inventor, has made a substantial investment in the patent, is a university, or is an organization whose primary purpose is to commercialize the technology.<sup>178</sup> The SHIELD Act is an excellent attempt at creating a one-way fee shifting regime that imposes fees on patent trolls while not discouraging plaintiffs with meritorious claims who would not be able to pay an opponent's fees. However, the bill stalled when Jason Chaffetz and Peter DeFazio, the Representatives that introduced the SHIELD Act, stated they would defer to the much more comprehensive Innovation Act introduced in the 113th Congressional session.<sup>179</sup> While the Innovation Act does cover more aspects of patent reform, its fee shifting section is designed to create a two-way mandatory regime.<sup>180</sup> Nonetheless, the Innovation Act passed the House of Representatives 325-91, but then stalled in the Senate during the 113th Congressional term.<sup>181</sup> Even though this patent reform bill was unsuccessful, House Judiciary Committee Chair Bob Goodlatte reintroduced a similar bill, under the same name, in the House of Representatives in 2015 that, at the time of this publication, was recommended by committee for further consideration.<sup>182</sup>

Patent litigation fee shifting is a volatile subject at this point in time. Whether the current regime is kept, with the lower threshold set in *Octane Fitness*, or a new fee shifting regime is created through legislation has yet to be determined. However, neither scenario provides adequate protection against patent trolls. There have been multiple empirical studies<sup>183</sup> on the effects of fee shifting and all tend to agree that fee shifting statutes do not have the effect intended. While the results are more prominent in studies

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176. Ryan Hauer, *Another Attempt at Patent Reform: S.1013 the Patent Abuse Reduction Act of 2013*, 24 DEPAUL J. ART TECH. & INTELL. PROP. L. 367, 378 (2014).

177. See H.R. 845 § 2(a)(4).

178. See *id.* § 2(d).

179. See Jimm Phillips, *Goodlatte Bows Innovation Act to Target Patent Litigation Abuse*, WASH. INTERNET DAILY, Oct. 24, 2013, at Today's News.

180. See Innovation Act, H.R. 3309, 113th Cong. § 3(b) (2013).

181. See Erica Teichert, *Congress to Push Patent Troll Bill in 2015, Goodlatte Says*, LAW360 (Nov. 18, 2014, 3:58 PM), <http://www.law360.com/articles/597447/congress-to-push-patent-troll-bill-in-2015-goodlatte-says>. Interestingly, instead of introducing the same Innovation Act that passed the House, Senate Judiciary Chairman Patrick Leahy altered the bill's text and introduced it into the Senate under a different name. Leahy removed the fee shifting provision from the Innovation Act because it appeared to be the most controversial part of the bill. Leahy later stated that he withdrew his version of the bill from the Senate due to pressure he received from Senate Majority Leader Harry Reid. *Id.*

182. H.R. 9 (114th): *Innovation Act*, GOVTRACK, <https://www.govtrack.us/congress/bills/114/hr9> (last visited Nov. 4, 2015).

183. See Rennie, *supra* note 136, at 20–25 (describing the various empirical studies on fee shifting statutes).

involving two-way fee shifting, the studies indicate that one-way fee shifting does not always promote the specific policy objective in mind.

A study involving a mandatory two-way fee shifting rule for medical malpractice cases concluded that it was unclear whether the rule had a deterrence effect on low merit claims.<sup>184</sup> The researchers noted that any increase in dropped claims may have been the result of plaintiffs “dropping weak claims [in favor of pursuing] nuisance strategies.”<sup>185</sup> Multiple studies have also been done on Alaska’s statewide two-way fee shifting law that is essentially mandatory.<sup>186</sup> In one study, the researchers found that civil filing rates in Alaska were not substantially different from rates in other states.<sup>187</sup> The researchers suggested that “if fee shifting affects case filing trends and trial rates in Alaska, the effects are complex and may result in a net situation little different from that found in states that do not shift fees.”<sup>188</sup> Another study found that the Alaska Rule was not an effective means for reducing meritless litigation.<sup>189</sup> Finally, a study focusing on “low-probability-of-prevailing” plaintiffs in a two-way fee shifting regime concluded that plaintiffs who bring weak claims in such a regime are more likely to go to trial because they know that trials often have erroneous outcomes.<sup>190</sup> These conclusions are all in line with the findings, discussed above, that post-*Octane Fitness* fee awards did not indicate any enhanced protection against patent trolls.<sup>191</sup> Therefore, a continuation of the current two-way fee shifting regime in patent litigation does not look to be able to provide adequate protection for victims of patent troll litigation.

Theoretically, a one-way fee shifting regime would fix many of these problems. By only requiring patent troll plaintiffs to pay the defendant’s fees, all incentives caused by the prospect of having their own fees paid are removed. Ideally, this would entail less risk of unintended consequences.<sup>192</sup> Although not many studies focus on one-way fee shifting, and those that do usually deal with pro-plaintiff rules intended to promote access to the courts, their principles can still be informative for a pro-defendant patent

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184. *Id.* at 21–22 (the fee shifting statute involved in this study was ultimately repealed at the urging of the Florida Medical Association, the group that argued for its enactment in the first place, when it appeared that low merit claim filings actually increased).

185. *Id.* at 22.

186. See Chien, *supra* note 137, at 373 (noting that Alaska is the only state within the United States that has this type of fee shifting statute that so closely resembles the “English Rule”); ALASKA R. CIV. P. 82(a) (“Except as otherwise provided by law or agreed to by the parties, the prevailing party in a civil case shall be awarded attorney’s fees calculated under this rule . . .”).

187. Rennie, *supra* note 136, at 22.

188. *Id.* at 23.

189. *Id.* at 43.

190. A. Mitchell Polinsky & Daniel L. Rubinfeld, *Does the English Rule Discourage Low-Probability-of-Prevailing Plaintiffs?*, 27 J. LEGAL STUD. 141, 152 (1998). See also Chien, *supra* note 137, at 372.

191. See Choung, *supra* note 166 (finding that, in the six months after *Octane Fitness*, fees were actually awarded more often for plaintiffs than defendants).

192. Chien, *supra* note 137, at 376.

fee shifting statute.<sup>193</sup> In the context of a pro-plaintiff fee shift in constitutional tort cases intended to increase filings, a study found that there was only minimal evidence of such an effect.<sup>194</sup> Therefore, it follows that a pro-defendant fee shifting regime intended to lower the filing rate would not likely have its intended effect.

As the empirical studies show, neither type of fee shifting has been proven to adequately carry out its objective. It has been admitted that isolating the effects of fee shifting can be challenging due to differences in jurisdictions utilizing versions of the English and American Rule.<sup>195</sup> However, that each of the studies discussed above have reached similar conclusions, along with the fact that current statistics in patent fee shifting are in accordance with them, gives weight to their merit.

### B. HEIGHTENED PLEADING REQUIREMENTS

One of the patent trolls' most effective strategies is the use of demand letters. Patent infringement demand letters are intended to be a means of proving willful infringement.<sup>196</sup> If it is proven that a party willfully infringed a patent, courts may award increased damages.<sup>197</sup> Therefore, parties acting in good faith will ensure their demand letters are as detailed as possible to increase their chances of proving willful infringement.<sup>198</sup> Patent trolls, however, abuse this litigation device and engage in bad faith negotiations, leveraging the high cost of a successful defense to obtain a settlement well below that cost.<sup>199</sup> Often, the predatory activity begins and ends with a demand letter.<sup>200</sup> However, demand letters are not always predatory and are often used by non NPEs to remedy a situation without filing a lawsuit.<sup>201</sup> A good faith demand letter informs the recipient which

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193. *Id.*

194. Rennie, *supra* note 136, at 25.

195. *Id.* at 20.

196. See Kevin Raudebaugh, *Willful Infringement After Seagate: How the Willfulness Standard has Changed and What Attorneys Should Know About It*, 5 SHIDLER J.L. COM. & TECH., 2009, at 1, 7 (explaining that demand letters are used to prove the alleged infringer had knowledge they were infringing).

197. See 35 U.S.C. § 284 (1952) (“[T]he court may increase the damages up to three times the amount found or assessed.”); Matthew D. Powers & Steven C. Carlson, *The Evolution and Impact of the Doctrine of Willful Patent Infringement*, 51 SYRACUSE L. REV. 53, 57 (2001) (showing that courts have interpreted the increased damages to be a form of punitive damages used to deter deliberate infringement of valid patents).

198. See Raudebaugh, *supra* note 196, at 7. Note that until recently, upon receiving a demand letter, a potential infringer had an affirmative duty to determine whether or not he or she was infringing. This usually entailed acquiring an expensive opinion of counsel. However, in 2007, the CAFC removed the affirmative duty to obtain an opinion of counsel. See *id.* at 5–6. See also *In re Seagate Technology, LLC*, 497 F.3d 1360, 1371 (2007).

199. See *Protecting Small Businesses Hearing*, *supra* note 144 (statement of Food Marketing Institute).

200. *Id.*

201. *Id.*

patent is infringed, which product of theirs is infringing, and how it infringes.<sup>202</sup> Predatory demand letters, on the other hand, are meant to deceive the recipient and force them into a settlement before the merits of the infringement claim can be judicially addressed.<sup>203</sup> A successful patent troll demand letter results in the troll obtaining a licensing fee from the recipient without spending any money on litigation.<sup>204</sup> To compound the problem, patent trolls use a maze of shell corporations to send the demand letters, making it hard to identify and litigate against the troll.<sup>205</sup> Both houses of Congress have recently introduced bills to address this problem, but neither found their way to the President's desk.<sup>206</sup>

The nuisance-value patent troll often sends hundreds or even thousands of identical demand letters to retailers and end users of commercial products to sweep in as many low value settlements as possible.<sup>207</sup> These predatory demand letters provide very little information to the recipient. They often do not identify what patent or claim is allegedly infringed, allege infringement of an expired patent, or state vague theories of infringement.<sup>208</sup> For example, a retailer received a demand letter from an NPE only two paragraphs in length claiming infringement based on "technology that enables debit cards and gift cards to read and process information via the magnetic strip on the back of the card."<sup>209</sup> The retailer consulted an attorney who informed them they used a different technology than the one asserted.<sup>210</sup> The NPE refused to drop their settlement demand and instead lowered the offer.<sup>211</sup> The retailer eventually paid the NPE just to make it go away, and then paid five figures in legal fees.<sup>212</sup> Recipients of demand letters are forced to choose between costly litigation to challenge the letter or compliance with the letter's offer, regardless of how weak the claims of infringement are.<sup>213</sup>

If the recipient of the demand letter decides to take their chances in court, that recipient will find that the entity sending the demand letter is not the average litigant. Patent trolls use a complex web of shell companies to

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202. *Id.*

203. *Id.*

204. *Id.*

205. Hauer, *supra* note 176, at 371.

206. Innovation Act, H.R. 3309, 113th Cong. § 3(e) (2013) ("[I]t is an abuse of the patent system and against public policy for a party to send out purposely evasive demand letters to end users alleging patent infringement."); *id.* § 4(a)(3) (2013); Patent Transparency and Improvements Act of 2013, S. 1720, 113th Cong. §§ 3(a)(1)(A), 5(a) (2013).

207. Hayden W. Gregory, *From the Hill—Combatting So-Called Patent Trolls: Demand Letters Demand Attention*, 7 LANDSLIDE, May–June 2014, at 1, 2.

208. See *Protecting Small Businesses Hearing*, *supra* note 144 (statement of Food Marketing Institute).

209. *Id.*

210. *Id.*

211. *Id.*

212. *Id.*

213. *Id.*

purchase, hold, and assert their patents.<sup>214</sup> Frequently, the only asset for each shell is the patent it is asserting.<sup>215</sup> This makes it nearly impossible for the demand letter recipient to determine the party it is actually litigating against, since Federal Rules of Civil Procedure 7.1 does not require a litigant to disclose a parent corporation unless it holds 10% or more of its stock.<sup>216</sup> This is problematic for two reasons. First, a shell company whose only asset is a patent has very little to produce in discovery, and therefore has significantly lower costs during this stage of litigation.<sup>217</sup> Second, if the defendant prevails and is awarded damages they are faced with a new set of hurdles. These shell companies are often judgment proof.<sup>218</sup> The prevailing defendant would have to identify the ultimate parent corporation, purposefully made difficult by a maze of shell corporations, and then attempt to pierce the corporate veil.<sup>219</sup> Patent trolls understand how to structure their shell corporations in a way to provide extra levels of protection against veil piercing actions.<sup>220</sup> Furthermore, courts are reluctant to pierce the corporate veil, and the protective structure used by patent trolls makes it particularly difficult to do so.<sup>221</sup>

In recent years, Congress has attempted fix these problems by making three amendments to Title 35 of the United States Code. The three amendments would result in increased pleading requirements, enhanced joinder provisions, and limitations on discovery.<sup>222</sup> These amendments work together to minimize the unfair advantages patent trolls have. The increased pleading requirements would require disclosure of any parent corporation that has an interest in the patent.<sup>223</sup> Under the new joinder

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214. Robin Feldman & Tom Ewing, *The Giants Among Us*, 2012 STAN. TECH. L. REV. 1, 4 (2012) (finding that one well known patent troll had 1276 shell companies associated with it).

215. See *Protecting Small Businesses Hearing*, *supra* note 144 (statement of Food Marketing Institute).

216. See FED. R. CIV. P. 7.1(a)(1).

217. Sid Venkatesan, *Examining the Effects of Patent-Troll Legislation on Startups*, TECHCRUNCH (Aug. 3, 2013), <http://techcrunch.com/2013/08/03/effects-of-patent-troll-legislation-on-startups> (stating that defendants may have a lot of highly technical documents that require a large number of attorney hours to sift through, whereas the troll has minimal documents).

218. Peter Schechter, *Guest Editorial: Throwing Trolls Off the Bridge*, PATENTLY-O BLOG (Mar. 10, 2013), <http://patentlyo.com/patent/2013/03/guest-editorial-throwing-trolls-off-the-bridge.html>.

219. Feldman, *supra* note 214, at 40 (explaining that the owners and investors of the shell corporation are regarded as separate and distinct entities and the only way to hold them liable for actions of the shell corporation is to pierce the corporate veil).

220. *Id.* at 40–41 (“A key predicate in piercing the corporate veil concerns the presence or absence of distinct legal entities. Some [patent trolls] are structured so that each layer is a distinct legal entity, providing a measure of protection.”).

221. *Id.*

222. See Patent Abuse Reduction Act, S. 1013, 113th Cong. (2013); Innovation Act, H.R. 3309, 113th Cong. (2013); Patent Transparency and Improvements Act of 2013, S. 1720, 113th Cong. (2013).

223. S. 1013 § 2(a); H.R. 3309 § 4(a).

provisions, a defendant would be allowed to join the “interested” parent corporation and hold them liable.<sup>224</sup> Finally, the discovery amendment would limit early discovery to “core documentary evidence.”<sup>225</sup> The pleading requirements and joinder provisions would render the practice of using large amounts of shell corporations obsolete.<sup>226</sup> The discovery limitations would drastically decrease discovery costs until the scope of the infringement claim can be narrowed, at which point the defendant would be able to escape the lawsuit for a low settlement or possibly show their device is outside the scope of the patent.<sup>227</sup>

While this three pronged approach could theoretically have a strong deterrent effect on abusive patent troll tactics, the reality is not as bright. First, these amendments would not impose any hardships on the patent troll business model until they file a lawsuit. This leaves them free to continue sending mass numbers of vague and misleading demand letters<sup>228</sup> and since, as discussed above, many claims begin and end with a demand letter, it is not certain that this approach will have much of an effect on nuisance-value patent trolls.<sup>229</sup> If anything, implementation of these amendments may cause patent trolls to shift most of their resources to pursue nuisance-value tactics. However, this discussion is arguably moot because both bills proposing the three pronged approach stalled in Congress.<sup>230</sup>

A different bill was later introduced into the Senate that had specific provisions giving penalties for bad faith demand letters.<sup>231</sup> The Patent

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224. S. 1013 § 3; H.R. 3309 § 3(c).

225. S. 1013 § 4(a) (“[I]f the court determines that a ruling relating to the construction for terms used in a patent claim asserted in the complaint is required, discovery shall be limited, until such ruling, to information necessary for the court to determine the meaning of the terms used in the patent claim . . . .”); H.R. 3309 § 3(d) (“[I]f the court determines that a ruling relating to the construction of terms used in a patent claim asserted in the complaint is required, discovery shall be limited, until such ruling is issued, to information necessary for the court to determine the meaning of the terms used in the patent claim . . . .”).

226. Hauer, *supra* note 176, at 390 (explaining that once the parent corporation is disclosed, it can then be joined and held liable for a judgment entered against it).

227. *See id.* at 392.

228. The Innovation Act does mention demand letters in section 3(e), stating that “[d]emand letters sent should, at the least, include basic information about the patent in question, what is being infringed, and how it is being infringed,” and any litigation stemming from purposely evasive demand letters is “a fraudulent or deceptive practice and an exceptional circumstance.” H.R. 3309 §3(e). However, if a patent troll does not intend to litigate, they will not suffer any consequences for sending vague demand letters.

229. *See Protecting Small Businesses Hearing, supra* note 144 (statement of Food Marketing Institute).

230. The Patent Abuse Reduction Act never made it out of its initial Senate committee. The Innovation Act, although it passed the House of Representatives, stalled in the Senate. *S. 1013 (113th): Patent Abuse Reduction Act of 2013*, GOVTRACK, <https://www.govtrack.us/congress/bills/113/s1013> (last visited Sept. 26, 2014); Ryan Davis, *IP Bills Have Momentum in New Congress*, LAW360 (Nov. 5, 2014, 12:53 AM), <https://www.law360.com/articles/591038/ip-bills-have-momentum-in-new-congress>.

231. *See Patent Transparency and Improvements Act of 2013*, S. 1720, 113th Cong. § 5(a) (2013).



Transparency Improvements Act of 2013 would make sending large quantities of false, vague, and misleading demand letters an unfair or deceptive act for purposes of the Federal Trade Commission (FTC) Act.<sup>232</sup> This allows the FTC to sanction patent trolls engaging in demand letter tactics deemed to be in bad faith. However, some believe that this will do little to prevent abusive demand letters because patent trolls can continue to send them as long as they rework the letter to avoid misleading statements.<sup>233</sup> The bill does, however, require all assignments of a patent that alters the “ultimate parent entity” to be disclosed to the USPTO.<sup>234</sup> While this will allow for the identification of the parent entity prior to the filing of a lawsuit, the bill does not include a joinder provision. Therefore a defendant will still have the difficult task of piercing the corporate veil.

Either approach described above will not adequately minimize abusive patent troll tactics. Implementation of the three prongs in the Patent Abuse Reduction Act and Innovation Act would merely shift the field of patent trolls to focus on nuisance tactics. Implementation of an amendment that makes bad faith demand letters a violation of FTC law would be nothing more than a slight annoyance to patent trolls that could be avoided with minor changes to the wording in their demand letters. Furthermore, a combination of the two would not have an added effect because neither approach relies on the other.

#### IV. THE CUSTOMER SUIT EXCEPTION

The general rule courts follow when faced with multiple, similar lawsuits is to allow the suit filed first to proceed and stay subsequently filed suits.<sup>235</sup> There is an exception to this rule in patent litigation called the “customer suit exception,” where a later filed action “brought by the manufacturer of infringing goods takes precedence over a suit by the patent owner against customers of the manufacturer.”<sup>236</sup> This rule is based on recognition that “the manufacturer is the true defendant in the customer suit.”<sup>237</sup> The rule has been further justified on the grounds that “a decision in the suit between [the patentee and manufacturer] would settle the issue finally and prevent further suits.”<sup>238</sup> Therefore, allowing the manufacturer to step in with a declaratory judgment could render all suits against customers moot if the product is found not to be infringing.

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232. *See id.*

233. *See Davis, supra* note 230.

234. *See* S. 1720 § 3(b).

235. *Love, supra* note 28, at 1615.

236. *Katz v. Lear Siegler, Inc.*, 909 F.2d 1459, 1464 (Fed. Cir. 1990).

237. *Codex Corp. v. Milgo Electronic Corp.*, 553 F.2d 735, 737–38 (1st Cir. 1977).

238. *Delamere Co. v. Taylor-Bell Co.*, 199 F. Supp. 55, 57 (S.D.N.Y. 1961).

However, more recent Federal Circuit interpretations of the rule have restricted its availability.<sup>239</sup> The Federal Circuit has stated that “the guiding principles in the customer suit exception cases are efficiency and judicial economy . . . .”<sup>240</sup> Further, judicial economy is determined by looking at three factors: “(1) whether customer defendants are ‘mere resellers’ or ‘mere customers’ of the manufacturer’s product; (2) whether the customers agree to be bound by any decision in the manufacturer’s case; and (3) whether the manufacturer is the sole source of the infringing products.”<sup>241</sup> The first factor renders the exception inapplicable to cases where the customer uses the manufacturer’s infringing product in their larger device. For example, in *Air Products and Chemicals v. MG Nitrogen Services*, the customer was allegedly infringing a patent by using the manufacturer’s membrane equipment in the customer’s nitrogen production units.<sup>242</sup> The court held that since the customer was not merely a reseller of the manufacturer’s membrane equipment, the customer suit exception did not apply.<sup>243</sup> The second factor will often be stipulated to by the customers. The third factor renders the exception inapplicable where the customer purchased from multiple manufacturers.<sup>244</sup> For example, in *Emerson Electric v. Black & Decker*, the customer suit exception was deemed inapplicable because the customer purchased the allegedly infringing item from two separate manufacturers.<sup>245</sup> Finally, since high-tech products are mostly constructed by sourcing component parts from multiple suppliers and since these products are a dominant source of patent suits, it is increasingly difficult to apply the customer suit exception.<sup>246</sup>

When granting a manufacturer’s request to stay lawsuits brought against their customers, courts will use phraseology such as “the manufacturer’s presumed greater interest in defending” and “to guard against possibility of abuse.”<sup>247</sup> However, the more recent developments in customer suit exception jurisprudence seem to be losing sight of its initial purpose. A more liberal application of the customer suit exception would allow more manufacturers to get involved in the action and would likely result in a decrease in the overall amount of nuisance-value patent litigation filings.

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239. Love, *supra* note 28, at 1617.

240. *Tegic Commc’ns Corp. v. Bd. of Regents of Univ. of Tex. Sys.*, 458 F.3d 1335, 1343 (Fed. Cir. 2006).

241. Love, *supra* note 28, at 1618 (citing *Tegic Commc’ns*, 458 F.3d at 1343).

242. *Air Prods. & Chems., Inc. v. MG Nitrogen Servs., Inc.*, 133 F. Supp. 2d 354, 357 (D. Del. 2001).

243. *Id.*

244. Love, *supra* note 28, at 1618–19.

245. *Id.* at 1619 (citing *Emerson Elec. Co. v. Black & Decker Mfg. Co.*, 606 F.2d 234, 241 (8th Cir. 1979)).

246. *See id.* at 1618–19.

247. *Kahn v. General Motors Corp.*, 889 F.2d 1078, 1081 (Fed. Cir. 1989).

One of the driving forces behind the customer suit exception is the theory that “the manufacturer is the true defendant in the customer suit.”<sup>248</sup> There are several distinct benefits of getting the manufacturer involved in the litigation. First, manufacturers have a stronger incentive to litigate an infringement suit than their customers.<sup>249</sup> Through claim construction, the manufacturer can set the scope of the patent in a way that allows them to design around the patent, thereby eliminating the need to make royalty payments.<sup>250</sup> Also, by vigorously defending the infringement action, the manufacturer will send a message to other patent trolls that it is not an easy target, thus minimizing future actions against itself and its customers.<sup>251</sup> Second, the manufacturer is in a much better position to litigate an infringement action than their customers.<sup>252</sup> In general, customers have little, if any, understanding of the field of the patent and often do not understand what role the allegedly infringing component plays in their device.<sup>253</sup> On the other hand, the manufacturer’s in-house knowledge and expertise is helpful in finding prior art, expert analysis, and, most importantly, establishing noninfringement.<sup>254</sup> Finally, manufacturers are in the best position to value the patent rights.<sup>255</sup> The manufacturer’s in-house knowledge of both the product and the marketplace make them the best party to provide evidence in determining reasonable royalty damages.<sup>256</sup> Therefore, since overcompensating the patentee can impede the very innovation the Patent Act is meant to foster, it is socially beneficial for the manufacturer to be defending the infringement action.<sup>257</sup>

If more manufacturers were able to routinely defend infringement lawsuits against their customers, nuisance-value infringement actions would likely decline. Initially, patent trolls would have to begin strategically targeting the customers of manufacturers that do not defend their customers.<sup>258</sup> Eventually, this will cause customers to make the majority of their purchases from manufacturers who are willing to defend their

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248. *Codex Corp. v. Milgo Elec. Corp.*, 553 F.2d 735, 737–38 (1st Cir. 1977).

249. Love, *supra* note 28, at 1621.

250. Jason Rantanen, *Slaying the Troll: Litigation as an Effective Strategy Against Patent Threats*, 23 SANTA CLARA COMPUTER & HIGH TECH. L.J. 159, 161 (2006).

251. *Id.*

252. Love, *supra* note 28, at 1626.

253. *Id.* at 1628.

254. *See id.* at 1628–29.

255. *See id.* at 1631.

256. *See id.* (citing *Georgia-Pacific Corp. v. U.S. Plywood Corp.*, 318 F. Supp. 1116, 1120 (S.D.N.Y. 1970) (setting out factors to consider when determining reasonable royalty damages)).

257. *See Marina Lao, Unilateral Refusals to Sell or License Intellectual Property and the Antitrust Duty to Deal*, 9 CORNELL J.L. & PUB. POL’Y 193, 214 (1999).

258. Love, *supra* note 28, at 1631.

product.<sup>259</sup> Thus, the target pool for patent trolls engaging in nuisance-value litigation will start to decline.<sup>260</sup>

By expanding the customer suit exception, either through Congress or judicial action, the field of targets for nuisance-value patent trolls would be largely diminished. The first step would be to modify the test given by the Federal Circuit. A modification allowing for a manufacturer whose product is the main component of the allegedly infringing device would promote a more liberal application of the exception. Furthermore, allowing the manufacturer to step in for its customers as early as the demand letter stage would minimize the mass demand letter tactic used by many patent trolls.

## CONCLUSION

NPEs come in all shapes and sizes, but it is widely agreed that those who pursue numerous end users for the purpose of extracting licensing fees are unfairly exploiting the patent system. Many of the current and proposed solutions offer little, if any, protection for this class of targets. However, one proposal, allowing for a more liberal application of the customer suit exception, has promise. By allowing the manufacturer of the product allegedly infringing a patent, rather than the end user of the product, to litigate the action would promote a more proper valuation of the patent in question. In turn, this would lower the appeal of the end user as a target for patent litigation and minimize the number of nuisance-value lawsuits filed by patent trolls.

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259. *Id.*

260. *Id.*

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