

NON-PRACTISING ENTITIES

Not all NPES are created equal

Matthew Rizzolo and **Keyna Chow** analyse why perceptions of non-practising entities vary widely across different IP sectors



Matthew Rizzolo



Keyna Chow

Non-practising entities (NPEs) have been active in intellectual property sectors for decades, and come in many shapes and sizes. Some NPEs are viewed favourably – but others have been called “trolls,” and a few may be even viewed as criminal. What might affect the perception of NPEs in any given situation? Many factors are at play.

Generally, NPEs are organisations who do not practise their IP rights, but instead enforce these rights for monetisation purposes. The business models of NPEs vary widely. Some NPEs purchase IP, other NPEs invent IP, and some NPEs do both. NPEs monetise their IP in two main ways: licensing and litigation. Many first seek to license their IP to practising entities without litigation. These NPEs may approach their targets with a licensing offer or demand. If and when negotiations fail, these NPEs may then file a lawsuit alleging infringement of their IP. The success of any given NPE’s monetisation efforts largely depends on its ability to obtain licensing fees and royalties, while incurring minimal legal fees and associated costs.

Patent NPEs

The most well-known NPEs are in the patent sector, commonly known as patent assertion entities (PAEs). While some PAEs focus primarily on monetising their patents, others – such as research entities and universities – have different primary goals (eg, education). For these entities, patent monetisation is often merely an opportunity to further the organisation’s primary goal. The US International Trade Commission categorises NPEs in a similar manner. “Category 1” NPEs are “[u]niversities, research institutions/entities, start-ups, individual inventors, manufacturers whose products do not practice the patents.” “Category 2” NPEs, on the other hand, are “[e]ntities whose business model focuses on purchasing and asserting patents.” Some well-known patent NPEs are Intellectual Ventures, InterDigital, Acacia Research Corporation, and the Wisconsin Alumni Research Foundation.

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Copyright NPEs

In the copyright realm, it is nothing new for an entity to aggregate copyrighted materials, offer to license them, and enforce them if attempts to license fail. Automated online enforcement of copyright provides an affordable alternative to litigation and forms a big part of the copyright landscape. The music publishing industry has a long history of acquiring copyrights and licensing them. American Society of Composers (ASCAP) and Broadcast Music, Inc (BMI) are two well known non-profit organisations who collect licence royalties on behalf of copyright owners (eg, songwriters or composers), and distribute those royalties back to the copyright owners. Other companies who don’t make and sell copyrighted materials, such as television distribution companies, have relied on licensing as their business model. Even companies that have traditionally focused on products, such as record companies, are evolving into licensing businesses.

One famous copyright NPE case in recent years is *Righthaven LLC v Hoehn*.¹ Righthaven

was a holding company who sought to acquire copyrights from authors of previously published news content who then initiated lawsuits targeting website owners, including bloggers and nonprofit organisations, for unauthorised copying and posting of news articles. Some early defendants quickly settled, but Righthaven eventually met its demise as one court ruled that it lacked standing due to an insufficient transfer of the right to sue and another court ruled in favour of defendants on their fair use defence.

Perhaps the most fascinating story involving a copyright NPE was Prenda Law. Three lawyers, the principals of Prenda, created shell companies, commissioned the production of pornographic videos, claimed copyrights on those videos under the shell company, uploaded them on the internet, and then lured potential targets (ie, individual persons) to illegally download and share those videos online. Prenda Law then threatened the targets with copyright infringement lawsuits, and offered to settle lawsuits silently for thousands of dollars, typically below the cost of a legal defence. Prenda was mostly successful in extorting the settlement amounts from their targets, but the scheme was eventually exposed. Now the lawyers behind Prenda Law have been indicted on fraud, perjury, and money laundering charges, and have pleaded guilty to some of these charges.

Trademark/trade secret NPEs

On the trademark side, so-called “trolls” have been active in the form of cybersquatters and opportunistic applicants. Cybersquatters register domain names of famous brands, and capitalise by selling the domain names to the brand owners. Opportunistic applicants, on the other hand, register well-known marks or popular phrases, and threaten litigation to enforce their marks. In the US, though, trademark rights are based on use, not mere registration – thus brand owners generally prevail over these opportunistic applicants

when disputes arise. Further, “trolling” seems to be less of an issue with trademarks than with other IP. The nature of trademarks is to exclusively identify the commercial source or origin of products or services. Unlike with patents and copyrights, businesses use trademarks to differentiate their identity from one another, and generally have less incentive to license another’s trademarks.

Similarly, NPEs have not yet appeared to present a significant issue or controversy in the trade secret sector. Before the Defend Trade Secret Act (DTSA) was passed in 2016, there were fears that the new act would prompt an uptake in “troll-like” activities. Some commentators even predicted that “trade secret trolls could be the new patent trolls”, but such fears have not come to pass. Again, the nature of the IP right at issue may be a limiting factor. Trade secrets must be information not generally known (or reasonably ascertainable) by others that a business can use for a commercial advantage. High transaction and enforcement costs associated with trade secrets likely make them unappealing to most NPEs.

Not all NPEs are viewed the same

There are many factors that may affect how a NPE is perceived. At least four factors are at play: (1) nature and strength of the IP rights; (2) business model of the NPE; (3) nature of the target; and (4) enforcement behaviour.

Fundamental to the perception of a NPE is the nature of IP rights asserted. A NPE is generally viewed less favourably when it asserts exclusionary IP rights irrespective of whether the target has engaged in copying. A patent is generally more of an “exclusive” right than a copyright, for example – independent creation is a valid defence in a copyright infringement case, but not in a strict liability patent infringement suit. This may be one reason why patent NPEs are viewed with more disdain than copyright NPEs.

The strength of the individual IP rights being asserted also matters. For example, NPEs asserting high-quality patents, even if they seek large damages, are generally viewed more favourably than NPEs who bring weak claims and seek to settle for the cost of litigation. While many operating companies settle these “nuisance suits” as part of the cost of doing business, others – most famously Newegg – often take a stand and will pay their attorneys to litigate rather than settle with a NPE.

Perception of a NPE is highly influenced



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by its business model. Organic acquisition- ie, invention – is generally viewed more favourably than aggregation. This is true for both patent and copyright NPEs. For example, universities and research institutions are perceived favourably as innovators and contributors, while other NPEs are perceived merely as brokers or unnecessary “middlemen”. Copyright NPE Righthaven, whose business model was aggregating previously published news content, rather than creating new content, faced the same perception issue. Notably, this factor does not appear to affect the perception of ASCAP and BMI, who are aggregators of copyrighted music materials. This may be explained based on ASCAP’s and BMI’s “non-profit” status, in contrast to the

for-profit status of other NPEs.

Nature of the target is also relevant to the perception of a NPE. The smaller the target, the worse a NPE is perceived. Defending an infringement lawsuit is part of the cost of doing business for many large companies. However, the same is not true for individuals or small entities, who may lack the funding and expertise to defend such a lawsuit. For example, Righthaven was labeled as a “copyright troll” for its practice to bring “no-warning lawsuits” targeting small businesses and non-profits. Prenda Law was labeled as a “porn troll” for its scheme to extort money by shaming individual persons in the names of copyright infringement. Many patent NPEs, such as MPHJ Technologies and Innovatio IP, were similarly derided for enforcement campaigns focused on small entities.

Specific enforcement behaviour also affects the perception of a NPE. Overextension of IP rights is a common theme. For example, a NPE who indiscriminately sends mass demand letters without regard for the merits of infringement is likely to be viewed unfavourably, and may even rise to the level of unfair trade practices. In the case of MPHJ Technologies, for example, such behaviour drew the attention of the Federal Trade Commission. Broad automated online enforcement of copyright, by NPEs and others, has also drawn scrutiny from regulators and the courts. Some NPEs employ these approaches to cast a wide net over targets, and their return on investment is largely determined by the number of targets who are willing to settle, rather than based on the merits of the IP rights asserted. Such enforcement campaigns are typically viewed as unfavourable.

When companies are faced with threats of litigation from a NPE, it is important to know the opponent—and that includes how the NPE may be generally perceived, whether by the public, a judge, or jury. Companies can gain a strategic advantage by understanding the NPE’s business, its prior activities, and enforcement strategy. Factors such as the NPE’s business structure, the main revenue source of the NPE, how the NPE acquires its IP, and the historical enforcement tactics of the NPE may colour the public’s perception. A resourceful target of a NPE may be able to use this perception to its defensive advantage, whether in litigation or public relations.

Footnote

1. *Righthaven LLC v Hoehn*, 716 F.3d 1166 (9th Cir 2013).

Matthew Rizzolo is based in Ropes & Gray’s Washington, DC office. He advises technology companies to both enforce clients’ IP rights and defend clients from patent infringement claims. Keyna Chow is an associate in the intellectual property litigation practice based in the firm’s Silicon Valley office. She advises companies on offensive and defensive IP strategies.