TAKING STOCK

HOW RETAILERS CAN PROTECT THEMSELVES FROM PATENT TROLLS

You are pleased with the return on investment your retail shop has seen from the customized email campaign you initiated last year. Sales are up and your phones are constantly ringing with new prospects. Then, one day, you receive a certified letter telling you that the way you've executed your email communication violates a direct-marketing patent. You're surprised that there's a patent for this, but what's more confusing is that the letter came from a company you've never heard of.

You've just been hit by a patent troll, or non-practicing entity (NPE) — a company that doesn't actually produce or sell any patented products, but makes its money by suing or threatening to sue business owners for alleged infringement of patents it has purchased.

Patents are one part of intellectual property (IP) risk, an area of growing concern for many businesses, And retailers are a top target of patent trolls: From 2010 to 2016, the retail sector was targeted in more than 3,000 NPE lawsuits, a record pace for the industry, according to patent risk services provider RPX Corporation. But like risks related to other strategic assets, retailers can take steps to manage their IP risk.

HOW PATENT TROLLS WORK

NPEs typically purchase patents in large numbers — from inventors, through patent brokers, or from other companies — and look to enforce them against companies that may be using technology cited in those patents without permission. NPEs' singular goal in their enforcement campaigns is to extract a payment out of those they target. They can try to enforce multiple patents simultaneously against companies that may not even know they are infringing on patent rights. In fact, the example described above is based on an actual case in which one NPE struck over 140 companies with accusations of patent violations over an eight-year campaign.

Litigation is often preceded by an assertion letter, which is a notice of infringement or invitation to license, similar to what the retailer in the above example received. A company could spend months and several thousand dollars just figuring out what to do after receiving such a letter. When a matter proceeds to litigation, it can be a lengthy, costly and distracting process. A single patent litigation suit can take up to 18 months to resolve and cost millions of dollars, not to mention diverting employee time and attention from the business. Combined, these factors can slow a company's growth, cause it to lose out on investment opportunities, or even force it to close.

It's clear that assertions brought by patent trolls can lead retailers and restauranteurs into complex and uncertain territory, with potentially significant ramifications. Risk managers need to know the scope of the problem and the mitigation strategies available to make informed decisions when faced with this risk.

HOW PATENTS BECOME AVAILABLE

Patents are like any other asset class that can be bought and sold. An NPE can buy them and then go after organizations that they believe are infringing. And while it may seem like a predatory practice, it's entirely legal.

NPEs count on the probability that if they purchase 25 patents, for example, they might be able to make a profit by asserting eight or nine. Those patents generally become available in two ways:

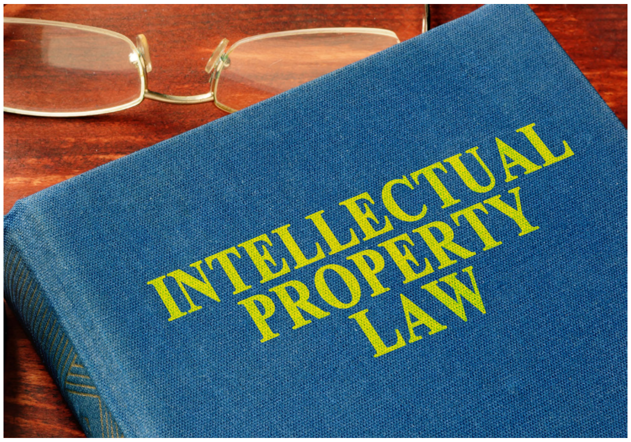
- Through direct sale: Like a driver's license, patents need to be renewed. But unlike a license to drive an automobile, the lifecycle of a patent typically costs $33,000 to $35,000 — a sizable expense for some organizations. If a company decides to take its business in a different direction, it might try to sell some of the patents it no longer needs. Sometimes, companies sell these assets directly to NPEs.
- On the secondary market: Companies that go out of business may sell their patent portfolios to pay off debts. Inventors may also abandon their patents and sell them after failing to commercialize products.

LITIGATION TRENDS

The rise of NPE litigation can be traced to the convergence of technology at the consumer level. As innovation took off in the late 1990s and early 2000s, so did patenting of various components of the technologies being developed. Innovation occurred at such a fast clip that patent applications were often filed and issued on similar and overlapping technologies.

Fast forward a few years and the technologies being developed 10 years prior were now being combined to create products and software, such as smartphones and online shopping tools, designed to make life more efficient. Any one of these new technologies could encompass multiple patents — and given that many patents now existed for similar technologies, it became difficult for companies to be certain they were not infringing on patents held by others. NPEs saw a business opportunity in this complexity and began buying and enforcing patents that related to multiple technologies.

NPE litigation ramped up around 2007, mapping closely with the introduction of new consumer technologies, and hit its highest level in 2011. Through 2015, the number of lawsuits remained consistent, but in 2016 the frequency of patent litigation cases brought by NPEs slowed. In part, this was due to legislation and court decisions that changed the nature of patent litigation. The America Invents Act of 2011, for example, created the Patent Trial and Appeal Board (PTAB) which conducts hearings on the validity of patents that may be of low quality. For companies defending against patent trolls' attacks, this offers a lower-cost alternative to litigation in a federal district court, though these proceedings can still cost hundreds of thousands of dollars.



A recent court ruling imposes new limits on patent trolls. In May 2017, in *TC Heartland LLC v. Kraft Foods Group Brands LLC*, the US Supreme Court ruled that patent infringement cases "may be brought in the judicial district where the defendant resides, or where the defendant has committed acts of infringement and has a regular and established place of business." The decision ends 27 years of patent infringement case law that defined a company's location as almost anywhere it did business. Under that definition, many patent litigation cases ended up being filed in Eastern District of Texas, which has developed a reputation as a plaintiff-friendly jurisdiction.

On the surface, the decision seemingly prevents plaintiffs from filing their cases in districts where they believe they'll receive a favorable ruling. But the ruling only addresses one half of the statute at issue, leaving open for lower courts to interpret the following:

- Patent infringement suits can be filed where a defendant commits an act of infringement.
- These cases can also be filed where a defendant has a regular and established place of business. For example, a retailer headquartered in Boston that has stores and distribution centers in 30 additional states can be sued for patent infringement where it has an obvious presence.

This may result in plaintiffs continuing to bring cases in districts they deem friendly.

INSURANCE COVERAGE IS AVAILABLE

Patent infringement litigation remains a persistent and costly problem for the thousands of companies that are sued by or threatened with litigation each year. And while recent legislative changes and court decisions appear to be having an impact, NPEs continue to find new targets and evolve their strategies, making this a risk many businesses will need to address.

What risk managers may not know is that IP insurance options are available to cover lawsuits brought by NPEs and may also be available to cover lawsuits brought by other companies, including competitors. Retailers can purchase claims-made, non-admitted coverage for IP risks on a standalone basis. And the market for that coverage is growing, with three insurers entering the IP marketplace since the start of 2016, adding more competition and capacity for buyers. Retailers should discuss these potential options and the best way to structure such coverage with their insurance advisors.

This briefing was prepared by Marsh's Retail/Wholesale Practice, in conjunction with Marsh's FINPRO Practice and RPX Insurance Services.

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