Analyzing the Role of Non-Practicing Entities in the Patent System

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Abstract:

Currently, there is an important debate about the role of non-practicing entities in patent litigation. People are asking: what are the costs and benefits associated with NPE litigation? Are they too high, too low, or just right? This paper makes two contributions to the discussion. First, we review a recent study, *The Direct Costs of NPE Disputes*, by James Bessen and Michael J. Meurer. The study presents new data on the litigation costs and settlement expenses incurred by a subset of defendants in NPE cases. Some of their findings are provocative, but we find their methodology to be deficient in several respects, which limits the usefulness of the data and thus the implications that can be drawn from them. We also offer suggestions for future research on NPEs, including data collection and analysis. Second, we argue that the study asks the wrong question. The debate should be reframed to focus on the merits of the lawsuits, including patent system changes focusing on reducing transaction costs (e.g., lawyers’ fees) in patent litigation, instead of focusing solely on whether the patent holder is a non-practicing entity.

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Introduction

Historically, most patent litigation was brought by large companies to protect their markets.\(^1\) Recently, however, an increasing number of patent lawsuits have been initiated by entities who do not manufacture products themselves – including universities, individual inventors, failed businesses, and speculators who purchase patents from others. This heterogeneous group of patent holders has loosely been referred to as “non-practicing entities,” or “NPEs” for short. Some pejoratively refer to some or all NPEs as “patent trolls,” analogizing that these patent holders wait until another brings a product to market and then jumps from under the bridge to demand a toll.

What are the costs and benefits of NPE litigation in patent law? As part of the America Invents Act, the General Accounting Office (“GAO”) must complete a report on NPEs by September 2012.\(^2\) Two Boston University researchers, James Bessen and Michael J. Meurer, have recently released a study called “The Direct Costs from NPE Disputes.”\(^3\) Their study purports to assess “the direct costs of patent assertions by non-practicing entities.” The Bessen & Meurer study relies on two proprietary data sources compiled by RPX Corporation: (1) results of a survey of certain NPE defendants; and (2) a database of NPE lawsuits from 2005 through 2011. The study finds that the direct costs of NPE patent assertions are “substantial, totaling about $29 billion accrued cost in 2011.” One quarter of these costs are litigation costs – primarily legal fees for accused infringers. The study argues that this ratio “implies that a substantial part of the direct costs of NPE litigation is a deadweight loss to society.” It also claims that “NPE patent assertions hurt small inventors....” Finally, Bessen and Meurer find “little evidence that NPEs promote innovation overall.” The study’s conclusions, especially the $29 billion figure, have been reported widely in the press, including coverage by CNN, Bloomberg, Reuters, the BBC, the Atlantic, the Huffington Post, CNet, and numerous blogs.\(^4\)

At the outset, we acknowledge that Bessen & Meurer’s study provides interesting new data. Public data on litigation costs and settlements in patent litigation is scarce. The vast majority of patent cases settle, and most settlement agreements include a confidentiality provision prohibiting the parties from publicly disclosing its terms. Furthermore, companies rarely publicly disclose the amount paid to outside lawyers in attorneys’ fees. The study provides new information about costs and settlements that was not previously available, and for that we commend them. In addition, they provide data on the previously unexplored topic of NPE

\(^1\) Colleen V. Chien, Of Trolls, Davids, Goliaths, and Kings: Narratives and Evidence in the Litigation of High-Tech Patents, 87 N.C. L. REV. 1571 (2009).


assertions that did not result in litigation. This is also an interesting issue. As described in more detail below, some of their results are provocative and deserve further scrutiny while others are questionable. However, as academics interested in patent law, patent policy, and empirical methodology, there are a number of limitations in Bessen & Meurer’s methodology which we recommend they or others address. In our opinion, these limitations require that Bessen & Meurer’s findings on the issue of NPEs be viewed with some reservations and skepticism.

Our views can be summarized as:

(1) **Figures Based on Biased Sample.** Bessen & Meurer’s $29 billion calculation of the direct cost of NPE patent assertions should be viewed as the highest possible limit. The true number is very likely to be substantially lower. It is the outer bound because the survey is not a random sample; instead it likely is a biased sample, which renders Bessen & Meurer’s extrapolation of the total costs similarly biased too high.

(2) **Lack of Basis for Comparison of Figures.** The vast majority of the $29 billion figure consists of settlement, licensing, and judgment amounts. For economists, these are not “costs,” as they are classified in the Bessen & Meurer study, but rather “transfers.” Such transfers to patent holders are the contemplated rewards of the patent system. Furthermore, before declaring litigation costs (i.e., lawyers’ fees) too high, there must be some basis for comparison. Bessen & Meurer provide no such comparison. For further academic studies, we propose comparing them to either the ratio of lawyers’ fees to settlements in practicing entity patent litigation or complex commercial litigation more broadly.

(3) **Questionable Definition of NPE.** Bessen & Meurer’s calculations rest upon a questionable and very broad definition of NPE. We suggest that they disaggregate among different categories of NPE, which should be possible with RPX’s database.

(4) **Lack of Credible Information on Benefits of NPEs.** Bessen & Meurer’s estimate of the benefits of NPE litigation is based upon an analysis of very limited information, namely SEC filings from 12 publicly traded NPEs. We recommend a survey of NPE plaintiffs analogous to the survey of NPE defendants to provide more complete information on this issue.

In general, we believe that focusing on whether the patent holder is an NPE or practicing entity is the wrong question. Our point is not to extol or criticize NPEs. There surely are some NPEs that are bad actors and some that are good actors. Instead, our goal is to focus the conversation on the right question: analyzing the merits of the cases, and locating ways to reduce patent litigation expenses by creating or improving institutional mechanisms to address patent validity and patent infringement.

We also believe that Bessen & Meurer should include more disclosure about the methodology. That is especially important here because it appears that they do not have personal access to
some or all of the underlying RPX data. After recounting our substantive points in Section 1, we discuss our methodological concerns in Section 2.

1. Perceived Flaws in the Survey and Analysis

   a. Estimate of costs is likely biased too high

First, we believe that Bessen & Meurer’s estimate is likely biased to be very high. Their estimate is based upon a relatively small survey which was extrapolated to the larger population of NPE lawsuits. We find flaws with both the survey and the subsequent extrapolation.

With respect to the survey, it is not a random sample of NPEs. Without a simple random or stratified sample or other evidence that the sample is representative, it is improper to impute the results of the sample to the larger population. According to Bessen & Meurer, RPX sent the survey to “about 250 companies” which include “RPX clients and nonclient companies with whom RPX has relationships.” This vague description of survey recipients is difficult to evaluate. We recognize that confidentiality concerns may limit the amount of disclosure about the sample that can be provided. Still, we recommend that Bessen & Meurer release substantially more information about the surveyed population, which need not include the identity of the subjects, but which can permit examination for whether it appears representative. Information about the frequency at which the subjects were defendants in patent litigation, some information about the legal counsel engaged by defendants in these suits (i.e., American Lawyer 100 firms or less expensive smaller firms), a more detailed breakdown of the industry of the subjects, a more detailed breakdown of revenues of the subjects, and how many of the subjects were RPX clients would be helpful.

Without this information, we are left to make several assumptions about the pool of survey recipients, which we feel are reasonable, and which lead us to the conclusion that there is a strong selection bias. RPX calls itself a “defensive patent aggregator.” A large portion of RPX’s business model is providing subscriptions to customers who are repeat defendants in patent infringement lawsuits. RPX asserts that its subscription fees “are significantly lower than the typical patent acquisition and defense costs a client would otherwise face.” It seems extremely likely that RPX’s clients have experienced high litigation costs, perhaps much higher than the average company. As such, the survey has a strong selection bias here in favor of companies that are repeat defendants in NPE litigation and thus need the services of RPX to reduce future patent liabilities. In other words, high litigation costs are probably the reason the companies became RPX clients in the first instance. The other subjects who received the survey are identified only as “nonclient companies with whom RPX has relationships.” Without more information, we can only assume that these are potential customers of RPX. Again, these are likely companies with higher litigation costs and liability exposure compared to the average company. They may also be more risk-averse and settle for higher amounts than the average company. Thus, without further information, the companies to whom the survey was sent are likely biased, with these companies having much higher litigation costs than average.

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5 Bessen & Meurer Study, page 10, n.8 (“To preserve data confidentiality, statistical analysis was performed by RPX personnel working under our direction.”).

We further suspect that the subset of companies that actually responded to the survey is even more biased. According to Bessen & Meurer, 82 companies completed the survey, a response rate of approximately one-third. Bessen & Meurer provide no descriptive information about how these 82 companies compare to the approximately 250 companies to whom the survey was sent. We believe such information should be disclosed. Without more information, a reasonable assumption is that the responding companies likely had easier access to the information (i.e., better electronic record keeping), which likely means larger companies, and/or were more motivated to respond (i.e., they have higher exposure and costs). Thus, it is very likely that there were selection effects on multiple levels: the solicited companies had higher costs and expenses than the average company, and the responding companies had higher costs and transfers than the universe of companies solicited. Our view is supported by Bessen & Meurer’s disclosure that 72% of the 82 respondents are publicly-traded companies, while only 14% of all NPE defendants are. Public companies are much more likely to engage higher priced lawyers and have higher litigation costs and expenses.

If Bessen & Meurer’s sample was biased, then their estimate of the costs for the population of NPE defendants must be biased as well. In fact, their estimate of the population magnifies the bias from the small sample. Extrapolating from a sample to the full population is only sound if it is a representative sample, preferably randomly generated. Furthermore, the sample size of respondents (82 for litigated cases, and a mere 46 for unlitigated cases) is very small. At best, Bessen & Meurer’s estimates of costs and transfers can be understood as the highest possible bound. In other words, the actual costs and transfers from NPE litigation cannot be higher than their figure, and are very likely to be significantly lower.

Bessen & Meurer acknowledge that their sample is non-random, but contend that there is evidence that it is representative. The contention is based upon benchmarking their survey to other estimates of litigation costs. Their benchmarking analysis is incorrect, in our view, because it is based upon inaccurate assumptions about patent litigation. Bessen & Meurer assert that “most lawsuits are not settled by an initial summary judgment but are settled before trial,” and consequently they benchmark their costs to a survey of costs near trial. Similarly, Bessen & Meurer benchmark to a second survey by assuming that the average patent lawsuit progresses through the completion of discovery before settling. The empirical data is inconsistent with both statements. Most cases settle much, much earlier. For example, the median patent case filed in 2000 was resolved in approximately 300 days, while the median patent case filed in 2000 and resolved on summary judgment took almost 600 days for resolution. This data comes from patent cases filed in 2000 (and mostly resolved by 2005), a time period before the recent uptick in NPE cases. NPE cases are often filed in speedy venues and likely are resolved even faster,

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7 Even if the sample was unbiased, researchers normally make clear that their estimates of the larger population include uncertainty. This is typically accomplished through reporting the confidence interval. Here, with a relatively small sample (82 respondents), the range of potential values of the population would likely be large. Bessen & Meurer, however, report an exact number: $29 billion.

8 Bessen & Meurer Study at p. 14.

9 Bessen & Meurer Study at p. 14. This statement references a previous article by one of us, but apparently misinterpreted our results.

and thus cheaper, than the median from the 2000 study.\textsuperscript{11} Thus, the benchmarking does not support Bessen & Meurer’s contention that their data is representative. It actually shows the exact opposite; it shows that it is biased too high.\textsuperscript{12}

b. \textit{Analysis of the costs of NPE litigation lacks an adequate baseline}

Second, Bessen & Meurer state that the costs of NPE litigation to defendants are “substantial,” as measured two different ways. They first assert that the \textit{direct} costs (the sum of legal costs and settlement/judgment costs) are “substantial” because they total $29 billion.\textsuperscript{13} They later assert that the \textit{legal} costs are 23% of the total and \textit{settlement/judgment} costs are 77%.\textsuperscript{14} Bessen & Meurer assert that this ratio “implies that a substantial part of the direct costs of NPE litigation is a deadweight loss to society.” Even assuming that Bessen & Meurer’s estimates on the population were accurate, we question both of their inferences.

Turning first to the $29 billion “cost” figure, we disagree with their terminology. By Bessen & Meurer’s own estimate, roughly three-quarters of the direct costs are verdicts, licensing fees, or other settlement amounts. According to standardized economic terminology, these figures are “transfers” contemplated by the patent system, not “costs.”\textsuperscript{15} In other words, this is the money paid to a patent owner in exchange for the disclosure and expense required to obtain a patent. The transaction has resulted in money moving from one entity to another in exchange for intellectual property rights, and economists do not consider these costs. Only if the patent lawsuits by NPEs are meritless, and these transfers have no relation to the value of the asserted patents, are Bessen & Meurer correct that the full amount should be viewed as a cost. Bessen & Meurer report that the median settlement amount from their sample is $1.38 million and the median of litigation costs is $560,000. RPX reports on its website slightly different information: “in the majority of NPE assertions almost half the cost to operating companies is legal cost.”\textsuperscript{16} Those numbers are provocative, as is Bessen & Meurer’s data on the skewed distribution of legal costs, and deserve further scrutiny. But we do not believe that on their face they prove that all or most patent lawsuits brought by NPEs are meritless. It could be that these are legitimate cases of infringement without sky-high damages.

\textsuperscript{11} The data from cases filed in 2000 is the best available public data. As for summaries of data, Article One Partners reports that 62% of NPE cases settle within 6 months. http://c179931.r31.cf1.rackcdn.com/news_4a296ccd-407-5257-bde5-68b5e0ed5aop%202011%20Napa%20Summit%20Takeaways.pdf. RPX also may have assembled its own data on current cases, especially for those involving NPEs. We suggest that such data be made available.

\textsuperscript{12} There is another reason that the 2011 AIPLA cost study that Bessen & Meurer use to benchmark is inapplicable. The 2011 AIPLA study is based upon responses from 2010, which likely solicited data from 2009. This may make the cost estimates too low. However, the 2009 responses presumably are from competitor patent litigation, not NPE litigation. Because competitor litigation is more document intensive and frequently litigated more heavily by both parties – e.g., due to the injunction risk – we believe that NPE litigation must be less expensive than competitor litigation. Thus, on balance, the 2011 AIPLA study costs should be higher than Bessen & Meurer’s data. The fact that they are inline further supports the view that Bessen & Meurer’s data is biased too high.

\textsuperscript{13} Bessen & Meurer Study at p. 2.

\textsuperscript{14} Bessen & Meurer at p. 12, n. 12.

\textsuperscript{15} Richard A. Posner, \textit{ECONOMIC ANALYSIS OF LAW}, Chapter 1 (7\textsuperscript{th} ed. Aspen 2007).

That leaves the 22% of direct costs that Bessen & Meurer report as legal costs, an amount which Bessen & Meurer deem “substantial.” Bessen & Meurer are correct that attorneys’ fees and other litigation costs to the accused infringer are properly considered “costs” by economists. The costs to the accused infringers are dollars which economists would consider in the bad ledger. The litigation costs to the patentees and to the courts, which Bessen & Meurer did not measure, would also be placed on this bad ledger.

We believe, however, that for completeness, these costs must be balanced with the policy goals and benefits of NPE litigation. Without this balancing, the necessary implication of Bessen & Meurer’s assertion is that all litigation is wasteful and should be abolished. Take for instance the criminal justice system. It costs money for accused wrongdoers to hire legal counsel. But that doesn’t mean that we should abolish the entire system. Rather, the costs are balanced against the public policy of punishing wrongdoers, deterring others from committing crimes, etc. Turning back to patent law, the policy interests which need to be considered include promoting innovation, rewarding inventors, and deterring infringement.\footnote{17}

A different way to consider the legal cost issue is to pose the question: what should we compare the costs to? As empirical scholars, we need to evaluate whether the $6.7 billion (23% of $29 billion) is statistically different from some other number. It is unrealistic to assume that the costs should be zero. No one is surprised that lawyers charge a lot of money to represent accused infringers who are large corporations. We believe it should be compared to the costs of patent litigation between practicing entities. More precisely, how does the ratio of legal fees to recoveries in NPE lawsuits compare to the ratio in competitor lawsuits? We recommend further research into the ratio for competitor or practicing entity litigation to make such a comparison. We also suggest a comparison to complex commercial litigation. We submit that without a baseline, one cannot evaluate whether the legal costs in NPE cases are too high, too low, or just right.

Before moving to our next point, we want to highlight the issue of transaction costs in patent litigation. Even if one were to make the extreme assumption that all NPE lawsuits are meritless, then what are needed are low-cost mechanisms to challenge the validity of asserted patents. The new inter partes review (IPR) and post grant review (PGR) proceedings authorized by the America Invents Act may present opportunities for low-cost patent invalidation. The final rules governing these new mechanisms are yet to be finalized, and thus we do not yet know whether this will reduce the wasteful transaction costs in challenging low-quality patents. Perhaps, as some have contended, the estoppel provision governing both IPR and PGR may perhaps prove to be too heavy a burden for challengers to bear, perhaps not.\footnote{18} Other than these administrative mechanisms to invalidate patents, perhaps a small claims court could be created for patents below a threshold value to cheaply and quickly resolve patent infringement claims.\footnote{19} Perhaps

\footnote{17} In theory, enforcement of patents, including by NPEs, may also lead to other positive externalities such as encouraging potential infringers to develop searching or licensing practices or help bring about more and more efficient compliance with others’ patent rights more generally.

\footnote{18} We recognize that the estoppel issue is complicated because of a concern that small patent holders may be harassed by serial oppositions.

\footnote{19} Robert P. Greenspoon, \textit{Is the United States Finally Ready for a Patent Small Claims Court?}, 10 MINN. J.L. SCI. & TECH. 549 (2010). We understand that a task force of the American Bar Association’s IP Section is currently investigating this option.
early-stage ADR may be effective, or curtailing substantial discovery until after Markman. In other words, if the real policy concern is high transaction costs, then we need alternative, low-cost mechanisms to invalidate patents or to prove non-infringement. Marketplace solutions for reducing transaction costs are also possible. These include reducing the legal fees to accused infringers on lower value cases by alternative fee arrangements (i.e., capped fees per phase of the case), engagement of less expensive counsel, and perhaps RPX’s defensive acquisition model.

In sum, making all NPEs a scapegoat for the costs associated with patent enforcement will end up hurting inventors who are solely focused on creating valuable technologies without addressing the real policy options for improving the patent system.

c. Relies upon a questionable definition of NPE

In addition, Bessen and Meurer use an expansive definition of non-practicing entity, beyond those even used by most critics of NPEs. Bessen & Meurer equate NPE and patent troll\(^20\) and define them as:

patent assertion entities, individual inventors, universities, and non-competing entities (operating companies asserting patents well outside the area in which they make products and compete).

There is certainly no uniformly accepted definition of who is an NPE or patent troll.\(^21\) The America Invents Act does not specify the definition the GAO should use in its study. Some entities clearly fall within the definition of an NPE: for instance, a shell company unrelated to the original inventors which purchases a patent for the sole purpose of enforcement. That said, Bessen & Meurer’s definition is extremely broad. Many leading scholars do not consider universities, which rarely if ever engage in commercialization of a product, as trolls.\(^22\) University faculty and graduate students are often true innovators and have core competencies in sectors that are creative and innovation-centric. However, their profession – academic research – does not involve manufacturing, marketing and distribution capabilities.

Similarly, many do not view individual inventors as patent trolls. While admittedly anecdotal, individual inventors frequently complain that most large companies ignore requests to license their patents, even when infringing.\(^23\) If university and individual patentees are to receive compensation for their patented inventions, then their licensees or proven infringers must sell

\(^{20}\) Bessen & Meurer expressly state that NPEs and trolls are the same. Bessen & Meurer Study, p. 1 (“‘non-practicing entities,’ commonly known as ‘patent trolls’...”).

\(^{21}\) John M. Golden, “Patent Trolls” and Patent Remedies, 85 TEX. L. REV. 2111, 2112 n.7 (2007) (observing that “a widely accepted definition of a patent troll has yet to be devised”).


\(^{23}\) This is an age-old complaint by individual inventors who are NPEs. In the early 1850s, for instance, Elias Howe’s repeated requests for I.M. Singer & Co. to pay a license fee for its (unauthorized) use of Howe’s patented lockstitch were rejected, resulting in Howe (an NPE) suing Singer for infringement. See Adam Mossoff, The Rise and Fall of the First American Patent Thicket: The Sewing Machine War of the 1850s, 53 ARIZ. L. REV. 165, 183-84 (2010).
products or services embodying their patents.\textsuperscript{24} In the absence of such market adoption, there is rarely if ever a reward to be had.\textsuperscript{25} Such innovators do not typically have the access to capital that is necessary to bring their inventions to market. They also do not have the existing channels of manufacturing, marketing and distribution. As a result, their options in trying to receive any compensation for their patented technologies are quite limited. We question whether such individual inventors should be included within the definition of NPE.

Bessen & Meurer also include patent owners who manufacture products (i.e., practicing entities) within their definition of non-practicing entities – if the patents are “well outside the area in which they make products.” We take no position on the objectively correct definition of non-practicing entity, but merely note that including practicing entities within the definition of non-practicing entities is very difficult to justify.

In our opinion, the definition used by Bessen & Meurer is somewhat unconventional, and the breadth of Bessen & Meurer’s definition partially drives their results. Bessen & Meurer’s calculation assumes every time a small inventor licenses a patent to a practicing company, it results in a “deadweight loss,” regardless of the merits of the infringement claim. We note that innovators who do not manufacture products or offer services that embody their patented technologies (which are included within Bessen & Meurer’s definition of NPE) are not parties to be simply tossed aside as socially unproductive actors.

We believe that Bessen & Meurer’s results would be more meaningful if they were disaggregated among the different categories, which should be possible with RPX’s database. For instance, one may be interested in the direct costs and transfers caused by shell patent holding companies who are unrelated to the original patent owner. Alternatively, one could study the costs and transfers using a broader definition of NPE but which excludes universities.\textsuperscript{26} We believe that these disaggregated estimates would provide a clearer picture. Obviously, narrowing the definition of non-practicing entity would lower Bessen & Meurer’s $29 billion figure. Unfortunately, without more information, we have no ability to determine the size of this reduction.

\textbf{d. Ignores small businesses who are patentees}

Finally, Bessen & Meurer argue that “much of the burden” of NPE litigation falls on small inventors. They assert that the “direct costs of NPE patent assertions are relatively larger for small companies.”\textsuperscript{27} From this data, they make the leap that NPE litigation is bad for small

\textsuperscript{24} We recognize that in rare circumstances these patentees can receive compensation without sales. For instance, they may receive an up-front, lump-sum licensing fee, or they could sell their patent rights to a practicing entity that does not end up practicing the particular patented invention.

\textsuperscript{25} A number of people have discussed the peculiar problems that various types of non-practicing entities or small firms might face in appropriating value from their inventions. See, e.g., John M. Golden, \textit{Principles for Patent Remedies}, 88 TEX. L. REV. 505, 545 (2010) (“For small firms or independent inventors …, patent rights might be the only effective means to obtain a return on investments in research and development.”)

\textsuperscript{26} Others studying patent litigation have disaggregated universities, among other types of NPEs. See John R. Allison, Mark A. Lemley & Joshua Walker, \textit{Extreme Value or Trolls on Top? The Characteristics of the Most-Litigated Patents}, 158 U. PA. L. REV. 1 (2009).

\textsuperscript{27} Bessen & Meurer Study at p. 2.
businesses. We concur that NPE litigation – all litigation in fact – is usually undesirable for small business defendants. But what about small business/patent owner plaintiffs? The patent system is one of the few tools that small businesses have to compete against larger, more established players in the market. When Bessen & Meurer refer to “small businesses,” they only mean the accused infringers. Patent owners with valid and infringed patents must be considered within this category as well.

Bessen & Meurer also contend that NPEs do not increase innovation incentives. To measure returns to patent holders, Bessen & Meurer look at revenues and expenditures from “12 publicly traded NPEs.” Bessen & Meurer find that less than a quarter of these NPEs’ revenues flow to innovative activity, which Bessen & Meurer define as purchases of other patents or direct R&D expenses. Before addressing Bessen & Meurer’s argument, we note that financial data about NPEs themselves is extremely difficult to obtain. Nearly all NPEs are private companies, and private companies rarely disclose internal corporate details. If the concern is that settlement dollars transferred to NPEs are not provided to R&D or inventors, we suggest these private NPEs be surveyed, preferably on a random basis. Similar to the RPX survey of NPE defendants, a survey of NPEs on issues such as litigation costs, settlements, transfers to inventors, and other issues, could be of tremendous value. A survey of NPEs has the additional advantage of exploring both sides of the issue. It could reveal a more complete and balanced picture of patent litigation than one can obtain from surveying only one side, the accused infringers.

Currently, publicly traded NPEs, which Bessen & Meurer relied entirely upon, may be the only publicly available data. However, there is no plausible reason to believe that these 12 publicly traded NPEs are representative of the NPEs involved in the more than 20,000 lawsuits in RPX’s database. For that reason, we question Bessen & Meurer’s analysis about the benefits of NPEs. Finally, we believe that payments by NPEs to the original patent holder should be compared to a baseline. Why is a quarter too low? Without these payments, the inventors may receive zero compensation for their patents. NPEs may provide an avenue for those outside the marketplace, such as universities and individual inventors, to obtain payouts for valid and infringed patents. Those payouts theoretically incentivize others to innovate.

By creating options to generate rewards for innovators otherwise shutout of the marketplace, even publicly-traded NPEs may play a valuable role. Together with contingency fee lawyers whose business models depend on choosing the right patents and the right patentees, NPEs can create important avenues for appropriating rewards for valuable patent rights that are owned by non-market players. Even if other entities use their patented technologies, they may lack the resources to enforce their patent rights by hiring traditional patent attorneys who engage in hourly billing practices. The risk and uncertainty associated with representing patentees that do not have the ability to pay traditional hourly billing rates is prohibitive, and hence, most such patentees are shut out of the typical enforcement mechanisms that are available to large companies. Taking on the burden of enforcing patents through a contingency fee representation

28 We are not accountants, but we suspect that many settlements include payouts over time including installment payments, which Bessen & Meurer’s method may not count properly.
29 We find the analysis by Bessen & Meurer on these 12 publicly traded NPEs difficult to follow, and we recommend further explanation. At a minimum, the identity of the 12 companies should be provided in the paper.
is an option that is available primarily for a select group of innovators with patent rights that are perceived as valuable before litigation commences.30

Ultimately, such an approach favors those who are capable of producing patented products and/or services and punishes those who cannot take their patented technologies to market, without addressing the real legal question in all patent disputes – is there a valid patent claim that is infringed? In short, instead of focusing on the merits of the patent claim, the nature of the parties are used as proxies for judging the merits of the patent claim—a fundamentally flawed and unfair result that will significantly distort the supply of inventions.

2. Recommended Additional Disclosures about Methodology

Before mentioning our suggestions for further disclosure, first we defend Bessen & Meurer from criticism raised by others. Some have argued that Bessen & Meurer’s results are “biased” because they received funding from a group, the Coalition for Patent Fairness, with an interest in the direction of the results.31 These critics have also argued that the results are biased because RPX, the company who conducted the survey and provided other data, apparently has a similar interest in the direction of the results. We believe that this criticism misses the mark. We do not believe that receiving funding or using industry data is automatically indicative of biased data. Instead, we believe that when the appearance of potential bias is present, it is incumbent on the researchers to show that their data is valid, reliable, and transparent.

We contend that Bessen & Meurer should provide more information on the issues of validity, reliability, and transparency. As is, Bessen & Meurer’s study does not provide us enough information to evaluate the quality of the data and methods. Because Bessen & Meurer note that even they do not have access to some and perhaps all of the underlying data themselves,33 the validity and reliability of RPX’s data are critical.34 This includes both the litigation cost survey and the general NPE database. With respect to surveys, the norm in academic articles is to provide copies of the exact survey language and describe in detail any promotional materials.35 This practice permits other researchers to verify that necessary and appropriate precautions were taken to avoid bias. The Bessen & Meurer study does not provide sufficient information. The missing information could be critical. For instance, we understand that the documentation

32 Transparency means fully disclosing the precise methods used in a study. Reliability refers to whether the measurements can be reproduced if generated by others. Validity refers to how accurate the measurements are. Lee Epstein & Gary King, The Rules of Inference, 69 U. CHI. L. REV. 1 (2002); Robert Lawless, Jennifer Robbennolt & Thomas Ulen, EMPIRICAL METHODS IN LAW, (Aspen 2010).
33 Bessen & Meurer Study, page 10, n.8 (“To preserve data confidentiality, statistical analysis was performed by RPX personnel working under our direction.”). Perhaps confidentiality obligations change the dynamic, but we note that this arrangement – legal academics authoring a study without even having access to the underlying data – is highly unconventional.
34 See Lee Epstein & Charles E. Clarke, Jr., Academic Integrity and Legal Scholarship in the Wake of Exxon Shipping, Footnote 17, 21 STAN. L. & POL’Y REV. 33 (2010) (noting that it is appropriate to treat funded research with skepticism, and that validity, reliability, and transparency are the keys to accessing such scholarship.)
35 Epstein & King, supra note 32 at 46 (noting the convention on reporting responses to surveys).
informed potential subjects that the results of the study would be used to lobby for changes in the patent laws. Such an instruction could be read as encouraging exaggeration. It could also affect the response rate and increase the bias in the sample, with those more interested in patent reform (i.e., those with larger patent exposure) being more likely to complete the survey. If the documentation included this sort of statement, it would cause survey experts to seriously discount the results. With respect to RPX’s NPE database, the study reports that RPX classifies which patent holders are NPEs. Because there is some discretion in these classifications, we recommend providing some measure of reliability of coding.36

Our comments should not be understood to say that we know that the databases are unreliable or lack validity. It merely means that we have insufficient information to evaluate, and we believe that the burden of persuasion should fall on the researcher. Given that the survey data contains confidential information of third parties, we recognize the difficulty in full disclosure. However, these shortcomings limit the usefulness of the data. We note some encouraging news on the disclosure front: RPX has recently indicated that it will provide more information about the study.37 Hopefully the additional information will remedy our concerns.

Conclusion

In sum, as patent scholars, we strongly believe that data is critical to the study of the patent system. The patent system is too important to evaluate without data. Data can help us make informed policy choices. Bessen & Meurer’s study provides some new data for discussion. However, limitations in the data suggest that us that their findings should be viewed skeptically, as an outer boundary of the costs of NPE litigation, and one that is likely to be substantially overstated.

With respect to the debate about NPEs, we believe that focusing on costs and transfers from NPEs are somewhat beside the point. The bigger picture is whether the lawsuits are being brought because the defendants are infringers of a valid patent, or whether the defendants are merely easy targets for a nuisance lawsuit. That requires looking beyond the identity of the patentee. It means we need to evaluate the patents being asserted to see if there are credible patent claims that are valid, enforceable, and infringed.

36 Reliability is typically reported by using measures such as Cohen’s Kappa. See Mark A. Hall & Ronald F. Wright, Systematic Content Analysis of Judicial Opinions, 96 CAL. L. REV. 63, 105–06 (2008) (stating that the best practice for relaying reliability information is to report a coefficient such as Cohen’s Kappa).