

digital media patents for profit

Companies like Acacia are aggressively pursuing these hot patents, and target companies need a sound response strategy

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Consider a small business holding more than 1,000 patents but commercializing few or none itself and suing companies it views as infringers. A century ago this might have described Thomas Edison's revered Menlo Park laboratory. Today it could refer to a "patent troll" or patent holding company. Since Intel's former general counsel Peter Detkin invented the term¹ five years ago, the activities of these companies have been the subject of heated public debate and numerous headlines.

Recently, however, the term patent troll has emerged as a convenient label for a variety of business strategies, applicable both to many established companies and to companies with an exclusive strategy of licensing and litigation. In its most common meaning, patent troll refers to a

company that asserts patent rights as its primary business model (a patent troll may or may not commercialize technology or products embodying that technology) in order to generate revenues from either licensing agreements or damages settlements with alleged infringers.

Since late 2005, technology media outlets have spotlighted litigation involving a diverse set of companies associated with patent trolling in the digital media and information technology industries:

- *Research in Motion Ltd. (RIM), the maker of BlackBerry email devices, agreed to pay \$612.5 million to settle an infringement claim from patent-holding company NTP Inc.*
- *Software maker Visto Corporation has sued seven companies offering wireless email services, including RIM and Microsoft, for allegedly*

violating its patents.

- *Burst.com won a \$60 million settlement from Microsoft Corporation and is suing Apple Inc. for alleged infringement of Burst's patents for super-fast digital media transmission.*
- *The U.S. Supreme Court reversed a lower court damage award and an appeals court grant of an injunction to MercExchange LLC, which had alleged that eBay Inc.'s "Buy It Now" feature infringed its patents.*
- *Acacia Research Corporation expanded an infringement lawsuit over video-on-demand services, originally filed against DirecTV, to include 45 cable, internet, and satellite companies.*

In these types of cases, patent litigation can represent either a plaintiff's primary

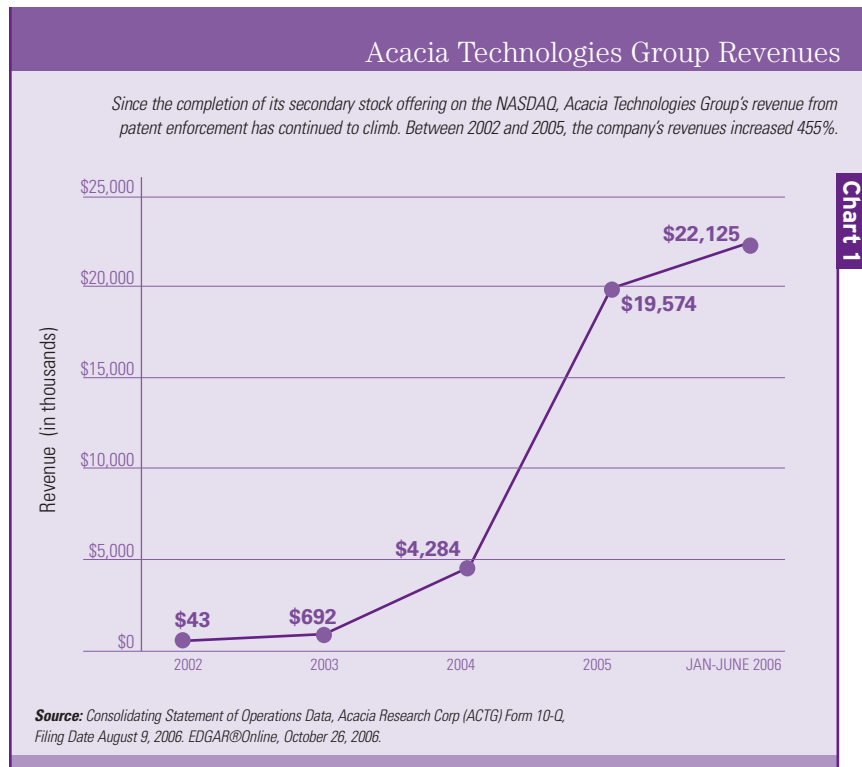
business strategy, a means to expand market opportunities for its technology, a simple case of patent protection, or a final attempt to monetize assets prior to bankruptcy. One patent troll frequently cited in the media, Acacia Research Corporation, holds a large array of patents in the digital audio and video content distribution segment. A brief study of Acacia's history provides some useful insights into the motivation, relative success, and likely future of patent troll strategies.

Acacia: The Growth of a Patent Troll

Acacia Research Corporation, incorporated in 1993 and based in Newport Beach, California, has two business units: CombiMatrix (a producer of biotechnology products) and Acacia Technologies Group (which maintains and licenses its electronic technologies patent portfolio). Acacia Technologies Group holds patents for a variety of electronic applications including credit card protection technology, a variety of computer systems and software, and digital media technology. The company claims to control more than 160 patents, including 50 patent portfolios it obtained in 2005.

As shown in **Chart 1**, Acacia's revenue has continued to grow since 2002, the year that it completed a secondary offering on the NASDAQ. Between 2002 and 2005, Acacia Technologies Group's revenues increased 455%. In addition, Acacia has secured at least 11 licenses since 2005 and has licensing deals involving internet advertising (Priceline.com), bar code reading (Nokia), credit card fraud protection (RadioShack), and network data storage (IBM). Although its portfolio includes patents representing multiple industries, one technology in particular—digital transmission of audio and video media—has emerged as a major component of Acacia's litigation and licensing strategy.

In 1995, Acacia purchased a number of patents related to networked digital media from inventors Paul Yurt and Lee Browne. These patents, as well as patents it has subsequently acquired in this area, have since been bundled into a collection termed the Digital Media Transmission (which it has trademarked



as "DMT") patents. One school of thought, promoted by Acacia, holds that the DMT patents are central to interrelated system operations. Amid growing public acceptance of that perception, DMT has become Acacia Research Corporation's primary weapon in attempting to secure dominance in the sector.

Acacia pursues a single-minded business strategy: targeting infringers of technology patents that it owns and seeking compensation through licensing agreements or litigation. Acacia has filed 39 infringement lawsuits since January 2004, two-thirds of them in the U.S. District Court for the Northern District of California.² This litigation spans the company's technology portfolios.

The Role of Digital Media Technology

Three primary methods exist for delivering media over the internet: downloading, in which consumers wait for the file to be transferred to their own computer before viewing/listening; progressive downloading, which enables users to access sequential portions of the file as it downloads; and streaming, which allows users to immediately access any segment of the file by maintaining the content on a centralized server. Over the last two

decades, various commercial and proprietary systems have been developed to take advantage of each of these transmission protocols, and technologies and services dedicated to specific products and types of media have been adopted: music purchases on the web (such as iTunes), video-on-demand for watching news and sports programming, distance learning (from college programs to online seminars or "webinars"), and security systems.

What makes digital media services over the internet such a target of patent troll infringement litigation? First, the complexities of audio and video technology preclude the dominance of a single standard protocol for the digital transmission and storage of such media. Second, existing technologies involve various network systems, software, and hardware, which provides numerous targets for patent litigation, including many companies with deep pockets. Third, the complexity of the systems and the broad claims set forth in many relevant patents issued in the 1990s make it difficult to quickly determine liability or patent validity. For example, some of the claims may refer to "transmission" in general terms without specifying whether the transmission should be relevant only

to the internet. (Some of the patents purchased and executed by Acacia are written very broadly.)

Amid these complexities, the courts are starting to recognize the challenges raised by recently issued business and method patents and the resulting patent disputes. For example, in the May 2006 Supreme Court eBay decision, the court was split between those judges stating that the traditional test to evaluate injunctive relief is sufficient and those who suggested that these patent conflicts require new considerations, such as whether the patent "(a) is a business method patent; (b) is just a small component of a much larger product that the defendant manufactures; and (c) is owned by an entity that 'use[s] patents not as basis for producing and selling goods but, instead, primarily for obtaining licensing fees.'"³

DMT and Acacia's Business Model

Although Acacia has approached companies in an array of industries—

three of the 22 patents owned by the company are "indefinite" and thus potentially invalid. Although some companies have had marginal success contesting Acacia's infringement claims, others have simply signed licenses or settled litigations funding Acacia's additional patent purchases.

By asserting the widespread application of patented DMT technology to all digital audio and video transmissions, Acacia, like others, has established a powerful business strategy, using the threat of infringement litigation to induce digital media content providers, hardware manufacturers, and end users (including educational institutions) to sign licensing agreements with the company. Income from those agreements provides Acacia with its primary source of revenue and capital and funds its patent acquisition strategy. Targets include virtually any media, broadcast, enterprise, or satellite company that transmits audio or video, including video-on-demand, as well as colleges and universities that use video

but had assets of \$108 million, including \$17 million in cash and equivalents.⁸ Until recently, however, most of Acacia's litigation has settled in Acacia's favor, and as noted earlier, no court has yet ruled on whether DMT is essential to streaming media.

Legal and Legislative Response

Patent infringement claims recently brought by companies such as Acacia or MercExchange are changing the way courts are evaluating the relief of the claim and leading them to employ new tests. Currently, Acacia is litigating its suit against DirecTV and a slew of other companies, ranging from adult entertainment websites to satellite and cable companies, for alleged infringement of its DMT patents. In the summer of 2004, U.S. District Court Judge James Ware reviewed Acacia's preliminary patent claims and issued a Markman Order, a pre-trial opinion by a judge based on the review of evidence presented on patent validity and infringement claims. Judge Ware ruled that two of Acacia's patent claim terms against adult entertainment internet providers (the "sequence encoder" and "identification encoder") were indefinite, which in trial would render certain patent claims in the suit invalid.⁹ The multiple suits filed by Acacia against adult entertainment, satellite, and cable companies have since been consolidated, and in December 2005, Judge Ware again upheld his previous ruling that two of Acacia's claims were essentially invalid. A final ruling is anticipated soon, after which the case will likely either go to trial in district court or perhaps be appealed to a higher court.¹⁰

Significantly, however, corporate and university targets and their legislative allies have begun to fight Acacia's strategy and the company's licensing has slowed, with most of its agreements signed in 2004 and 2005. Major companies including Intel and Sirius Satellite Radio filed suit against Acacia Technologies in 2005, seeking declaratory judgments ruling that various Acacia patents were invalid. Member colleges of the American Council on Education are threatening to sue Acacia over its ownership claims of patents for streaming media technology

The first rule of defense is prevention: companies should work with counsel during the development phase of their business

including MasterCard, Microsoft, Toshiba, and Staples—digital media transmission firms have been at the center of many of the company's claims. Acacia has asserted claims that the accepted streaming media technologies owned or utilized by large digital media companies today are founded on Acacia's DMT technology. Acacia acquired its DMT patents in 1995⁴ and began making claims of patent infringement in November 2002, yet these patents have never been legally judged essential to the transmission of digital media over networks,⁵ nor has their validity been determined. To date, only one case has been brought testing the validity of the DMT patents. In December 2005, judges in the U.S. District Court for the Northern District of California found, in response to Acacia litigation against alleged infringers, that

on the web for distance learning and online courses. On its website, Acacia boasts more than 500 licensees, covering an array of industries and involving a number of patented technologies in the company's portfolio. DMT licensees include The Walt Disney Company, Bloomberg, Xerox, Wachovia, and 108 cable TV companies.⁶

If it does not secure licensing agreements from its targets, Acacia litigates aggressively. Peter Detkin (now an executive with Intellectual Ventures, a company many regard as itself a patent troll) estimates that Acacia has filed half of all infringement litigations brought in the past five years by companies that own patents but don't produce products.⁷

It is not easy to gauge the success of Acacia's DMT licensing/litigation model. In the first half of 2006, the company lost \$12.4 million on \$16 million in revenue

used in online education programs. Meanwhile, legislatures are contemplating changes to the patent system. It remains to be seen if legislation planned by Senators Orrin Hatch (R-UT) and Patrick Leahy (D-VT) will institute a first-to-file patent system with limited damages for infringement.¹¹ In addition, the Coalition for Patent Fairness has recently stepped up its efforts to encourage legislators to set standards for multiple aspects of patent litigation, including damages. Although individual companies have had only marginal success at fighting Acacia, these regulatory and political changes would strike at the heart of many patent troll business structures. It is unclear how well Acacia's model would withstand such a concerted counterattack.

Recent declaratory judgment rulings on the validity of allegedly infringed patents could signal a change in the tide for patent trolls, but the ultimate outcome is still uncertain. The Supreme Court's ruling in favor of eBay against MercExchange directs judges to weigh a broad array of factors—including the public interest in keeping a particular invention in the marketplace—when considering the remedy for patent infringement. Nevertheless, the Court found that the trial judge who denied MercExchange an injunction (only to be reversed by an appeals court) went too far in holding that injunctions should be denied to plaintiffs that don't make products based on patents they hold, or that show a willingness to license their inventions. The high court ruled that such plaintiffs should have the same rights as other patent holders in pressing for injunctions. Thus, while the eBay ruling is likely to prove inconclusive in terms of stemming the tide of patent troll infringement suits, it does illustrate the conflicts among judicial and legislative bodies with respect to the treatment of patent trolls.

How Can Target Companies Respond?

Regardless of how legislative activities unfold and whether future injunctive relief or damages findings favor defendants or plaintiffs, a well-considered response will continue to be essential for companies that are potential targets for patent troll litigation, and similarly, any intellectual

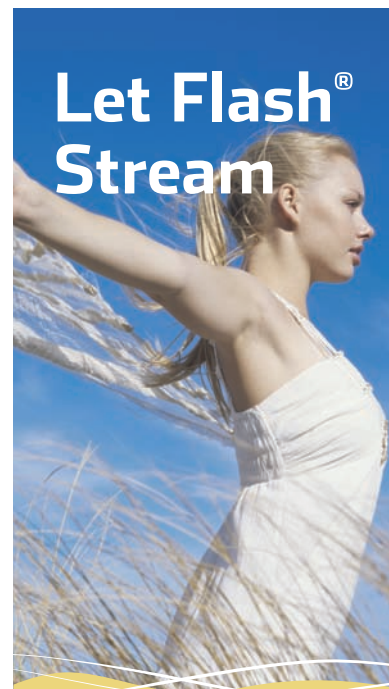
property litigation. Firms operating in industries as diverse as handheld communication devices, traditional retailing, and education are all potential targets.

Essentially, there are three feasible options for external and in-house counsel and executives of target companies to consider. Each should be fully evaluated, and ideally, the selected strategy put in place well in advance of any infringement lawsuits. In some cases, patent holders may determine that to settle immediately makes the most business sense, without consideration of validity of the patents, infringement, or value. Alternatively, companies may analyze the impact of multiple outcomes, perhaps enlisting assistance to assess likely validity, infringement liability, and damages, and then move toward an appropriate settlement. Other companies, after evaluating the same issues, may elect to litigate to an ultimate resolution.

Regardless of the direction chosen, designers, engineers, and other technical specialists can provide important input to counsel as they weigh these complex options. Expert economists may also be retained to assess the numerous economic and financial factors involved and to help determine accurate damages assessments and settlement strategies. This approach will be especially important in the likely event that more patent trolls attempt to pursue the Acacia model of blending licensing tactics with litigation.

BE PREPARED

What should corporate and outside counsel do to defend their clients against infringement allegations and possible payouts? The first rule of defense is prevention: companies should work with counsel during the development phase of their business to determine if patents relevant to their technology and products already exist in the market. If your company is approached regarding a potential licensing agreement, you can work with counsel to examine the opportunities, costs, and risks associated with that agreement. Should your company be faced with the threat of litigation, corporate and outside counsel may want to engage technical, industry, and economic



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experts to develop a comprehensive, fact-based perspective on the issues at stake.

This process should begin with a clear understanding of your products and services and your own patent portfolio, as well as an assessment of the presence and value of external related patents. Such an assessment can be complex and frequently requires the help of experts with specialized knowledge of the industry and the technology at issue who will, at a minimum, address five key issues:

- *Ensure that you establish the validity of your/your client's patents;*
- *Research patents and prior art (publicly available information) that may be relevant to your/your client's products and services;*
- *Help determine whether you or your client are infringing if you are approached by an IP owner regarding a potential license;*
- *Weigh the costs and risk of litigation versus the licensing fees in comparison to the value you assign to the patents at issue;*
- *Assess the fundamental importance of the patents at issue to your overall business and technology strategy.*

CONFRONT LITIGATION WISELY

If licensing discussions fail, leading to the threat of litigation, it is critical for the target company to thoroughly assess its strategic options and accurately quantify risk. Especially where emerging technologies are involved, this can be a complicated endeavor, requiring experts

with specialized knowledge of the industry sector, including products, pricing, and market dynamics; of the legal issues associated with intellectual property; and of the economic issues involved in settling and/or litigating. At a minimum, this response will entail three elements:

- *Assessing the fundamental importance of the patents at issue to your overall business and technology strategy (a "pay or fight" decision);*
- *Determining the validity of the patents and whether your/your client's products and services infringe those patents;*
- *Weighing the costs of litigation versus settlement (again, in comparison to the value you assign to the patents at issue).*


A rigorous economic analysis can help you make an informed decision at the start of the evaluation process, based on a thorough assessment of the business and economic implications of each available option. Conducted either in advance of any potential litigation or in connection with an active lawsuit, such an analysis would focus on economic as well as technical issues: competitive market conditions, the value of the patents at issue to sales and profits, the likelihood and amount of damages, alternative technologies to those alleged-

ly infringed, and technical differences between your technology and the technology you allegedly infringe.

Focusing on the Economic Issues

Given the increasing frequency and potentially huge costs of IP litigation, companies considering the threat of patent trolls would be well-advised not to get enmeshed in debates on fairness or morality issues regarding patent trolls, or any other patent litigation, at the expense of preserving their business. Instead, they should address infringement allegations by a patent troll as an economic issue and work with knowledgeable legal counsel to minimize exposure during product development and prepare thoroughly for litigation.

Companies such as Acacia or MercExchange will likely continue to be centrally involved in multiple patent infringement claims. These firms and their business models are driving change in the way courts evaluate claims, relief, and patent validity. The result is a challenging new landscape that target companies must address with a rigorous, proactive attitude toward presenting or defending the claims.

To learn about the latest developments on the Acacia DMT patents, visit StreamingMedia.com's Acacia Research Patent Education Page at: <http://www.streamingmedia.com/patent/>. 



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Footnotes

1. "Has the Enemy of Patent Trolls Become One?" *CIO Insight* (December 5, 2005), Sept. 7, 2006, <http://www.cioinsight.com/article2/0,1540,1902291,00.asp>.

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4. Acacia's DMT patents expire in 2011.

5. Hachman, Mark, "Porn Kings Aflame Over Multimedia Patents; Beginning today, a small Southern California firm will take on the online

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10. *Streamingmedia.com*, "Acacia Update: No News is Good News?" (September 5, 2006), <http://www.streamingmedia.com/article.asp?id=9403>.

11. This legislation was introduced in Congress during 2005 by Representative Lamar Smith (R-TX) but later withdrawn.