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Hedge Fund Gets PTAB To Eye VirnetX Patents In Apple Case

By **Ryan Davis**

Law360, New York (October 7, 2015, 10:00 PM EDT) -- A hedge fund persuaded the Patent Trial and Appeal Board on Wednesday to review two VirnetX network security patents that Apple has been found to infringe, as the board rejected VirnetX's argument that the fund's petitions should be denied as an improper attempt to manipulate its stock price.

The PTAB found that The Mangrove Partners Master Fund Ltd., run by 37-year-old Nathaniel August, had shown that there is a "reasonable likelihood" that VirnetX Inc.'s patents are invalid as obvious or anticipated. The board instituted America Invents Act inter partes reviews, despite previously rejecting multiple petitions by Apple Inc. and Microsoft Corp. challenging the same patents.

Just as it did last month when it decided **not to sanction** a different hedge fund run by Kyle Bass for challenging drug patents under the America Invents Act's inter partes review program, the PTAB said that it did not matter that Mangrove challenged VirnetX's patents as part of a short-selling strategy, since the AIA allows anyone to file petitions.

"Profit is at the heart of nearly every patent and nearly every inter partes review," it said. "As such, an economic motive for challenging a patent claim does not itself raise abuse of process issues. We take no position on the merits of petitioner's investment strategy."

The board's decision to review VirnetX's patents at Mangrove's request opens a new chapter in story of both the controversial practice of hedge funds targeting patents in AIA reviews and the long-running VirnetX infringement litigation.

Mangrove Partners, which has assets under management of \$450 million, **filed its petitions** in April, challenging VirnetX's patents on a method for securely communicating over the Internet. VirnetX is a patent licensing company that acquired the patents from government contractor Science Applications International Corp.

Mangrove apparently followed a model pioneered by Bass, who set up a subsidiary of his Hayman Credes Master Fund LP to challenge numerous drug patents. Bass reportedly took a short position in the stock of the companies whose patents he targeted and stood to gain if the price dropped. To date, the PTAB has denied the three Bass petitions it has ruled on.

VirnetX's patents are significant because a Texas jury found that Apple products infringed them, a decision the Federal Circuit largely **affirmed last year**, although it vacated the jury's \$368 million damages award. A retrial on damages, combined with a trial over different VirnetX patents, is slated for January in the Eastern District of Texas, so Apple could potentially benefit if the patents are ultimately invalidated by the PTAB.

In its opposition to Mangrove's petitions, VirnetX argued that they were "part of a rapidly expanding group of controversial filings by hedge funds using the inter partes review process to move stock prices and reap profits."

VirnetX said that before filing the petitions, Mangrove held a short position of 270,000 shares of VirnetX stock. A month after the petitions were filed, when any movement in the stock price caused

by the challenge would have subsided, Mangrove no longer held a short position, VirnetX said.

"This demonstrates that the petition was part of a coordinated investment strategy ... to manipulate [VirnetX's] stock price," it said, calling such activity an "improper purpose that the board should not condone."

However, the board reiterated the statement it made when it rejected a drug company's motion for sanctions against Bass, and held that an AIA petitioner's motives are immaterial. It also rejected VirnetX's arguments that Mangrove's petitions failed show likelihood of success or should be rejected because numerous other petitions challenging the same patents have failed.

The patents challenged by Mangrove have been the subject of scores of AIA petitions, but none of the others were instituted. Apple filed several petitions, which the board denied as time-barred, as did Microsoft, which had also been accused of infringement, but later settled with VirnetX. Apple has gotten the board to review some other VirnetX patents, however.

A company called New Bay Capital also challenged the same VirnetX patents in 2013, but the **reviews were terminated** after VirnetX accused it of a running a "shakedown" where New Bay said it would not challenge the patents in exchange for millions of dollars.

At the urging of drug companies, which have been outraged by Bass' strategy of targeting drug patents, Congress is **considering legislation** that would effectively ban hedge funds from filing AIA petitions.

Attorneys for the parties could not immediately be reached for comment Wednesday.

The patents-in-suit are U.S. Patent Numbers 6,502,135 and 7,490,151.

Mangrove is represented by Abraham Kasdan of Wiggin and Dana LLP and James T. Bailey.

VirnetX is represented by Joseph E. Palys and Naveen Modi of Paul Hastings LLP.

The cases are The Mangrove Partners Master Fund Ltd. v. VirnetX Inc., case numbers IPR2015-01046 and IPR2015-01047, before the Patent Trial and Appeal Board.

--Editing by Jeremy Barker.

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