

# HACKING THE PATENT SYSTEM

## A GUIDE TO ALTERNATIVE PATENT LICENSING FOR INNOVATORS

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BY MARTA BELCHER AND JOHN CASEY  
JUELSGAARD INTELLECTUAL PROPERTY & INNOVATION CLINIC  
STANFORD LAW SCHOOL



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# Introduction to Alternative Patent Licensing

The patent system is intended to incentivize innovation, but the current system often does the opposite. The traditional model of patent licensing—whereby a company pays a patent owner to license an invention that the company legitimately uses—has been hijacked by non-practicing entities (“patent trolls”) and other aggressive patent holders who assert overbroad patents that never should have been granted in the first place. Within this broken patent regime, companies are increasingly hacking the system—that is, finding alternatives to the traditional patent licensing model in order to both promote open innovation and protect the companies themselves. These strategies can be organized into three broad categories: (1) defensive patent aggregators, which pool member companies’ resources to defensively purchase patents for the group and to fight patent trolls; (2) patent pledges, whereby companies opt to openly and defensively license their patents to others; and (3) patent troll insurance. This paper provides a guide to these alternative patent licensing options for small companies and startups that care about protecting themselves and not making a broken patent system any worse.

## The Patent System Is Broken

The core purpose of the patent system is to incentivize innovation. Patents give inventors monopolies over their inventions for a period of time in order to allow inventors to recoup the costs of R&D and to generate profits that reward inventors’ efforts—thereby encouraging future investments. In exchange, patentees dedicate their inventions to the public domain once their patents expire.

Yet, in many high-technology industries today, the patent system is a [scourge on innovation](#). Patent trolls buy overbroad patents, often from bankrupt companies, for the sole purpose of extorting licensing revenues from companies that are actually innovating and creating new products. Overworked patent examiners increasingly grant overbroad, obvious, and non-novel patents—particularly on [software](#). Some companies aggressively assert their patent portfolios to keep legitimate competitors out of the market entirely. Small companies are particularly vulnerable, since the [cost](#) of fighting a lawsuit (even a flagrantly frivolous one) could easily put a startup out of business. Faced with the constant threat of crippling litigation, small companies often perceive their best—or only—option to be laying low and hoping to stay off patent holders’ radar.

## Innovators Are Hacking the System to Use Patents for Good

Fed up with the patent mess left by Congress, the U.S. Patent and Trademark Office, and the courts, companies are collaborating to formulate private solutions. These patent licensing alternatives broadly fit into three categories: defensive patent aggregators, patent pledges, and patent troll insurance.

Defensive patent aggregators use membership fees to purchase patents and give perpetual licenses to members so that future owners of the patents (should the organization subsequently sell the patents) cannot sue members for infringement. Defensive patent aggregators are different

from trolls because they buy patents solely for defensive purposes and promise never to assert the patents they own. These organizations often also use membership fees to challenge patents that may be asserted against their members. Defensive patent aggregators include Allied Security Trust, which uses a bidding system to distribute the cost of purchasing each patent among the members who are most interested in each patent; RPX, which buys patents and patent rights on behalf of all of its members; and Unified Patents, which purchases and challenges patents in specific technology areas.

Patent pledges are public commitments that companies make to license their patents in a manner that supports open innovation. By committing to the Defensive Patent License, for example, companies opt into a network in which each company has promised not to sue any other company in the network for patent infringement, except defensively. The Open Invention Network owns hundreds of patents that it licenses for free to any company that promises never to assert its own patents against Linux technology. Through the License on Transfer Agreement, participants agree to license their patents to all other participating companies, but each license only becomes effective if the patent is transferred to a third party. Companies can also make pledges unilaterally. For example, in its Innovator's Patent Agreement, Twitter makes a commitment to its employee inventors that it will not make offensive use of any patent without the inventor's permission. Other examples of unilateral pledges include The Patent Pledge, through which companies promise not to sue small startups for software patent infringement; Google's promise through the Open Patent Non-Assertion Pledge not to assert certain patents against those who implement open source software; and Tesla's opening of its patent portfolio to the public royalty-free.

Two defensive patent aggregators—RPX and Unified Patents—as well as a professional organization for advertisers are now offering insurance to protect companies against the threat of patent troll litigation. Policyholders pay an annual premium, and if a patent troll sues, the insurance reimburses for certain defensive expenses, which may include litigation expenses, pre-litigation expenses, or settlement costs, depending on the policy. Insurance can provide much-needed predictability for companies that are worried about the sudden cash drain associated with a patent troll lawsuit—particularly small companies that could be crippled by such expenses. In many cases, insurance also provides the resources necessary to fight trolls on the merits rather than quickly settling a lawsuit just to avoid legal fees. Trolls often depend on the high cost of litigation to force their targets to settle, even when the trolls' legal claims are dubious. For this reason, insurance that provides funds to defend a claim can help deter against troll lawsuits in the first place.

Each option described in this paper has tradeoffs both for individual companies and innovation as a whole. Patent pledges, for example, make a powerful public statement about a company's values, and can attract talent and publicity. On the other hand, pledging to openly license a patent might lower the patent's market value and, consequently, the company's value for potential buyers and investors. Defensive patent aggregators require annual membership fees that may be prohibitively expensive for some companies, but the licenses and patent intelligence services that come with membership may be well worth the cost for others. This paper explores these options and analyzes some of the drawbacks and benefits of each for small companies and startups, with

the understanding that every company must consider its own unique situation in deciding whether to participate in any (or all) of these alternatives to traditional patent licensing.

## Opting Out of the Patent System May Not Solve the Problem

Many of the patent licensing alternatives described in this paper—particularly patent pledges—assume that participants have obtained patents of their own. However, many innovators who have understandably lost faith in the patent system have opted out by declining to seek patents on their own inventions.

There are many reasons that companies may opt out of the patent system. Obtaining a single patent can cost [\\$20,000](#) in legal fees, if not more, and the process can take many years. Some conscientious employees may be reticent to patent their inventions and assign them to their employers out of fear that the patents will later be abused. Once a patent is obtained, asserting it offensively may reflect poorly on the company, alienating current and potential employees as well as the public. If the company were to fail, the patents would likely be sold, and might ultimately fall into the hands of a bad actor.

However, for companies that are concerned with both self-preservation and furthering innovation, there may be some inherent benefits of obtaining patents in the first place:

- First, patents can be used defensively in infringement lawsuits brought by competitors. Defendants in patent infringement lawsuits can countersue the plaintiff for infringing one of the defendant's own patents. This, of course, assumes that the plaintiff has products of its own that could infringe, which is not the case with many trolls or other non-practicing entities like universities—but it makes patents valuable for defending against litigious competitors as well as deterring lawsuits from competitors in the first place.
- Second, patenting an invention clarifies the prior art and can help prevent future patents on overbroad or obvious technologies. All patented inventions must be novel and non-obvious. When determining whether to grant a patent, patent examiners in the U.S. Patent and Trademark Office look for “prior art” that evidences that the technology had been invented before or is obvious in light of previous inventions. Patent examiners have limited time to conduct their research, however, and often miss important prior inventions. One of the most important sources for identifying prior art is other patents. Patenting an invention thus helps clarify who invented what, and can help to prevent bad, obvious, or overbroad patents from being granted in the future.
- Third, patenting an invention may help prevent others from claiming it as their own. Keeping an invention a trade secret rather than patenting it runs the risk that another company could independently invent and try to patent the same thing. (Patent law includes a prior use defense, but only if the original inventor was using the invention more than one year before the subsequent inventor filed its patent, and even then there are limitations to how the original inventor can use the technology.) Original inventors can also simply publicly disclose the invention without filing a patent application, which may serve as prior art to prevent others from patenting the disclosed invention.

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