Non-practicing entities: Enforcement specialists?
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We examine whether non-practicing entities (NPEs) have a superior ability to pursue patent lawsuits. We develop a theoretical model that predicts that cases with superior ached patentees resolve faster than cases with opponents of equal ability. Our empirical analysis of a sample of US patent litigation cases shows this duration pattern for NPE cases. The result is robust to controlling for patent and court characteristics but also for an important feature of NPE cases, a lack of product market interaction with the potential infringers. Finally, we observe, in line with our theory, a similar duration pattern for large firm patentees; firms with access to a similar legal expertise.

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1. Introduction

Firms specializing on generating licensing revenues from patents without using them for own production, so called non-practicing entities (NPE), received recently particular attention. These entities are discussed controversially by legal scholars, economists, and politicians (e.g., Bessen et al., 2012; Reitzig et al., 2007) because the number of patent litigation cases involving NPEs increased tremendously in recent years (Economist, 2013; Chien, 2013). The debate about NPEs has even reached the highest legislative levels of the United States; 19 bills were put before Congress proposing to regulate NPE activities since 2013.1 The prevalent negative perception of NPEs is expressed by the term patent troll, which compares them to the mythical trolls who hide under bridges built by others, unexpectedly popping up to demand payment of tolls (Bessen et al., 2012, p. 26). This notion describes the presumption that NPEs create hold-up situations by suing their targets at the most vulnerable times, e.g., after they made a large sunk investment. Related to this, NPEs are criticized for a lack of transparency, dubious demand letters and forum shopping. Furthermore, NPEs are seen as a threat because they are usually not prone to counter lawsuits because they are only active on the licensing market.

We focus on an alternative explanation why NPEs are a danger for suspected infringers2; specialization benefits in enforcement. Firms like NPEs that are specialized on generating revenues from licensing have to be able to protect their intellectual property and for a sustainable business model they require a high level of legal expertise. In addition to in-house expertise, it is claimed that NPEs are skilled in hiring and supervising law firms, and that their regular interaction with lawyers leads to benefits of repeated interaction (Cotropia et al., 2014). Furthermore, McDonough (2006) argues that NPEs have ample of funds for litigation. The argument that resources and ability matter is in line with the observation that large firms are more likely to prevail at court (e.g., Galanter, 1974; Black and Boyd, 2010; Eisenberg and Farber, 1997) and that patents owned by individuals and firms with small patent portfolios are more likely to be part of a lawsuit (Lanjouw and Schankerman, 2001, 2004). Even more specifically, Galasso et al. (2013) show that the transfer of patents owned by individual inventors to firms with large patent portfolios reduces litigation risk.

On the positive side, advantages in enforcement are a source for gains from trade, especially vis-à-vis small financially constrained

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2 For the sake of brevity, we use the term infringer throughout the article. Though, we do not mean to prejudge and actually mean suspected infringer.

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inventors. Even though not all NPEs acquire patents and some rather file patents themselves, the defendants highlight the inter-
mediary role of NPEs. Because small innovators lack the resources
to pursue litigation, Ronspies (2004) and McDonough (2006) argue
that small entities are disadvantaged in protecting their intellectual
property rights, and are not able to litigate large, financially potent
infringers.

However, even though Haber and Werfel (2016) identify in an
experimental setup financial constraints as a main driver for individual
inventors to sell their patents, there exists so far no evi-
dence on the presumed superior enforcement ability of NPEs. We
focus our analysis on providing evidence on this claim by analyzing
NPEs through the lens of litigation. If specialization effects of NPEs
exist, they should influence the behavior at court, leading to dif-
f erent observable outcome patterns. In patent infringement cases
the patentee sues an infringer for compensation of damages and
potentially for injunctive relief. Because the vast majority of cases
end in a settlement (roughly 90 percent between 2004 and 2007) we
follow Galasso and Schankerman (2010) and focus the analy-
ysis on the settlement timing. We extend the theoretical model and
empirical analysis of Galasso and Schankerman (2010) and analyze
the role of litigation ability. If the patentee is more productive in
convincing the judge or jury, the model predicts a shorter duration
because the infringer anticipates this advantage and is willing to
pay more in order to settle the claims. However, if the patentee is
disadvantaged, the infringer is willing to pay less. According to this
reasoning we expect cases with a, relative to the infringer, stronger
patentee to settle earlier, and cases with a weaker patentee to settle
later compared to cases with symmetric litigants. Consequently, if
NPEs have a superior ability, NPE cases should settle earlier as long
as the NPEs do not litigate similarly strong infringers.

We test this prediction using an unique sample of patent litiga-
tion cases filed between 2004 and 2007 in the United States.
This detailed data set allows the identification of different types
of patentees and infringers, and the matching of patent and court
characteristics. We first compare cases brought to court by NPEs
with cases brought to court by non-NPE patentees. We show that
NPE cases differ from other patent cases. NPEs sue more often large
firms, and they rely on more valuable patents, measured by a vari-
ey of citation-based indexes, from technology classes with less
fragmented patent rights.

In line with our prediction we find that NPE cases are indeed
resolved significantly faster. However, this effect vanishes com-
pletely if NPEs sue large firms3; firms that are presumably similarly
capable of pursuing lawsuits. In our analysis we control for patent
as well as for court characteristics. Furthermore, in NPE cases the
patentee does not compete with the accused infringer; NPEs are
rather in a (potential) technology providing position. We rely on the
case documents to characterize the business relationship between
the litigants for all of our cases, i.e., we differentiate between cases
in which the accused infringement took place through a compet-
ing product and cases in which the accused infringer relied on the
patent as an input. We find not only that the duration pattern can-
not be explained by a lack of product market competition between
the litigants but also that the business relationship between the
litigants does not affect the case duration. Finally, in line with our
theory, we also show that cases with large firm patentees show a
very similar pattern.

In a final step we match the patent applicants to the patents
in our sample in order to investigate whether NPEs acquire their
patents from small, potentially financially constrained, innovators.
By relying on the patent portfolio size of the patent applicants

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3 We define firms as large if they are covered by the Forbes list, see p. 13 for the
definition.
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