Published on *The National Law Review* https://natlawreview.com

Hitting Non-Practicing Entities Where It Hurts

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The Federal Circuit Affirms an Award of Substantial Sanctions Against a NPE with a Business Model of Bringing Litigation To Extract Quick Settlements

Eon-Net LP v. Flagstar Bancorp, No. 2009 - 1308 (Fed. Cir., July 29, 2011) (Judges Lourie, Mayer and O'Malley)

In a July 29 decision, the Federal Circuit affirmed a district court award of substantial sanctions against a Non-Practicing Entity (NPE) that had a business model of suing numerous companies for nuisance value settlements. As the Court succinctly stated:

> The record supports the district court's finding that Eon-Net acted in bad faith by exploiting the high cost to defend complex litigation to extract a nuisance value settlement from Flagstar. At the time that the district court made its exceptional case finding, Eon-Net and its related entities, Millennium and Glory, had filed over 100 lawsuits against a number of diverse defendants alleging infringement of one or more patents from the Patent Portfolio. Each complaint was followed by a "demand for a quick settlement at a price far lower than the cost of litigation, a demand to which most defendants apparently have agreed." Slip Op at 22.

We think that this is a potentially important holding because the Federal Circuit approved an exceptional case for enhanced sanctions based on the business model adopted by some NPE's—suit followed by quick settlement at lower-than-litigation cost. As we discuss below, the *Eon-Net LP* case represents the latest in a string of judicial opinions providing defendants with additional ammunition against NPE's pursuing "objectively baseless" litigation. However, the threat of sanctions may also lead NPE's to be more difficult in their settlement demands and willingness to offer quick and early settlements.

Background

The case at issue involved three document processing systems patents, U.S. Patent Nos. 6,683,697 ("the '697 Patent"), 7,075,673 ("the '673 Patent"), and 7,184,162 ("the '162 Patent") (collectively

"the Patents") owned by Eon-Net LP, a patent holding company formed to enforce various patents. The Patents are part of a larger patent family ("the Patent Portfolio") originating with a parent patent application filed in 1991. Between 1996 and 2001, Millennium L.P., an Eon-Net related company, filed four lawsuits asserting various claims of the Patent Portfolio. After 2001, Eon-Net hired new outside litigation counsel, and the number of patent cases filed on behalf of Eon-Net and its related entities skyrocketed. By the time the district court in the present matter had issued sanctions against Eon-Net, more than 100 lawsuits had been filed, almost all of which resulted in early settlements or dismissals.

Eon-Net sued Flagstar Bancorp in 2005, alleging infringement of the ‘697 patent. The district court entered summary judgment of noninfringement in favor of Flagstar, finding that Eon-Net failed to adequately investigate its claims prior to filing suit, and finding that the claims were baseless. The district court also assessed Rule 11 sanctions in the amount of $141,984.70 against Eon-Net and its attorney.

After the Federal Circuit vacated and remanded both the summary judgment and Rule 11 decisions in 2007, *Eon-Net LP v. Flagstar Bancorp*, 249 F. App’x 189 (Fed. Cir. 2007), Eon-Net pursued the case (even adding new claims for infringement). But after receiving an unfavorable Markman decision on claim construction, Eon-Net stipulated to noninfringement. The district court subsequently granted Flagstar’s motion for attorney fees under 35 U.S.C. §285, finding that Eon-Net pursued baseless claims; the lawsuit was brought for the improper purpose of seeking a nuisance value settlement; Eon-Net destroyed evidence; and, Eon-Net’s litigation tactics were improper. Upon invitation from the district court, Flagstar renewed its prior Rule 11 motion. The district court reinstated in full the $141,984.70 in attorneys fees and costs against Eon-Net and its attorney for violation of Rule 11. The district court also found the case to be exceptional under 35 U.S.C. §285, and awarded Flagstar $489,150.48 in attorneys fees and costs after Eon-Net continued to litigate the case after remand.

The Federal Circuit Decision

The Federal Circuit upheld the district court’s claim construction, and affirmed the judgment of noninfringement to which Eon-Net had stipulated.

In reviewing the district court’s finding of an exceptional case under 35 U.S.C. §285, the Federal Circuit stated:

> Indeed, "[l]itigation misconduct and unprofessional behavior may suffice, by themselves, to make a case exceptional under § 285." Absent litigation misconduct or misconduct in securing the patent, sanctions under § 285 may be imposed against the patentee only if both (1) the patentee brought the litigation in bad faith; and (2) the litigation is objectively baseless (citations omitted). Slip Op at 17.

Eon-Net failed to show that the district court’s findings regarding the accused litigation misconduct were clearly erroneous. Eon-Net also failed to overcome the finding that its infringement allegations could only be supported by baseless claim construction positions.

Certainly Eon-Net’s behavior during the course of the litigation was egregious, as the court described in detail.[1] But that alone would not have warranted our *Client Alert*, for the behavior giving rise to

sanctions in any given case is based on the particular facts of the case. What caught our eye was the Federal Circuit's condemnation of the business model of filing litigation to obtain a quick return through settlement:

> Eon-Net's case against Flagstar had "indicia of extortion" because it was part of Eon-Net's history of filing nearly identical patent infringement complaints against a plethora of diverse defendants, where Eon-Net followed each filing with a demand for a quick settlement at a price far lower than the cost to defend the litigation. Slip Op at 22.
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> Meritless cases like this one unnecessarily require the district court to engage in excessive claim construction analysis before it is able to see the lack of merit of the patentee's infringement allegations…. Thus, those low settlement offers—less than ten percent of the cost that Flagstar expended to defend suit—effectively ensured that Eon-Net's baseless infringement allegations remained unexposed, allowing Eon-Net to continue to collect additional nuisance value settlements. Slip Op at 23.

The Federal Circuit affirmed the finding that the case was exceptional under 35 U.S.C. §285, and was disturbed by the ability of an NPE, such as Eon-Net, to impose high costs on a company to defend against meritless claims, while at the same time the NPE faces little downside risk other than the loss of future licensing revenue.[2]

Potential Implications of Eon-Net LP

We stress that the Federal Circuit did not uphold sanctions merely because a NPE sought to enforce its patent rights. Rather, the Federal Circuit was clearly bothered by the ability of an NPE to exploit the "system" to extort nuisance value settlements while facing little downside risk.

Indeed, some NPE's count on defendants to settle based on the inescapable fact that defense of even a suit on a bad patent is expensive. That cost is built into the architecture of patent litigation. As our colleague David Griffith chronicled in "Patents by the Numbers" in Andrews Kurth's *IP and Technology Developments* the median cost of defense in 2009 (as reported by AILPA) was $650,000 if less than one million was at risk, $2.5 million if $1 million to 25 million at risk - $2,500,000. In addition, the median time for an infringement case to get to trial was 2.5 years (2009 data from a report by PwC). While the rate of success was 38% in the 15 most active patent dockets (1995-2009) as reported by PwC (31% for NPE's) if the patentee survives summary judgment motions and gets to a jury, its odds improve to a 75% win rate (according to the University of Houston Law Center's patstats). Given these statistics, the temptation for any operating company faced with a lawsuit is to settle and move on with its business if the NPE's offer of settlement is far less than the cost of defense. NPE's count on that temptation.

The Federal Circuit stopped short of stating that business models like that of Eon-Net provide the sole basis for finding an exceptional case under 35 U.S.C. §285. However, the language of the decision does suggest that the business model may *per se* satisfy the "bad faith" element of the two part requirement for finding an exceptional case. This decision seems to be an attempt by the Court to try to level the playing field for patent litigation by increasing the downside risk for a NPE. Moreover, this case follows a string of other cases, including *eBay* (which held that irreparable harm would not be presumed in a preliminary injunction action even if infringement had been found) and

MedImmune (which allows declaratory judgment actions to be brought under less stringent standards than the Federal Circuit had historically applied).

Just as importantly, we are seeing many other trends and techniques that defendants are starting to use to combat vexatious NPE litigation. Some defendants are finding success in obtaining venue transfers from courts thought to be more favorable to NPE litigation; others are using declaratory judgment actions; yet others are pursuing early summary judgments (by some accounts approximately 60% of patent cases are decided on summary judgment and patentee success at the summary judgment stage is only 12%).

Our firm also has had success strategically employing the re-examination to narrow or even eliminate patent claims from weak (or worse patents). Our success is consistent with some compelling statistics. Again our colleague David Griffith reported that the chances that PTO will grant an ex parte/inter partes reexamination application are greater than 90% (based on USPTO statistics as of March 2011). According to an AILPA 2009 report, the median cost of an ex parte reexamination was $10,000; for an inter-partes proceeding the median was $188,000. Moreover, according to USPTO statistics as of March 2011, in most cases claims were cancelled or modified:

ex parte reexamination (third party requested re-exam)	inter partes reexamination
All claims confirmed: 24%	All claims confirmed: 12%
All claims cancelled: 13%	All claims cancelled: 45%
Claims modified: 63%	Claims modified: 43%

The bottom line: defendants in NPE litigation should consider in the calculus of settlement not only litigation cost but also the trends and techniques favoring defendants over NPE's, especially now that *Eon-Net LP* may encourage courts to shift the expenses of defense that NPE's count on encouraging quick settlement—at least in the most abusive cases.

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1. The court provided an extensive litany of Eon-Net's sanctionable behavior throughout the course of the litigation, including: destroying relevant documents prior to the initiation of the lawsuit; flaunting the fact that as a patent enforcement company they did not believe they needed to have a document retention policy; refusing to participate in the claim construction process; lodging incomplete and misleading evidence with the court; submitting declarations contradicting deposition testimony; and, evidencing a general disdain and disrespect for the court process including statements made at a deposition by a party witnesses complaining that his deposition was "an inconvenience and a bother" and that he was "so sick of this stuff by now. I am so sick of this stuff, especially this haggling over stupidities and trivialities which is the name of the game in litigation." Slip Op at 20.

2. The Federal Circuit also affirmed the Rule 11 sanctions, even though it was undisputed that Eon-Net's counsel did examine portions of Flagstar's website and reach a conclusion that it worked in a manner that infringed the '697 patent. "A reasonable pre-suit investigation, however, also requires counsel to perform an objective evaluation of the claim terms when reading those terms on the accused device." Slip Op at 26. It was not clearly erroneous for the district court to conclude that Eon-Net's claim construction position "borders on the illogical" and that "[t]he specification exposes the frivolity of Eon-Net's claim construction position." *Id.*

National Law Review, Volume I, Number 228