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BUSINESS DAY

Has Patent, Will Sue: An Alert to Corporate America

By **DAVID SEGAL** JULY 13, 2013

If you're a corporate executive, this may be one of the last sentences you want to hear: "Erich Spangenberg is on the line." Invariably, Mr. Spangenberg, the 53-year-old owner of IPNav, is calling to discuss a patent held by one of his clients, which he says your company is infringing — and what are you going to do about it?

Mr. Spangenberg is likely to open the conversation on a diplomatic note, but if you put up enough resistance, or try to shrug him off, he can also, as he put it, "go thug."

He demonstrated what that sounds like in a brief bit of role-play recently, sitting in the apartment he is renting for the summer in Paris near the Arc de Triomphe. His voice dropped, the curse words flowed, and he spoke with carefully modulated menace.

"Once you go thug, though, you can't unthug," he explained, returning to his warm and normal tone. "Actually, you can unthug, but if you do that, you can't rethug. Then you just seem crazy."

Mr. Spangenberg's company, based in Dallas, helps "turn idle patents into cash cows," as it says on its Web site. A typical client is an inventor or

corporation, with a batch of patents, demanding a license fee from what it contends is an infringer, usually a titan in the tech realm. His weapon of choice in this business — the brass knuckles of his trade, so to speak — is the lawsuit.

In the last five years, IPNav has sued 1,638 companies, according to a recent report by RPX, a patent risk management provider, more than any other entity in the patent field. “To get companies to pay attention, in some percent of the market, you need to whack them over the head,” Mr. Spangenberg said. “In our system, you can’t duel, you can’t offer to fight in the street, which would be fine with me.”

This combat readiness has made Mr. Spangenberg, a high-school dropout raised in Buffalo, very rich. He earns about \$25 million a year, he says, which is at least a couple of million more than the country’s top bank executives. Until recently, he lived in a 14,000-square-foot home in Dallas; it is now on the market for \$19.5 million. He often flies on a company jet, and at one point he owned 16 cars, six of them Lamborghinis.

His clients, who pay IPNav a percentage of any recovery, contend that he earns every dollar and praise him as a hero.

“Erich saved our bacon,” said Steve Dodd, a patent holder with a client company called Parallel Iron. “We were more than \$1 million in debt and I was getting ready to file for bankruptcy.”

Mr. Spangenberg’s opponents use less flattering terms to describe his work. Like shakedown artist. Or patent troll.

There is debate about the definition of patent trolls, but the term broadly refers to people who sue companies for infringement, often using patents of dubious value or questionable relevance, and then hold on like a terrier until they get license fees. In recent years, patent trolls — they prefer “patent assertion entities,” or P.A.E.’s — have gone from low-profile corporate migraine to mainstream scourge.

This is partly because the number of patent infringement suits has more than doubled in recent years, to 4,731 cases in 2012 from 2,304 in 2009, according to that RPX report. The cost to businesses, which pass along the expense to consumers, is immense. One study found that United States companies — most of them small or medium-sized — spent \$29 billion in 2011 on patent assertion cases.

“And only about \$6 billion of that money wound up in the hands of inventors,” said James Bessen, a co-author of the study and a professor at the Boston University School of Law. “As for the other \$23 billion, most of it goes to legal expenses, both for defendants and patent troll companies, with the rest going to operating expenses of the trolls — overhead and marketing — and finally, patent troll company profits. That’s why we call this type of litigation a tax on innovation. It discourages innovation much more than it encourages it.”

The notoriety of trolls also arises from legal claims that, at minimum, sound absurd. Like the P.A.E. that last year mailed letters to companies contending it had a patent on e-mailing scanned documents and asking for a license fee of \$1,000 per employee. Or the company that has sued for license fees from podcasters through a patent originally filed in 1996, long before podcasts were conceived.

The inevitable counterattack on patent asserters has begun. In June, President Obama announced a handful of executive orders “to protect innovators from frivolous litigation.” Companies, large and small, are starting to vent and fight back, and figures as varied as Judge Richard A. Posner, of the United States Court of Appeals for the Seventh Circuit, and Marc Maron, the stand-up comedian and podcast host, have denounced trolling. Mark Cuban recently gave the Electronic Frontier Foundation \$250,000 to help finance “The Mark Cuban Chair to Eliminate Stupid Patents.”

Mr. Spangenberg has been called “a costly nuisance,” “one of the most notorious patent trolls in America” and many unprintable names in the

comments sections of Web sites like Techdirt. He has achieved a certain infamy.

In his telling, he is protecting put-upon inventors. But he may simply be profiteering from a flawed and creaky legal system.

Mr. Spangenberg speaks in rapid-fire clumps of words, usually while looking down and grimacing slightly, as though trying to lift a barbell. When we met, he was wearing what he calls “my uniform”: a pair of jeans and one of his 40 identical black, short-sleeve, mock-turtleneck Nike T-shirts.

He doesn’t mind his public reputation as an ogre, and by all means, he says, call him a troll — though he thinks the name is a bogus effort to taint his profession.

When it comes to work, he is focused to the point of being obsessive. As an associate at a corporate law firm — after taking the ACT test, he attended the University of Delaware and eventually earned a law degree from Case Western University — he once worked four days straight without sleep, and was taken to the hospital in an ambulance.

“I had a mild seizure,” he said. “There’s only so much coffee and caffeine tablets you can take.”

He stands about 5-foot-6 and was bullied as a child because of his height. He always fought back, he says, and he usually lost; his nose has been broken by an assortment of fists. This has given him a lifelong hatred of bullies, which explains, he says, why he wound up in a job where he often stands with a small company assailing a larger one.

But IPNav doesn’t exactly fight using the Marquess of Queensberry rules. In a 2008 ruling, Judge Barbara B. Crabb of Federal District Court in Wisconsin, concluded that Mr. Spangenberg was involved in witness tampering — specifically, inducing a lawyer to “intimidate a witness on the eve

of trial.” The eviscerating 62-page ruling was in a case brought by DaimlerChrysler against a company owned by Mr. Spangenberg called Taurus IP. The carmaker accused Mr. Spangenberg of breaking a 2006 we-won’t-sue-you-again agreement over certain tech patents.

It was a complex case, but here’s a quick summary: one company controlled by Mr. Spangenberg (Orion IP) was accused of having signed a settlement with DaimlerChrysler. Later, a different Spangenberg-owned company (Taurus IP) sued DaimlerChrysler with related patents. Mr. Spangenberg seemed to be trying a double dip — angling for two settlements from the same defendant. Tsk, tsk, said Judge Crabb, though she used tougher language and painstakingly enumerated the maze of companies in the Spangenberg empire. She ordered Taurus IP to pay DaimlerChrysler \$3.8 million to cover its legal fees and succinctly described Mr. Spangenberg’s business model this way: “to license patents through litigation: first file a lawsuit, then negotiate a licensing agreement as part of a settlement.”

“It was a mauling,” Mr. Spangenberg said of Judge Crabb’s takedown, now under appeal. But weirdly enough, the ruling turned out to be terrific public relations.

Soon after Judge Crabb’s decision, IPNav’s phone was ringing with new business. RadioShack, Bridgestone and other companies wanted to strike a variety of deals to monetize their patents. The mauling had laid bare Mr. Spangenberg’s aggressive business techniques. IPNav soon grew from five employees to 80, most of whom are patent specialists; it currently manages about 10,000 patents. (One of its many relationships, as it turns out, is as licensing agent for a company suing The New York Times Company for patent infringement.) It has offices in Shanghai, Tel Aviv, Dallas and Dublin.

He calls the apartment he now rents “the Paris office” and says he spends summers there because the time zone is convenient for conversations with employees around the world. Mostly, though, he just loves Paris, as does his

wife, Audrey, and their son, Christian, 20. Mr. Spangenberg is particularly fond of the architecture, the food and the Impressionist art, which he and his wife collect. He doesn't speak much to the locals, because he can't.

"I tried learning French with a tutor," he said, "but after a few lessons she told me my accent made me sound retarded and that was the end of that."

In the patent world, Mr. Spangenberg says he has cultivated a reputation as a bit of carnivorous monster, but even his opponents say he can be perfectly reasonable. One, a lawyer named David Tsai, says IPNav's lawyers dropped a case against his clients — Hulu, Amazon and Twitter — after he demonstrated that they were not infringing.

"They agreed they had no standing," Mr. Tsai recalled.

But such comity may be the exception among companies in Mr. Spangenberg's sights. Not long ago, Rackspace, a cloud storage company based in San Antonio, became an IPNav target, and Alan Schoenbaum, Rackspace's general counsel, became Mr. Spangenberg's most vocal critic.

Mr. Spangenberg contends that Rackspace is infringing a patent held by his client Parallel Iron. Steve Dodd started Parallel Iron in 2001 with three friends in the tech and telecom world. Together, they began to draft patent applications for a data storage and retrieval system.

"I worked on this in my basement for two years," Mr. Dodd said. "We didn't get into this to enforce patent rights. We got into it to build a storage system. But this was the end of the tech bubble. We couldn't have timed it worse."

Mr. Dodd and his group were \$1.3 million in debt when a consultant introduced him to Mr. Spangenberg. After sizing up the patents, IPNav agreed to pay Parallel Iron \$250,000 for exclusive rights to monetize the patents for a fixed time, and to finance any litigation. Parallel Iron would keep 42.5 percent

of any settlement revenue and verdicts, with the rest split between IPNav and the lawyers it hired.

As usual, Mr. Spangenberg would handle overtures to companies and negotiations. He considers this one of his specialties.

“Love, fear or greed,” he says, citing the key human motivations that are his leverage when he approaches any company. “I always start with love.”

That usually means an assertion letter, which may not sound very loving to recipients. In 2011, a judge in Wisconsin — not the one who mauled him — quoted from an IPNav assertion letter that included this sentence: “We are focused on addressing these issues without the need for costly and protracted litigation.”

“The implied ‘or else!’ oozes from this letter like lye from lutefisk,” wrote Judge Stephen L. Crocker of Federal District Court, referring to a gelatinous dish popular in Nordic countries. And Wisconsin, apparently.

Neither love nor fear worked on Rackspace, and the two companies were soon filing suits against each other. Going to court will cost Rackspace somewhere between \$1 million and \$5 million, Mr. Schoenbaum estimated. A license would have probably been a bargain by comparison, and he said Rackspace might have acquired one if it were infringing Parallel Iron’s patents. But the company’s lawyers decided it was not, and Rackspace became one of a handful trying to turn the tables on patent asserters.

“The game is to extort license fees out of companies for less than defense costs,” Mr. Schoenbaum said in a recent phone interview, referring to IPNav. “We don’t want to encourage that behavior. We’ll just continue to be sued until we demonstrate that we can’t be pushed into a settlement.”

The dispute in this instance revolves around Rackspace’s use of open-source software called the Hadoop Distributed File System. It stores, processes

and analyzes vast amounts of data. Facebook and LinkedIn — both sued by Parallel Iron — are among its many users.

So, the key question: Does the Hadoop Distributed File System infringe Parallel Iron's patents?

David Pratt, the president of a company called M-CAM, agreed to weigh in. M-CAM is based in Charlottesville, Va., and performs what it calls "stress tests" on patents on behalf of banks that are making loans to companies with intellectual property. Mr. Pratt described himself as "patent-agnostic," which is to say he came to this task without any particular bias.

His conclusion was that Parallel Iron has a very weak case.

"The problem is, these patents are severely challenged by what we call precedent innovation," he said, using a fancy term for ideas that are in the public domain before a patent is granted. "What's described in Patent No. 7197662," referring to Parallel Iron's patent, "has been done a thousand times. I.B.M. has been doing it since the beginning of computers."

Mr. Pratt followed up by e-mailing a patent that predates Parallel Iron's and which, he suggested, was quite similar. As Mr. Pratt put it, "There's virtually no chance that '662 and its family could survive a full-scale re-examination by the Patent Office, because there are a lot of things that could disable or destroy it."

Mr. Spangenberg was unimpressed by this analysis. Before he signs up clients, he spends \$100,000 to \$250,000 on experts who take a month or more to study both the validity of a patent and whether anyone is infringing it. The findings of these experts, he said, were highly encouraging.

"Steve and his partners patented a very specific and very effective way to store and retrieve data," he said. "It's not the only way to do it. It just so happens that if you look at Hadoop and you look at Parallel Iron's patents,

they're practically identical."

It's hard to say whether Mr. Spangenberg in this case is sticking up for outgunned inventors or wheedling a settlement that he and those inventors don't deserve. And it's the fuzziness of such issues that leads to the sort of knotty legal morass that companies pay to avoid. If nothing else, here, as with many other cases, Mr. Spangenberg has found the opening he needs.

Given the time and money it takes to sort out patent claims, there is something a little insane about the American way of resolving these disputes. Germany has a specialized patent court, which streamlines the process. In the United States, there is talk of setting up patent markets, so that start-up companies could quickly find out what patents they need and whom to pay, rather than putting out their product and waiting to be sued.

Mr. Spangenberg agrees that the United States system is deeply flawed. "We're using the courts as a marketplace, and the courts are horribly inefficient and horribly expensive as a market," he said.

But as long as the system exists, Mr. Spangenberg is going to exploit its ambiguities and pokiness for all it's worth.

Ambiguity is written into many patents. In the 1990s, court decisions pushed the Patent and Trademark Office to become more lenient about filings, according to legal experts. Soon, software *concepts* were being patented, and you didn't need to build an example of the concept in question. A broad draft and description would suffice.

"If you're an inventor, you want patents that are flexible and broad," said Daniel Ravicher, president and executive director of the Public Patent Foundation, a nonprofit group that monitors abuses in the patent system. "You want language like 'systems to do things with processes with widgets.' "

Moreover, patent holders in recent years have become more brazen about

asserting claims on inventions that haven't yet been conceived, according to Professor Bessen at Boston University. A patent granted in 1985, for example, and titled a "system for reproducing information in material objects at a point of sale location" was originally intended for retail kiosks to sell cassettes. But a company called E-Data acquired the patent and argued that "point of sale" could include a buyer with an Internet connection. Which meant that E-Data could sue companies selling products online, which it did.

"E-Data collected about \$100 million," Professor Bessen said. "And that's only a modestly successful troll."

Mr. Spangenberg learned just how potent such patents could be the hard way. In 1996, he was chief executive of a telecom company, SmarTalk, that was accused of patent infringement.

"This guy sues us," he recalled. "I brought in a law firm and they do a presentation about how we'd litigate, which will cost us something like \$3 million to \$5 million. I know it'll be way more than that."

So he called his adversary, who invited him to his office on Wilshire Boulevard in Los Angeles.

"It's like walking into Versailles," Mr. Spangenberg recalled. "This enormous space, and these puffy chairs you sit in and your feet don't touch the floor. I said: 'I get it. I love the setup. I took a psychology course. What do you want?' "

In minutes, they shook hands on a deal in which SmarTalk would pay \$500,000 for a license.

The experience provoked an epiphany: Patents, which are often considered a cost for companies, can also be a hugely valuable asset.

Mr. Spangenberg started IPNav in 2003. He and his wife subsequently acquired a portfolio of 14 patents from a company called Firepond. As money

poured in, he went through an acquisitive phase that he characterized as a combination of “nouveau riche on steroids” and midlife crisis, which is how he ended up with 16 cars and a mansion with a gold leaf ceiling and a Baccarat chandelier. He snapped out of it a few years ago, after he bought so much wine at a Christie’s auction that it was delivered in an 18-wheel truck. His son said he’d need to live to 200 to consume all of it.

He and his wife have since moved into an apartment, a 2,000-square-foot two-bedroom in Dallas, and he sold off all but one of his cars, a Ferrari. But he’s hardly depriving himself; he’s currently in the market for a Monet.

The constant in his life has been incessant work, and you need a few spreadsheets to chart the 50 or so companies that he either owns or co-owns as a patentasser. One of those spreadsheets is for Parallel Iron, which, with an assist from IPNav, has won just under \$10 million in settlements, according to Mr. Dodd, the inventor. Whether these companies believed that they were infringing, or were merely avoiding a drawn-out and costly lawsuit, is hard to say. The settlements all come with confidentiality agreements.

Still in progress for Parallel Iron are suits against Google, EMC, Hitachi, Adobe and others. Which is just a sliver of Mr. Spangenberg’s work. Some 100 other patent campaigns on behalf of other patent-holding companies partnered with IPNav are under way.

That means a lot of phone calls from a guy who might go thug, and enough litigation to keep a battalion of lawyers busy for years.

A version of this article appears in print on July 14, 2013, on page BU1 of the New York edition with the headline: Has Patent. Will Sue.

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