THE DIRECT COSTS FROM NPE DISPUTES

99 CORNELL L. REV. (forthcoming 2014)
Boston University School of Law & Economics Research Paper No. 12-34
(June 25, 2012, revised July 2013)

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Abstract:

In the past, “non-practicing entities” (NPEs), popularly known as “patent trolls,” have helped small inventors profit from their inventions. Is this true today or, given the unprecedented levels of NPE litigation, do NPEs reduce innovation incentives? Using a survey of defendants and a database of litigation, this paper estimates the direct costs to defendants arising from NPE patent assertions. We estimate that firms accrued $29 billion of direct costs in 2011. Although large firms accrued over half of direct costs, most of the defendants were small or medium-sized firms. Moreover, an examination of publicly listed NPEs indicates that little of the direct costs represents a transfer to small inventors.
1. Introduction

The American patent system has experienced an explosion of patent litigation over the past decade initiated by parties called Non-Practicing Entities (NPEs).\(^1\) The term Non-Practicing Entity identifies parties who own and sometimes assert patents, but do not practice technology covered by their patents.\(^2\) Commentators agree that there has been an explosion of NPE patent litigation, and that NPE lawsuits differ in important ways from other patent lawsuits,\(^3\) but they disagree in their normative assessments of this phenomenon. We believe that this explosion is troubling, and herein we present evidence that NPE litigation imposes substantial direct costs on high-tech innovators with little apparent offsetting benefit to inventors or innovators\(^4\) from assertion of NPE patents.


\(^3\) John R. Allison, Mark A. Lemley & Joshua Walker, Extreme Value or Trolls on Top? Evidence From the Most-Litigated Patents, 158 U. Penn. L. Rev.1, 12-15 (2009); John R. Allison, Mark A. Lemley & Joshua Walker, Patent Quality and Settlement Among Repeat Patent Litigants, 99 Geo. L. J. 677, 686-689 (2010); Bessen et al, supra note 1 at 29; Feldman et al. supra note 1, at 8 (“Of the 10 parties who filed the greatest number of patent litigations in the years we studied, all were patent monetization entities.”)

\(^4\) We use the term inventor to refer to the creator of a new technical idea that may be eligible for patent protection. We use the term innovator to refer to a party who develops technical ideas into new technology with commercial value.
In this Article we present results from a unique survey of firms targeted by NPE patent assertions. We augment the survey results with information derived from a comprehensive database of NPE litigation, and information derived from financial disclosures by publicly traded NPEs. We find that: (1) the estimated direct accrued costs of NPE patent assertions total $29 billion in 2011; (2) much of this burden falls on small and medium-sized companies; (3) publicly-traded NPEs likely cost small and medium-sized firms more money than these NPEs transfer to inventors; and (4) the distribution of costs imposed by NPEs is highly skewed, probably because NPEs pursue a range of different business strategies.

The survey we will describe is unique in three ways. First, it includes defendant companies that are privately held, including small firms. Second, it reveals information about costs associated with cases in which NPE patents are asserted but which are resolved before a lawsuit is filed. Finally, it provides aggregated information about NPE patent license fees. These kinds of information have not been available, in part, because the terms of patent licenses are often secret, and in part because previous surveys have simply not asked about assertions that did not advance to the filing of lawsuits. The costs disclosed by this survey are significant and should play a prominent role in policy debates about the treatment of NPE patent lawsuits.

Our survey results are largely consistent with the only other study of NPE litigation costs, a study we completed recently with co-author Jennifer Ford. In contrast to the $29 billion annual cost figure estimated in this Article, we previously estimated the

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5 The survey was conducted by RPX, a firm that helps companies manage risk from exposure to patent litigation. The Coalition for Patent Fairness paid RPX to defray part of the expense of conducting this survey.


7 Bessen et al, supra note 1.
annual cost of NPE litigation to publicly traded American firms to be about $80 billion.\footnote{Id. at 31.}

The previous analysis used a slightly different data set, a very different empirical approach and a different concept of “cost.” Rather than surveying defendants and asking them to report costs, we observed the stock market reaction to the filing of an NPE lawsuit against a defendant firm. We estimated litigation cost by analyzing stock price movements associated with lawsuit filing.

We are not surprised that the survey generated lower costs than the stock market event study, because the survey measures only direct costs from NPE patent assertions while the earlier study measured total costs. Direct costs include the cost of outside legal services, licenses fees, and other direct costs incurred in response to NPE litigation risk. Indirect costs captured by our event study methodology include the opportunity costs of the effort exerted by legal, managerial, engineering, and scientific personnel inside the firm, and other business disruption costs such as loss of goodwill, loss of market share, or disruption of innovative activities.

This new study also complements our earlier study by providing information on companies that are not publicly listed, including small companies. This information helps reveal the extent to which NPEs help small and medium firms realize profits from their innovations and the extent to which small and medium firms, to the contrary, incur costs as the targets of NPEs.

NPEs are individuals and firms who own patents but do not directly use their patented technology to produce goods or services, instead they assert them against companies that do produce goods and services. In the past, some NPEs have played a valuable role in bringing innovations from small inventors to market. Some inventors
lack the resources and expertise needed to successfully license their technologies or, if necessary, to enforce their patents. NPEs provide a way for these inventors to earn rents that they might not otherwise realize, thus providing them with greater incentives to innovate.\footnote{See Ashish Arora, *Patents, licensing, and market structure in the chemical industry*, 26 Research Policy 391, 395-97 (1997); see generally, Naomi R. Lamoreaux and Kenneth L. Sokoloff, *Inventors, Firms, and the Market for Technology in the Late Nineteenth and Early Twentieth Centuries*, In Learning by Doing in Markets, Firms, and Countries, edited by Naomi R. Lamroeaux, Daniel M. G. Raff, and Peter Temin. (1999).}

But in the past, also, some NPEs have used patents opportunistically. During the late nineteenth century, “patent sharks” were widely seen as extracting money from innocent individual farmers and railroad companies.\footnote{Gerard N. Magliocca, “Blackberries and Barnyards: Patent Trolls and the Perils of Innovation,” 82 Notre Dame L. Rev. 1809, 1829, 1832 (2007).}

However, while NPEs have been around for a long time, over the last few years, NPE litigation has reached a wholly unprecedented scale and scope.\footnote{Patent Freedom. 2012. “Litigations Over Time,” available at: https://www.patentfreedom.com/about-npes/litigations/; RPX. 2012. “US Litigations Involving NPEs,” available at: http://www.rpxcorp.com/index.cfm?pageid=45.} In 2011, 2,150 unique companies were forced to mount 5,842 defenses in lawsuits initiated by the actions of NPEs.\footnote{Id. These figures come from the RPX database described below. About 4% of these defenses were mounted as declaratory actions rather than infringement suits; these were nevertheless initiated by the NPEs. The figure for 2011 reflects, to some extent, an effort by NPEs to initiate litigation before the America Invents Act took effect, restricting multi-party lawsuits. Nevertheless, the trend shown in Figure 1 illustrates rapid growth before 2011.} Moreover, the number of defenses has been growing rapidly (see Figure 1). Part of this growth has been fueled by new sources of funding and new business models.\footnote{Andrei Hagiu & David B. Yoffie, *The New Patent Intermediaries: Platforms, Defensive Aggregators, and Super-Aggregators*, 27 J. Econ. Perspectives, 45, 52 (2013); Executive Office of the President, Patent Assertion and U.S. Innovation, 5-6, June 2013.}

\section{2. Literature Review}

Large scale NPE patent litigation is a recent development, thus the empirical literature is limited, but growing rapidly. Our NPE lawsuit event study is the most closely
related piece of earlier research; in it we found that the annual wealth lost from NPE lawsuits was about $80 billion for publicly traded U.S. firms. In theory, this cost could be composed mostly of transfers in the form of royalty payments to NPEs. Indeed, a number of papers argue that NPEs play a socially valuable role by enabling small inventors to realize greater profits from their inventions. These papers, however, do not provide empirical evidence to support that assertion.

Our 2011 paper rejected that possibility based on the evidence available to us; we concluded that much of the cost born by technology companies as they defend against NPE lawsuits is a social loss and not a mere transfer. The survey results we describe below provide strong additional support for our view that much of cost imposed on defendants is a social loss. In particular, the current study finds that NPEs impose costs not only on large technology companies, but also on very many small and medium firms, making it even less likely that innovative start-ups are net beneficiaries of NPE activity.

One other researcher has quantified the costs to defendants from NPE litigation. Catherine Tucker examines the effect of a lawsuit by an NPE (Acacia) against several firms that make medical imaging software. She compares the impact of the lawsuit on sales of both medical imaging and text-based medical software produced by the targeted firms. She also compares the sales by the targeted firms to the sales of medical imaging software made by other firms in the industry who were not targeted with a lawsuit. She

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14 Bessen et al, supra note 1 at 31.
finds that sales of medical imaging software declined by one-third for targeted firms. She attributes the sales decline to a “lack of incremental product innovation during the period of litigation,” and she conjectures that incremental innovation was deterred by concerns it would create additional risks in the on-going litigation.\textsuperscript{17}

Two other strands of previous research are especially relevant to this project. First, earlier work has quantified legal fees associated with patent litigation. We collected data about legal fees that were made public in court decisions concerning fee-shifting in patent cases.\textsuperscript{18} Also, the American Intellectual Property Law Association conducts a biannual survey of its members and includes questions about fees in patent lawsuits.\textsuperscript{19} The sources are helpful and we report some of their findings below, but they do not contain information about NPE litigation in particular, and they do not contain information about assertions that never reach the filing of a lawsuit.

A better-developed strand of literature reports various characteristics of NPE litigation.\textsuperscript{20} While not measuring costs, these studies do shed light on the question of whether the private losses to firms targeted by NPE patent assertions also tend to be social losses. The answer appears to be yes. NPE patent litigation has all the hallmarks of patent notice failure that distorts the patent system and makes it impede technological

\textsuperscript{17}Id. at 1.
progress. In *Patent Failure* we show that the U.S. patent system works well for chemical and pharmaceutical inventions because the system provides clear notice to the world of the scope and existence of patent-based property rights. For most other inventions, especially software and business methods, notice failure means that innovative firms are targeted in patent infringement suits through no fault of their own.

Notice failure is likely for NPE lawsuits. Sixty-two percent of the time they feature software patents which are notoriously difficult to interpret. Allison, Lemley, and Walker study patents litigated multiple times and usually asserted by NPEs; they find that software patents account for 94% of such lawsuits. The patents asserted in NPE lawsuits are often subject to lengthy prosecutions which delays public access to information about patent claims. Rather than transferring technology and aiding R&D it appears that NPEs usually arrive on the scene after the targeted innovator has already commercialized some new technology.

3. **Data**

**a. Survey**

Between February and April 2012, RPX invited about 250 companies to participate in a survey of their NPE-related costs. The pool of invitees included RPX clients and non-client companies with whom RPX has relationships. Most invitees were

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23 Id. at 47-51.

24 Bessen et al, *supra* note 1 at 29.

25 Allison et al., *Most Litigated*, supra note 3, at 695-96 (74.1% of most litigated patents and 93.7% of the assertions).


technology companies, but certain non-technology companies with NPE exposure were also invited (for example retailers with e-commerce exposure). Participants provided information to the extent that doing so was consistent with their obligations to third parties. The information was aggregated and anonymized such that individual data was not disclosed.28

Participants filled out a standardized Excel template that included a range of questions about their NPE-related costs. The instructions for the template asked that participants include certain statistics estimating all of their direct (external spend) NPE-related costs from 2005-2011. An NPE was defined to include patent assertion entities and other parties using the same definition as the NPE Lawsuit Database (see below). A list of each participant’s NPE litigations from that database was provided to ensure alignment between the survey response and database. Templates were submitted by email or directly into a secure online data room. To the extent possible, an RPX study team reviewed the submission for quality and completeness. If needed, the company was asked certain follow-up questions. Finally, RPX aggregated the submitted data within a secure computing environment. The resulting dataset forms the basis of the data tables provided in this document.

Of the 250 companies invited to participate, 82 provided data on lawsuits and of these, 46 also provided data on non-litigation patent assertions and related costs.

b. NPE Lawsuit Database

In addition to the survey, we also used a comprehensive database of NPE litigation developed by RPX. These NPE litigation statistics are based on cases coded

28 Although RPX provided data for this study, RPX did not exercise control over the substance of our text.
“830 Patent” in the PACER database which is maintained by the Administrative Office of the U.S. Courts. In case counts, RPX excludes misfiles, non-patent, false marking and other non-core patent infringement cases. When a case is transferred, RPX counts it as one case and allocates it to the venue to which it was transferred. When several cases are consolidated into one, RPX counts it as one case but with multiple defendants. When a case is severed RPX counts it as separate cases. In defendant counts, RPX rolls up operating company subsidiaries into a parent entity (Samsung Group and Samsung Electronics count as one defendant).

RPX defines NPEs to include patent assertion entities, individual inventors, universities, and non-competing entities (operating companies asserting patents well outside the area in which they make products and compete). RPX identifies NPEs through a manual review process. In this review process, RPX reads patent complaints found in PACER and checks information in the complaint against its NPE database. RPX also checks its database of plaintiff counsel, searches public filings and performs web research. Some of the factors they consider when determining whether a company is an NPE (or more specifically a patent assertion entity “PAE”) include: Is the entity the same as or share a substantial financial link with a known PAE? Is there any evidence that the company sells a product or offers a service? Does the entity webpage prominently mention technology, licensing, and patents; and not offer a product or sales? Does the complaint indicate whether the entity has a product in-market or in-development that is being harmed by infringement? Are the lawyers involved known to specialize in

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29 This database does not include patent disputes before the International Trade Commission.
30 Declaratory actions are included in case counts unless otherwise noted.
representing NPEs? Is this entity known as an NPE or as an established operating company?\(^{31}\)

This definition of NPE is broader than some other definitions. There is no consensus among researchers on the proper definition of NPE. Schwartz and Kesan have criticized our reliance on a broad definition because it reaches plaintiffs like universities who are more meritorious in some sense.\(^{32}\) They argue that because the database includes lawsuits filed by universities, and other supposedly meritorious plaintiffs, it overstates the costs incurred by “bad” trolls.\(^{33}\) It is surely difficult to attempt to distinguish “good” NPEs from “bad”—some people argue that universities sometimes are bad players who occasionally abuse overly broad patents. But the difficulty of divining the true nature of NPEs does little to distort our conclusions for two reasons.

First, relatively little of the patent litigation we study comes from universities—only about one percent of the NPE lawsuits.\(^{34}\) Instead, the lawsuits in the RPX database were overwhelmingly filed by “patent assertion entities.” The RPX database, in fact, closely matches other efforts to categorize litigants. The counts of lawsuits are very similar to those compiled by Patent Freedom. Also, Colleen Chien checked the RPX database against her own categorization of 1,000 lawsuits and found little difference.\(^{35}\)

So our definition of NPE is hardly “unconventional” as Schwartz and Kesan claim.

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31 There are a range of views among scholars and policy-makers about the appropriate definition of NPE, and different analysts are likely to assemble different NPE litigation databases. Based on our experience researching patent litigation, we believe that the RPX database yields statistics that are consistent with information about NPE patent litigation from other sources.
33 Id. at x.
35 Id.
Moreover, changes to our database, such as excluding universities, are likely to have only a small impact on our aggregate estimate of direct costs.

Second, although universities perform research that is extremely valuable to society and although most university licensing is done in a socially efficient manner, when universities engage in patent litigation, especially against defendants who have inadvertently infringed, they nevertheless create social costs. The problem of cost that we identify is not based on the identities, motives, or other activities of the NPEs, but is based, instead, simply on the excessive litigation the NPEs create. From this perspective, we are no less sanguine about excessive litigation among practicing companies, a point we highlight in our book, *Patent Failure*. And so our estimate of $29 billion implies socially wasteful litigation-related expenditures and reduced innovation incentives even if it includes university litigation. We discuss this topic more in Section 6.

c. Sample characteristics

Table 1 compares characteristics of the survey sample with RPX’s database of NPE lawsuit defenses. Data for the survey are on the left while data for the entire database of NPE defenses are on the right. The 82 surveyed companies collectively mounted 1,184 defenses in NPE lawsuits beginning between 2005 and 2011. Of these, 784, or 66%, were resolved by adjudication or settlement and did not involve indemnification or other factors that cause costs to be atypical.

Note that a possible truncation bias arises because so many lawsuits were unresolved at the time of the survey. Because lengthier disputes tend to be more costly, at least as far as legal costs are concerned, and because the number of lawsuit filings has

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36 Bessen and Meurer, *supra* note 22 at 120-146.
risen sharply in recent years, cost estimates based only on resolved lawsuits might be understated.\textsuperscript{37}

We divided the companies into sub-categories based on their revenue in the most recent year reported (small/medium at under $1 billion or large at over $1 billion) and whether they were in the broad software industry, including e-commerce and finance, or instead in a hardware industry (everything else).\textsuperscript{38} The latter distinction might be significant because most hardware industries involve greater sunk capital costs than do software industries or finance and for this reason hardware industries may be more at risk of hold up.\textsuperscript{39}

The right panel shows that small and medium firms dominate the universe of NPE defendants. Small and medium-sized companies make up 90% of the defendant firms, mounting 59% of the defenses. Firms making less than $100 million in revenue account for 82% of the defendants and 50% of the defenses.\textsuperscript{40}

As the Table shows, our survey sample consists of companies that are larger, more likely to be public and which experience relatively more lawsuits than the average NPE defendant firm. In the rows that control for size and industry sector, survey firms appear to experience about twice as many lawsuits as companies in the comprehensive database. This is not surprising, however, it raises the possibility that our sample might be unrepresentative of the broader population, possibly experiencing costs that are greater


\textsuperscript{38} To preserve data confidentiality, statistical analysis was performed by RPX personnel working under our direction.

\textsuperscript{39} Readers should be mindful of the distinction between the industry of the defendant and the technology covered by the patent asserted by the NPE. In particular, it is important to recognize that problematic software patents are often asserted against hardware manufacturers.

\textsuperscript{40} This estimate assumes that firms with unreported revenue have revenue less than $100 million.
or smaller than those of the universe of sued companies. Below we do some tests to see whether the survey appears to have unrepresentative costs.

4. Findings

a. Mean and median costs

Table 2 provides estimates of mean legal\textsuperscript{41} costs, licensing costs and total costs (the sum of these) with standard errors in parentheses. The last column also shows median total costs.

Median total costs per litigation defense fall roughly around half a million dollars, smaller for small and medium firms, larger for big ones. However, mean total costs are much higher, nearly eight million dollars for our survey sample. This difference implies that the distribution of costs is highly skewed, as we explore below. Thus one must be particularly careful in extending judgments about the costs of litigation based on small samples. While “typical” costs might only be a few hundred thousand dollars, mean costs—reflecting the large costs in a small number of very costly lawsuits—are an order of magnitude higher.

Mean total costs are, not surprisingly, significantly greater for large companies than small and medium companies. This difference is significant at the 1% level.

The first column reports the legal component of costs. Mean legal costs per defense range from $420,000 for small/medium companies to $1.52 million for large companies.

\textsuperscript{41} In the survey estimated legal costs for a particular case were specified as: “Value of any legal costs related to this matter through December 31, 2011. Include outside counsel (lead and local), experts, discovery costs, prior art searching, jury consultants, graphics, other expenses, and other related costs. Include any costs that were ultimately recouped or expected to be recouped by indemnification agreements or other mechanisms. Exclude in-house legal costs.”
Column 2 of Table 2 reports the dollar amounts paid to the plaintiff to settle the case. Column 3 reports the total costs, the sum of legal and settlement costs. The mean settlement costs for small/medium companies are $1.33 million and for large companies, $7.27 million. Mean total litigation costs are $1.75 million for small/medium companies and $8.79 million for large companies.

Legal costs are about a third as large as settlement costs, or about one quarter of total litigation costs (slightly larger for small/medium companies). This implies that a substantial part of direct costs of NPE litigation is a deadweight loss to society.

Also note that NPE litigation is relatively more costly to smaller companies. In our sample, the large company litigation costs were five times as high as small/medium company litigation costs. But (see Table 1) the mean revenue of large companies in our sample is nearly seven times the mean revenue of the small and medium companies. This means that, roughly speaking, smaller companies pay more in direct NPE litigation costs relative to their size.

Hardware firms have higher costs than software firms. This difference is significant at the 5% level. Since hardware firms generally have greater sunk costs than software firms, this difference is consistent with the interpretation that hardware firms are more easily subject to holdup and hence they have to pay more to settle litigation.

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42 In the survey estimated settlement costs for a particular case were specified as: “Value of settlement. If a running royalty, estimate the present value of royalties. If there was an exchange of patents or other non-standard deal structure then estimate expected present value cost of that deal.” Settlement costs include damage awards in a small number of cases.
43 Weighting the ratios in Table 2 to represent the relative weights of small and large companies in the total database, legal costs are 23% of the total and licensing costs are 77%.
44 The indirect costs of NPE lawsuits, such as those measured by Tucker, supra note 16 and Bessen et al., supra note 1 are likely to be a more significant source of deadweight loss.
b. Comparison to other studies

As noted above, the survey sample was not randomly selected and hence it could be unrepresentative. In particular, it might be that survey respondents tended to be firms with higher than average litigation costs.

We can check the representativeness of our sample by comparing our findings to other empirical evidence. First, we compare our survey results to two different measures of patent litigation costs, and then we compare our measures of NPE assertion costs to data on NPE licensing revenue. AIPLA conducts a bi-annual survey of its members who estimate typical legal costs through discovery and through trial. They report these estimates for three categories of patent lawsuits depending on the amount at issue in the controversy, specifically, whether the amount at issue is less than $1 million, between $1 million and $25 million, and greater than $25 million. The first and third categories provide the ranges shown in the addendum to Table 2.\textsuperscript{45} Few patent lawsuits, including NPE lawsuits, go to trial,\textsuperscript{46} so the figure for costs through discovery is more comparable to our survey results. The AIPLA cost estimates are comparable or even higher than the mean direct legal costs estimates from our survey.

This crude comparison can be refined in two ways. First, we make an adjustment to the AIPLA figures to account for the fact that most patent lawsuits terminate before discovery is complete. We made this adjustment in previous work,\textsuperscript{47} and derived an estimate of expected patent litigation costs from the AIPLA survey responses of

\textsuperscript{45} For the middle range, the estimated costs are $1.6 million through discovery and $2.8 through trial.
\textsuperscript{46} Kesan and Ball 2005.
\textsuperscript{47} We are grateful to David Schwartz and Jay Kesan for observing that we failed to make this adjustment in our initial working paper version. We developed the adjustment used here in Bessen & Meurer, \textit{supra} note 17, at 82.
$483,000.\textsuperscript{48} This figure is about one-third of the mean direct legal cost in our survey, but notice that it is very close to the median total direct cost of $560,000 reported in Table 2. This median number includes settlement payments as well as direct legal costs. The median direct legal costs are merely $200,000 which is lower than the adjusted legal cost figure from the AIPLA survey. This brings us to an important question of interpretation – do AIPLA survey respondents report means or medians? We cannot tell from the survey question, but we suspect that respondents interpret “typical costs” as median costs.

We also compared the survey means to mean legal fees from patent cases in the years from 1985-2004 in which a patent owner was required to pay the defendant’s legal fees.\textsuperscript{49} Converted into 2011 dollars, the cost for lawsuits that ended in summary judgments was $840,000; the cost for those that ended in a trial verdict was $3.64

\textsuperscript{48} The expected legal cost associated with filing a patent lawsuit depends on the frequency of each of the different ways a lawsuit may be terminated. Kesan and Ball analyze patent lawsuit termination data available from the Administrative Office of the Federal Judiciary. Jay P. Kesan & Gwendolyn G. Ball, How are Patent Cases Resolved? An Empirical Examination of the Adjudication and Settlement of Patent Disputes, 84 WASH. U. L. REV. 237, 238 (2006). After examining 5,207 lawsuits filed in 1995, 1997, and 2000, they found that most cases terminate short of trial, summary judgment, or through other substantive court rulings. Id. at 310-12. In particular, 4.6% of lawsuits reached trial, 8.5% of lawsuits terminated with a summary judgment, dismissal with prejudice, or confirmation of an arbitration decision, and the remaining 86.9% of cases terminated earlier in the process. Id.

Kesan and Ball constructed two proxies for legal fees in patent lawsuits: number of days until the suit terminates, and number of documents filed. Id. Their data showed that suits that go to trial last about 1.5 times as many days as suits that end with a summary judgment, and suits that end with a summary judgment last about 1.5 times as many days as all other suits. Further, their data showed that suits that go to trial generate about 2.5 times as many documents as suits that end with a summary judgment, and suits that end with a summary judgment generate about 2.5 times as many documents as all other suits. Id. Assuming that the expected legal cost in a suit that ends before summary judgment is one-half of the cost of a suit that reaches summary judgment, then the estimated amount the for the alleged infringer is $483,000.

Schwartz and Kesan offer two interesting conjectures about differences between NPE litigation and other patent litigation. First, “NPE cases are often filed in speedy venues” and thus are faster and cheaper than the patent suits studied by Kesan and Ball. Schwartz & Kesan, supra note 31 at x. And second, “[b]ecause competitor litigation is more document intensive and frequently litigated more heavily by both parties – e.g., due to the injunction risk – we believe that NPE litigation must be less expensive than competitor litigation.” Id. They conclude that the AIPLA survey costs are likely to be high compared to NPE litigation costs. Id. Their conjectures may be correct, but their conclusion does not necessarily follow. NPE litigation costs may be higher on average than litigation costs in typical patent lawsuits because the stakes tend to be higher and hold-up problems are especially severe, because defendants are larger than typical suits and more suits are concentrated in high tech industries.

\textsuperscript{49} Bessen & Meurer, supra note 17.
million. Making the same adjustment as above to account for early termination of cases yields an expected mean cost of $409,000. This mean is lower than the mean from our survey sample but not surprisingly different given the escalation in patent litigation costs because of the growth in electronic discovery in the past decade.

It is possible, of course, that our survey might report representative legal costs but unrepresentative licensing costs. This might happen, for instance, if our survey over-represented hardware companies who tend to have relatively higher licensing costs. However, Table 1 suggests that the share of hardware firms in the survey roughly matches the share in the universe of NPE defendants found in the database. Generally speaking, firms with higher licensing costs will tend to have higher legal costs, all else equal. This is because firms facing a large payout can typically reduce the payout or the likelihood of having to pay damages in trial by mounting a more aggressive (and more expensive) legal defense.

Our confidence in our licensing cost results is strengthened by independent evidence we have developed on the licensing revenue earned by NPEs. We obtained licensing revenue from disclosures\(^50\) by the 10 publicly listed firms that were predominantly in the patent assertion business during the period from 2005 to 2010 (Acacia, Asure, Interdigital, Mosaid, Network-1, OPTi, Rambus, Tessera, Virnetx, and Wi-Lan). We matched these firms to the lawsuits filed listed in Patent Freedom’s NPE litigation database.\(^51\) These companies filed lawsuits against 1,450 companies during this period, accounting for about one sixth of all PAE lawsuits filed in the Patent Freedom database.

\(^{50}\) We obtained licensing revenues from the firms’ 10-K reports.

\(^{51}\) Patent Freedom is an independent company that collects data on PAEs and provides advice and risk assessment. For details on the database and the matching procedure see Bessen et al., supra note 1.
During the period from 2005 through 2010, licensing revenues totaled nearly $6 billion. The mean licensing revenue per lawsuit defense comes to $3.8 million in 2010 dollars. This figure is quite close to the estimates we obtained from the survey. Averaging the mean licensing cost for different firm sizes as given in Table 2, weighted by the proportion of small/medium and large firms in the total sample (Table 4), also gives a combined average of $3.8 million.\textsuperscript{52} The estimate from the publicly listed PAE firms includes licensing revenues from non-litigated patent assertions, while the estimate based on Table 2 does not. But the data from the publicly listed firms does not account for accruals—much of the licensing revenue from lawsuits filed in 2010 was not collected in 2010, but later.\textsuperscript{53} This means that the estimate from publicly listed PAE firms tends to be relatively understated. Taking both of these differences into account, the two estimates are broadly similar.

In summary, when we use data from a very different sample and use a very different methodology we obtain results that are quite comparable. The close similarity of these means suggests that sample selection issues do not substantially bias the survey findings. It is possible, of course, that both samples could be biased the same amount for different reasons, but that seems unlikely.

c. The distribution of litigation costs

Sample means do not capture the distribution of costs. In fact, litigation costs are highly heterogeneous. Figure 2 shows cumulative distribution plots of total litigation

\textsuperscript{52} 1.33 \times 59\% + 7.27 \times 41\% = 3.77. If instead, we use the regression in the Appendix to predict litigation cost for the entire sample in the RPX database—this should better adjust for firm size differences—the weighted average cost comes to $3.2m.

costs for the small/medium and large companies in our sample. The smooth curves represent lognormal distribution functions fitted to the data.

As can be seen, the distribution is highly skewed. The median total litigation cost for small/medium companies is $318,000 and for large companies it is $646,000. A large fraction of lawsuits cost less than $200,000. But a small number of lawsuits cost much, much more. For large companies, 5% of the lawsuits cost more than $22 million.

This heterogeneity likely arises in part from variation in NPE tactics. Schwartz reports that some NPEs pursue nuisance suits in which they sue many companies, big and small.\textsuperscript{54} Plaintiffs using this tactic are willing to settle for small payments, often no more than the amount a defendant would spend on legal fees to defend the case. As one such plaintiff lawyer put it, “An NPE intuitively understands that we could go for triples or home runs, but we can also go for singles and get a good return and work on other things.”\textsuperscript{55} Alternatively, NPEs may act like big game hunters, targeting only one or a few firms, but expecting to win at least several million dollars. The lawsuit by NTP against BlackBerry maker RIM is a good example. NTP asserted patents of doubtful validity but managed to win at trial and obtain a settlement of $612.5 million from RIM.\textsuperscript{56} The survey data does not permit us to clearly identify NPE tactics, but it does suggest that NPE activity is not uniform.

While there are far fewer suits initiated by “big game hunters,” they represent a disproportionate share of the cost. The distribution of costs is such that the top 5% of

\textsuperscript{55} Id.
\textsuperscript{56} Bessen & Meurer, \textit{supra} note 22 at 49-50, 122-25.
defenses for large companies account for about two thirds of the total cost of defense for large companies.

d. Costs from non-litigated patent assertions

Many NPE patent assertions are settled without a lawsuit being filed. To gather information on non-litigated assertions, the survey also asked a series of questions regarding these. Rather than count assertions, the survey asked respondents to report cumulative costs. Most reported costs for the period from 2005 – 2011, but some did not have data for the entire period. Moreover, only 46 of the companies completed this section of the survey.

The costs of non-litigated assertions include legal fees and settlement costs paid to patent holders. They also include smaller amounts spent on NPE-specific patent buying programs (including RPX services), on NPE-specific clearance searches and on re-examinations of NPE patents.

The means of these components are reported in Table 3 along with the cumulative litigation costs incurred by these same companies. For the sample as a whole, non-litigation NPE costs were about half of the comparable litigation costs. For small/medium companies, in particular, however, non-litigation costs exceeded litigation costs. This might be because smaller firms lack internal legal resources, making it relatively more expensive for them to pursue litigation. Also, non-litigation costs were higher relative to litigation costs for hardware firms, perhaps again because hardware firms, being more at risk of hold up, find it less costly to settle sooner. This difference is not, however, statistically significant.
In any case, it is clear that non-litigated patent assertions are responsible for much of the direct costs imposed by NPEs on operating companies. In this regard, it is likely that our sample under-represents these cost because we have only surveyed companies that have been involved in litigation. That is, we have not included potentially large numbers of small companies that have only settled NPE patent assertions and have not gone to court. Anecdotal evidence from small companies suggests that there might be very many such firms and their costs are missing from our analysis.

5. Aggregate costs of NPE assertions

a. Aggregation

What is the aggregate cost of NPE patent assertions, including both litigated and non-litigated assertions? To estimate this, we began by estimating the mean cost of resolved litigation for small/medium firms and for large firms. We could have directly used the data in Table 2, however, this might overstate costs because the average small/medium firm in our survey sample is larger than the average small/medium firm in the entire database (see Table 1).\(^{57}\) To correct for this within-category variation, we regressed log cost against log revenue for the survey sample and, using this, computed the predicted mean cost over the actual distribution in the database for each size category.\(^{58}\) In using these means, we assume that the lawsuits in each category in the database will, on average, accrue costs equal to these respective mean values. That is, for

\(^{57}\) In fact, we calculated aggregate costs using the data in Table 2, including the software/hardware categories. These estimates came out about 5-10% higher than those reported in Table 4.

\(^{58}\) Regressions are reported in the Appendix. We used a regression that also included a dummy variable for firms with less than $100 million in revenue in order to capture a non-linearity in the relationship between log cost and log revenue. The predicted mean cost per litigation was $1.527 million for small/medium firms and $5.641 million for large firms. We also ran regressions using hardware/software dummy variables, however, the coefficients on these dummies were not statistically significant.
lawsuits where the defendant was indemnified by a third party, we assume that some party will pay an amount equal to the mean cost for defendants in that category, even if the defendant firm itself does not necessarily pay this amount. Also, we assume that lawsuits that are still underway will eventually accrue costs equal to these means, even if the current out-of-pocket costs are not yet equal to this accrued cost.

To adjust these figures to account for non-litigation assertions, for each category we divided the total non-litigation cost by the total number of lawsuits filed, including lawsuits that were still active. This gave us a pro-rated non-litigation cost per lawsuit filed. We added this to the mean litigation cost for each category to give a total cost of NPE assertions per lawsuit filed.59

The second part of this exercise consisted of breaking the cases in the RPX NPE database into the two size categories. Where revenue was reported (about 74% of the database), we allotted the defenses to small and large cells depending on whether the revenue was smaller than or larger than $1 billion.60 We conservatively assigned those companies without reported revenue to the “small” cells.

b. Year-by-year accrued costs

The left portion of Table 4 reports the number of defenses reported in the NPE database by year for each size category. The right portion shows the aggregate cost of NPE assertions per year calculated by multiplying the number of defenses reported on the left by the prorated total cost of defense per cell (where the cost of defense includes license cost). The final column reports the aggregate cost, summing over both categories

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59 These are $3.17 million for small/medium firms and $7.59 million for large firms.
60 RPX gathered revenue data from financial statements of publicly listed firms as well as estimates based on information such as number of employees available for private firms. Revenues were not reported when a private firm could not be definitely identified in their data sources.
for each year. Aggregate direct costs of NPE patent assertions grew rapidly from about $7 billion in 2005 to $29 billion in 2011.61

It is important to note that these totals represent accrued costs, not necessarily the immediate out-of-pocket cost. That is, we accrue the projected cost of a lawsuit in the year in which the suit was filed, even though the lawsuit might not be resolved. This is important because about half of the lawsuits filed in 2011 were not resolved at the time of our survey. The implication is that substantial sums will be flowing to NPEs over the next several years from lawsuits already filed. Because the number of NPE lawsuits has been growing so rapidly, the current revenues of NPEs likely understate the total costs of lawsuits already filed.62

Moreover, the effect of these assertions does not just fall on a small number of large companies. Some NPE advocates have argued that NPE litigation is largely a matter of lawsuits against a small number of large “serial infringers.” These data show, to the contrary, that about 59% of the litigation events are directed to small and medium-sized companies and about 37% of the aggregate cost falls on small and medium-sized companies. Moreover, this share is likely understated because, as discussed above, this analysis does not include those companies that have only had NPE assertions that did not go to court.

Finally, these tabulations do not include the indirect effects of NPE assertions on the business of defendants. Case study evidence suggests that there are significant

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61 As a point of comparison, Polinsky and Shavell calculate “the litigation costs associated with the U.S. tort system are approximately $46 billion per year.” A. Mitchell Polinsky and Steven Shavell, Costly Litigation and Optimal Damages, available at: http://ssrn.com/abstract=1990786 (2012).

62 We also caution readers not to rely on intuition based on the median cost of defending against NPE patent assertions. Median cases are “typical” but of course it would not be correct to multiply the median cost by the number of assertions to calculate aggregate costs numbers.
indirect costs of NPE patent assertions. These include diversion of management or engineering resources, delays in new product introductions and improvements, loss or delay of revenue, and credit constraints. Bessen, Ford, and Meurer estimate the total business costs of NPE litigation for public firms using stock market event studies. Although the samples and methods are not directly comparable, they find an aggregate loss of stock market capitalization of around $80 billion per year during recent years, corresponding to an aggregate cost in operational funds to the firms of about half that amount. This suggests loosely that total business costs of NPE assertions might be at least twice as large as the figures reported in Table 4.

c. Benefits to innovators

It is sometimes argued that NPEs facilitate innovation by providing incentives to small inventors who would not otherwise be able to license their patents. In this view, “NPEs create patent markets, and … those markets enhance investment in start-up companies by providing additional liquidity options. NPEs help businesses crushed by larger competitors who infringe valid patents with impunity.”

How much of the costs accrued by defendants actually flow to inventors? We can gain some indication of this by looking at the expenditures of publicly listed NPE firms. Examining the 10-K filings of these firms, we identified the licensing revenues these firms received as well as the payments these firms made to inventors in the form of royalties (when the inventor kept title to the patent) and patent acquisition payments

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63 See Tucker, supra note 16.
64 Bessen et al., supra note 1.
65 Risch, supra note 20 at 459.
(when the NPE bought the patent). We also obtained the amount that the NPE firm spent on its own R&D, which some of these firms perform in order to acquire more patents. Table 5 reports the mean annual payments for those years where we could identify both licensing revenues and payments to inventors.

The top panel of the table displays the out-of-pocket payments made by defendants. The licensing revenues are the mean settlement payments these NPEs received per year, just over $1 billion in 2010 dollars. Using the mean ratio of defendant legal costs to settlement costs from Table 2 (.3 to 1), the second row of Table 5 shows the imputed defendant legal cost, summing to a total annual cost to defendants of $1.5 billion from this group of NPEs.

The second panel shows the flows to inventors and to NPE R&D departments. Payments to independent inventors come to only 5% of the direct costs to defendants (7% of NPE licensing revenues). Note furthermore that this figure likely overstates the long term flow of funds to inventors because it compares current licensing revenues to current patent acquisition payments but the patents acquired will likely accrue additional licensing revenues in the future. If we include payments to the NPEs’ own R&D departments, then, loosely, payments to inventors come up to 20% of defendants’ costs. Finally, 47% of the direct costs to defendants is eaten up by NPE operating costs and another 10% consists of NPE profits.

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66 In some cases we used patent acquisition payments from the Cashflow Statement; in others, we used the amortization of patent assets from the Income Statement. The latter includes more than payments to inventors, such as legal costs related to patent acquisitions.

67 The data include the following years for each company: Acacia, 2007-11; Asure, 2002-6; Interdigital, 2004-11; Network-1, 2003-11; OPTi, 2002-10; Rambus, 2003-11; Tessera, 2005-11; Virnetx, 2007-11; and Wi-Lan, 2006-11. Figures for Tessera only include the Intellectual Property business unit.

68 We also include licensing revenues from patents acquired in the past, but patent acquisitions have been increasing rapidly, so this is a much smaller effect.
Based on these figures, it seems difficult to make a convincing argument that the effect of NPEs is to increase innovation incentives. First, previous research has shown that the defendants in these lawsuits are largely tech companies that invest heavily in R&D.\(^{69}\) This estimate suggests that their losses are much larger than the possible flows to small inventors, especially if one adds indirect costs of NPE litigation to the direct costs reported in Table 5. Effectively, what defendants pay in costs as a result of NPE litigation reduces their own R&D budgets. Small inventors would have to be an order of magnitude more innovative per dollar of R&D than the defendant companies, in order for the net effect on innovative activity to be positive.\(^{70}\)

Second, to the extent that small inventors are important for innovation, NPE patent assertions hurt small inventors in at least two ways. As we have seen, the majority of defendants in NPE lawsuits are small/medium companies and these companies accrue larger costs relative to their size.\(^{71}\) Risch finds that the median revenue of a company filing an NPE patent in his sample is $6.3 million. Given that the median revenue of a company in the RPX database of firms sued by NPEs is $10.8 million, it appears that the typical firm sued by an NPE is roughly the same size as the typical firm benefiting from

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\(^{71}\) Colleen Chien “estimated 70-80% of unique defendants targeted by patent trolls make less than $10M per year. Their small size makes them more vulnerable and less able to absorb the impacts of demands: 40% of survey respondents reported that their company delayed hiring or achievement of another milestone, changed the product, pivoted their strategy, shut down a business lines or the entire businesses, and/or lost valuation due to a patent demand. The smaller the company, the more likely it was to report a significant operational impact.” (survey of 223 tech startups) Chien “In my survey I found that the likelihood that a company reported an actual litigation, rather than the threat of one, increased with the revenue. Litigations represented only 31% of demands received by companies under $10M in revenue, but 67% of demands received by companies with over $10M in revenue.” Chien “Among the 90 patentees that Acacia and Intellectual Ventures have profiled on the “Investor Testimonials,” “Inventor Spotlight,” and “Senior Spotlight,” sections of their websites, based on our analysis, only about 10% appeared to be connected to practicing companies not focused on patents. (See Appendix)” Colleen Chien, *Startups and Patent Trolls* (2012), available at: http://digitalcommons.law.scu.edu/facpubs/553
NPE activity. Also, these costs make things more difficult for small inventors who wish to license their technology—not just their patents—to other firms. If the prospective licensees expect NPE-related costs, they will be less willing to license from small inventors or they will not be willing to pay as much.

Third, the incentives provided to patent holders by the current crop of NPEs may be the wrong kind of incentives. NPE activity may skew the research agenda of small firms away from disruptive technologies and toward mainstream technology and associated patents that can be asserted against big incumbents. Even worse, small firms are encouraged to divert investment from genuine invention toward simply obtaining broad and vague patents that might one day lead to a credible, if weak, lawsuit.

The publicly listed NPEs are only a part of the population of NPEs, but an important part, accounting for about one-sixth of all NPE lawsuits. It is possible that the private NPE firms might pay higher royalties to inventors or pay more to acquire patents. But there is no evidence of this, nor evidence to support the common assertions from patent lawyers that NPEs help small inventors. The available evidence suggests, instead, that NPEs burden small firms.

6. Response to critics

An earlier version of this Article has attracted significant criticism. The most thoughtful commentary comes from David Schwartz and Jay Kesan whose work appears in the same issue of the Cornell Law Review.72 In this section, we address our critics with special attention to Schwartz and Kesan. For convenience, we have organized the critical comments into three main questions.

72 Schwartz & Kesan, supra note 31 at x.
1) Have we overstated the direct costs from NPE disputes?

Given the explosion of NPE patent litigation, it is difficult to precisely pin down the direct costs to defendants, but we believe the $29 billion annual figure derived above is a plausible estimate, the true number could be higher or lower. Before we take issue with the claims that our estimate is biased upward, we take a moment to review some findings that do not seem to be disputed.

We have not read anyone who seriously disputes that NPE patent litigation has exploded. Something important is happening. Over a decade the amount of NPE litigation has grown from less than 5% of all US patent litigation to over 60%. We have not read anyone who seriously disputes that NPEs have a bargaining advantage over practicing entity patent plaintiffs because NPEs are invulnerable to patent counter-claims, and they have lower litigation costs, especially discovery costs. We have not read anyone who seriously disputes that NPE litigation is concentrated in business method, software, computer, and telecommunications technologies; technologies for which many believe the US patent system performed poorly even before the rise of NPE litigation. These observations suggest that NPEs have rushed in to exploit failings in the patent system by displacing operating company plaintiffs because the NPEs can more effectively extract payments from innovators who are targeted as defendants through no fault of their own.

Thus, the case for new patent policy reform was already made before this study.

Returning to the costs from NPE disputes, we first observe that the total costs to defendants may far exceed $29 billion once the indirect costs of NPE disputes are accounted for. Our event study research indicated the annual aggregate cost to defendants from NPE lawsuits is about $80 billion. The survey we describe in this Article did not
attempt to quantify the indirect business costs from NPE patent assertions, because the lawyers who received the survey probably did not have good information on indirect costs.

The event study methodology captures the reaction of stock market investors to the filing of an NPE lawsuit. Investors care about and have reason to learn about both direct and indirect costs borne by defendant firms because these costs are reflected in changes in share value. Schwartz and Kesan criticize the event studies for two reasons. First, a professor has “harshly criticized” this methodology.73 Second, they tell us that the estimates do not correspond with their personal experiences as patent attorneys.74 Nevertheless, this methodology is widely accepted, used in over a thousand research studies.75 And we suspect that our sample of 2,887 events for publicly listed firms is likely far more representative than the experience of a few attorneys who are unlikely to have direct knowledge of investor losses in any case.76 Although the event study needs to be interpreted carefully, this sort of criticism does little to dispel the indication that the private costs of NPE disputes might well be higher than $29 billion.

Critics have identified two different types of biases that might cause our survey-based measures of direct costs to be overstated: misleading responses by respondents, or manipulation by RPX, and statistical bias attributable to the survey sample or the survey

73 Schwartz & Kesan, supra note 31 at x (discussing Glynn S. Lunney, Jr., On the Continuing Misuse of Event Studies: The Example of Bessen and Meurer, 16 J. INTELL. PROP. 35 (2008). Lunney is skeptical of the efficient market hypothesis that is central to financial economics.)
74 Schwartz & Kesan, supra note 31 at x.
75 Our search of scholarly papers in the SSRN archive (ssrn.com) found 2191 papers using the key words “event study.”
76 Schwartz and Kesan also point out that the event studies are only for publicly listed firms. Schwartz & Kesan, supra note 31 at x. That is correct; including private firms would make the aggregate cost even higher. They also criticize the study for not considering what happens after the lawsuit is filed. In fact, the paper does look for evidence of a “bounce back” by extending the event study window, but finds, to the contrary, that losses deepen. And the paper discusses the literature that finds that stock market values are not restored when the lawsuits are settled.
response pattern. We do not take the first type of criticism seriously. This study provides the best available survey data related to activities that are usually shrouded in secrecy. Ideally, the federal government will take steps to make patent settlement and licensing more transparent and make more empirical analysis of NPE patent litigation possible.77 We cannot guarantee the honesty of survey respondents, but we assume for the most part they simply copied data used in their survey responses from available business records. Why would a respondent be dishonest when there is so little to be gained from the distortion of single survey response? RPX has reputational concerns that lead us to believe it was in their best interest to help us produce an honest report. We have not received any compensation from RPX or any other source to carry out this research.78 This project fits nicely with our long-standing research interests.

Schwartz and Kesan have more plausible concerns about sample and response bias. They argue that our sample of firms (RPX clients or firms that have some relationship with RPX) has higher than average litigation costs, and that among this sample the firms that are most likely to respond are the firms with the highest litigation cost.79 Then they observe that if these biases are present, it is not appropriate to impute the mean costs derived from our survey to the entire population of NPE defendants.80

Out of concern about possible biases, Section 4.b demonstrates the plausibility of our results by benchmarking the outside legal costs and license payments measured in this study against patent litigation cost measures derived from other data sets using a

78 We did receive funding for a summer research assistant from the Computer and Communications Industry Association.
79 Schwartz & Kesan, supra note 31 at x.
80 Id.
variety of methods.\textsuperscript{81} In particular, we use two different sources of data on patent litigation costs to confirm that the payments for patent defense reported in the survey are plausible. Furthermore, we show that the license revenue per lawsuit derived by publicly traded NPEs corresponds closely to license payments reported in the survey.\textsuperscript{82} Of course critics may question whether publicly traded NPEs differ systematically from non-public NPEs in terms of their license revenue per lawsuit. Once again, the lack of transparency concerning patent licenses blocks us from further investigating this question.

Why doesn’t the bias suggested by Schwartz and Kesan appear in our survey data? They have merely identified possible biases; they have not established that these are significant. Indeed, we provide estimates of the costs of litigation from three different sources (survey, publicly listed NPEs, and stock market event studies) and these are all more or less consistent, once differences in the costs being measured are taken into account. It is possible, of course, that all three of these data sources represent biased samples, but that seems unlikely and Schwartz and Kesan would need to come up with some explanation why all three would have similar biases.

Moreover, there are \textit{a priori} reasons to believe the biases are not present or even push the data in the opposite direction. To understand the possible sample bias, one must understand why firms subscribe to the RPX service.\textsuperscript{83} If the main effect of RPX membership is a fixed reduction in expected litigation cost per defense, then high frequency defendants are more likely to select membership, but there would be no relationship between membership and expected cost per suit, and thus no sample bias. It

\textsuperscript{81} See supra text at notes x.

\textsuperscript{82} See supra text at notes x.

\textsuperscript{83} Firms select RPX service if the subscription fee is less than the expected litigation savings. RPX seeks to reduce expected litigation costs by acquiring patents, by facilitating syndicate patent purchases by members, by providing litigation intelligence, and recently by offering insurance.
is even possible that certain firms who face NPE suits at a high frequency, have a relatively high aggregate expected NPE defense cost, and lower than average defense costs per suit.\(^{84}\) This could happen if experience with NPE suits makes defendants more efficient – perhaps because they have previously gathered relevant documents to meet discovery requests, trained personnel to handle depositions, developed litigation strategies, etc.\(^{85}\) The Schwartz and Kesan discussion of response bias also confounds litigation frequency with cost per defense. They speculate that respondent firms likely had “easier access to the information.”\(^{86}\) Perhaps this is true, we have no way to know, but this seems to be an attribute associated with frequency of litigation, but not with magnitude of defense costs. Finally, they suggest various reasons why large firms are over-represented in our sample, and this may distort our results.\(^{87}\) We are careful to note that large firms do indeed face higher costs (and small firms face higher costs relative to their revenue), but we account for this difference in the extrapolation that yields our aggregate cost figure.

In the two years since we first published our event study, no one has come forward with actual empirical evidence to suggest our estimates are substantially biased. Certainly, more data and better research could generate lower estimates, but Schwartz and Kesan simply have no empirical basis for their conclusion that the $29 billion estimates is “substantially overstated.”\(^{88}\)

2) Is $29 billion in direct cost really a problem?

\(^{84}\) As Schwartz and Kesan suggest other assumptions are consistent with RPX membership being positively correlated with high costs per defense. Schwartz & Kesan, \textit{supra} note 31 at x.

\(^{85}\) One additional point, because the RPX subscription fee rises with firm size, it is not clear that only large and high litigation firms select membership.

\(^{86}\) Schwartz & Kesan, \textit{supra} note 31 at x.

\(^{87}\) Id. at x.

\(^{88}\) Id. at x.
Yes, a $29 billion tax on innovation is a problem that keeps us up at night. Not much of this payment goes to inventors or innovators, most of the payment is dissipated by transfers to the NPE owners, investors, and personnel, and the lawyers representing both the NPEs and the defendants. Most importantly, the direct costs from NPE disputes are borne by firms because they chose to innovate and thereby exposed themselves to the largely unavoidable risk of an NPE lawsuit. Unfortunately, this tax on innovation by defendant firms is not counterbalanced by significant transfers from NPEs to other inventors or innovators. Hence, patent assertion by NPEs constitutes a tax on innovation.

Schwartz and Kesan assert, to the contrary, that most of what defendants pay is merely a transfer to “meritorious” patent owners. They note that defendants’ payments to outside counsel are less than one-quarter of the total direct cost. But that is not quite right: they forget that NPEs also spend on legal fees and other operating costs. As we see from Table 5, for publicly traded NPEs, about 70% of the payments that defendants make go to legal costs of both parties or to operating costs of the NPEs. We see no evidence that private NPEs are any more efficient at transferring wealth to worthy inventors.

Schwartz and Kesan counter that the data in Table 5 are unrepresentative because they come from a small number of NPE firms and that sample includes three firms that conduct substantial R&D in house (Interdigital, Tessera and Rambus). The NPEs in that sample account for about one sixth of all of the lawsuit defenses in the total database, so while the sample is hardly a small one, but it might be unrepresentative. However, there is no reason to conclude that it necessarily is unrepresentative and, in fact, several of the

89 Schwartz & Kesan, supra note 31 at x.
90 Id.
91 Depending on how one counts profits, only a couple percent flows to profits of the NPE firms.
92 Schwartz & Kesan, supra note 31 at x.
large private NPEs are also known to conduct their own R&D. Nevertheless, this table sharply contradicts the common rhetoric about the benefits of NPEs: most of the money that defendants pay does not represent a transfer to inventors; instead it is largely consumed by legal and operating costs. If we exclude the three R&D performing firms, then 78% of the cost is consumed by these costs while 21% flows to inventors. The evidence, although limited, suggests that NPEs are hardly a socially efficient way of funding inventors.

Schwartz and Kesan also fail to consider dynamic effect on innovation incentives of the costs arising from inadvertent infringement. They fundamentally misapprehend the patent policy framework we developed in Patent Failure and apply in this Article. In Patent Failure we measured the aggregate benefits that large American firms derived from their patents, and the costs they incurred because of the assertion of other parties’ patents. We studied the period from 1984-1999, a time before NPE litigation was significant, and we found that for most technologies and most industries, the US patent system imposed a net tax on innovation. We attribute this failure to the deterioration of the notice function of the patent system. Especially for business methods and software, the patent system provides innovators who might be targeted with a patent suit with little information about the existence, ownership, or scope of relevant patent rights. The patent tax that we identified in our book arises because of legal costs, various indirect business costs, and also transfers in the form of license and damages payments.

93 Morton and Shapiro develop a formal model addressing these concerns. See, Morton & Shapiro, supra note 70.
94 Bessen & Meurer, supra note 22, at 95-146.
95 Id. at 138-146.
96 Id. at 147-164.
97 Id. at 187-214. We build the case that most patent infringement is inadvertent. For example, we show that patent defendants are hardly ever shown to be copyists. Id. at 126. See also, Christopher A. Cotropia & Mark A. Lemley, Copying in Patent Law, 87 N.C. L. Rev. 1421 (2009).
Innovation is equally discouraged by the payment of legal costs and the payment of transfers.

What Schwartz and Kesan are really expressing is simply their hope that the license payments gained by NPEs provide a positive incentive for invention and innovation, and that this incentive more than offsets the harm done to defendants. But we already know that the aggregate value of patent-based incentives is smaller than the aggregate value of negative incentives in the sectors affected by NPE litigation. Furthermore, we cast serious doubt on their premise that NPEs actually provide a significant incentive for invention or innovation. In Section 5.c we show that publicly traded NPEs transfer a small fraction of the cost they impose to inventors.

Schwartz and Kesan’s line of argument appeals to many commentators who believe that NPEs provide a special benefit to small firms and independent inventors by vindicating their patent rights.98 At the outset we are suspicious of this argument because the small inventors who really get a significant return from their patents in the biotech and medical device industries have flourished without relying on NPE enforcement. We have trouble seeing how a trickle of NPE payments to small firms in the tech sector makes much difference to the overall rate of innovation. We note that the majority of small high-tech firms do not rely on patent protection to profit from their R&D.99 We also note that only about one-half of the patents asserted by NPEs come from small firms and independent inventors.100 And this study shows that most of the firms sued by NPEs are,

98 See references cited in footnote 14.
100 RPX data, 50% of litigated patent are sourced come from companies with under $200M in revenue. Colleen Chien, Race to the Bottom Intellectual Asset Management Magazine (January/February 2012), Figure 2. Risch, Patent Troll Myths, at 27-28, 31
in fact, small firms. These findings suggest that NPEs do more to discourage innovation among small firms than they do to encourage it.

3. Are there good NPEs?

A third significant line of criticism is that our critical treatment of NPE patent litigation lacks nuance. Critics contend that certain NPEs play socially valuable roles, and they get unfairly tarnished because of the actions of other problematic NPEs. Peter Detkin from Intellectual Ventures commented on our work:

“They are taking a small piece of the puzzle and extrapolating out to the entire puzzle,” explains Detkin. He believes that the basic premise behind the research is a real phenomenon—that there are bad actors who impose costs onto everyone because of the improper way in which they use the legal system. “When I coined the term ‘troll’ more than 10 years ago, I was talking about people who take specious patents that were likely invalid and asserted them broadly across an industry to extract nuisance value settlements.” Ten years later, Detkin thinks some of the research validates his suspicions that a lot of people are “gaming the system and that there is a consummate cost to society.”

Detkin disagrees with Bessen and Meurer’s characterization of the NTP suit as socially harmful. “To me, when you win at trial and on appeal, that means that your patents are not of ‘doubtful validity’ anymore.” In fact, the amount of the settlement alone speaks volumes about the strength of NTP’s claims. As former head of IP litigation for Intel, Detkin agreed, saying “I would have to be hard pressed to go to my management and say “You should pay more than half a billion dollars for patents we don’t think we infringe.”

We certainly acknowledge that certain types of NPE behavior are likely to be socially desirable. Certain NPEs administer patent pools, others facilitate technology transfer and outsourcing of R&D. However, we disagree with the view that only

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“nuisance value” trolls are problematic. NPEs that press their assertions on to trial have a strikingly low win rate,102 and even those that find a measure of success in the court generally cause harm to innovation.

We disagree with Detkin, and with Schwartz and Kesan that an NPE like NTP is “meritorious,” and we lament the ability of NPEs to extract large settlements or court awards from small, innovative firms like RIM. We believe the NTP suit is a poster child for the problem of patent notice failure and harmful patent assertion by NPEs. NTP was founded by a failed wireless e-mail innovator named Campana and his patent attorney. Campana obtained patents on wireless e-mail containing vague claims that were hidden from RIM during the early years of research and development of the BlackBerry.103 RIM was unaware of Campana’s invention and did not become aware of his patent until after they succeeded with their innovation. Nevertheless, RIM was forced to share the fruits of its success with NTP, a company that contributed nothing to the success of the BlackBerry. Supporters of NTP might consider them “meritorious” because they achieved litigation victories in court (however, the asserted claims were later invalidated during reexamination104) and a large settlement payment. Our view is that NTP acted opportunistically to expropriate a portion of the rewards earned by a genuine innovator.

Schwartz and Kesan accuse us of focusing on the wrong question, asserting that the real question is “whether the lawsuits are being brought because the defendants are

102 Allison, et al., supra note x, at x, find that the win rate for the most litigated patents is a mere x%. Win rates must be interpreted cautiously because cases that go to trial may differ from cases that are settled. One study that controls for selection bias estimates that 59% of NPE patents would be found at least partially invalid for lack of novelty or obviousness if they were litigated through trial. Shawn P. Miller (2012), “Where’s the Innovation? An Analysis of the Quantity and Qualities of Anticipated and Obvious Patents,” George Mason University, http://mason.gmu.edu/~smille9/ShawnMillerPublication2.pdf.
103 Although NTP succeeded in court, the relevant claims were ultimately invalidated during reexamination at the PTO – too late to benefit RIM. Fix.
104 NTP has challenged this result, and that challenge has not yet been resolved. More.
infringers of a valid patent.” However, standard economic welfare analysis implies that patent litigation even over valid patents can be socially harmful. If litigation incurs tens of billions of dollars of socially wasteful expenditure each year, then this represents a static loss in social welfare. If litigation also decreases innovation incentives, then the social losses could be much larger. Large numbers of expensive lawsuits by NPEs impose substantial costs on society regardless of whether the patents involved are valid or not.

7. Policy implications

The rapid growth and high cost of NPE litigation documented here should set off an alarm warning policy makers that the patent system still needs significant reform to make it a truly effective system for promoting innovation. The heterogeneous nature of NPEs – ranging from universities, to semiconductor design firms, to trolls – suggests that policy reform should address troll-like behavior rather than merely status as an NPE.

The top priority is reform of the patent system to improve notice; this kind of reform will make the patent system perform more like an idealized property system.

105 Schwartz & Kesan, supra note x, at x.
106 Schwartz and Kesan appear to misunderstand that we applied the label of “deadweight social loss” to socially unnecessary expenditures related to litigation and assertion. They assert, incorrectly, “Bessen & Meurer’s calculation assumes every time a small inventor licenses a patent to a practicing company, it results in a “deadweight loss,” regardless of the merits of the infringement claim.” Schwartz & Kesan, supra note 31 at x. That is not so. First, ex ante licensing typically does not involve much transaction cost by comparison to the kind of ex post licensing that NPEs do. We only measure the activity of NPEs and only count social losses to the legal and operating costs, not to actual transfers to inventors or NPE investors.
More rigorous enforcement of the claim definiteness standard would be an excellent step forward. Likewise, we favor rigorous implementation of recent Supreme Court decisions restricting the patentability of business methods and other abstract processes which are difficult to propertize. It is also crucial to provide greater transparency in the patent system. Feldman and Ewing document the remarkable opaqueness of Intellectual Ventures in connection to its patent ownership and patent assertion.\textsuperscript{109} Finally, courts should rigorously supervise patent damages awards to make sure that damages are proportionate to the value of the patented technology.\textsuperscript{110} These reforms should not harm genuine inventors who crave publicity rather than secrecy, and who should still be able to obtain broad, but clear patent protection.

It is also instructive to look for policy reforms suggested by the law and economics analysis of the generic problem of frivolous lawsuits. One promising policy reform is greater use of fee-shifting to favor defendants in cases brought by trolls. Allison et al. (2010) find that troll patents fare poorly in court. The bargaining power of a troll seeking a nuisance settlement would be greatly diminished in an aggressive fee-shifting regime. Similarly, more stringent pleading requirements have been justified in other areas of the law as a method of reducing frivolous lawsuits; this strategy might also work for patent litigation.\textsuperscript{111} Lastly, we think it is wise to consider reforms that shelter end users of technology from NPE litigation.\textsuperscript{112}

\textsuperscript{109} Robin Cooper Feldman & Thomas Ewing, The Giants Among Us, x Stanf. Tech. L. Rev. x (2012) (Intellectual Ventures holds the 5\textsuperscript{th} largest patent portfolio of any U.S. company and comprises over 1200 subsidiaries).


\textsuperscript{111} Douglas, A. Blaze, Presumed Frivolous: Application Of Stringent Pleading Requirements In Civil Rights Litigation, 31 Wm. & Mary L. Rev. 935 (1990).

8. Conclusion

Using these survey data and the associated database of NPE litigation our major findings are these:

- The direct costs of NPE patent assertions are substantial, totaling about $29 billion accrued in 2011. This figure does not include indirect costs to the defendant’s business such as diversion of resources, delays in new products, and loss of market share. Even so, the direct costs are large relative to total business spending on R&D, which totaled $247 billion in 2009, implying that NPE patent assertions effectively impose a significant tax on investment in innovation.

- Much of this burden falls on small and medium-sized companies who make up about 59% of the companies sued and who pay about 37% of the direct costs. NPE litigation costs smaller companies more relative to their revenues. In addition, smaller companies pay relatively more to NPEs from assertions that do not go to court. The burden of all of these costs appears to rebut the assertions that NPEs play an important role in improving the profits of innovative start-ups.

- About a third of the cost to defendants involves patent assertions that do not go to court. Moreover, we have likely underestimated these costs because we have not surveyed small companies that do not also have NPE patent litigation.

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• NPEs appear to be highly heterogeneous. Much of the litigation appears to consist of nuisance suits that settle for a few hundred thousand dollars. But some NPEs are “big game hunters” who seek and get settlements in the tens or hundreds of million dollars.

• Little of the out-of-pocket payments made by defendants ends up in the pockets of small inventors. Only about 5% goes to independent inventors and roughly half of that goes to large firms; if one adds the R&D spending of some of the NPE companies, that share rises to 20%. Nevertheless, most of the out-of-pocket cost—roughly 70%—goes to socially wasteful legal fees or operating expenses of the NPEs.

These findings imply that the recent surge in NPE litigation is a significant social problem associated with billions of dollars of socially wasteful expenditure each year as well as reduced innovation incentives for both small and large firms. Moreover, while NPEs appear to assert a high percentage of patents that would be found invalid if challenged in court, even valid patents found impose social costs when litigated. More generally, our analysis suggests that a major cause of the high rates of litigation may be poor patent notice that creates high levels of possible inadvertent infringement. In this sense, NPE litigation may be more a symptom of a deeper problem rather than the result of a particular business model.
We join our critics in the call for more research on the costs and potential benefits of NPEs. But we also note that legal scholars have now accumulated quite a bit of empirical evidence. In particular, over the last several years we have made three different estimates of the costs that NPEs impose on defendants, each using a different data source, a different methodology and estimating a slightly different measure. Together, all three provide a reasonably consistent picture: these costs are substantial and the available evidence further suggests that the defendants’ private costs correspond to substantial social costs as well. This picture might not correspond to preconceived notions about NPEs nor to the personal perceptions of individual patent attorneys, but until better evidence comes along, this evidence provides an important guide for policy.


Colleen V. Chien & Mark A. Lemley, Patent Holdup, the ITC, and the Public Interest, 98 Cornell L. Rev. 1 (2012).
Colleen V. Chien, *Patent Trolls by the Numbers*, Santa Clara Univ. Legal Studies Research Paper No. 08-13, available at:


Tables and Figures

Notes: For 2005 – 2011. The left panel describes the sample used for this study. The right panel reports summary statistics from RPX’s database of all NPE lawsuits. In the sample, all companies report revenue. In the RPX database, only 74% of companies have reported revenue; we assume that companies without reported revenue are small/medium sized. The resolved lawsuits have been terminated due to settlement or adjudication. The number of resolved suits excludes those that were simple transfers, had zero litigation costs (e.g., for incorrect defendants), where the company was substantially indemnified, or where the costs born by the company do not reflect the total direct costs of litigation for other reasons. Revenues are for the most recent year. Small/medium companies are those with revenues less than or equal to $1 billion; large company revenues exceed this amount. Companies identified as “software” include companies whose main product is software, e-commerce, finance, or undefined. “Hardware” includes everything else.

Table 1. Summary Statistics of Sample

<table>
<thead>
<tr>
<th></th>
<th>Sample</th>
<th>Mean Revenue ($million)</th>
<th>All NPE lawsuits</th>
<th>Mean Revenue ($million)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Companies</td>
<td>Lawsuit defenses</td>
<td>Lawsuits / company</td>
<td></td>
</tr>
<tr>
<td>Number</td>
<td>82</td>
<td>1,184</td>
<td>14.4</td>
<td>$12,474.7</td>
</tr>
<tr>
<td>Resolved lawsuits</td>
<td>784</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Percent resolved</td>
<td>66%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Company size</td>
<td>Share</td>
<td>Share</td>
<td>Share</td>
<td>Share</td>
</tr>
<tr>
<td>Small/medium</td>
<td>44%</td>
<td>13%</td>
<td>2.7</td>
<td>$297.1</td>
</tr>
<tr>
<td>Large</td>
<td>56%</td>
<td>88%</td>
<td>14.9</td>
<td>$22,005.0</td>
</tr>
<tr>
<td>Company industry</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Software</td>
<td>37%</td>
<td>26%</td>
<td>6.7</td>
<td>$7,103.1</td>
</tr>
<tr>
<td>Hardware</td>
<td>63%</td>
<td>74%</td>
<td>11.2</td>
<td>$15,573.7</td>
</tr>
<tr>
<td>Public company</td>
<td>72%</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Table 2. Mean Litigation Costs per defense in million dollars

<table>
<thead>
<tr>
<th></th>
<th>Direct legal costs</th>
<th>Licensing costs</th>
<th>Total cost</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Mean (Standard err)</td>
<td>Median (Standard err)</td>
<td>Mean (Standard err)</td>
</tr>
<tr>
<td>All</td>
<td>1.38 (0.26)</td>
<td>6.53 (1.76)</td>
<td>7.91 (1.86)</td>
</tr>
<tr>
<td><strong>Company size</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Small/medium</td>
<td>0.42 (0.12)</td>
<td>1.33 (0.42)</td>
<td>1.75 (0.49)</td>
</tr>
<tr>
<td>Large</td>
<td>1.52 (0.30)</td>
<td>7.27 (2.01)</td>
<td>8.79 (2.13)</td>
</tr>
<tr>
<td><strong>Industry</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Software</td>
<td>1.50 (0.41)</td>
<td>1.82 (0.45)</td>
<td>3.32 (0.81)</td>
</tr>
<tr>
<td>Hardware</td>
<td>1.33 (0.33)</td>
<td>8.14 (2.35)</td>
<td>9.48 (2.48)</td>
</tr>
</tbody>
</table>

**Addendum on legal costs**

- **AIPLA survey (2011)**
  - Cost through discovery: 0.49 – 3.60
  - Cost through trial: 0.92 – 6.00

- **Fee shift cases (Bessen and Meurer 2012)**
  - Summary judgments: 0.84
  - Trial: 3.64

Note: Standard errors in parentheses. The total number of cases is 666; sub-category shares are listed in Table 1. Fee shift data have been deflated to 2011 dollars.
Table 3. Non-litigation costs per company in million dollars

<table>
<thead>
<tr>
<th></th>
<th>Mean cost</th>
<th>TOTAL</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Legal</td>
<td>Licensing</td>
<td>Other</td>
<td>Mean</td>
</tr>
<tr>
<td>All</td>
<td>0.50</td>
<td>24.59</td>
<td>4.66</td>
<td>29.75 (13.89)</td>
</tr>
<tr>
<td>Company size</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Small/medium</td>
<td>0.05</td>
<td>7.85</td>
<td>0.23</td>
<td>8.14 (7.68)</td>
</tr>
<tr>
<td>Large</td>
<td>0.77</td>
<td>34.40</td>
<td>7.25</td>
<td>42.43 (21.22)</td>
</tr>
<tr>
<td>Industry</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Software</td>
<td>0.38</td>
<td>11.83</td>
<td>4.14</td>
<td>16.35 (9.14)</td>
</tr>
<tr>
<td>Hardware</td>
<td>0.56</td>
<td>30.76</td>
<td>4.91</td>
<td>36.24 (20.03)</td>
</tr>
</tbody>
</table>

Note: Standard errors in parentheses. Results are for a sub-sample of 46 companies that reported full litigation and non-litigation costs. Figures are totals over 2005-11 per company, although not all companies reported all years.
Table 4. Aggregate Accrued Direct Costs of NPEs by Year

<table>
<thead>
<tr>
<th>Year</th>
<th>Small/medium</th>
<th>Large</th>
<th>Small/medium</th>
<th>Large</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>919</td>
<td>482</td>
<td>$2,916</td>
<td>$3,657</td>
<td>$6,574</td>
</tr>
<tr>
<td>2006</td>
<td>899</td>
<td>530</td>
<td>$2,853</td>
<td>$4,021</td>
<td>$6,874</td>
</tr>
<tr>
<td>2007</td>
<td>1,238</td>
<td>976</td>
<td>$3,929</td>
<td>$7,406</td>
<td>$11,334</td>
</tr>
<tr>
<td>2008</td>
<td>1,571</td>
<td>1,004</td>
<td>$4,985</td>
<td>$7,618</td>
<td>$12,603</td>
</tr>
<tr>
<td>2009</td>
<td>1,461</td>
<td>1,198</td>
<td>$4,636</td>
<td>$9,090</td>
<td>$13,726</td>
</tr>
<tr>
<td>2010</td>
<td>2,588</td>
<td>1,857</td>
<td>$8,213</td>
<td>$14,090</td>
<td>$22,303</td>
</tr>
<tr>
<td>2011</td>
<td>3,424</td>
<td>2,418</td>
<td>$10,866</td>
<td>$18,347</td>
<td>$29,213</td>
</tr>
<tr>
<td></td>
<td>59%</td>
<td>41%</td>
<td>37%</td>
<td>63%</td>
<td></td>
</tr>
</tbody>
</table>

Note: Aggregate costs are calculated by the method described in the text. Aggregate costs include legal costs, settlement costs and other costs for resolved lawsuits, unresolved lawsuits and non-litigated assertions. These report accrued costs, that is, we include the full projected cost of currently unresolved lawsuits.
Table 5. Annual Payments From Defendant to NPEs and Inventors

<table>
<thead>
<tr>
<th>Payments from defendants</th>
<th>Annual Expenditures ($2010 millions)</th>
<th>Share of Defendant Payments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Licensing revenues of NPEs</td>
<td>$1,161</td>
<td>77%</td>
</tr>
<tr>
<td>Implied defendant legal cost</td>
<td>$348</td>
<td>23%</td>
</tr>
<tr>
<td>TOTAL defendant payments</td>
<td>$1,510</td>
<td>100%</td>
</tr>
</tbody>
</table>

**Payments for invention**

<table>
<thead>
<tr>
<th></th>
<th>Annual Expenditures ($2010 millions)</th>
<th>Share of Defendant Payments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Royalties + patent acquisition</td>
<td>$59</td>
<td>5%</td>
</tr>
<tr>
<td>Small inventors</td>
<td>$32</td>
<td>3%</td>
</tr>
<tr>
<td>Large inventors</td>
<td>$27</td>
<td>2%</td>
</tr>
<tr>
<td>NPE own R&amp;D</td>
<td>$169</td>
<td>15%</td>
</tr>
</tbody>
</table>

**NPE operating costs**

|                        | $818                                 | 47%                        |

**NPE net income**

|                        | $115                                 | 10%                        |

$1,161
Figure 1.

Source: RPX database
Figure 2. Cumulative Distribution of Total Direct Litigation Cost by Company Size

Note: Horizontal axis is logarithmically scaled. Distributions are fit with lognormal cumulative distribution functions. The distributions are for resolved lawsuits.
Appendix

Table A1. Log cost regressed against log company revenue

<table>
<thead>
<tr>
<th></th>
<th>(1)</th>
<th></th>
<th>(2)</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Coefficients</td>
<td>Standard Error</td>
<td>Coefficients</td>
<td>Standard Error</td>
</tr>
<tr>
<td>Intercept</td>
<td>10.30</td>
<td>(0.85)</td>
<td>10.90</td>
<td>(0.91)</td>
</tr>
<tr>
<td>Ln(Rev)</td>
<td>0.13</td>
<td>(0.04)</td>
<td>0.10</td>
<td>(0.04)</td>
</tr>
<tr>
<td>Revenue &lt; $100m</td>
<td>-1.11</td>
<td>(0.63)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Note: 784 observations.