

Intellectual **PROPERTY**

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VirnetX lawyer
Douglas Cawley

A tiny Nevada
company tries to
prove its critics wrong.

Trolling for Respect

BY ANNE STUART

LOUSY PATENTS = MESSY LITIGATION ■ IS THERE A FOREIGN ACCENT TO TRADE SECRET CASES?

A tiny Nevada company denies that it's a nonpractice entity.

Trolling for Respect

BY ANNE STUART

Before last spring, VirnetX Holding Corporation was on a roll.

The tiny Zephyr Hills, Nevada, software company had gone to trial against three high-tech giants—Microsoft Corporation, Apple Inc., and Cisco Systems Inc.—accusing each of infringing on its patents for technology that automates secure Internet communications. Represented by outside counsel Douglas Cawley of McKool Smith in Dallas, VirnetX won multimillion-dollar awards against Microsoft in 2010 and Apple in 2012 in jury trials before U.S. District Judge Leonard Davis in Tyler, Texas. (Microsoft later settled for \$200 million; Apple has appealed.) Along the way, Cawley and VirnetX settled similar suits against other major players, including Siemens AG, NEC Corporation, and Mitel Networks Corporation.

Then came the Cisco trial in March, in which Cawley faced Cisco's outside counsel, New York lawyer John Desmarais. The case involved the same infringement claims, the same court and the same judge—but a different jury and,

ultimately, a very different outcome.

This time, VirnetX lost.

The verdict must have seemed sweet to VirnetX's critics, who haven't been shy about calling VirnetX a patent troll—a business that exists primarily to pursue aggressive patent-infringement lawsuits against other companies. But Cawley, whose motion for a new trial blames the loss on "Cisco's intentional (and successful) efforts to confuse the jury," calls that characterization unfair.

"I think it's not legitimate and, in fact, it's offensive," he says. "This is a company that was founded to build products. But they don't have the resources to release a major product in the face of this litigation," he says. Instead, he says, VirnetX has had to invest its time and money to protecting its intellectual property. Had VirnetX not done this, he says, the company would have vanished long ago. It is fair, though, he says, to call it a David-and-Goliath case, "and to make matters worse, Goliath is slinging mud at David and calling him a patent troll."

But the Goliaths on the receiving end of VirnetX's lawsuits paint a different

picture of that David. Representing Microsoft in that 2010 trial, defense attorney Matthew Powers accused VirnetX of purchasing the patents from another company solely "to go sue Microsoft" for infringement. "VirnetX has never sold a product, never," Powers, then with the Silicon Valley office of Weil, Gotshal & Manges and now at his own firm, Tensegrity, told the jury.

Representing Apple in 2012, Danny Williams of Williams, Morgan, & Amer-son, took a similar tack: "They haven't sold anything," Williams told the jury in his closing arguments. Yet VirnetX, which is traded on the New York Stock Exchange, "has convinced the stock market that they are worth \$1.5 billion," Williams said, referring to testimony about the company's market capitalization. "How are they going to hold up that paper worth that they've convinced the stock market is real? Ask yourself: Is this what's going on here?"

AS CAWLEY HAS EXPLAINED SEVERAL times in court proceedings, VirnetX's history—at least conceptually—dates back to when the first Gulf War started



VirnetX lawyer Douglas Cawley says Cisco confused the jury.

in 1990 and when the U.S. military was trying to defend itself against the Iraqi army's Scud missiles. The military was using an unmanned aircraft for reconnaissance to detect these ballistic missiles and quickly transmit images of them via satellite to the battlefield or the Pentagon, which in turn could have aircraft or troops destroy the missiles before launch.

The problem: Military satellites were at capacity at the time, and the information being transmitted required far more bandwidth than was available. The only other option: renting a public satellite also used for broadcast television—an option that was, of course, far less than secure.

So the military turned to a major defense contractor, Science Applications International Corp. (SAIC) of McLean, Virginia, to develop a method for securing those communications. After completing that project, Cawley says, the SAIC systems architect who headed that team, a retired U.S. Navy officer and Vietnam veteran named Edmund "Gif" Munger, began thinking about similar ways to

quickly and reliably secure other types of communication over public and commercial channels. Their efforts coincided with the rise of the public Internet.

By the late 1990s, Munger and his SAIC colleague, electrical engineer Robert Short III, were working on projects to develop secure online communication channels for the Central Intelligence Agency. Their efforts included ways to protect virtual private networks (VPNs), which are widely used to allow remote users to access an organization's network via a highly secure path or "tunnel" through the Internet or another public infrastructure.

The problem: At the time, the process of using secure VPNs was so cumbersome and complicated that the team worried that most of the CIA's users would bypass them in favor of simpler—but less secure—ways to communicate. In the 2010 Microsoft trial, Cawley used this analogy: "If you have a burglar alarm system and the keypad is so complicated that you can't really figure it out, then you're going to leave the house without setting it. That's the way we all are," he told the

jury. "And the people working on this knew that wasn't a solution for what the CIA needed for one of its agents to be able to quickly but securely communicate over the Internet."

In 1999 the two developed technology to simplify the process; the following year, while still with SAIC, they filed for the first two patents on it. (The Patent and Trademark Office issued the first patent in 2002, the second in 2007.) However, Cawley says, as a development company, SAIC wasn't interested in starting a business to promote the technology.

Around the same time, a mutual acquaintance introduced Munger and Short to another security-industry veteran, Kendall Larsen, then senior vice president and general manager of security products for another CIA contractor, Phoenix Technologies Ltd., a Milpitas, California-based software company. Larsen's lengthy IT-industry resume included stints as a senior executive, primarily in sales, for RSA Security, Xerox Corp., IBM, Novell, and others.

Larsen was captivated by Munger and Short's work: "He believed this invention would transform the way people communicated over the Internet, and he encouraged Phoenix to adopt it," Cawley says. "But this was shortly before 9/11"—and, after the terrorist attacks of September 11, 2001, many companies, including Phoenix, shifted their focus to projects related to national security and antiterrorism.

When Phoenix declined to take on Munger and Short's invention, Larsen left the company and spent the next few years raising seed money to build a business around the invention. Initial investments came from friends and relatives, followed by two rounds of funding from a small investment fund.

VirnetX was formally incorporated in 2005. (The company's name, which Cawley says was Munger's idea, is a contraction of "virtual network exchange.") In 2006 the company acquired the patents from SAIC and hired Short as chief scientist and Munger as chief technology officer (the latter has since retired). In 2007, after a reverse merger with PASW, a small publicly held company, VirnetX Inc. became VirnetX Holding Corp. The company, which has 15 employees, was initially based in Scotts Valley, California, south of San Jose; it's since moved about 250 miles away to Zephyr Cove, Nevada,



John Desmarais says Cisco maintains that VirnetX could not patent what Cisco was already doing.

a small town just over the state line, to take advantage of Nevada's tax benefits.

As its first project, the company wanted to adapt its technology to make it easier for users of the Microsoft Windows operating system to use the Internet securely. "Their vision was that they would come up with a product that users could use as a patch, and any communication functionality that Windows offered could be secured without anybody having to do anything more than push a button," Cawley says. "So they wrote the software and developed the product."

And then, he says, came a nasty surprise: They discovered that the Windows software was already being sold with the same capability, offering secure business communications "with just one click." That effectively torpedoed VirnetX's effort, Cawley says: "The product had been designed as an add-on to Windows, and since Windows already did this, no one was going to be interested in the technology."

SO IN 2007, VIRNETX FILED A LAWSUIT against Microsoft, claiming infringement

on two patents for secure VPN technology. (Originally represented by Morrison & Foerster of San Francisco, VirnetX switched to McKool Smith about nine months before trial. Cawley says he doesn't know the reason for the switch, but it may have to do with his 2009 victory over Microsoft in a similar patent infringement suit filed by i4i Inc., a Canadian company that makes content management software. In 2011 the U.S. Supreme Court upheld a federal court decision ordering Microsoft to pay i4i nearly \$300 million in damages.) On the trial's opening day, Cawley told the jury "that 'just one click' that Microsoft refers to that starts the invention is the same as what was patented by Mr. Munger and Dr. Short and their co-inventors." Microsoft, of course, disagreed, arguing that one of its own employees—a witness at the trial—had worked on the concept as early as 1996. But the jury sided with VirnetX, awarding the company nearly \$106 million. Microsoft later settled for \$200 million and a licensing agreement.

Within months after the Microsoft verdict, VirnetX filed similar suits against

Apple, Cisco, and several other companies, all in the Eastern District of Texas. Why that particular location? "It's known as being a friendly venue for patent holders to bring suits and as a 'rocket docket,' a place where cases are decided relatively quickly," says Christina Mulligan, an intellectual property specialist and assistant professor at the University of Georgia School of Law. Cawley agrees: "You can reliably get to trial in 18 months to two years," he says.

While most of the defendants ultimately settled [see timeline], Apple and Cisco battled through to trials, with roller-coaster results. In November 2012 VirnetX scored its \$368 million verdict over Apple; in March 2013, the VirnetX lost to Cisco—and saw its stock drop by nearly 27 percent.

Based on what it called "Cisco's campaign of confusion," VirnetX promptly requested a new trial and judgment as a matter of law. "The grounds in general were that the judge's claim construction and the undisputed evidence established that there was infringement and that Cisco argued differently than what the judge had said was the correct construction for the claim," Cawley says. In his motion, Cawley wrote: "Cisco's counsel was so persistent in confusing the jury that VirnetX had to approach the bench 28 times during trial . . . its counsel continued its deliberate attempts to confuse the jury all the way through closing arguments."

DAVIS'S RULING ON VIRNETX'S request was pending at press time. Desmarais declined to be interviewed before hearing Davis's decision, but did respond to an emailed question about why Cisco prevailed when Apple and Microsoft lost. "VirnetX's patents were directed to a very specific set of inventions that were never commercialized because they were not needed or useful on the commercial Internet," he wrote. "In the litigations, VirnetX tried to read their patent claims broadly enough to cover traditional VPNs and other secure communications that were already being used in Internet applications. Our

approach to the trial was to repeatedly emphasize the commonsense theme that you cannot patent what Cisco was already doing. Apple did not run that theme. Microsoft tried that approach, but did not execute it effectively.”

But Microsoft, at least, did share Cisco’s opinion about the value of VirnetX’s technology. During that trial, lead attorney Powers pointed out repeatedly that SAIC, Phoenix Technologies, and other companies had repeatedly turned down the option to buy the technology. “Everybody who has looked at their technology closely, who had the technical expertise to evaluate it, who had the economic motivation to invest in it or buy it because it would be worth a lot of money if it really worked, all of those people said ‘No,’ ” Powers told the jury, according to a transcript. “That’s the reality.” (Powers declined to comment for this article.)

Attorneys for both Microsoft and Apple have characterized VirnetX as a company that sues first and talks later. During the Microsoft trial, Powers told the jury that after the software giant received VirnetX’s letter claiming patent infringement, Microsoft wrote to VirnetX twice asking for details and requesting a meeting. “They gave us no information. They had no meeting,” Powers said, according to a transcript. “What they did was sue us.” In the Apple trial, Williams argued that VirnetX never approached his client to discuss its suspicions that numerous Apple products contained VirnetX’s technology. “They just sued them outright,” Williams said, according to a transcript. Testimony from VirnetX’s own witnesses indicated that the company viewed Apple as “a great potential customer” for VirnetX’s technology, Williams said. “Nevertheless, they came and sued us first. They didn’t come and talk to us.” (Williams didn’t respond to requests for comment.)

AT PRESS TIME THE COMPANY WAS awaiting rulings in the Apple and Cisco cases—and

had filed new suits accusing both Microsoft and Apple of patent infringement in products released since the original complaints. Meanwhile, the company’s primary source of revenue is its \$200 million settlement from Microsoft.

But CEO Kendall Larsen insists that his company isn’t a patent troll. “The judge has said he’s never allowed a patent troll in his court and he doesn’t consider us one, and we’ve been there three times now,” he says. “The Patent and Trademark Office doesn’t view us that way. We have inventors in-house.”

And the fact that the company hasn’t yet produced a product is meaningless in terms of patent protection, he says. “It’s a component technology,” he says. “Not everyone has to be an end-user product provider.” In June the company announced the availability of its Gabriel Connection Technology OEM Software Development Kit, described as the first in a series for companies who want to incorporate VirnetX’s technology into their own applications.

VirnetX CEO Kendall Larsen says that Judge Davis doesn’t allow patent trolls in his courtroom and doesn’t consider his company to be one.

That said, the company does hope to create end-user products eventually, Larsen says. “But that shouldn’t be the basis of our decisions about patents. You can’t fight too many wars at one time, and you’ve got to defend the company’s patents and capital.”

Mulligan, the University of Georgia professor, doesn’t buy it. “VirnetX is the canonical patent troll. It is a ‘patent-holding company.’ It has never made any product or provided any service. Its business model is to acquire patents and assert them against companies that independently developed the technology

described in the asserted patents.”

Such activity subverts the intent of the patent system, she says. “We think of patents as good, because they provide incentives for inventors to create new products without the concern that a competitor will copy the product without having to pay the potentially high costs of developing the invention themselves. But this system does not work when the patent holder does not practice the patent, waits for someone else to invent the same thing, and attacks the subsequent inventor with a lawsuit or demand letter it could not have expected.”

Michael Risch, associate professor at the Villanova University School of Law, disagrees. “There are tons and tons of real patent trolls out there,” he says, but he doesn’t count VirnetX among their numbers. He considers VirnetX’s real business to be licensing, a common and legitimate approach in the high-technology industry. “We have some great inventions from companies that spend money on research and development but don’t make any-

thing,” he says, adding: “Buying patents is part of our history.”

In Cawley’s view, the story is simply one about a small group of entrepreneurs whose dreams of bringing an invention to market have been sidelined by the need to fight off much larger predators. “This is a company that was founded to build products. But they discovered that major technology companies did not respect their intellectual property. They were, essentially, foreclosed from the market,” he says. “They have to devote all their resources to this [litigation]. Had they not done so, they would have disappeared back in the late 2000s.” ■