

## Patent dispute over the App Store This man demands \$18 billion from Apple

Patrick Racz accuses Apple of stealing his idea and developing iTunes and the App Store based on it. He is demanding a huge sum in compensation. Who is the man - and does he have a chance?

By **Sascha Zastiral**

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The "Home House" in central London aims to be a "community of eccentric characters and individuals." The decoration inside the chic private members' club is clearly aimed at this: in an adjoining room on the first floor, a huge crystal chandelier hangs from the high, gold-painted stucco ceiling. Two statues frame the fireplace. On a table in the middle of the room stands a large rhinoceros sculpture decorated with pieces of mirror. The music channel MTV once held parties here.

Patrick Racz is sitting in one of the armchairs. The 60-year-old is tall and stocky, with short, dark hair. He is wearing jeans and a black sweater under his jacket. In the 1990s, Racz was involved in the founding of the private club, which soon attracted leading representatives of the music industry. Racz had made a name for himself as a successful inventor and entrepreneur in London.

After discussions with representatives of the music industry, the entrepreneur developed the concept for a download and payment portal on the Internet. Users would be able to buy or rent copy-protected music, films and games.

Sound familiar? For good reason, says Racz. He accuses [Apple](#) of stealing his idea and using it to develop the iTunes and App Store, among other things. He is demanding a massive \$18 billion in compensation .

It is the fight of one man against a global corporation: for years, the inventor and Apple have been waging a patent war in American courts. Racz is supported by wealthy investors. And it is not impossible that he will win.

### From horticulture to water filters to the technology sector

When Patrick Racz talks about his life, he speaks calmly and with British understatement. He grew up on a strawberry farm on the Channel Island of

Jersey. His father was one of the hundreds of thousands of Hungarians who fled the country after the failed uprising against the communist regime in 1956. He only went to school for eight years - a fact that critics like to point out when they want to discredit Racz. He only found out the reason why Racz had little use for school lessons when he was over 40. That was when he was diagnosed as being on the autism spectrum.

"People didn't know what it was back then," he says. "So it wasn't recognized in me. I just learned differently than other children. My brain is wired differently." This also expressed itself in his talent for creative solutions, he continues. "It helped in business because I was always able to outline a path to future products and future markets." Racz is in prominent company. Well-known personalities who publicly acknowledge their neurodiversity include Virgin founder [Richard Branson](#) and Tesla and SpaceX owner [Elon Musk](#).

After dropping out of school, Racz initially completed an apprenticeship in horticulture. In the 1980s, in his early 20s, he moved to London and began working in sales for a company that sold office equipment.

In the mid-1980s, however, Racz read a Guardian article about how awful the quality of tap water was in many British cities at the time. That gave him an idea: "At that time, practically nobody was selling water filters in the UK. It was a business opportunity." Racz flew to Philadelphia to work for water filter manufacturer General Ecology, used his savings from selling office equipment to buy a container load of water filters on the spot, and in return received a promise that the company would be his exclusive supplier in the UK. "It was a success. In the first year, we were able to sell filters worth half a million pounds."

When other companies followed suit and the market became tighter, Racz had his next business idea: the water filters he sold were installed directly under the sink. The filtered water came from a small faucet that had to be screwed into the sink. Kitchen manufacturers were not very enthusiastic. "The designers didn't like it because it had a negative effect on the aesthetics of a modern kitchen. The installers complained because it was difficult to drill through stainless steel," says Racz. So he developed a mixer tap for the kitchen with an additional faucet for filtered water. Racz applied for a patent for his three-way faucet, which he called "Triflow." He found two business partners who were already working in the plumbing sector. Together they founded the faucet manufacturer Triflow Concepts in 1989. "We grew by 40

percent every year for ten years," says Racz. That's when he got his nickname, which sticks with him to this day: "Tap Man."

At the end of the 1990s, Racz sold his shares in the company to his business partners "in a multimillion-dollar deal," as he says. Too early, he says dryly. "I should have stayed longer, especially in view of what followed. But I wanted to get into the technology sector."

### **Racz saw the Napster disaster coming for the music industry**

The trigger was a business trip to South Korea in 1998. "A business partner showed me his MP3 player, the 'MPMan'." It was the first commercially available MP3 player in the world. A short time later, during a trip to the USA, he saw another early model, the Diamond Rio PMP300, and bought it. Back in Great Britain, he showed the device to his friends in the music industry. "Some of them said at the time: This is just a short-lived trend, it won't catch on." Racz warned his friends to take the technical innovation seriously. "I explained to them that it could decimate the music industry. Because at the time there was no way to pay for MP3 files, no rights management and basically no system to control it." In short: Racz anticipated what the file-sharing platform Napster would do to the industry from 1999 onwards.

That's how he came up with the idea for his anti-piracy alternative "Smartflash," says Racz. "I was sitting in my office with the MP3 player and a card reader for American Express credit cards in front of me." At that time, the first credit cards with a chip came onto the market. He looked at both and thought: This could be the solution. A chip-based card system as a supplement to playback devices such as computers or MP3 players, on which "banking functionality, personalization and accountability" could be combined. End customers should be able to buy or rent digital goods such as music files, videos or e-books, which would then be linked to their digital ID.

However, Smartflash did not necessarily have to rely on a card-based system. Apple claimed this in court, but failed "because it is not true," says Racz's team. Rather, the patent applications show that the technology could also have been integrated into the end devices themselves.

He quickly looked around to see if there was any comparable system on the market, says Racz, and filed several patent applications. And he hired IT expert Hermen Hulst to work out the software architecture. Hulst, who is listed as co-inventor of the patents, later went into video game development.

Racz also struck deals with retailers and manufacturers. Gemplus, a French SIM card manufacturer, came on board as a technology partner. Pop star [Britney Spears](#) was to become a brand ambassador.

But in March 2000, the entire technology sector was thrown into turmoil. The dot-com bubble began to burst. Smartflash also went into a tailspin, although not because of the dot-com crash itself, Racz stresses today. Gemplus withdrew its support as a technology partner and a loan of 100 million euros. A spokeswoman for Racz added after the interview: "The support was withdrawn because, as Patrick did not know at the time, senior executives at Gemplus had close ties to [Steve Jobs](#) and Apple and in 2001 revealed details of Smartflash's plans, plagiarized Patrick's intellectual property and tried to pass off his technology as their own."

The Thales Group, which bought Gemplus successor Gemalto in 2019, did not comment on the allegations when asked.

### **The fight against Apple became Racz's new life mission**

Racz says he put all his assets into his company to keep it alive. "We had offices in Philadelphia, London and Paris. I sold shares in technology companies that I owned for a fraction of their value. My employees' salaries were costing me £150,000 a month at the time. I didn't want to give up." But it was no use. In 2002, Racz had to liquidate his company. "I put my heart and soul and a lot of money into developing this technology. In the end, I was left with nothing."

For the entrepreneur, the bankruptcy became a personal crisis, and he fell into a deep hole. "I lost a year of my life," says Racz. "I couldn't look at my children without bursting into tears. I felt like I had let my wife and my family down."

When Apple boss Steve Jobs introduced the iTunes Store in April 2003, Racz was furious. He believed he recognized many elements of his Smartflash concept, "for example in the way Apple connected software with hardware." Only later did he find out that Gemplus also worked for Apple. A leading Gemplus employee, to whom Racz had explained his plans for Smartflash in detail in 2000, is said to have been given a director position at Apple in 2005.

Racz was not able to do anything about it until 2008, when he was granted patents in the USA. He began looking for allies who could help him take Apple and other companies to court, which he also accused of violating his

patents. In 2009, a lawyer in London introduced him to Montague "Monty" Koppel, a financially strong investor. Koppel attracted further investors. They promised Racz the necessary financial means to take action against Apple. If the tech company lost or agreed to a settlement, they would receive half of the amount paid.

"Monty became something like a father figure to me back then," Racz recalls of the investor, who died in 2017. "He gave me my life back. We were very close friends." For Racz, the fight against Apple became his new life's mission.

### **An initial success was not lasting**

In 2013, a Smartflash subsidiary, to which Racz had transferred the rights to his patents, filed a lawsuit against Apple in a federal court in Texas. Further lawsuits against [Google](#), [Amazon](#) and [Samsung](#) followed.

In February 2015, the sensation came: The jury in Texas awarded Smartflash compensation of \$533 million. The jury found that Apple had infringed three of Racz's patents, which related to digital rights management, data storage and payment systems. And they concluded that Apple had not only infringed the patents without permission, but had also done so intentionally.

Apple immediately counterattacked after the decision. The company said in a statement: "Smartflash does not manufacture products, has no employees, creates no jobs, has no presence in the United States, and exploits our patent system to demand royalties for technology that Apple invented." Apple refused to "pay this company for ideas that our employees have worked for years to innovate." "Unfortunately," the company had no choice "but to fight this battle through the court system," the statement continued.

In other words, Apple branded Racz a so-called patent troll. The consequences were not long in coming. Racz and his family were inundated with hate messages, including death threats. "What kind of person looks up an email address and then writes to the person that their children should be burned alive? Or that ISIS terrorists should behead them?" Racz asks incredulously. "Apple stole my technology and ruined my life." He had to hire bodyguards.

### **A company-friendly patent law helps Apple**

Apple spared no expense or effort to push back against Racz's claims. The Cupertino-based company also took action against Racz's patents. A committee that was only created in 2012 played into Apple's hands.

After US corporations increasingly came under pressure from patent hunters who registered patents or acquired them with the obvious aim of collecting royalties, they lobbied in Washington and were heard: The government weakened some aspects of patent protection in the US and set up the Patent Trial and Appeal Board (PTAB), which can retroactively declare patents invalid - which has since happened thousands of times. Critics complained that the new regulations had excessively strengthened large corporations over smaller companies and investors. Christopher Coons, a Democratic senator, once complained that the regulation had led to "a steady erosion of patent rights."

Racz says Apple initiated nearly 50 cases before the PTAB between 2015 and 2018. Some of the decisions were made by judges who had previously worked as lawyers for Apple, Racz complains.

Boris Teksler, Apple's former patent chief, once made something of a Freudian slip in connection with the PTAB: According to the magazine "The Economist," Teksler admitted that "efficient infringement" of patents, where the benefits outweigh the legal costs of defending against a lawsuit, could almost be seen as a "fiduciary duty." At least for capital-rich companies that can afford to litigate endlessly. When asked, Apple did not comment on this. The company refers to its statement from 2015 and to two court rulings.

Starting in the summer of 2015, Apple gained the upper hand in the dispute with Racz: The judge who had once presided over the proceedings in Texas stayed the jury's decision against Apple. He himself had incorrectly informed the members of the jury about the calculation of the damages. The amount of compensation should therefore be renegotiated. In March 2017, an appeals court completely overturned the jury's decision. A year later, in April 2018, a federal appeals court also upheld the PTAB's decision that several of Racz's patents were invalid.

**Legal expert: "US authorities are often staffed with industry insiders"**

However, the Briton shows no signs that he will end his dispute with Apple any time soon. He assures us that the investors who support him are still on board.



Racz is currently suing the US Patent Office to force the release of unredacted emails and documents relating to his patents. Racz wants to use this to prove, among other things, that Apple has used its influence and power to influence the patent system in the US.

The sum that Racz is now demanding from Apple – \$18 billion – corresponds to the inflation-adjusted revenue that Smartflash “lost due to Apple’s patent infringement,” explains a Racz spokeswoman.

Robin Feldman, a law professor at the University of California in San Francisco, has mixed feelings about Racz's dispute with Apple. "US authorities are often staffed with industry insiders who share the industry's perspective," says Feldman. "If that is the case, it could be difficult for Mr. Racz to prove that the authority is specifically biased against his case." However, she admits: "The entire system could be rigged in favor of the industry."

Racz's patent claims are also formulated very abstractly, the professor adds – as was common at the time. "Most software patents were drafted this way when Mr. Racz filed his patent." But the US Supreme Court has rejected exactly this type of formulation in a number of cases. In 2014, the Supreme Court declared in the so-called Alice decision "that an inventor must add more than just 'conventional steps specified at a high level of abstraction,'" explains Feldman. "Reading, retrieving and writing data," for example, as described in Racz's patents, "could easily be viewed as similar to what was rejected in the Alice decision." Since then, however, the courts and the patent office have not always conscientiously followed this decision, although they are obliged to do so, Feldman adds.

Meanwhile, Patrick Racz continues to work on telling his side of the story. Simon Morris, the former Chief Creative Officer at Amazon and a personal friend, is currently trying to find a film studio that is interested in producing a documentary about the dispute between Smartflash and Apple, says Racz. He himself is working on his autobiography and is in talks with publishers about it. The title of the planned book: "Rotten Apple."