

An Economic Battle Plan For Patent Litigation

Monday, March 19, 2007 --- \$1.5 Billion. A phrase that should sharply concentrate the mind of any in-house IP counsel.

That's the verdict against Microsoft brought in by a San Diego jury in a patent infringement lawsuit this February. According to Bloomberg News, verdicts in the 10 largest patent cases in 2006 totaled another \$1 billion.

Patent litigation can be deadly for your company – not just from legal fees or the possibility of an injunction, but from increasingly common massive damages awards and the heavy impact of these cases on a company's ability to compete.

Focusing on the science of patent cases instead of the economics may represent a lost opportunity for a plaintiff and nothing short of a fatal injury for a defendant.

This article is not going to wax romantic about the wonders of invention, the genius of Thomas Jefferson or the struggles of the mythical garage inventor.

We are not concerned here about maintaining the purity of the patent system or in patent "reform" which is proposed in every Congress and never happens. And, although they are simply economic parasites, this article will not tell you how to destroy patent trolls – just how to lessen the damage they cause.

This article discusses the use of patent litigation by corporations to achieve the greatest possible economic advantage over their competitors – how plaintiffs can maximize the competitive benefit and how defendants can minimize such advantage for plaintiffs and perhaps, even damage their opponent's competitive position

For too long, patent litigation has been overwhelmingly focused on the "science" of the case. Technically-trained litigators pore over file histories and spend hours in creative claim construction – all to get a "perfect" result where all of the technical pieces fit together for infringement or anticipation.

While this scientific inquiry is going on, however, the economic side of the case is often just a second thought. Damages analyses are performed by accountants rather than economists and without any real economic analysis. The competitive relationship between the litigants – critical to any sophisticated damages analysis – is sometimes virtually ignored.

What can a litigant do to get the focus where it ought to be – on the bottom

line?

1. For Plaintiffs – Choose your targets wisely

If you are not a patent troll – meaning a plaintiff who either has no “real” operations or does not practice the patent being sued on – your selection of targets for potential lawsuits should closely track the company’s competitive objectives. Although throwing a wide net to all possible infringers might seem like a good idea (and probably is a good idea for a licensing program), when it comes to actually filing a lawsuit and getting into a two-year-long multimillion-dollar war, you should focus on the companies whose infringement is actually costing you sales. Indeed, under any theory of patent damages recovery, the more direct a competitor a defendant is, the higher the potential recovery – and, of course, the more effective the injunction.

When prioritizing potential targets, look closely at not only your current competitors but, even more particularly, at the companies who are in the space you want to enter. Clearing out that space before you introduce that new product line can make that next move much easier.

2. For Defendants – Determining why you were sued can govern your counterattack

For a defendant, often it is obvious why a plaintiff has chosen to come after you, but just as often it is simply baffling. Where the plaintiff is obviously trying to drive you out of the market or knock you down a peg, it may be time to bring out some of your own patents (or even acquire some patents) to fire back with. If your opponent has any sense, it will not give you a license to practice those very patents that give it a competitive advantage (except at an outrageous price), although you should certainly license those patents if you can afford to do so.

Another tack a defendant can use against a direct competitor is to put its energies into designing around the patent as early as possible. Not only will this make any possible injunction difficult, if not impossible to obtain, but it will cut off damages for continuing infringement, reduce the plaintiff’s ability to recovery for past damages and enable you to continue to compete against your litigious competitor. Designing a “non-infringing substitute” should not be left to the last minute.

When you are sued by a troll or by a company against whom you do not compete, the economic stakes are different. It is less likely that you will be able to countersue with your own patents, but the potential damages award should be lower that it would be if the plaintiff were a direct competitor – lost profits damages are not available at all and damages in the form of a reasonable royalty should be substantially lower. Indeed, where a plaintiff is not a competitor and the cost of designing around the patent is modest, the potential damages can practically be eliminated altogether

3. Hire an economist early

As previously noted, it is not uncommon for accountants to be hired as damages experts. This, in my opinion, is wrong. Not only should your damages expert be an economist – to perform the very sophisticated analysis required by the Federal Circuit, but plaintiffs should consider bringing in an economist even before they file – to assist in the selection of targets whose infringement is causing the company the most competitive injury and whose exclusion from the market will do the company the most good.

Establishing the market in which the patented goods and the infringing goods compete is critical to any sophisticated damages analysis – this task can only be reliably performed by an economist.

4. Make your damages analysis a priority

This suggestion is critical as a sheer matter of strategic litigation analysis. As we all know, patent litigation is a long haul, expensive in both legal fees and in corporate resources. Before a plaintiff decides to go down this road, or a defendant decides it is not willing to settle early and wants to fight it out, each party should do at least a preliminary damages analysis, assisted by an economist. Without knowing the real risk and reward of proceeding deep into the litigation, the parties cannot make an intelligent analysis of whether to try to settle early and how hard to fight.

Although the above might seem to be an obvious piece of advice, it is surprising how infrequently it is followed. More often than not, litigation is launched, and continued, based solely on an analysis by the engineers of the likelihood of an infringement verdict or of a finding of invalidity, with damages analysis left to the last minute. Although this might have made a modicum of sense when an injunction was a certainty after a finding of infringement, in the wake of the eBay decision, proceeding with a case without a hard look at the possible damages award, makes little sense.

5. Make any settlement serve a competitive purpose

Giving a rival the very tools it needs to effectively compete against you would appear to make little business sense. Yet, Jeff Weedman, VP of Proctor & Gamble, says that his company pursues just this strategy: “We will license to our competitors The fact that we’re going to license technology means that we’re no longer simply competing with the innovations of our competition, but we’re also competing with ourselves. This forces us to run faster and innovate faster to stay ahead.”

Although this practice may work for P&G, deliberately allowing your competitors the right to use your core inventions is an economic trade-off that most companies would regret in very short order. Allowing a competitor to use this technology in a settlement of a hard-fought lawsuit is an equally serious mistake, unless the royalty were high enough to take away any possible competitive advantage.

On the defendant's side, make sure that any settlement gives you the right to continue competing with the plaintiff, this time without fear of a lawsuit. The lawsuit will have given you a good idea of what competitive areas the plaintiff really cares about. A settlement with a license (especially one that includes patents not yet issues, if you can get such a concession) will give you the freedom to move into the plaintiff's competitive space until you can come up with an effective workaround that you can pursue without either paying royalties or fearing a lawsuit.

In the final analysis, putting economics at the forefront of any patent litigation will bring the litigant the most effective relief.

--By Richard Cauley

Richard F. Cauley is a senior trial lawyer specializing in patent and licensing litigation. A former partner at the law firm of McDermott Will & Emery, LLP, based in Silicon Valley, Mr. Cauley has over 20 years of trial experience in complex patent infringement and other trademark and copyright litigation. He has successfully represented clients in the semiconductor, computer and disk drive industries. Mr. Cauley has prevailed in numerous important cases for major industrial clients throughout the U.S.