

Preface

Since 1790, patents have influenced the activities of people and companies inside and sometimes even outside the United States. Patents attempt to create marginally greater incentives for people and companies to invest time, money, and talent in research and development. The goal is to shift some resources away from producing the products and services using existing technology and into producing new technology that makes available new products and services. The desired benefit of this shift is that future use of the new technology will permit lower-cost production of products and services (new and old) and consumption of new and more valuable products and services. The result is a higher rate of economic growth and a corresponding improvement in the welfare of U.S. consumers.

Patents seek to bring about this happy result by creating legal rights. Patent rights generally are designed to permit those who have made the desired investments of time, money, and talent in designing new technology to capture its economic value during the term of the patent on that technology. The nature of the rights granted and the remedies against so-called infringers generally are designed to permit market transactions to determine the value of any particular bit of technology and direct its use in a way that creates the greatest possible value. Through market transactions, the additional reward a patent provides for developing some bit of new technology depends on the economic value that technology makes available. Through market transactions, each bit of technology is used in the best possible way to yield the largest possible benefits for producers and consumers.

Although simple in theory, it has proved difficult in practice to implement patent laws and procedures. The actual operation of the patent system does not always reflect the theory. One manifestation of those difficulties is the large number of patent infringement actions commenced each year in United States. In each of those actions, the owner of a patent

asserts that some company is violating its rights by using certain processes, selling certain products, or supplying various services. In an ideal patent system, there would be no patent litigation. Patents would exist only for inventions of the type patent law is intended to induce, the scope of the rights would be defined in a way that would permit patent owners to capture only the values of the inventions that justified the grants, the scope of patent rights would be clear to everyone involved, rights would be granted promptly so that everyone knew at every point in time what inventions were subject to patent rights, and the remedies against violations of rights would leave potential infringers with nothing to gain by disregarding the rights and patent owners nothing to gain by litigating rather than using the rights or licensing others to use them.

However, none of these goals has been achieved in practice. One consequence is that patent owners and producers and consumers of products and services using technology frequently disagree about whether certain rights should exist, what products and processes are within the scope of the rights, and the remedies available for violations of the rights. Those disputes lead to litigation or the prospect of litigation.

Over the last 30 years, patent litigation has increased in volume and, perhaps, importance. Serious news services serving the business community report on the filing of patent infringement actions. News services report on the results of patent trials and the amounts of damages awards, particularly those in the hundreds of millions of dollars. Businesses have sprung up whose entire reason for existence seems to be to make money through patent litigation. Other businesses have sprung up to acquire patents with the ostensible purpose of helping companies avoid patent litigation. Attorneys and legal scholars have produced books and articles on patent litigation. Attorneys and law schools devote enormous amounts of time and energy-developing the skills and information that enable attorneys to maximize the chances that some patent owner or accused infringer will prevail in the litigation process.

However, the reality is that, from time immemorial, businesspeople have recognized that patent litigation is not the most efficient way to resolve patent disputes. Throughout history, businesspeople overwhelmingly prefer settlement and licensing to litigation. There are many sound reasons for this preference. The settlement process costs much less than the litigation process, takes much less time than the litigation process, provides an outcome under which each party bears less risk, provides agreements that achieve results unavailable to the courts, and probably provides as good or even better assessment of the merits of the underlying dispute.

Given that settlement has proved to be more important than litigation, the settlement process deserves at least as much and probably more attention than the litigation process. If settlement decisions by the parties are at least, and probably more, important than litigation decisions by judges and juries, the resources available to help people involved in the settlement process should be at least as good as, and probably better than, those available to people carrying out the litigation process.

Settlement decisions and processes are not easy. The decision to settle an infringement action or an infringement dispute is complex. A variety of different types of information are needed to make well-informed settlement decisions. Ultimately, a decision

to settle an infringement action or dispute involves the price and other terms. The right price and terms in a particular situation are usually far from apparent.

The purpose of this book is to describe a way for patent owners, accused infringers, and their attorneys and advisors to deal with the complexity of the decision to settle and the information needed to make that decision. My goal is to provide a systematic way for the reader to gather the right kinds of information and process that information in a well-defined way so that settlements are achieved earlier, with less cost, and on the most sensible terms. There is no way to rid the United States entirely of patent litigation. However, I believe every step in that direction provides large gains for everyone affected by patents.

Briefly, this book is organized in four parts. Part I describes the standard model of settlement decisions adapted to fit patent actions and the settlement options most commonly used in the patent context. In the early 1970s, Professor William F. Baxter of Stanford Law School and others developed this economic model of settlement decisions. This development was part of what became known as the law and economics movement. The author learned the basic model at that time while working as Professor Baxter's research assistant. In simplest form, a patent owner will be willing to settle for payments greater than its expected value of litigating to judgment. A potential infringer will settle for payments less than its expected cost of a judgment. Litigation costs, the expected value and cost of increased damages, and the expected value and cost of attorneys' fees awards alter this simple model. A party's aversion, indifference, or preference for risk influences the perceived value or cost of the option to litigate and therefore the prospects and terms of settlement. In most situations, the risk-discounted expected value and cost of litigating to judgment will control settlement. There are four basic settlement options. One important option includes a license for the future. Another option includes an injunction and no license. Therefore, settlement will also depend on the forces that influence decisions to grant and accept a license and the range of mutually acceptable royalty payments. Decisions to license will depend on the owner's view of the commercial value of some invention without licensing and a potential infringer's view of its value with licensing. Settlement prospects and terms will sometimes be driven by the value or cost of litigating and sometimes by commercial value. A patent owner's decision to litigate or settle one action or dispute is also typically influenced by the owner's perception of the impact of one judgment, settlement, or license on its existing and future relations with other actual or potential infringers and actual or potential licensees. A potential infringer usually considers the same factors from a very different perspective. The patent model shows how settlement decisions are influenced by these third party effects. Part I explains how these and other factors influence the prospects for settlement, the price, and the terms.

Part II shows how this model is applied to help make settlement decisions in particular situations. It explains how to identify the specific facts and make the estimates that shape each party's settlement decision and how to translate that information into dollar amounts showing whether various types of settlement are in the economic interests of the parties. This part contains many examples geared to reflect common situations.

Part III describes the data I developed on how patent litigation works. How frequently are patent actions resolved by trial, pretrial motion, or settlement? How long does it take for patent actions to be resolved by trial, motion, or settlement? When does settlement usually occur? Who wins and loses on trials and motions? Are patent owners as successful as often reported? Are damages in patent actions as large as advertised and large enough to explain the large number of actions parties litigate rather than settle? Part III also describes data developed by others, including studies of the issues that lead to litigation and how patent owners and accused infringers tend to do on those issues.

Part IV describes the law that people involved in settlement must understand and ways to adapt settlement practices to the constraints of the law. The law often interferes in unproductive ways with settlement and licensing agreements. This part also describes how the law should be changed to remove these obstacles to agreements—changes the patent reformers unfortunately ignore.

Chapter 1 describes the contents and organization of the book in more detail. Those interested should browse Chapter 1 for more information.

Chapter 1 also explains how people involved in patent disputes may use the economics approach to settlement described in this book. The one assumption of this book is that people primarily deal with patents based on economic results. In other words, people are making dollars-and-cents decisions. People engaging in patent disputes for others reasons should not read this book. This economics approach to settlement may be used qualitatively or quantitatively. Used qualitatively, this book will help patent owners, potential patent infringers, and their attorneys understand the nature of the factors that drive settlement decisions and the relationships among those factors. Some people will find it sufficient to use those basic concepts combined with their experience, instincts, and back-of-an-envelope calculations. Others may find it helpful to take the further step of applying the approach in a quantitative way—that is, by collecting the needed commercial and legal facts, making the needed estimates, and processing those numbers using the economic model of settlement decisions to identify the types of agreements and payment terms under which a settlement would be preferable to litigation.

When used either way, the approach may be used to help plan and conduct settlement negotiations. One side or both sides may employ the approach in a variety of ways. The parties may use the approach in connection with mediation or some other dispute-resolution process. For example, the parties may provide the necessary information in confidence to a neutral, trusted person who will conduct the analysis and use the results in any way both parties believe will assist in reaching an agreement. The analysis may be used to provide a basis for a business decision to accept or reject a settlement proposal. The analysis is useful in managing patent litigation by helping a party to decide whether the value of some additional litigation effort is greater than the costs.

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