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ADR

Bulldozing barriers to patent-case ADR use

Parties' agreement can address concerns over costs, remedies, more.

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CONTROLLING PATENT litigation costs is one of the toughest and most important challenges currently facing corporate general counsel. Intellectual property-based companies often spend 60% to 90% of their total litigation budget on patent disputes. And the cost of playing this game continues to grow. With vast fortunes at stake and the potential to achieve decisive competitive advantages, patent litigation has become the sport of kings. In this age of outsourcing and offshore manufacturing, intellectual property is one more piece that multinational corporations move around the Monopoly board. This article explores one of the potential solutions: the strategic use of alternative dispute resolution (ADR) techniques to reduce the costs and disruptions of patent litigation, as well as to avoid prolonged periods of business uncertainty and stock market angst.

Patent litigation presents a special case for ADR application. The CPR Institute for Dispute Resolution has established a patent commission made up of corporate intellectual property experts to study how ADR techniques can be fine-tuned to better address the legal and business peculiarities of patent disputes. The commission's work began with the observation that ADR is grossly underutilized in the intellectual property arena and, when used, often arises late in the

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Considering ADR in patent disputes

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process after significant costs have already been incurred.

There are a number of reasons why ADR is often ignored or rejected as a way to resolve patent disputes. One often-heard explanation is that the subject matter of patent disputes is "technical." Because of this complexity, there is little chance the dispute can be adequately resolved by a neutral (mediator or arbitrator) who doesn't possess the same level of technical sophistication as the parties. The "it's technical" argument is an outgrowth of the engineering mindset that reveres the ability to grasp the smallest nuances and provide the most elegant technical solution. As a result, there is a tendency for engineering or tech-based companies to treat patent disputes as a right-brain "I'm smarter than you" competition as opposed to looking at the issue as part of vast sea of gray that defines the business and legal problem solving.

While the engineering approach is exactly the skill set necessary for invention, it can be a detriment in litigation strategy development and dispute resolution. If not kept in check, an exclusive focus on "who is right" engineering arguments can lead to a disaster in arbitration and can easily derail a mediation that has the potential for a mutually beneficial business resolution based on future business or pricing.

It is not unusual for more experienced corporate representatives, knowing the disadvantages of the technical-only approach, to limit the roles of the technical teams in mediations to avoid bogging down in the technical minutiae. What must be remembered is that, at the end of the day, if a patent dispute goes to trial, the majority of the elegant engineering arguments will be lost and never become a part of the final decision-making process. In order to avoid seeing how sausage is made, all stakeholders, including the technical team, will likely be better off addressing their dispute in an ADR forum where they control the process rather than casting that dispute to the uncertainties of the trial court.

Concerns about arbitration

Another concern is that the arbitrator will simply get it wrong and the parties will not have recourse to a judicial appeal. Even worse is the scenario in which an arbitrator may enjoin a party from using the technology at issue, again without appeal. What these arguments fail to consider is that arbitration is a private proceeding designed by, agreed to and implemented by the parties. Therefore, the parties by agreement can dictate the types of remedies available and the scope of damages that may be awarded. For example, the parties can agree that the arbitrator is not authorized to impose an injunction. To avoid runaway damage awards, the parties can agree to a high/low damages range that guarantees the plaintiff minimum damages for entering into the arbitration but limits any payout by the defendant to a set ceiling.

One legitimate concern is that arbitration can be at least as expensive as a full-blown trial. Again, the solution lies firmly in the hands of the parties. Granted, the professional and economic motivations of some outside counsel may be to leave no stone unturned, no document unreviewed and no deposition untaken. However, the parties to a dispute can eliminate or reduce many typical litigation costs by taking a firm hand and agreeing between themselves to limit discovery, the number of experts, the issues to be resolved and the duration of the arbitration. This is where a strong in-house counsel, backed by senior management, can take the lead and have a significant impact.

But the most difficult barrier to achieving resolution of a patent dispute in ADR is failing to fully understand the financial complexity and competitive ramifications of a patent settlement or arbitration judgment. Most commercial litigation is resolved through the payment of a sum certain that is then incorporated into the balance sheets of the disputing companies and forgotten. It is more difficult, however, to quantify the value of a patent and its impact on future competition. That is, patent settlements and judgments often take the form of a royalty fee per each use of the intellectual property.

Past infringing use of intellectual property can be calculated with some degree of accuracy based on the number of units manufactured or sold. The uncertainty lies in attempting to estimate the number of times the intellectual property will be used in the future, i.e., a thousand product units or a million product units. In addition, the risk for the settling party having to pay the royalty may be whether its future use of the intellectual property will be in a low-priced product or a small part of a high-priced product. A fee-per-use royalty may cause a future low-price product to be too expensive to manufacture and sell.

For example, the same semiconductor

chip set or computer interface might be used in a low-end computer peripheral or in a high-end computer system. Likewise, as a result of changing technology and markets, what may appear to be a very valuable ADR settlement based on cross licenses, future royalties or discount deals on products can turn out to be virtually worthless in the future marketplace. For example, at one time hard modem telephone intellectual property was extremely valuable. Now, however, with the advent of much more powerful computer microprocessors capable of performing "soft modem" tasks, hard modem intellectual property may be of little or no value.

The financial complexities are not an insurmountable barrier to resolution of such disputes. What is important is that in-house counsel and senior management understand these complexities and integrate the corporate-strategy people into the early stages of a patent dispute and resolution. To put it another way, the purchase or sale of a patent license, even as a result of ADR, is not totally dissimilar from the sale or acquisition of a business. Therefore, it is only natural that the strategy experts should be engaged to help quantify and bless any such decision. With this kind of upfront preparation, ADR can be successful in dramatically reducing the transactional costs associated with patent disputes, often leading to a more reasonable result between the parties.

Given the disparity between the initial demand and the risk presented by trial, it is not at all unusual for patent cases to settle in ADR for 3% to 10% of the litigation demand. In this sense, patent litigation is like any other commercial litigation in that the damages claims become softer as they move toward the higher ranges. And, given the plaintiff's risk of losing its patents, most plaintiffs, with the exception of the "lone inventors" who all believe they are the next Lemelson, understand that one dollar today is better than the hope of two dollars tomorrow.

Few patents are islands

It is important to remember that most patent cases do not stand alone. Instead, they are often part of ongoing licensing programs through which an inventor is systematically attempting to negotiate licenses with all of the manufacturers and users of the invention in a particular industry segment, i.e., all semiconductor manufacturers who use the same piece of equipment or make the same type of microchip or all Internet content providers who use streaming media. Successful licensing programs are built upon a series of licensing negotiations enforced by the threat of litigation.

Plaintiffs may benefit from a confidential, nonbinding result.

However, patent litigation also creates risk to the plaintiff who, in order to bring a suit, must put its IP on the line. That is, litigation of patent disputes is not a zero sum game that results in the plaintiff either getting a huge judgment or nothing. On the contrary, it is more like the *Jeopardy!* game show where contestants can go into negative numbers. Defendants will typically challenge the validity of the plaintiff's patents. If the patents are proven to be invalid as to that defendant, they are invalid as to the rest of the world, which means the end of any future licensing program.

Given these dangers, the plaintiff in a patent dispute could very well benefit from asserting a risky patent in a private arbitration where the result would be confidential, would not have binding precedential effect and, by agreement, the decision of the arbitrator could be limited to a simple statement of win or lose without substantive explanation.

Finally, because of the global reach and applicability of intellectual property, there is a well-founded concern about whether governments and courts in some parts of the world have the ability or motivation to protect the intellectual property rights of noncitizen corporations. Even if there is a legal system to protect intellectual property rights, the prolonged time to trial and judgment in many countries may not address the infringement until well after the competitive damage is done or the infringer has become judgment-proof.

In fact, such concerns about China and several other Asian nations are significant deterrents to foreign investment in those growth economies. Here again, the use of ADR might provide parties with more assurance of a fair evaluation and decision. One way proactively to address these concerns is by including mandatory ADR clauses in foundry agreements (where the inventor contracts with a manufacturer to produce the goods that will be branded and sold by the inventor). Therefore, if the foreign manufacturer uses the inventor's intellectual property for its own purposes, the infringement can be addressed in private arbitration rather than in the foreign courts.

In addition, assuming the adequacy of personal jurisdiction over the manufacturer under the contract, this method creates an additional contract cause of action against the manufacturer in the United States even though the actual infringement may fall outside of the jurisdiction of U.S. courts. When there is no privity of contract between the inventor and the infringer, the trick is developing the leverage to motivate the infringer into arbitration. In either of the scenarios above, the ultimate issue will be assuring that the arbitration judgment will be enforceable either in the foreign jurisdiction or in the United States. With strategic planning, ADR presents the potential to sidestep the uncertainty of foreign courts and to enforce and protect intellectual property rights.

Steps to consider

Based on the above discussion, there are a few guidelines for effectively using ADR to reduce patent litigation costs and risks:

■ At the inception of business relationships, counsel should try to lock ADR requirements into contracts with business partners that are in a position to potentially infringe a company's intellectual property.

■ Every patent dispute has two major components: liability and damages. Throughout the dispute process, counsel should pay at least as much attention to the analysis of potential damages and business impact as they do to liability. The reality is that the liability issues are more subjective and the technical part of the team can argue about them all day. Damages, however, are what really count and are much more suitable for early evaluation and handicapping. Understanding the damages exposure will better enable counsel to weigh the alternatives and the potential use of ADR.

■ At first notice of the patent dispute before litigation has commenced, counsel should take a hard look at exposure,

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ADR can help control patent litigation costs

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impact and costs, and consider the potential for an early mediation. The dispute research clearly confirms that the longer a dispute goes on, the more the parties' positions calcify, and the more the damage claims escalate. Too often, in-house attorneys do not take these initial notices seriously and miss the opportunity to resolve a dispute for a small fraction of what the claim will grow into by trial.

■ Once litigation commences, it is important to develop parallel strategies. That is, counsel should treat every litigation as if they fully intend to go through trial. At the same time, it is important for counsel to step back and determine how they can leverage the case into ADR.

■ If the opposing side agrees to arbitration, counsel should take the time to create an agreement that limits the arbitration to only the issues that actually need to be decided, limits discovery to only what is necessary to try those issues and carefully prescribes the arbitrator's authority and form of decision.

■ If the parties agree to mediation, counsel should carefully select a negotiation team that has the expertise and authority necessary to resolve the case. Counsel should be ready to make a thoughtful and well-organized opening presentation of the best legal, technical and business arguments. Although some neutrals will disagree about the value of opening presentations, often they are the first time the parties hear the opposing position other than through the filter of their own counsel. Then, at the right time, counsel should be ready to put the technical liability arguments to the side in order to try and come to a business resolution. The focus should be on resolution, not on who's right.

■ Just because litigation has commenced does not mean that the parties cannot move the case to arbitration. Once the litigation issues have taken form, the parties may begin to see the risks of trial (i.e., loss of patents v. high damages award) and the advantages of a more limited private forum. Knowing this, counsel should focus their litigation strategy on heightening the opponent's risk and leverage the opponent into arbitration.

■ Finally, some parties, after spending millions of dollars on litigation costs, will then try to save a few bucks and choose their neutrals by price. This approach is simply foolish. The neutral fees will be insignificant compared to the litigation costs. Parties should get the neutral who can best do the job.

Patent litigation costs can be controlled. However, to do so takes strong and knowledgeable corporate managers who are willing to make decisions and to take informed risks, and outside counsel who, in the best interests of their clients, can help guide them through this process. The penalty for failing to act can be grossly expensive and protracted litigation outside the control of the corporate decision-makers—with the potential to result in a business disaster for either or both sides. NLJ