

United States

Patent enforcement: licensing and litigation considerations

The value of owning patents continues to grow in the United States. As Alan Greenspan recently observed, “The economic product of the United States has become predominantly conceptual”. As a result, patent enforcement has become a primary source of revenue for a wide range of industries. Manufacturing giants, including IBM and General Electric, now enforce patent portfolios as a leading source of revenue growth – according to Deloitte, since 1993 IBM has earned over \$10 billion from enforcing its patent portfolio. Effective patent enforcement is even more important as manufacturing operations are increasingly moved offshore to less-developed countries.

In short, patent owners can no longer afford simply to file away their patents and wait for infringers to appear. Maximising the value of patents requires careful planning and continual diligence. According to the *Harvard Business Review*, each year US companies fail to capitalise on over \$1 trillion-worth of patent assets.

Effective management of a patent portfolio requires a careful assessment of the value of each patent (to both its owner and competitors) and the costs, risks and rewards of licensing and litigation options. Aside from the need to predict royalties and potential damages claims, the assessed value of a patent or patent portfolio may direct a company towards licensing or litigation in the first instance. Less valuable patents may simply not be worth the expense of litigation focused on that one patent, but may be successful licensing subjects and may be raised defensively in response to claims by an infringer.

Several methods are widely used to assign a value to patents, none of which is universally accepted to the exclusion of all others. Valuation methods can be broadly divided into three main categories: cost, market and income-based methods. Cost-based methods are the least sophisticated and focus on the patentee’s own expenses and assessment of the patent’s value. Market-based methods focus on sales of comparable technology.

Income-based models are the most objective and often the most accurate, focusing on sales of the patented technology itself.

Any reliable valuation method involves forecasting the potential exploitation of the patented technology and is therefore subject to some inaccuracy, just as the valuation of investment securities depends upon the vagaries of future income and is subject to potential fluctuation. The patentee should consider:

- the value of the patent to the patentee’s core business;
- the value of the patent to the patentee’s competition and other third parties; and
- the value and costs of maintaining exclusivity versus the value and costs of sharing the patented technology.

After assessing the value of patents, companies seeking to remain competitive need to develop well-reasoned strategies, accounting for the risks and potential rewards of patent enforcement options. Those enforcement options generally fall under the two broad categories discussed in this chapter: licensing and litigation.

An effective patent enforcement programme may involve licensing, litigation or a combination of both. Costs and benefits vary according to several factors, including:

- the unique technology;
- the value to a competitor;
- the strength of the patent; and
- the stage of the patent lifecycle.

In any licensing programme, litigation readiness is an important element. Similarly, licensing options may be relevant in litigation. Thus, the considerations for each category are not mutually exclusive and must be considered together in devising a sound enforcement strategy.

Licensing

Licensing is often viewed as a compromise because it requires the patent owner to share his or her intellectual property. However, it can also lead to significant market expansion and generate new sources of revenue for the patent owner through the business relationship. It is also generally less expensive than pursuing litigation.

Benefits

Successful licensing is cooperative in essence and therefore bears generally lower expenses than litigation in terms of public and business relations, as well as legal costs. Successful licensing may enhance a company's reputation in the industry. By taking a licence, a licensee acknowledges the legitimacy of patent rights and sets the trend for cooperation. In addition, licensing revenue provides a predictable stream of income. In the United States, licensing revenue is increasing as a proportion of overall business revenue. According to Kevin G Rivette and David Kline, authors of *Rembrandts in the Attic: Unlocking the Hidden Value of Patents*, during the 1990s annual patent licensing revenue in the United States increased from approximately \$15 billion to over \$100 billion. Deloitte estimates that in 2007 patent licensing revenues will total approximately \$500 billion.

With increasing frequency, companies are acquiring patent rights ancillary to or even beyond their core business. Strategic alliances with other companies already positioned to exploit the technology often create a win-win situation. In return, the other companies may also seek to partner with respect to technology which the patent owner is ill situated to exploit.

In addition to the avoided costs of litigation, the costs of developing, manufacturing and marketing a patented product or process can be reduced or even eliminated through licensing.

Texas Instruments was an early success story in enhancing the value of its patent portfolio with a successful licensing programme. In the early 1990s this computer hardware company extracted hundreds of millions of dollars from a large but ageing patent portfolio. It was the first company to yield over \$1 billion from a patent portfolio alone, separate from manufacturing operations. More recently, IBM has generated between \$1.5 billion and \$2 billion in patent licensing revenue annually. Thomson Corporation generates 75 per cent of its total earnings through licensing revenue – \$390 million a year.

Disadvantages

Because licensing represents a compromise, the patent holder must cede some value of the patented technology to the licensee. It may be that the patent holder is not

prepared to realise that value based on production or marketing infrastructure, making licensing a better option than litigation. Where the patented technology is within the patentee's core business, however, sharing technology with competitors (even for a reasonable royalty) may be counter-productive. Licensing may also involve the loss of some level of control over how the patented technology is exploited. A poor licensee may not exploit the full potential of the technology or, worse, may tarnish the reputation of the technology. Non-exclusive licences, a thorough background investigation of the licensee and licensing provisions for quality monitoring and control can reduce but never eliminate those risks.

While the costs of licensing may not always approach the costs of infringement litigation, they are substantial and may include expenses related to investigating the potential licensee, negotiating the licence and, eventually, sharing revenue.

If licensing negotiations fail, many of the backfire risks associated with litigation may be realised. For example, in 2006 Sun Microsystems Inc unsuccessfully attempted to license software technology to Network Appliance Inc. Network Appliance responded with a patent infringement suit against Sun in late 2007 in regard to its own patent portfolio.

Although licensing patented technology may appear to provide good benefits at a low cost, poorly drafted licence agreements can often prove costly and sometimes fatal to a business. When drafting any patent licence, considerations of exclusivity versus non-exclusivity and running royalties versus paid-up royalties must be carefully weighed. In addition, a reasonable escape clause is always wise in case the licensee proves to be less than a good partner.

Other considerations

Litigation may be necessary

Successful licensing strategies do not exclude the possibility of litigation. Aside from the potential for default by the licensee, which would lead to even more complex litigation, litigation readiness is required for optimal licensing negotiations. Licensing negotiations often succeed more efficiently if there is a credible threat of litigation. Demonstrating that a company has already built a strong case during negotiations will disabuse any potential licensee of the notion that it might be unwilling to litigate.

Know your licensee before entering an agreement

A reasonable competitor with a history of making licences work will generally enhance the outlook of licensing options. In contrast, an unreasonable infringing competitor with a history of contesting the valid patent claims of

others should be approached about licensing only with great care. Approaching a recalcitrant infringer with a licensing proposal could simply warn the infringer of a potential claim, providing the opportunity to sue first in a jurisdiction of its choice in a declaratory judgment action.

Consider patent lifecycles and timing

In general, patents at the beginning of their lifecycle present better licensing opportunities. Depending on other operations, the patentee may need the stream of income from a licensing programme before litigation may become economically feasible. Licensing negotiations can also provide insight into market demand and the strength of the patent, without the risks associated with litigation. In contrast, it may be that a patent nearing the end of its lifecycle is already heavily licensed to other parties, reducing the benefit to a new potential non-exclusive licensee and making that potential licensee less motivated to negotiate a licence.

Litigation

In contrast to licensing, patent infringement litigation may be viewed as an uncompromising approach to patent enforcement or the result of a failed compromise. As such, the patent holder seeks to recover the entire value (or more) of its patented technology and maintain exclusive control. However, in most cases the costs and risks associated with patent litigation are greater than with licensing. Patent litigation is a formidable weapon and must be carefully wielded. In the wrong hands or under the wrong circumstances, patent litigation can destroy those who initiate it, leaving the intended target unscathed.

Benefits

In many respects, the benefits of litigation represent the inverse of the risks of licensing. For example, whereas with licensing there is a risk of ceding control over some aspect of the patented technology, litigation seeks to maintain exclusive control, avoiding the risks of lost commercial exploitation or tarnishment of the property. Litigation provides the opportunity to ensure that competitors are excluded from practising the patented invention. If the patented technology is within the patent holder's core business, ceding market share and profits to direct competitors through licensing may be counter-productive and the threat of infringement litigation may present greater value. Litigation puts competitors on notice that patent rights will be enforced vigorously, reducing the risk of future infringement. Litigation also provides for greater certainty with respect to ending a competitor's infringing activity.

There is no better way to demonstrate seriousness in

patent enforcement than by initiating litigation. Well-run litigation signals commitment and may provide leverage in negotiating future licences and royalties. Litigation against wilful infringers may provide for treble damages, attorneys' fees (in exceptional cases) and interest. With a recalcitrant infringer, immediate litigation with no licensing negotiations may be the most effective approach.

There are many examples of cases where patent litigation has enhanced patent value and ultimately has been responsible for significant business success. For example, Polaroid's effective litigation to enforce its instant camera patents resulted in an award of almost \$1 billion and is credited with shutting down competitor Kodak's instant camera operations. More recently, in *NTP Inc v Research in Motion Ltd* the plaintiff obtained a \$612.5 million settlement following a complex litigation history with remand from the Court of Appeals for the Federal Circuit. An initial damages judgment of \$23.1 million was raised to \$53.7 million after the plaintiff established wilful infringement. A looming injunction then threatened to halt the defendant's multibillion-dollar BlackBerry handheld email device operations altogether, leading to the stratospheric settlement. As part of the settlement, the defendant obtained a perpetual licence to the technology it had been selling.

Disadvantages

Although litigation can lead to a significant financial return and the exclusion of competitors, there are two main disadvantages: cost and uncertainty.

The cost of litigation is always high when compared to licensing. For this reason alone, licensing may be the best option for a smaller, start-up organisation facing infringing activity with respect to complex technology. Patent litigation also involves a substantial cost in terms of human resources and business infrastructure, including:

- case preparation;
- employee distraction;
- attendance by witnesses, including the inventors; and
- document production.

Due to the complexity of innovative technology, the outcome of patent infringement cases is difficult to predict both at trial and on appeal. A recent study indicates that, on average, district courts find in favour of patentees only 60 per cent of the time. This unpredictability in outcome increases on appeal. For example, the Court of Appeals for the Federal Circuit has overturned district court claim constructions in almost half of the appeals it receives relating to claim construction.

The risks associated with litigation do not end with costs and uncertainty. As many sophisticated corporations and their legal teams have learned, patent litigation presents onerous and often unpredictable backfire risks, ranging from the risk of losing proprietary trade secrets in discovery to facing counterclaims from a defendant's competing patent portfolio. The following cases provide examples of those risks in practice:

- *Qualcomm v Broadcom* (No 05cv1958B (SD Cal 2007)): This recent patent infringement case brought by Qualcomm illustrates how the conduct of litigation itself can create new exposure for a patent holder. Qualcomm brought an unsuccessful patent infringement action against Broadcom and found itself facing penalties for failing to locate and produce certain emails to the other party during litigation. Qualcomm's legal officers and outside counsel argued vigorously that the failed production was inadvertent and due to the enormity and complexities of its business operations and document systems, but the court was not persuaded.
- *Motorola Inc v Hitachi Ltd* (750 F Supp 1319 (WD Tex 1990)): This case demonstrates the risks of a competing patent portfolio (particularly in complex technological products) and the dangers of suing a longstanding business partner. Motorola brought suit against its longstanding business partner, Hitachi, in the field of microprocessors, only to find itself on the receiving end of an injunction based upon Hitachi's counterclaims for patent infringement. Having worked with Motorola for years and even having licensed the very patents at issue from Motorola in other instances, Hitachi understood Motorola's

products as they applied to its own portfolio and obtained the injunction, shutting down a key Motorola product – a product that was arguably more important to its operations than the infringement it sought to vindicate in bringing suit.

Other litigation considerations

If litigation is the option that ultimately makes the most sense, companies should be prepared to litigate vigorously. Litigation should never be pursued half-heartedly. Litigants should also be prepared for disruption and surprises (eg, in regard to document production, employee time and testimony).

Companies should also choose the defendant carefully – picking a single, weak opponent and gaining an early victory may set a positive track record for future licensing negotiations, but it also gives future defendants, which may have more litigation resources, a preview of the case.

The risk of public and business relations fallout should also be considered in any litigation strategy.

Conclusion

Thorough analysis and seasoned judgement are required to determine the best patent enforcement strategy. The decision of whether to litigate or to license requires tempered consideration of all the relevant factors – some of which defy arithmetic evaluation, but may nonetheless undercut more concrete factors. Although licensing provides greater short-term certainty and litigation provides greater ultimate certainty, each represents a compromise of risks and rewards not suitable to every circumstance. Eternal vigilance is the cost of realising a patent's maximum potential by licensing or litigation.

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