Patent Litigation: Is it Worth the Expense?

If Rights Are Uncertain, Pursuing Licensing with Alleged Infringer Might Be Best Option

Tech-savvy companies know that successful enforcement of intellectual property rights and, particularly, patent rights can offer substantial rewards. In the U.S. patents represent a constitutionally granted monopoly to exclude others from using an invention, and whether through judgments, settlements, license royalties, or injunctions, patent holders stand to benefit significantly from their ability to protect their rights.

An aggrieved patent holder's right to seek remedy in court is undisputed, but the race to the courthouse should also be tempered by an appreciation for the significant costs, many hidden or unanticipated, which go hand-in-hand with the potential benefits of a successful suit. Pride of invention can quickly be smothered by a well-organized and financed legal effort, leading to the maxim that holds that a patent is only as strong as the balance sheet behind it.

Direct Costs

Certain costs in patent litigation are apparent: outside litigation counsel, expert witnesses, discovery expenses, and associated services are expensive. According to the American Intellectual Property Law Association, the average litigation cost was $769,000 per party in cases where less than $1 million was at risk. That figure more than tripled to over $2.6 million where $1 million or more was at risk.

These nationwide averages can mask the higher costs in certain jurisdictions where high-stakes patent litigation is most common. In the Northern District of California with its detailed patent litigation procedures, for example, a good rule of thumb is to expect $3 million in fees for the first patent in suit and $1 million for each additional patent to be litigated. These numbers indicate that a "bet the company" scenario may be a real hazard for smaller-sized litigants.

Moreover, these costs begin accruing relatively early in patent suits as compared to other types of cases. Prospective plaintiffs risk severe sanctions if they don't first analyze carefully their patents and compare them to the allegedly infringing technology. After a complaint is filed, but frequently long before trial, there is a unique and expensive proceeding called a claim construction, or Markman hearing, in which the court interprets the patent's words and phrases.

The parties typically retain experts specifically to provide opinions regarding the interpretation of the patent. Following the court's issuance of a claim construction ruling, discovery will begin anew regarding whether the accused products infringe the patent and whether the patent is valid in light of the way the court has construed it. Due to the Markman hearing's influence on the remainder of the case, the claim construction process is important.

While the typical costs of litigation can be anticipated, the many hidden costs associated with patent cases are frequently overlooked. These indirect costs can be disruptive and can adversely impact normal business operations, especially in smaller companies.

Discovery

First, discovery in patent cases—in the form of document requests, interrogatories, witness depositions, and expert reports—is a significant source of these hidden costs. Within weeks of beginning a patent case, each party serves document requests upon the other. These requests require the opponent to search for documents relating to the patent infringement allegations in the complaint.

In responding to these requests, outside counsel, unfortunately, is of limited help, as only the company actually knows what documents it has and where they are located. Additionally, data

collection is a complicated process, requiring searches of hard copy and electronic sources, accumulated over a period of many years.

Litigants might assume that only limited documents need be turned over, but compilation of records from one source is rarely sufficient in a patent case that typically requires the disclosure of technical product development, marketing, executive, and sales documents.

Employees from many departments must be diverted from their daily responsibilities to assist in locating relevant information. In many cases, these are key R&D personnel who may be diverted from focusing on projects vital to the company's future prospects.

Costs inflate further when depositions begin. Witnesses, often as many as a dozen or more, must be prepared for depositions by meeting with lawyers, usually for at least a day. In patent cases involving older technology (patents can live for 20 years), some of the key witnesses may no longer work for the company, making preparation difficult and more costly. In situations where there is animosity between the litigant and the former employee, there are additional logistical costs and risks associated with the provision of such testimony.

Expert Witnesses

Second, expensive expert witnesses are usually required in patent cases. In fact, multiple experts are frequently necessary to cover the technology, as well as the damages calculations. Because the patentee has the burden of proof, the testimony and credibility of its experts is critical to the success of its case.

Among other things, the expert must be educated as to the details of: (1) the development of the patented technology; (2) the market for the accused devices; (3) how the products are manufactured; (4) the distinct legal procedures of patent claim construction and determination of infringement and the subtle meanings of various patent law doctrines; and (5) a lengthy review of related patents and publications that can number in the dozens. In addition to the experts' hourly rates, the process of fully educating an expert requires extensive travel, detailed analysis of the relevant technology by attorneys, and company personnel.

Company Secrets

Third, the possible disclosure of confidential information is yet another hidden risk of patent litigation. As part of the discovery process, the parties may be required to divulge sensitive information to defendants and potentially to the public. In patent suits, information relating to product development, manufacturing, marketing, and sales is usually discoverable by the opposing party, as might be pricing information and customer lists.

Courts typically protect the parties' confidences by issuing a Protective Order that limits the disclosure of confidential information to only the court, the parties, and their lawyers, but given the bulk of documents and witnesses involved in a patent case, vigilance must be observed (and associated costs incurred) to keep confidences within the scope of the Protective Order.

Patent Invalidity

A fourth hidden pitfall that plaintiffs sometimes overlook is that most accused infringers in defending against the patent claims assert that the patent in question is invalid and seek a declaratory judgment for invalidity. Depending on the strength of the plaintiff's patent and the skill and resources of the defendant's counsel, a defendant may successfully invalidate the plaintiff's patent. In that instance, the plaintiff would not only lose its case for monetary damages but also would lose its proprietary rights in the technology, which could have far-reaching effects.

Customers Lost

Finally, businesses should also consider their third-party relationships before engaging in patent litigation. Customers may hesitate before dealing with companies that are embroiled in litigation if they have another source for similar products. And for businesses that are dependent upon external financing, the risks and expense of litigation may dissuade lenders or investors. Development-stage and emerging companies are particularly at risk where venture capital or some form of IP-secured lending is involved. Similarly, smaller publicly traded companies may encounter undesirable volatility in their share prices when engaged in litigation with a much larger adversary.

Because patent litigation costs are high and there are other aspects to lawsuits that affect litigants' business operations, plaintiffs must seriously consider all of the effects of legal action before asserting patent rights. Shareholders in particular may question the benefits of litigation if the ultimate recovery does not offset the costs.

The board of directors of a company, especially a smaller one, should closely scrutinize management's motivations for litigation in such high-stakes contests. In some instances, winning the case might represent a Pyrrhic victory for the company, if awarded damages do not exceed the tangible and other expenses (such as product pipeline disruption) that accrue during the course of protracted litigation.

High Risk, High Return

Of course there are some instances in which litigation is appropriate. The rewards for a well-organized and financed patent enforcement action can be huge. The successful litigant can expect to receive damages in the form of lost profits or a reasonable royalty for the entire period of the infringement. Willful infringement can result in a tripling of these damages by the court.

The long-term, strategic benefits include a strong deterrent effect on other potential infringers of the patents in question and will also increase the likelihood that future patent disputes are settled out of court. The deterrent effect can also extend to other patents in the enforcer's estate once the patentee's ability to prosecute a successful infringement action becomes known.

In light of the obvious and hidden costs that are incurred by litigants once cases commence, would-be plaintiffs should carefully assess their claims to determine if litigation is the best course of action for protecting their intellectual property.

In situations where patent rights are uncertain or where the potential recovery does not outweigh the costs of litigation, plaintiffs may find that they can protect their shareholders and customers more efficiently by pursuing licensing arrangements with the alleged infringer. For those companies with the resources to pursue litigation, however, the benefits are manifest.

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