

INTELLECTUAL PROPERTY LITIGATION

Articles

Industry Perspectives on Patent Damages Including the Damages Component of Settlement Negotiations

By Charles W. Shifley

Industry perspectives on patent damages are, strikingly, a matter of defense perspectives—the perspectives of industries and their representatives sued for patent infringement. From many cases including many industry-wide and individual company discussions of damages and settlement, three big-picture perspectives emerge. First, the more creative, inflated, or “puffed” positions of plaintiffs do nothing to contribute to defense fears or desires to settle cases. Instead, they typically increase defense disdain for the plaintiff’s position. Posturing should be avoided. Second, in most situations, defense costs are the sole and real driver of defense desires to settle. Nothing settles a case like a plaintiff’s offer of a bargain compared to the costs of defense. (Nothing achieves a higher settlement like high costs of defense.) Third, the absolute amounts of potential payments by defendants are not as important to defendants as equality of payments with business competitors. Selling industry parity of settlement payments is well worthwhile. In sum, industry defendants are respectful of, and driven to accept, solidly grounded damage positions, offers that are better than the costs of defense, and parity with competitors.

Adverse effects of plaintiff posturing on settlement

Those who represent plaintiffs are often mistakenly seeking to generate the creative damage positions that they believe threaten havoc for defendants should the defendants lose in litigation. Proceeding from these puffed positions, plaintiffs seek high settlement amounts. While there is certainly something to be said for such creativity, and the author has advocated damage-theory creativity himself, [1] plaintiffs should understand that inflated damage theories in patent cases typically do not impress industry defendants. Those who have been sued in patent cases multiple times understand the inefficacy of such theories. Instead of being perceived as threats, such theories are at best perceived as lacking credibility, and at worst they can be seen as laughable. Instead of generating defense concerns, they increase defense disdain for all plaintiff positions. Puffed positions should be avoided, if settlement is the true goal.

For example, a man considered to be the inventor of the intermittent windshield wiper sued essentially all of the worldwide automotive industry. He was represented by able counsel. His damage theory held that because intermittent wipers, as an option, cost the consumer about \$50 at that time, and because internal automotive company reports set the wiper option costs at \$.50, there was a profit of \$49.50, of which he as inventor should get a half, or about \$25 per wiper system.

Of course, the position did not reflect reality. The nominal option price to

consumers did not reflect the revenue receipts of automotive companies. Dealers received the option prices, which were heavily discounted in negotiations with consumers. The automotive company revenues from options were more in line with costs than consumer or dealer prices. As well, the raw costs of the option parts did not reflect actual costs, including the necessary costs of selling whole cars to be able to sell options.

The plaintiff's position did not endear him to the industry, did not threaten the industry, and did not motivate the industry to settle. His position had the opposite effect. It caused the industry to have endless internal conversations about his unreasonableness. Essentially, every industry defendant refused to negotiate toward a settlement until the plaintiff became reasonable. It caused disdain for all of the plaintiff's positions on the basis that this one outrageous position reflected a general lack of credible positions. It also reinforced the defense drive to defeat the case on the merits and defeat the damage side of the case as well.

The plaintiff's position also increased industry cooperation. The lead defendant, Ford, enjoyed the cooperation of rivals General Motors, Chrysler, and others in collecting automotive industry license agreements and licensing testimony. Subpoenas resulted in immediate, cooperative responses for documents and testimony. Cooperation of rival executives and lawyers of the companies was enhanced by meetings in court and elsewhere to coordinate the defenses, which enhanced personal relationships that might otherwise have not existed.

An intense effort went into the defense case against damages. In the damages trial, the defense prevailed because its case was well grounded in the industry approach to a reasonable royalty, based on an extensive survey of the many industry license agreements. A retired General Motors chief patent counsel testified that the automotive companies were cost driven to wring pennies from product costs, licensed for pennies per car per invention as proven by licenses, and would not have paid more than a few pennies for the wiper inventions given the available noninfringing alternatives, which were well explained. The plaintiff was despondent about the result to the time of his death. [2]

As a second example, a patent attorney came to own a patent on adding attachments to instant messages when his Internet start-up client ceased operations, ceased to have any interest in the subject patent portfolio, ceased interest in paying his bills, and was more than happy to settle the bills by transferring its pending patent applications. He sued a leading instant messaging provider, in the person of a troll corporation [3] he established. [4] His damage theory was that the provider needed to pay a royalty for the accused infringing products, which were packaged as a free extra in packages of services including Internet access, news and other information services, access to chat rooms, and email. The troll's asserted royalty base was all the subscription and advertising revenues for all the packaged products, which were billions of dollars. His rate was calculated by the percentage of those users who used instant messaging, reflected in billions of instant messages each day. Of those users, the rate proceeded based on the percentage who used attachments in instant messages. It was also based on a profit apportionment, and amounts paid to acquire whole subsidiary companies that were instant messaging companies. [5]

His final position on a reasonable royalty was hundreds of millions of dollars.

Ignored in the plaintiff's position was the fact that a simple change of detail in the handling of instant message attachments was a complete avoidance of the plaintiff's patent. [6]

Again, the plaintiff's creative, puffed position did not lead to fear or motivation to settle. It again had the opposite effect. It blocked negotiations and motivated greater defense spending, with increased intensity toward invalidity and unenforceability defenses, as well as increased desire to defeat the puffed damage theory.

The author has experienced this same situation over and over, in case after case, with product after product, and in industry after industry (e.g., Internet delivery, night bowling, plastic extrusion, implantable defibrillators, concrete flooring, airbag actuator circuits, fluorescent lights, rail car wheels, etc.), regardless of industry type. The situation appears to be universal. Creative, higher end damages theories have the opposite effects than the effects intended by those who create the theories.

The lesson to be learned is that inflated damage theories should be avoided, if settlement is the goal. More threatening than a puffed position, in the author's opinion, is the damage theory that is based on relevant industry licenses, costs of non-infringing alternatives, and is so solid as to be impossible to ignore, consider to be ridiculous, or defeat. Such a theory will get a settlement, and if not, win a case.

Defense costs are often the sole driver of defense desires to settle

The costs of patent litigation are undoubtedly the highest they have ever been, and as high as any cases except perhaps antitrust. [7] The causes can be debated, but the fact of high costs of the defense of patent infringement lawsuits remains. The result is that many defendants settle for sums of hundreds of thousands and low millions of dollars as the better choice as between settling and incurring the costs of defense. And in suits against groups of defendants, the tendency to settle is greater because the costs of coordination of defense counsel are recognized to increase the costs of defense. [8] Asian companies, especially Japanese, also still tend to settle rather than litigate in the United States. They still sometimes settle on such terms as they can negotiate upon the filing of suits, without hiring defense counsel or even entering appearances in the litigation. Nothing gets a case to settle like offering a bargain compared to the costs of defense.

An observation now commonly reported is that the result of there being trolls and high costs of defense is that many trolls are receiving monies in amounts that were previously unimaginable. Trolls have developed a new industry, according to the U.S. Supreme Court and others, in that they now constitute an industry in which "firms use patents not as a basis for producing and selling goods but, instead, primarily for obtaining licensing fees." [9] By all appearances, and by reason of the workings of the current patent acquisition and enforcement systems, there are many more trolls than at any previous time in history. [10] These include for example NTP,

which sued and collected about \$612 million for the Blackberry; [11] MercExchange, which sued eBay; Refac; Acacia; Solaia; Orion and a host of others.

As a report from the front on this new industry, there indeed is a new industry in existence. This industry is populated by frustrated inventors, the owners of the assets of failed dotcoms, venture capitalists, contingent fee law firms, and private investors. The population of this industry is rapidly increasing, and the activities of the industry, especially in collecting settlements based on the costs of defense, are remarkably creative and successful.

As an example, the author encountered and a recent article reports on a lawyer who learned that a reputable company was selling a patent by private auction. The lawyer reportedly provoked a former client to buy it, and handled the suits brought to enforce it. Rather than suing a manufacturer, the troll sued product users. This tactic of suing a “tier down” from what might be expected now appears to be a common tactic. [12] Requested settlements reportedly ranged from \$600,000 – \$1 million, and the lawyer and client reportedly shortly collected about \$30 million, of which the lawyer’s law firm received roughly \$10 million. [13,14]

A defense perspective, of course, is that suits seeking “cost of defense” licensing are obnoxious. The fact remains, however, that settlements occur where the costs of defense exceed the costs of licensing.

The absolute amounts of potential payments by defendants are not as important to defendants as equality of payments with business competitors

A little-known phenomenon among those who plan patent suits is the frequent, greater interest of industry defendants to have parity with their competitors than in their absolute costs. All corporations are now highly cost driven, even though highly profitable. Wal-Mart is the epitome of cost-driven high profitability. Corporations are more driven, however, to gain parity or equality of costs per accused unit with their business competitors. Frequently, in a single defendant lawsuit, settlement is complicated by the lack of involvement of competitors, meaning that the defendant must anticipate higher costs than competitors if the defendant settles, especially for higher amounts. Trolls seem to be the only ones to understand this. Troll suits against whole industries sometimes enjoy the factor that defendants can assure that their competitors incur the same costs of licensing as they do themselves. It is certainly true that in organizing any industry-wide offers, defendants assure parity on a cost per unit basis.

Conclusion: Industries disdain creative damage theories, they act based on costs of defense, and they care about competitive costs

In summation, industries disdain creative damage theories, they act based on costs of defense, and they care about competitive costs. Industry defendants are respectful of, and driven to accept, solidly grounded damage positions, offers that are better than the costs of defense, and potential parity with business competitors. Present them with cases that include these aspects, and they will settle. Offer them creative, high-priced,

and noncompetitive settlement numbers, and they will put up a tough fight.

FOOTNOTES

1. See, e.g., C. Shifley, Upfront and Benchmark Payments as Part of Reasonable Royalty Patent Damages, *The Federal Circuit Bar Journal*, Spring 1994, at 33, where the author advocates that infringing sales of as little as \$323,000 can mean damages as much as \$30 million and more.
2. See *Kearns v. Wood Motors Inc.*, 135 F.3rd 775, 46 USPQ2d 1318 (Fed. Cir. 1998)(The case notes that Kearns left \$18 million in the court registry, refusing to collect it.); see also the report at <http://www.theautochannel.com/news/2005/02/25/005398.html>.
3. The author has heard the term “troll” so much that it has lost its derogatory aspect with the author. No criticism is intended by the use of the term “troll” of those who acquire and enforce patents without manufacturing any products covered by them.
4. As an aside, the troll’s corporate structure and financial arrangements were noteworthy. The troll consisted of three corporations and complex ownership interests, not just one corporation and simple interests. A first corporation owned the specific patent in suit. This corporation “A” was incorporated just before suit was filed, and the patent in suit was transferred to it for the purpose of the litigation, to avoid having any litigation issues infect other troll assets. Corporation “A” was owned by a previously-existing corporation “B,” which had owned the patent in suit, and also continued to own the trolls’ portfolio of several patents and applications related to the patent in suit, including many continuation and continuation-in-part applications. Corporation “C” also existed in relation to corporations A and B, with the stated purpose of collecting and distributing any net proceeds of the utilization and enforcement of the patents of corporations A and B. Minority shares in corporations A, B, and C were in the hands of several businesspeople, inventors and lawyers who were assisting with the troll’s business of litigation. The inventors of the portfolio of patents had been found and given corporate shares long after the time when they made their invention and assigned their patent rights, and just before suit. Majority shares of all three corporations were owned by the patent lawyer.
5. Plaintiff positions based on whole-company acquisitions seem to be now routine. They are also routinely disdained by defendants.
6. Non-infringing alternatives cap royalties. See C. Shifley, Alternatives to Patent Licenses: Real-World Considerations of Potential Licensees are – and Should Be – a Part of the Courts’ Determinations of Reasonable Royalty Damages, 34 *IDEA: The Journal of Law and Technology* 1993 at 1.
7. See the AIPLA Report of Economic Survey 2005.
8. This is another “report from the front,” based on the author’s experience.
9. *eBay Inc. v. MercExchange, L.L.C.*, 547 U.S., 126 S.Ct. 1837 (2006).
10. An alternate theory for the industry of trolls is the rapid creation of new technological industries, such as the Internet, software, computer, and biotech industries. The beginnings of the auto industry at the start of the 20th Century sparked a troll, called “Selden,” so trolls are not new to this age alone. See *To Promote Innovation: The Proper Balance of Competition and Patent Law and Policy*, Federal Trade Commission 2003, at pages 3 and 11-13,

<http://www.ftc.gov/os/2003/10/innovationrpt.pdf>.

11. See <http://www.computerworld.com/mobiletopics/mobile/story/0,10801,109216,00.html>. Note that an enforceable permanent injunction, pending enforcement, and frustration expressed by the judge were all required for the settlement of this size; in short, threat of a high damage amount did not settle the case, and again, those who wish settlement should expect that puffed threats provoke struggle.
12. Many trolls also offer a first taker of a license a first or “one-off” license paid up for a sometimes economical amount to provide themselves initial litigation funding for suits against other targets of their litigation and licensing plans.
13. L. Lerer, Quick Draw, IP Law and Business, July 2006, at page 30.
14. As another specific example of a troll, and the creativity of those associated with trolls, a troll encountered by the author in a patent infringement lawsuit involved noteworthy funding. A major conglomerate took a “license” to a patent portfolio of a troll, and contributed patents to the portfolio by assignment. In addition, the “license royalties” the conglomerate agreed to pay (and was apparently paying, given a high level of lawyers’ activity in litigation) were specifically required to be spent for patent enforcement. The payments were to be directed to the counsel representing the troll in enforcement litigation, and paid in the amounts of the invoices the counsel of the enforcement action directed to the conglomerate. The total was to be generous, and definitely adequate to fund the litigation. Further, the proceeds of enforcement, whether by settlement or judgment, were to be shared by the troll and the conglomerate. The first dollars received were to repay the conglomerate for its funding, and all further proceedings, to levels contemplated in the hundreds of millions of dollars, were to be split between the troll and the conglomerate based on a sliding scale of percentages of return in relation to the size of the total recovered. Perhaps the author is easily surprised, but this arrangement of patent assignment to a troll, litigation funding, repayment of a “licensee’s” royalty payments, and split of the proceeds received over and above litigation expenses strikes the author as a surprising, new arrangement caused by the times. It strikes the author as especially surprising as done by a conglomerate as prominent as the one encountered, and especially as done in the guise of a patent license. No particular effort seems to have been made by the conglomerate to assess the patents involved as a matter of legal advice before entering into this transaction.

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ABOUT THE AUTHOR

Charles W. Shifley is a Senior Shareholder at the Intellectual Property law firm Banner & Witcoff, Ltd.

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