

Strategic Approach To Licensing Infringers

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Strategies for avoiding court, and prevailing when litigation is necessary

RIFAC employs staffs of researchers and patent attorneys in addition to retaining outside technical consultants, who identify infringing products through field work (trade shows, visiting stores and businesses, clipping newspapers and directories, etc.), locate sources of supply, buy the infringing products, obtain documentation and determine the laws upon which products appear to infringe.

However, conducting a corporation with evidence of infringement will not generally result in a license unless a court action is filed. The data compiled by RIFAC from some 3,000 infringement notices indicates the reactions shown in Figure 1.

without the need for suit. Also, notices coming from a prestigious patent litigation firm should command a higher percentage of good-faith negotiations. These presuppositions support another adage: "patent enforcement has become a rich man's preserve," even before litigation is commenced.

The following forms of infringer resistance were documented in more than two dozen industries where infringers were offered licenses under various patents over the past decade:

1. Some corporations, especially those with large research laboratories, simply have the NIH (Not Invented Here) syndrome. An offer to license will be rejected regardless of infringement.
2. Some corporations take the position that no license will be paid

unless until after they receive a complaint.

4. Most companies do not routinely monitor issued patents and may actually infringe for years without them or the patent holder knowing it. When infringement is discovered, the infringers are in the unfortunate position of having sold a patented product or used a patented process for years without realizing that the price charged to their customers should have been increased to account for the royalty. Sometimes, the cumulative royalty liability for past years may be so much or more than the infringer's annual net earnings. In this situation, most infringers are reluctant to take a license prior to suit.

5. Many large companies, while claiming a policy of not knowingly infringing any valid patent claims,

REACTIONS TO NOTICES OF INFRINGEMENT

Infringer Reaction	Manufacturers	Major Users	Employees, Consultants, Wholesalers, Retailers, National Level	
			%	%
% replying to an infringement notice	75	50	40	5
% using a patent attorney to advise re infringement or patent liability in correspondence or meetings	50	20	7	4
% agreeing to explore license discussions	14	6	3	2
% offering more than minimal settlement (i.e. license agreement signed)	4	2	1.2	1.1

Figure 1

The Figure 1 data showing a tiny fraction of infringers willing to pay for a license voluntarily reinforces the adage that "a patent is nothing more than the right to sue." A patent has little value if the owner hasn't the financial muscle to enforce it. Presumably, the larger and more well known the patent holder, the higher the percentage of infringers who will negotiate a license

for until the patent is held valid by a court of law. These infringers act via suit before considering a license.

3. Often, small and medium businesses, especially importers, distributors and retailers, know little about patents and do not feel that patents apply to their sales or use. These companies generally do not educate themselves or seek patent

will simply play the odds and do nothing until sued. They know that most notices of infringement do not materialize into a lawsuit because of the costs and risks to the patent holder. When sued, they typically

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offer a reasonable value settlement. If rejected, these corporations will typically rely on an extensive and lengthy discovery proceeding and a series of motions until they hopefully eventually knock out the patent. If the patent holder loses the patent, money and courage to survive the ordeal, a settlement for modest compensation will be entered into to at least cover the patent holder's legal costs.

The company found it necessary to file suit against some 1,800 companies in federal courts throughout the country over the past five years. Furthermore, many suits were brought only after two patients spent one or two years gathering evidence in the form of infringing products, circuit diagrams, and back-and-forth legal arguments, in a battle often to persuade litigators to take a license.

SETTLEMENT STRATEGY

Settlement strategy should be based on an assessment of the merits, balancing between full payment of royalties versus the desire of the patent holder for the certainty of some reasonable compensation.

Litigation should be treated as a negotiating tool putting the patent holder on a more equal footing with the infringer, in order to obtain reasonable compensation. The trial is not an end in itself. However, many companies — large corporations usually — insist on it.

Even if the patent holder has adequate funds to bring and maintain a large patent infringement case, proper strategy and tactics make the difference between success and failure.

To many plaintiffs in patent actions being suit, spent years in discovery, prepared for the trial, and wind up with a net loss or minimal gain over with a favorable court decision. Unless a permanent injunction is rendered, the patent holder should actively maintain good relations with defendants and continuously pursue a licensing dialogue with them.

Strategy could be summed up as follows:

1. A patent holder should not file

suit and then, although commonly done, let the attorneys control the case through trial. We choose to take advantage of every opportunity at every stage of the litigation proceeding to aggressively seek an early resolution in the form of a fair license arrangement.

2. A plaintiff interested in settling before trial should not build back critical information and legal theories for purposes of improving its position at the trial. The defendants have every opportunity to know REFACT's factual and legal position at all times.

Patent law encourages public disclosure and REFACT deals with an open hand. We try to keep things as uncomplicated as possible, staying away from motions and other weapons of litigation, relying instead on the merits of our property rights. This helps defendants conduct intelligent litigation risk analysis and focus in on the issues and uncertainties, making an early and fair settlement possible.

• Promote Resolution •

All litigation developments, good and bad, promote a resolution of the dispute. If they are unproductive, then that is an opportunity to settle out the matter by making significant concessions to the other party.

3. Extensions of time for defendants to answer should be freely granted, if the defendants are interested in discussing settlement. Our policy is the same during discovery when answers or motions have to be provided by a certain deadline.

4. Unlike many plaintiffs, our licensing executives readily admit during discovery that there are still many uncertainties regarding the strength of the patent and infringement issues. This encourages defendants to take licenses at this early stage while the royalty rates are appropriately concessional. As the litigation progresses, costs accumulate, the patent validity position grows stronger, and the infringement insurance involved in its favor, rates REFACT requests will increase over time.

5. The patent holder should not be concerned that its insistence will

lead defendants to feel that its legal position is weak. Plaintiff's litigators are responsible for persuading defendants regarding the merits of the legal issues. REFACT's licensing executives assume the responsibility for resolving differences and reaching equitable deals. By keeping their functions separate, the litigators are not compromised by the actions of the licensing executives, who openly state that they are anxious to settle. That's their job.

6. When defendants file motions for summary judgment, these are opportunities to settle. Often, defendants will not consider any kind of settlement until they have exhausted their various motions for dismissal. At that point, the time is ripe to discuss a fair settlement.

7. After prevailing on the various motions to dismiss due to lack of, stopped, invalid, royalty infringement, etc., the plaintiff's bargaining position is strengthened. As a result, we will typically show two proposals on the table — one that is designed for acceptance by the defendant prior to a decision on the motion, and a less favorable proposal should the defendant wish to settle after losing its motion to dismiss.

8. Because REFACT prepares a standard royalty rate schedule to treat the entire industry uniformly, most settlement negotiations involve only two issues. One is the royalty rate in terms of proposed future sales volume, if the defendant wishes a lifetime paid-up license. The second is what are the various products and models that come within the scope of the claims covering the royalty base. We request that the defendant's past sales be verified by a CPA or a certification from that is provided.

9. On occasion, REFACT will accept the defendant's word on actual sales if it sounds right and is made a material representation in the settlement agreement. Sometimes, the verbal representations of sales prove to be less than the amount supplied to or bought from the defendant by resellers or customers. REFACT filed a complaint for breach of contract and fraudulent misrepresentation by one such licensee.

ROYALTY NEGOTIATION STRATEGY

Defendants often complain that the proposed royalty rate is too high in relation to their alleged "dispute margin" or "losses" on the product involved.

RIEAC doesn't often deviate from its set royalty rates based on sales. The royalty is for making, using or selling the patented item, regardless of whether the infringer sells, loses or breaks even in the marketplace. When a customer leases equipment from a rental business, the rental fee is not contingent on whether the equipment will make or save money for the customer. Likewise, we do not vary our license fee according to the fate of our licensee in the marketplace.

According to *The Wall Street Journal* (March 4, 1994), U.S. courts in recent years are awarding patent owners much higher damages than ever before. Awards of "lost profits" of up to 80% of the infringing sales are routinely approved by the CAFC, and damages based on a "reasonable royalty" from 15% to 25% of sales have become common. The CAFC stated that a "reasonable royalty" could be more than the selling price of the infringing machine.

Thus, a key to early progress is that the initial royalty rate is attractive enough to get competitors thinking of their ultimate liability (which would include both interest and possible triple damages).

The initial royalty rate should usually be less or somewhere near the low end of the following rules-of-thumb ranges: "that at least one-third of the licensee's profit should be obtained, that a minimum royalty of 5-8% should be obtained for manufacturer, manufacturer firms, that a royalty rate of 3-7% of sales should be obtained for machines, or that a minimum royalty rate of 5-7% of sales should be obtained with respect to the licensing of expensive equipment and systems." (Section 7.06, *International Property Management*, Clark Boardman, New York City.)

In a typical patent infringement licensing program involving cooperative mass-produced consum-

ables, once RIEAC had acceptance by a half dozen licensees, it raised its rate from 7-8% to 20%. After five dozen licensees and learning more in discussion about its case, RIEAC raised its rate to 4%. When RIEAC had about 50 licensees under its belt, its royalty rate was increased to 5%. At the time of this writing, there are more than 100 licensed brands and the present royalty rate is as high as 8%. Royalty income in the eight figures has made this licensing program a success, even though there has been no trial.

In addition to the income generated, the extent of licensee acceptance will be used as one of the arguments for showing patent validity, namely, commercial success.

LITIGATION STRATEGY

It is desirable to initially sue many manufacturing, wholesale and retail defendants in several federal district courts. They follow up as soon as possible with actions elsewhere to include the entire vertical marketing chain throughout the industry. A demand for jury trials may also be beneficial.

Many plaintiffs shy away from such drastic action, preferring to only sue one or a few leaders of the industry first. If they prevail in the litigation, then they offer licenses to the rest of the industry and sue if there is still resistance. The problem with this approach is that damages for the past six years preceding filing of the suit do not commence until the filing date. If all the other infringers refuse to receive the statute of limitations, then millions of dollars of royalties will be lost as time goes by in the absence of immediate suit against the rest of the industry.

Although occasional patent holders should consider suit on the retail and user level.

1. Retailers and users need the patent infringement imposed by establish a policy of buying only from suppliers licensed by the patent holder. This results in manufacturers, importers and leasers no longer voluntarily asking for a license.

2. The retailer or user may be

buying directly from a supplier abroad or from a supplier in a state where the patent holder has no plans to start an action. In this situation, the supplier may be bought in as a third party defendant, solving the plaintiff's jurisdiction problems. Further, the patent holder wants the supplier to know that it will not tolerate continuing infringing sales by any of the supplier's customers until the supplier takes a license.

3. Suing the retailer or user may be the only practical way to identify all of the manufacturers and distributors that are infringing the patent. Filing suit against retailers and users permits the plaintiff to discover the identity of suppliers over the past six years.

4. The patented item may be the kind of product that is primarily supplied by small manufacturing concerns that do not have the resources to indemnify customers, or that have already gone out of business. The only practical way to ensure that past damages will be satisfied in this situation is to join the distributors, retailers, and business users in the action from the start.

◆ Synergistic ◆

This industry-wide litigation strategy also has a synergistic effect that encourages settlement on the part of infringers.

1. Many defendants realize that it is futile to make the standard threat that they will fight all the way through trial and make it expensive for the plaintiff to sell its suit. They already know that the plaintiff is going to have to go through trial with other defendants because dozens and perhaps hundreds of defendants have been sued for infringement of a patent in various federal district courts. That defendant knows that the plaintiff is going to have to sue the infringer all the way through trial, regardless of whether that particular defendant sues. Obviously, the plaintiff has no incentive to give concessionary treatment to a defendant merely because it won't fight to the bitter end. It makes no difference whether one or out of fifty infringing

defendant stays in the suit.

Thus, the defendant can no longer get litigation leverage by threatening, "We're gonna bury you under a ton of paper." As far as RIFAC is concerned, if that defendant doesn't, another, and perhaps many others will try. The plaintiff employing this litigation strategy has shown by its actions that it is prepared for and will deal with the onslaught.

1. Because the industry knows,

from RIFAC's past practices, that everyone will eventually be sued for patent infringement, infringers at times request a license to avoid the inevitable. Because these firms illustrate a certain degree of bother and expense, we initially share our appreciation in various ways that are not done for infringers we are forced to sue.

3. Juries are sympathetic to the plaintiff, especially when Fortune 500 companies have refused over-

tures to license, companies have blatantly copied the claimed invention or are willfully infringing, or infringers are foreign companies who, for various reasons, may not be viewed in the best light by American juries.

In fact, a *Forbes* survey (June 17, 1995) indicates "juries believe in the patent system more than judges do." They are those who believe that infringers are more inclined to settle than take their chances with the jury.