

PRESENTATION:

**DISTORTION OF PATENT ECONOMICS
BY LITIGATION COSTS***

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My thesis today is neither revolutionary nor abstruse. On the contrary, it is no more than a modest, straightforward, common-sensical observation that has likely already occurred to many veteran viewers of the patent scene. It is, simply put, that the escalating, indeed skyrocketing litigation costs of the 1970's and 1980's have distorted patent markets and patent economics. Put another way, it is my observation that the escalating costs associated with litigating patent infringement and validity issues discourage challenges to patents, thereby essentially equating the entry barriers for presumptively valid, but weaker patents with those entry barriers associated with strong or judicially tested patents.

Let me elaborate. Patents present barriers to potential unlicensed competitors. Ideally the height of these barriers is a function of the patent's strength. Strong patents or patents that have already successfully passed judicial muster properly present a formidable barrier to potential competitors wishing to compete with the patentee by practicing the invention. The height of this entry barrier may be said to be equal to a royalty rate responsive to a number of market factors, including, for example, the cost of using a product or technology that competes with the patented product or technology, but is outside the patent's scope. But significantly, one factor that is not a part of the entry barrier equation for strong or judicially confirmed patents is uncertainty over the patent's validity.

By contrast, this factor can and often does play a vital role in determining the royalty rate, or metaphorically speaking, the height of the entry barrier for patents that are only presumptively valid, patents that have not yet run the litigation gauntlet. And the role this factor plays is obvious: it raises the entry barriers associated with such presumptively valid, but untested patents. Put another way, high litigation costs serve to discourage

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potential competitors from entering the market and challenging the patent. And if litigation costs are high enough in a particular instance, then the entry barriers associated with such untested and only presumptively valid patents may be raised to the level of those barriers associated with stronger, judicially tested patents. In short, burgeoning litigation costs have distorted patent markets by significantly discouraging potential patent challenges, hence distorting competition to a degree beyond that justified by the intrinsic strength or merit of the patent.

Now why, it is fair to ask, is this bad? The answer, it seems to me, is the sensible notion, inherent in the patent system (partly explicitly and partly implicitly), holding that for various reasons, some patents are improvidently issued and these patents, the notion holds, will be ferreted out and declared invalid through litigation. It follows that artificial disincentives to such litigation, such as escalating costs, may result in the unwarranted survival of some improvidently issued patents. In other words, the patent system contemplates that litigation challenges will catch those unworthy inventions that somehow slip through the Patent and Trademark Office filter. Barriers to such challenges that are unrelated to the intrinsic strength or merit of a patent contribute to the survival of unworthy patents, a result plainly inimical to the system.

And I should note parenthetically that the likelihood that escalating costs will have this untoward result may be increased if, as some observers fear, the Patent and Trademark Office's filter is becoming more porous, resulting in patent status for greater numbers of unworthy inventions. The greater porousness of the Patent and Trademark Office filter is said to stem from a variety of factors. Among these factors are (i) what I have observed as the trivialization of the unobviousness requirement and (ii) what commentators have noted as the increasing significance of commercial success in the validity calculus.

On this latter point, I find particularly incisive Professor Merges' California Law Review article in which he documents the dramatic increase in the importance of financial and licensing success in the validity calculus. He correctly points out that heavy reliance on these secondary factors tends to reward not actual invention, but rather such arguably irrelevant matters as superior distribution and marketing systems and service networks. Indeed, only a moments reflection suggests that licensing success may more accurately reflect today's high litigation cost environment rather than intrinsic patent strength. Too common to dispute is the scenario in which a potential competitor concludes that a license is cheaper and more certain than a lawsuit.

In sum, then, the pernicious effect of the escalating expense of patent litigation is that it artificially discourages court challenges to patent validity and thereby contributes to the risk that invalid patents will pollute the market.

But this is not the only pernicious effect of the high cost of patent litigation. The patent system, it seems to me, contemplates not only that litigation will eliminate improvidently issued patents, but also that would-be competitors will not be artificially discouraged from marketing a product or using a process that is as close to the border of the patent's scope as technology and law permit. High patent litigation costs are just such an artificial disincentive; in this respect, such costs have the essential effect of improperly expanding a patent's boundaries.

In summary, to restate my thesis, it is simply that high litigation costs distort patent markets by discouraging challenges to weak, potentially invalid patents and by discouraging potential competition at the borders of a patent's scope. To be sure, this thesis does not rest on firm empirical ground, but rather on intuition and anecdotal observation. Empirical investigation is needed to determine whether theory or thesis conforms to fact. This is a daunting and challenging task, no doubt heavy sledding for some lawyer–social scientist.

Yet, some of the pieces of the empirical puzzle may already be in place. No one, for example, doubts that patent litigation expenses today are very high, certainly much higher than 25 years ago. Nor is there much doubt that the expense of litigation can affect potential competitors' decisions whether to litigate, take a license or stay out of the market. The question is whether costs have risen to the point that they distort the market by significantly affecting the decision whether to compete or challenge an otherwise weak patent. I hope some enterprising investigator accepts the challenge to undertake the task of ascertaining whether my thesis fits the facts.

Finally, assuming that my thesis is valid, it is worth addressing, in general terms, what should be done about it. First, if litigation, because it is now so expensive, can no longer be counted on to ferret out invalid patents, perhaps steps should be taken to reduce the potential for the issuance of such patents. This might be done, for example, by legislative measures designed to reinvigorate the unobvious standard or lessen the importance of commercial success as an indicium of patentability. But these momentous steps are well beyond the scope of my remarks. Equally ambitious, yet closer to the aim of my remarks, is what can be done to stem the rising tide of patent litigation costs.

Of course, I have no certain panacea for the problem of skyrocketing patent litigation costs—except perhaps to suggest as did Dick the Butcher in *Henry VI, Part 1*, "Let's kill all the lawyers." But putting extremism to one side, let me make some observations, designed more to provoke discussion than to provide certain answers.

Let's focus first on discovery, for as any experienced practitioner will quickly confirm, the discovery stage is typically the costliest stage; it is the black hole of legal costs. Lawyers approaching the discovery stage of a large, complex patent case, like matter near a black hole, are sucked in and vanish, never to be heard from again. And continuing the metaphor, discovery, like a black hole, consumes vast amounts of energy, but gives off no light. I say this as a veteran of many patent antitrust discovery campaigns and now as a consumer of the results. My conclusion: discovery provides relatively little bang for the buck. Why? Probably the combined result of incentives built into the adversary system, coupled with the practice of billing by the hour and the compulsive thoroughness of most litigators. An extreme example from my own experience as a litigator: A six week deposition of a witness in a patent antitrust case. On reflection, the results of the effort confirm that the length and depth of that deposition owed more to the situs—the French Riviera—than to any rational cost-benefit analysis. More recently, I have reviewed numerous deposition transcripts in my five years on the bench and I find that the truly useful portions rarely amount to more than ten percent of the whole transcript. Much time is wasted by aimless fishing expeditions, a situation often exacerbated by well-coached evasive witnesses.

A complete remedy is not available. I would not change the adversary system and neither I nor anyone else is going to change the compulsively thorough and combative nature of most litigators. But there are some partial remedies. Principle among these are judicially imposed limits not just on the number of depositions, but importantly, also on their length. No deposition need last or should last six weeks. More than two to three days is almost always unnecessary. In my Division, Magistrate Judges handle all discovery matters. With their cooperation, I have recently increased my effort to monitor the problem of unnecessarily lengthy depositions.

Perhaps even more effective as control on litigation expense is to shorten the time from issue to trial. Surely a case that takes five or more years to litigate, as happened not infrequently when I was at the bar, costs much more than a similar case that start to finish is over in six months. This is one of the premises of our system in the E.D.Va. Because the trial date is certain and unchangeable, many cases settle.

In any event, if my thesis is correct, if escalating litigation costs are distorting patent markets, then a concerted effort should be made to reduce or control costs. This complex problem deserves the attention and study of this Section.

Also worth study is whether the distorting effect of high costs might be ameliorated somewhat by a clear fee-shifting provision. At present, fees are awarded to the prevailing party only in "exceptional cases," a far from clear category. Perhaps adopting a clear fee-shifting provision in patent cases would counter the ill effect of high costs. At all events, this and other cost cutting measures, and the thesis itself all merit closer study. Perhaps members of this Section will consider this a worthy task.

My thanks for your attention. I hope my discussion of entry barriers has not created any barrier to my returning to future events of this group.