Incentives to challenge and defend patents

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Berkeley conference, April 2004
Why it matters

- Cheap, secretive, error-prone PTO process
- Costly litigation
- Little in between
- “Rational ignorance”?  
  - If litigation works well  
  - Our main point: **That depends on relative incentives**
Do incentives matter?

- Optimists might think truth will emerge whatever relative incentives
- Would imply that truth emerges whatever relative spending
- Would imply litigants won’t bother to spend much
- We know that’s not true
Patentee often cares much more

• Validity challenge as public good
  – One patentee, many users
  – Reinforced if patentee discriminates based on challenges
    • Cheap to do

• Pass-through
  – If users (licensees) compete downstream, may bear little of the excess costs, *even collectively*
  – Downstream final consumers bear the burden
Example: $1 billion industry

- Patentee demands 5% royalty
  - Patentee’s stake in validity is $50 million
- Demand elasticity of -2
- 5 equal-sized firms, Cournot competition
- Their total stake is only $6 million because of pass-through
  - $1.2 million each
  - Over $44 million downstream
- Public good problem is factor of 5
- Pass-through is further factor of 8
Results of asymmetric incentives

- Patentee tends to win if merits at all equal
  - Challengers will only win what should be easiest cases
- Effect on bargaining in shadow of litigation
- Bad patents enforced rather than overturned
  - Incentives analysis does not depend on finding specific defects in specific patents
  - Examining record in patent litigation can’t find these errors, by definition
Likely results

- Too few challenges
- Inadequately pursued
- Too few bad patents overturned
- Downstream final consumers bear the brunt
Litigation costs

• Costly when undertaken
• May be *more* costly when deters litigation
  – Decision-maker doesn’t bear brunt of decision not to challenge
  – Settlements not always good: downstream consumers not at the table
What to do?

• Cheaper post-issue challenges
• Strengthen private incentives to challenge
• Accept adversarial approach deeply flawed here, improve PTO
• Competition agencies to represent final consumers