

Incentives to challenge and defend patents

Joseph Farrell and
Robert P. Merges

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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