The Appeals of Patent Mediation: Are Incentives to Mediate Patent Disputes Reduced on Appeal?

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INTRODUCTION

The success of mediation for emotional disputes, such as divorce cases, has been well-documented. However, there is evidence to suggest that mediation may be beneficial for highly technical patent lawsuits as well, which tend to exhibit characteristics uniquely situated for a mediation backdrop.¹ On October 3, 2005, the United States Court of Appeals for the Federal Circuit, the most common appellate circuit court for patent disputes, followed the lead of the other twelve circuit courts when it established an alternative dispute resolution (ADR) program. Initially, participation was entirely voluntary to test the merits of such a program.² A year later on September 18, 2006, the court made the program permanent by adopting a mandatory appellate mediation program.³ The adoption of this program was met with hesitancy and doubt as to whether cases commonly heard at the federal circuit would be amenable to mediation during the appeals process. Due to the prevalence of patent appeals at the federal circuit, many of the concerns were specific to distinctive types of patent law.

¹See David E. Sosnowski, Resolving Patent Disputes Via Mediation: The Federal Circuit and the ITC Find Success, 45 MD. B.J. 24 (2012) ("Mediation has the potential to, and often does, provide significant savings to parties engaged in patent litigation.").


I. INITIAL RELUCTANCE TO MANDATORY MEDIATION FOR PATENT DISPUTES

Prior to the federal circuit enacting the ADR program in 2005, the suggestion for a program that would force parties of a patent lawsuit to mediate at the appellate level triggered a considerable amount of controversy. In 2000, at the second annual Bench and Bar Conference held by the Federal Circuit Bar Association, an introductory program impressing the advantages of a mediation program was met with disinterest from court personnel in applying it to the federal circuit. Opponents to the program gave six justifications for their initial reluctance:

1. incentives to settle are reduced on appeal;
2. opportunities to discuss settlement are reduced on appeal;
3. complex patent cases are ill-suited for mediation;
4. when the government is a party, settlement approvals are problematic;
5. there is only a small group of mediators available; and
6. timing concerns in that the court lacked a backlog and did not want mediation delays to affect the favorable status quo.

Perhaps the most troubling and convincing of these justifications was the first—that incentives to settle are reduced on appeal. To gain a better appreciation for the obstacles that the federal circuit had to overcome in adopting the mediation program, it is important to explore some specific incentives that mediation offers and how the motivation for these incentives can change after the parties have fully litigated a trial on the merits and appealed the case to the circuit court.

II. INCENTIVES TO SETTLE ARE REDUCED ON APPEAL

To understand an opponent's reluctance to the mediation program based on the reduced incentives to settle on appeal, one must first recognize some of the significant incentives that mediation offers patent disputes before they even reach trial. Then, these incentives can be compared at both the trial and appellate court level to consider whether motivation to settle patent disputes is, in fact, reduced on appeal.

A. EXPENSES

One of the main hardships in patent litigation is the cost. In 2011, patent infringement cases, with less than one million dollars ($1M) at stake, cost an average of nine hundred sixteen thousand dollars ($916,000) to litigate; cases concerning damages of one million dollars

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5. Id. at 25.
6. Id. at 25-26.
7. Interview with Brian J. Philpott, Partner, Koppel, Patrick, Heybl, & Philpott, P.C., in Malibu, Cal. (Nov. 22, 2016).
($1M) to twenty-five million dollars ($25M) had an average cost of two million seven hundred thousand sixty-nine dollars ($2,769,000); and patent litigation with over twenty-five million dollars ($25M) at risk cost an average of six million eighteen thousand dollars ($6,018,000). These staggering figures are due in large part to the uniquely expensive discovery and expert witness costs associated with patent litigation. The discovery costs alone can exceed one million dollars ($1M), and expert testimony is heavily relied on to teach layperson decision-makers how to interpret exceedingly technical evidence.

These costs create a big incentive for parties, especially unfunded inventors, to settle a case prior to discovery. Even with the most clear-cut case, the cost of litigating an entire patent lawsuit may be too much for one side and prove to be an inefficient way to enforce or use patented technology. A mediator can use the lack of capital to convince a party in caucus that a smaller licensing agreement now may prove to be a better financial decision down the road, even if the party ends up winning given the court costs associated with obtaining a favorable decision.

Once the case is past the trial level and at appeal, the parties’ incentive to settle in an effort to save on litigation costs is greatly reduced. The initial discovery period is long over and the experts have already been paid for their services. While the appeals process can still be quite pricey, after factoring in expenses such as attorney’s fees, the parties dive deeper into their positions, after already spending such a large amount at trial. The fear of trial expenses is a strong tool for mediators because it explains to both parties that a settlement will be in their best interest from a cost perspective, bringing them closer together. Yet, this tool is weakened on appeal, leaving the mediator to rely on other devices.

B. DURATION

Time is, likewise, a large concern among patent disputes that can incentivize parties to settle a case through mediation. While lengthy lawsuits are rarely advantageous in any practice of law, patent litigation is especially affected when the court process impedes the development of new technology. The average time spent on a patent suit in district court is one to two years. Generally, this time period alone can be sufficient to turn a once state-of-the-art technological advancement into an archaic tool from the Stone Age. Modern society is currently going through what many call the “Digital Revolution.”

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10. Sosnowski, supra note 1, at 26-27.
11. See Greg Satell, Why The Digital Revolution Is Really Just Getting Started, FORBES
Technological advances in industries, such as medicine, energy, and software, are exploding at rates never before experienced. Although patent protection is guaranteed for twenty years, a patent’s value will often diminish long before that time with a new invention to take its place.

This fact allows patent mediators to explore creative solutions, such as exclusive licensing that can allow both parties to leave the mediation with an advantage on outside competition for as long as the technology is useful. Conversely, those same competitors might be the only winners in extensive litigation because both parties commit a substantial amount of time and money on something that could become useless by the final decision. A long process can also harm the defendant if an injunction is granted because it could prevent them from developing their own invention that may only be allegedly infringing in part.

Because the appeals process can take years, mediators will undoubtedly use time concerns as a tool at the appellate level. But as before, parties will feel more rooted in their cause after devoting such a long time at the trial level. Further, licensing deals only tend to incentivize when useful technology is at stake. If the technology is no longer useful after a long trial, the only value of the patent will be in recoverable damages for past infringements. This outcome creates a one-dimensional, retrospective dispute that essentially strips the mediator of his or her ability to incentivize a settlement through continued business transactions. With no potential future relationship in sight, parties will have less motivation to be collegial and instead be intransigent in their positions.

C. UNPREDICTABILITY

Mediating pre-trial is a common incentive because of the unpredictability of the outcome. The following sections will discuss a few of the unpredictable concerns that patent litigation can yield.

1. Claim Construction

Claim construction is a principal piece of any patent trial. It is the process whereby the court analyzes the “claims” section of the patent, which details the exact limitations of the invention. Construction is very important to the parties because it can often determine the outcome. If the court construes a claim broadly, there is a higher likelihood of infringement. Conversely, if the court construes the claim narrowly, then the defendant’s alleged infringement could avoid being

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12. Id.
13. Interview with Brian J. Philpott, Partner, Koppel, Patrick, Heybl, & Philpott, P.C., in Malibu, Cal. (Nov. 22, 2016) (cases may be won or lost based on the claim construction).
within the scope of the claim. The Supreme Court decided in Markman v. Westview Instruments, Inc.,\(^{14}\) that the job of construing the claims is given to the judge, rather than the jury, during what has been coined a Markman hearing. The Markman decision also meant that as a matter of law, claim construction would be reviewable \textit{de novo} by the appellate court.\(^{15}\) Thus, the reversal rate at the federal circuit is fairly high, creating even more unpredictability for the parties.\(^{16}\)

Applying this process to ADR, mediators can use the issue of unpredictability in ways that go beyond the normal concerns of a jury’s verdict and how much damages they will allow. The Markman hearing can be exceptionally detrimental to a plaintiff, who believes that the claims are written more broadly than the court decides. To avoid litigation, it is common to pay for licenses, even when it is not clear whether a particular use is infringing. If the plaintiff allows the court to adjudicate the issue of claim construction, they run the risk of jeopardizing licensing deals with third parties, whose agreements rely on those same claims. A mediator may inform the plaintiff and explain that not settling could have negative impacts that extend beyond the present dispute. This risk can create a major incentive to settle early, since patent licenses can be very costly, often exceeding six figures.\(^{17}\) The plaintiff might make a business decision that this one dispute is not worth risking the many licenses that they already have in place.

Conversely, at the appellate level, this incentive could easily be flipped. As a matter of public policy, a mediator does not have the power to reconstruct a claim, nor are the parties allowed to come to a settlement agreement that reconstructs a claim. Therefore, once the trial court judge has made a ruling on claim construction, the plaintiff will not have an opportunity to argue against it until it reaches the appellate court. A narrow claim construction could severely damage the licensing market for the patent, so if a trial court construes claims narrowly, then a plaintiff will have a strong desire to appeal the decision with the hope that the claim construction will be reversed.

Further, because Markman allows an appellate court to perform a \textit{de novo} review for all claim constructions, the reversal rate is relatively high, creating even more incentive for the plaintiff to appeal. At this point, because plaintiffs’ incentives to continue with the litigation go beyond the dispute at hand, they may greatly exceed defendants’ incentives to settle, thus creating an obstinate impasse. This can all be avoided through mediation before adjudication at the trial level, where many parties may privately stipulate to certain claim constructions for

\(^{15}\) \textit{Id.}
\(^{16}\) Sosnowski, \textit{supra} note 1, at 27.
purposes of settlement discussions.\textsuperscript{18}

2. Patent Validity

Patent validity is very similar to claim construction in that, as a matter of law, the judge must determine the validity of the patent before instructing the jury on patent infringement. When faced with an infringement suit, defendants generally defend by (1) standing firm behind the position of non-infringement as a shield, and (2) attacking the validity of the patent as a sword. The latter defense creates the risk of litigation for plaintiffs that extends beyond their relationship with defendants because an invalid patent defeats its protections entirely. However, ADR options do not carry this same risk. Even in arbitration, where there is a final adjudication, ADR professionals may consider patent validity as a defense but do not have the outright power to invalidate a patent,\textsuperscript{19} creating somewhat of a safe space for plaintiffs to defend their rights.

This ability to assert patent rights without threatening its validity again incentivizes plaintiffs to settle prior to adjudication at the trial level. Invalidating a patent is even more damaging to plaintiffs than a narrow claim construction because their entire patent is no longer legitimate. It negates all of the time and money that a plaintiff spends prosecuting the patent. Moreover, plaintiffs run the risk of third parties challenging existing licensing agreements for the patent by arguing frustration of purpose.

The points raised above regarding the incentives flipping from the trial court to the appellate level are even more salient here. Patent validity turns from one of the mediator’s strongest weapons to one of his or her biggest obstacles when a patent has been ruled invalid at the trial court. The plaintiff is no longer litigating the issue of the defendant’s infringement, but rather for the bigger picture of retaining a valid patent. Furthermore, a mediator would be hard-pressed to convince a defendant to pay anything for a license to an invalid patent. Hence, it is unheard of for parties to ever settle or even attempt to mediate a patent dispute after the patent has been invalidated.\textsuperscript{20}

3. Uneducated Jury Verdicts

Even one of the most common instances of unpredictability in litigation—the jury decision—is heightened during patent trials. These cases involve highly technical products and processes that can often overwhelm a layperson juror, despite an attorney’s best effort to simplify the information.\textsuperscript{21} Also, with so many nuances in patent law,

\textsuperscript{18} Koppikar, \textit{supra} note 9, at 166.

\textsuperscript{19} \textit{Id.} at 161.

\textsuperscript{20} Interview with Brian J. Philpott, Partner, Koppel, Patrick, Heybl, & Philpott, P.C., in Malibu, Cal. (Nov. 22, 2016).

the technology usually is not the only confusing part of the case. For example, if a patent is for a process to manufacture a product, a defendant could create the same exact product through different means and not be infringing. Expecting juries to comprehend the science behind the subtleties of the law can often be unreasonable. Therefore, many jury verdicts are returned uneducated and uninformed because most of the subject matter in patent litigation is foreign to the general public. These uninformed verdicts can leave very high-stakes litigation up to nothing more than speculation and chance.

Conversely, mediators of patent disputes generally possess technical backgrounds, typically in a field related to the dispute. This offers tremendous benefits to both parties prior to a trial. Not only can the mediator use the classic concern of jury unpredictability to nudge the parties, but the mediator is also uniquely situated to offer creative solutions that could only be conceived by someone with a firm grasp of the subject matter. The ability to use a mediator should greatly motivate parties to mediate. They then have shared control of the resolution process with a highly-qualified, neutral party, instead of leaving their fate to be decided by a randomly assigned jury with little appreciation for the subject matter at hand.

Since matters of fact are not reviewable on appeal, the power of unpredictability practically dissolves once the trial court has returned a verdict. The mediator will have a much more difficult time convincing the parties to come together after such a large part of the case has been taken out of their hands. A tangible verdict creates unequal bargaining power between each side because one party has a strong incentive to maintain the status quo rather than settle for something less. While mediators are trained to deal with unequal bargaining power, it is generally not a welcome feature of a case and takes a lot of control out of the mediator’s hands.

After the verdict has been returned, the mediator has fewer options to form a creative solution. A mediator may have had a unique perspective that would no longer be an issue at the appellate level. Returning to the patented process versus product example from above, if a jury delivers an uninformed decision of infringement because they could not look past the fact that both products were the same, then the mediator will have a harder time convincing the plaintiff to license only a part of the process, when he or she has already won on the infringement issue as a whole.

4. Injunctions

Similar to plaintiffs’ concerns about narrow claim construction and patent invalidity, defendants may fear injunctions, both preliminary and permanent, at the trial court level. Injunctions are

22. Id. at 765.
23. Id.
particularly debilitating because they can require defendants to shut down their entire production. Consequences of injunctions can include halting research, destroying inventory, and abandoning advertising campaigns.\footnote{Interview with Brian J. Philpott, Partner, Koppel, Patrick, Heybl, & Philpott, P.C., in Malibu, Cal. (Nov. 22, 2016).} Mediators will often use the fear of an injunction to bring defendants to the table for settlement discussions. Sometimes, not filing for an injunction will even be a stipulation of the mediation.\footnote{Kopikar, supra note 9, at 163.}

Once an injunction has been issued, a defendant loses a great deal of incentive to mediate because he or she has likely abandoned any business relating to the patent. Therefore, at the appellate level, a mediator can no longer use the fear of an impending injunction, nor the incentive of lucrative licensing deals since the opportunity has already passed. Additionally, even if the parties do agree to a licensing deal after an injunction is granted, the power to lift the injunction rests only with the court and petitioning the court wastes even more valuable time for defendants.

**CONCLUSION**

Based on the unpredictability of litigation outcomes and other concerns discussed, mediation would be very beneficial to parties involved in a patent dispute. The federal circuit has found success in its program—ordering mediation for cases at the appellate level.\footnote{Sosnowski, supra note 1, at 27 ("[T]he program had . . . a success rate of 45 percent").} However, after comparing some of the incentives at the trial and appellate court levels, it is understandable why the federal circuit was reluctant to initiate such a program. Due to the many disincentives of a patent suit proceeding from trial to the court of appeals, the federal circuit had to overcome numerous obstacles in order to achieve success. They did so largely by implementing a screening process,\footnote{Id.} which included factors that typically weigh against appellate mediation. The court was able to recognize the limitations of mediating patent disputes at the appellate level and effectively constructed the program with necessary parameters, such as whether the lower court found a patent invalid, issued a limiting claim construction, or issued an injunction.