COMMENT ON:
PATENT TRESPASS AND THE ROYALTY GAP: EXPLORING THE NATURE AND IMPACT OF 'PATENT HOLDOUT' BY BOWMAN HEIDEN & NICOLAS PETIT

Innovation and Patent Systems: Assessing Theory and Evidence
IP² Conference
Hoover Institution, Stanford University

May 18, 2017

Henry E. Smith
Harvard Law School

Introduction

- Heiden and Petit (H&P) show how rhetoric – "holdout" versus "holdup" – and an exclusive focus on patent holder opportunism have been used to (mis-)frame analysis and policy proposals in patent law.

- H&P develop the notion of "patent trespass" and show how it could be a problem.

- H&P do industry surveys that suggest that patent trespass can be a problem.

- These are well-taken and important points. Now . . .

- Is this much of a problem and if so what to do about it?

What can we learn from law (and economics)?

- Why trespass?
- Which remedies?
- Traditional law recognized the nature of the rights violation and the problem of two-sided opportunism.

No Trespassing Sign

Source: Djuradj Vujcic, CC BY 2.0

Trespass

- Trespass, unlike nuisance, does not require a showing – or even an allegation – of harm. It is a “sovereignty tort” like battery.
- It makes no reference to particular uses.
- Does this make trespass especially inappropriate for IP?
- Not necessarily. The point of trespass and its simple definition of “boundary crossing” style violation is to protect something indirectly – namely uses.
- In IP, that can’t be the information itself, which is nonrival. Maybe more indirectly it is the resources that go into commercializing inventions.

Trespass

- Trespass is an intentional tort but in the thinnest sense.
- One need only intend to be where on is; one need not intent to violate rights. One need not even know where the boundary is.
- This is particularly problematic in patent law, where notice is more difficult to furnish.
- This limit to the analogy suggests that something more than “trespass” is needed to describe the dangers on the infringers side.
- Deliberate trespass? Flagrant trespass? Or opportunistic trespass . . .

The Problem of Opportunism

- Nobel laureate Oliver Williamson: opportunism is "self-interest seeking with guile." Why is this bad?

- Opportunism is behavior that is undesirable but that cannot be cost-effectively captured – defined, detected, and deterred – by explicit ex ante rulemaking. Behavior that is technically legal but is done with a view to securing unintended benefits from the system, and these benefits are usually smaller than the costs they impose on others.

- If a potential violator knows too much about the value of entitlements and the value that a court will place on them, an informed violator can game the system by cherry picking property rights to violate: the violators will systematically pick undervalued assets to take. E.g. "patent trespassers."

Functional Equity

Aristotle: Equity (*epieikeia*) corrects “law where law is defective because of its generality.”

Story: constructive fraud, “Fraud is infinite” given the “fertility of man's invention.”

Williamson: “The capacity for novelty in the human mind is rich beyond imagination.

Opportunism: The Range of Tools

Four theoretical possibilities:

1. Ex ante tailored rules (e.g. fraud)

1. Ex ante untailored rules (e.g. some fiduciary law)

1. Ex post tailored standards (e.g. equitable safety valve: maxims, defenses, etc. based on good faith, disproportionate hardship)

1. Ex post untailored standards (the Chancellor's Foot)

An Illustration: Building Encroachments

- The law of building encroachments looks like a mess. Is it?
- As a continuing trespass, there is a presumption for an injunction.
- If an encroachment is made in <u>good faith</u> and presents <u>disproportionate hardship</u> (vast excess of harm to enjoined part over benefit to movant) then award damages.
- Problem is potential two-sided opportunism.

Remedies

- *eBay v. MercExchange* (2006): the movant must show:

- (1) that it has suffered an irreparable injury; (2) that remedies available at law, such as monetary damages, are inadequate to compensate for that injury; (3) that, considering the balance of hardships between the plaintiff and defendant, a remedy in equity is warranted; and (4) that the public interest would not be disserved by a permanent injunction.

- Good faith? What should be the standard? Willfulness??

- Disproportionate hardship is equipoise? Cost-benefit test? (Court's misplaced allergy to presumptions).

Remedies

- Traditional approach would be better for patent holdout and (opportunistic) patent trespass. (Gergen, Golden & Smith 2012).
- Holdout is a problem where there is a lack of notice or contrived surprise (esp. with SEPs). (Cf. good faith.)
- “Royalty stacking” (multiple margins) would be a problem only where there is an unknown patent and anticipated per unit damages. (Again, cf. equitable standard.)

Conclusions

- H&P have importantly widened the frame in the patent holdout/holdup literature and policy debate.
- They acknowledge that more empirical work needs to be done.
- Further development of their idea will benefit from:
- (i) zeroing in on the nature and problem of different classes of trespasses.
- (ii) mining the traditional law of equitable remedies for tested approaches to double sided-opportunism problems arising from simple structures of rights.