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U.S. Courts Can Order Production Of Patent Litigation Settlement Negotiation Communications

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In *ResQNet.com, Inc. v. Lansa, Inc.* (Fed. Cir. 2010), the U.S. Court of Appeals for the Federal Circuit held that patent litigation settlement agreements can be relevant in a different proceeding to the issue of the reasonable royalties that may be owed by a different infringer of the same patent(s). Last week, in *In re MSTG, Inc.*, the court took that decision one step further by holding that communications underlying such settlement agreements may be discoverable.

Discovery & Privilege

A general principle underlying the admissibility of evidence in a U.S. federal court is that all “[r]elevant evidence is admissible” unless the U.S. Constitution, a U.S. federal law, the Federal Rules of Evidence, or a rule prescribed by the U.S. Supreme Court provides otherwise. (FRE 402)

The scope of discovery in a patent case is governed by Rule 26(b)(1) of the Federal Rules of Civil Procedure:

Parties may obtain discovery regarding any non-privileged matter that is relevant to any party’s claim or defense Relevant information need not be admissible at the trial if the discovery appears reasonably calculated to lead to the discovery of admissible evidence.

The doctrine of privilege holds that a person in possession of relevant evidence can refuse to provide it if it is protected by a “privilege.” Common law privileges include attorney-client privilege, doctor-patient privilege, clergy-penitent privilege and marital privilege. In this case, MSTG asked the court to recognize an additional privilege—a settlement negotiation privilege.

The MSTG Litigation and Settlements

MSTG had sued AT&T Mobility LLC and other cell phone companies and mobile phone manufacturers for infringement of several U.S. patents directed to 3G technology. As noted by the Federal Circuit, “MSTG eventually settled with all parties except AT&T.” The settlements had varying terms, with most defendants being granted licenses under both the asserted patents and other MSTG patents. During the same time period, MSTG also licensed the patents to a consortium which was authorized to sublicense the patents to “its more than 50 members.”

The Reasonable Royalty Issue

One of the issues in the AT&T litigation was the “reasonable royalty” that AT&T would owe under 35 USC § 284 if it were found to infringe. Consistent with the *ResQNet.com* case, MSTG had produced “six license agreements and [an] option agreement,” but AT&T wanted more information relating to the underlying negotiations. It therefore “moved to compel the production of all ‘documents reflecting communications between MSTG or its attorneys, on the one hand, and either licensees or parties threatened with infringement by MSTG, on the other.’”

The magistrate judge initially denied the motion, but after MSTG’s expert testified that the royalty rates set forth in the settlement agreements were not good benchmarks for AT&T’s reasonable royalty because they resulted from “litigation related compromises” and encompassed additional patents, the magistrate judge granted AT&T’s motion on reconsideration. The magistrate judge reasoned that the negotiation documents might “shed light on why the parties reached their royalty agreements” and whether the royalty rates were relevant to a reasonable royalty rate for AT&T.

Is There A Settlement Agreement Privilege?

MSTG petitioned the Federal Circuit for a writ of mandamus to vacate the discovery order. The Federal Circuit considered two issues:

1. whether the patent license negotiations are protected by a settlement privilege
2. whether the discovery order amounted to an abuse of discretion where the settlement agreements already were of record

Rule 501 of the Federal Rules of Evidence permits federal courts to recognize new privileges, but that authority is constrained by the general preference for access to all relevant evidence.

[T]he Supreme Court has warned that evidentiary privileges “are not lightly created nor expansively construed, for they are in derogation of the search for truth.”

The Federal Circuit considered several guiding principals, including whether there was consensus among the states (no), whether Congressional action supported the privilege (no), the advancement of a public good (weak), the susceptibility of the privilege to exceptions (high), and the extent of the need to protect the sanctity of settlement discussions (low in view of other protections). The court therefore concluded that it should not recognize a settlement negotiation privilege.

[I]n light of reason and experience, we hold that settlement negotiations related to reasonable royalties and damage calculations are not protected by a settlement negotiation privilege.

The court quickly disposed of the second issue, and found that the magistrate judge had not abused his discretion in ordering discovery.

As a matter of fairness MSTG cannot at one and the same time have its expert rely on information about the settlement negotiations and deny discovery as to those same negotiations.

Will More Information Lead To More “Reasonable” Royalties?

As explained in the [Foley & Lardner LLP Legal News article](#), this Federal Circuit decision gives accused patent infringers “a potentially powerful new discovery tool to help establish what is, or is not, a reasonable royalty based on prior patent licenses.” Now, accused infringers may obtain

access to draft license agreements and negotiation communications that may help assess how closely the settlement agreement royalty rates reflect the value of the patented technology, or were influenced by other factors. While this decision reflects “a recent trend in expanding the scope of damages related discovery,” it “may impact the manner in which settlement negotiations are conducted in the future.” Patent holders may have a particular interest in creating a “record” that will support their position in subsequent litigation, but settling parties also may want to set the tone for whether a subsequent infringer—and likely competitor—will be subject to the same royalty rate.

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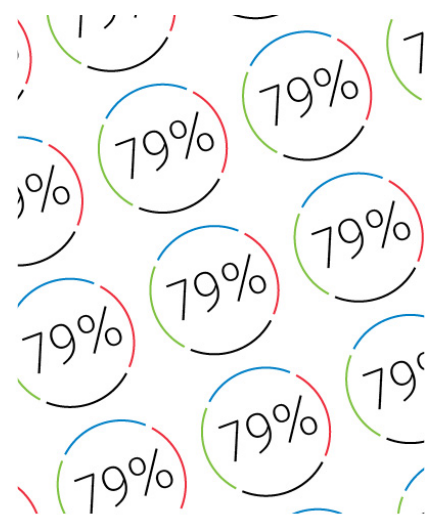
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