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How do legal surprises drive organizational attention and case resolution? An analysis of false patent marking lawsuits

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ABSTRACT

Legal surprises are unexpected suits or actions in which plaintiffs rely on claims or precedents that may be obscure, unfamiliar, or unknown to the defendants. Our study explores false patent marking suits, a unique type of patent-related legal surprise involving allegations of defendants marking products with ineligible patent numbers to deceive customers and/or deter competitors. An abrupt shift in U.S. Federal Courts' interpretation of intellectual property rights (IPRs) policy amplified plaintiff incentives for filing these suits while escalating defendant penalties for proven violations. Handling costly legal surprises such as false patent marking suits requires focused attention from managers. Our core premise is that temporal and evidential cues in the timelines and storylines of plaintiffs' legal narratives in surprise suits attract defendants' organizational attention. We hypothesize about temporal focus (past, present, and future) and evidentiary reasoning (relevance, credibility, and inferential power) as attention cues and possible predictors of the mode (litigation or negotiation) and timing of case resolution. We apply automated content analysis to official court records for 992 false patent marking cases (2009–2011) and quantify competing risks using hazard models. We find that differences in temporal focus and evidentiary reasoning in the legal narratives of surprise suits are significant predictors of case resolution mode and timing. We also find that defendants countersuing to redirect plaintiffs' attention is an effective negotiating tactic. We discuss the economic significance and strategic implications of our empirical findings on legal surprises, attention, case resolution mode and timing, and the unintended consequences of IPR policy changes.

1. Introduction

Legal surprises are unexpected suits or actions in which plaintiffs intend to strategically leverage the element of surprise to prevail over defendants (Sheridan, 1955). *Organizational attention* refers to the "noticing, encoding, interpreting, and focusing of time and effort by organizational decision-makers" on issues and answers (Ocasio, 1997; 189). Handling legal surprises often demands keen organizational attention from managers (Cunha et al., 2006). For instance, to protect and profit from their innovations, managers may focus their attention on negotiating and/or litigating costly legal surprises arising from disputes over intellectual property rights (IPRs) (Chien, 2011; Dosi et al., 2006; Mazzoleni and Nelson, 1998). In the context of IPRs, our study focuses on patent-related legal surprises. We explore the following research question: *How do legal surprises drive organizational attention and case resolution?*

Prior research generally examines what happens when plaintiffs own patents that are allegedly infringed upon by defendants (Fischer and Henkel, 2012; Lanjouw and Lerner, 2000; Lemley and Shapiro, 2005; Reitzig et al., 2007; Somaya, 2003). In such cases, defendants may experience surprise when lawsuits reveal unexpected information about the occurrence and detection of infringement (Lanjouw and Schankerman, 2001), the existence and scope of infringed patents (Merges and Nelson, 1990), or the enforceability and validity of infringed patents (Jaffe, 2000). We extend this prior work in a new direction by investigating a unique type of patent-related legal surprise called a false patent marking suit. *False patent marking* is the manufacturing and selling of products imprinted with ineligible patent numbers to unfairly deter competition and/or deceive customers (Federico, 1993; McCaffrey, 2011). Unlike infringement suits, which depend on plaintiffs first establishing the *eligibility of their own patents*, false marking suits hinge on plaintiffs showing the *ineligibility of defendants' patents*. In such cases, defendants may experience surprise when lawsuits claim that patents are counterfeit, nonexistent, incorrect, inapplicable, expired, invalid, or unenforceable (Cotter, 2010; Coursey, 2009; Rydstrom et al., 2011). Perhaps even more surprising for these

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defendants is the recent abrupt change in the financial penalties for violating false marking laws.

Prior to the U.S. Federal Circuit Court ruling in the *Forest Group, Inc. v. Bon Tool Co.* case on December 28, 2009, few people were aware of the illegality of false patent marking (O'Neill, 2010). Before this landmark decision, Federal Courts routinely interpreted Title 35, U.S. Code Section 292 as limiting penalties for false patent marking to $500 per offense, which offered little incentive to file suit (Teichner, 2011). However, after this decision, courts reinterpreted IPR policy and ruled that the $500 penalty could be applied *per article*, rather than *per offense*, which dramatically raised the awareness of and skewed the incentives for filing suits (Winston, 2009):

> "It is rare that a court will issue a decision that represents a ground shift in the law, exposes companies to significant and previously unknown penalties for certain conduct, encourages parties that have not suffered any actual injury to file lawsuits, and opens the floodgates to litigation. In December 2009, however, that is exactly what the Federal Circuit did." (O'Neill, 2010; 22)

This sudden IPR policy shift flooded courts with nearly 1000 false patent marking cases in 2 years, before being halted by the Leahy-Smith America Invents Act in 2011 (Kwok, 2012). The *Pequignot v. Solo Cup* case illustrates the strategic consequences of this shift. The plaintiff, patent lawyer Matthew Pequignot, alleged that the defendant, Solo Cup, marked 21 billion cup lids with expired patent numbers (Baird et al., 2011). The difference between the maximum total penalties calculated on a per offense or a per article basis is astronomical if each cup is defined as an individual article (O'Neill, 2010). Even if courts used discretion to set fines at a fraction of a cent per article, instead of $500 per article, Solo Cup's exposure still exceeded tens of millions of dollars (Baird et al., 2011). Ultimately, Solo Cup won on appeal, after showing evidence that it acted without intent to deter competitors or deceive customers (Anania and Rodrigue, 2011). Solo Cup's successful case resolution in court helped it avoid a damaging financial penalty. Many firms faced this same wave of surprise lawsuits filed during the 2009–2011 IPR policy shift.

When filing suits, plaintiffs construct *legal narratives*, or stories connecting facts and events, to make claims. The crux of a false patent marking suit is the plaintiff's story of when and why the defendant's patent is ineligible for use in marking its products. We posit that the timelines and storylines of plaintiffs' legal narratives may contain *temporal* and *evidential* cues that attract defendants' attention. *Temporal focus* is the extent to which people think about past experiences, present situations, and future expectations and incorporate this thinking into their attitudes, cognitions, and behaviors (Bluedorn, 2002; Shipp et al., 2009). *Evidentiary reasoning* is the process of marshalling various sources of information, evaluating their relevance, credibility, and inferential power, and drawing conclusions (Pirolli and Card, 2005; Schum, 2009). We further posit that these cues may be predictors of the mode (litigation or negotiation) and timing of case resolution. Timing and mode are useful metrics to litigants, since a case's total duration affects legal costs, which vary based on the mode (Cooter and Rubinfeld, 1989).

We organize our study as follows. First, we define and link the core concepts of legal surprise and organizational attention. We explain how plaintiffs use temporal focus and evidentiary reasoning as cues in the legal narratives of surprise suits. We then hypothesize about these attention cues as possible predictors of case resolution. We conduct an automated content analysis of court documents for 992 false patent marking cases (2009–2011). Our competing risks hazard models reveal that quantifiable differences in temporal focus and evidentiary reasoning in the legal narratives of surprise suits are significant predictors of case resolution mode and timing. We also find that countersuits are an effective negotiating tactic. Lastly, we discuss the implications of our empirical findings for scholars, managers, and policymakers.

2. Definitions and conceptual origins

To investigate the handling of legal surprises in false patent marking suits, we build our theory and hypotheses using prior studies in managerial decision-making and legal strategy.

2.1. Surprise and attention

Management scholars define surprise broadly as an umbrella concept that includes favorable and unfavorable instances of "any event that happens unexpectedly, or any expected event that takes an unexpected turn" (Cunha et al., 2006; 2). For managers, organizational surprises are discrepant *events* that create confusion, complexity, and pressure (Cornelissen, 2012) and that trigger a need to explain and interpret discrepancies (Louis, 1980). The source of surprise may be internal or external (Lampel and Shapira, 2001; Lampel et al., 2009). The positive or negative consequences of surprise may range in impact from barely noticeable to moderately disruptive to completely overwhelming (Ansoff, 1975; Perrow, 1984; Weick, 1993).

The concept of organizational attention stems from the attention-based view (ABV) of the firm (Ocasio, 1997). The ABV is a metatheory that connects the structure, process, and outcomes of attention to organizational action and adaptation (Ocasio, 2011). Applying the ABV, we conceptualize organizational attention as the process of allocating cognitive resources to solve problems, create plans, interpret issues, and make decisions (Ocasio, 1997, 2011). We note that the nature, sources, and consequences of surprise are all directly related to organizational attention. Discrepant events may spark challenges, confrontations, or crises that co-opt or capture organizational attention in unanticipated ways (Maitlis, 2005). These events may initially be perceived as surprising due to the lack of organizational attention focused on detecting emergent signals of the sources of surprise (Ansoff, 1975; Cunha et al., 2006; Weick, 2005). Subsequent success or failure in adapting to these events may depend on managers refocusing organizational attention on handling the consequences of surprise (Rerup, 2009; Sullivan, 2010; Winter, 2004). In other words, surprises demand managers' attention. Surprises may happen when managers do not direct enough attention to certain cues. Surprises may also create new problems or opportunities that require managers to redirect their attention to different cues.

Legal scholars define surprise more narrowly and in procedural terms. In legal settings, surprise means "Astonishment by the unexpected. Aroused by the unusual. The condition in which a party to an action finds himself, contrary to his reasonable expectation, through no fault or neglect of his own, and to his probable injury," (Ballentine and Anderson, 1969; 1245). For litigants, legal surprises are *actions*, and the source of a party's surprise is purely external —— it is based on the counterparty's claims and/or the underlying legal precedent —— and the consequences are presumed to benefit the action's initiator and harm its target (Sheridan, 1955). Opportunistic plaintiffs may apply the element of surprise and time pressure as competitive advantages in legal domains unfamiliar to defendants (Fentin, 1995; Merk, 2010). For example, by using new, but obscure legal precedents before they become widely known or are overturned, insightful plaintiffs may score profitable legal wins against unwary defendants (Rupert, 2009).

We view false patent marking suits as legal surprises, within the broader category of organizational surprises. From the defendant's perspective, the plaintiff's unexpected filing of a false patent marking suit is a surprise event. In such suits, the plaintiff's unexpected claim that the defendant's patent is ineligible for use in marking products is a surprise action. In addition, the plaintiff's use of an unusual legal precedent (the 2009–2011 IPR policy shift) to support its claim and maximize its financial gain also signals to the defendant the surprise costs of this action. Hence, defendants in false patent marking suits experience surprise that is triggered by: (1) surprise events (unexpected filing of suits); (2) surprise actions (unexpected claims and unusual precedents); and (3) surprise costs (unknown exposure to financial penalties).