MORE FIGHTS OVER INTELLECTUAL PROPERTY

Auto Industry Throws Away Henry Ford's Rulebook

By: Steven L. Oberholtzer & Bradley L. Smith

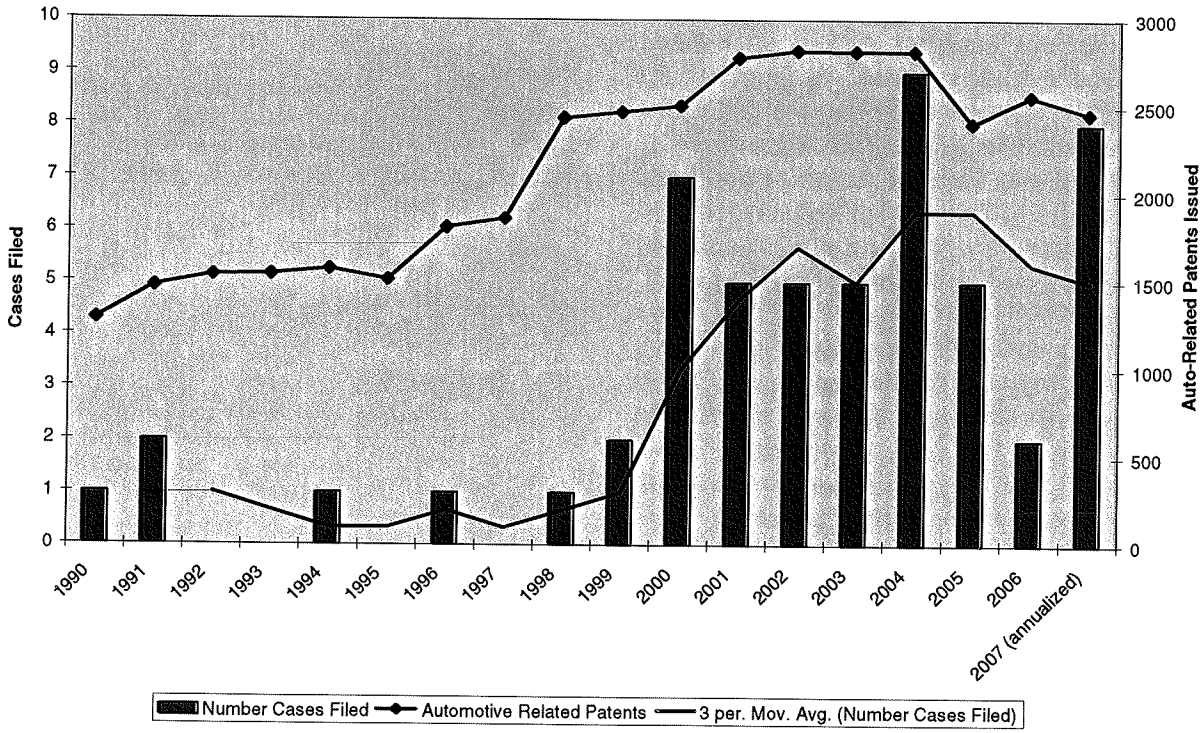
For decades, if an auto manufacturer or a supplier accused another automotive company of infringing a patent or trademark, the parties rarely went to court. The last big intra-industry intellectual property (IP) court fight started in 1903, when Henry Ford famously defied a consortium of automotive manufacturers which had purchased the rights to George Selden's patent for an "improved road engine." After the consortium failed in its eight-year infringement lawsuit against the fledgling Ford Motor Company, industry participants adhered to an unwritten rule that required allegations of IP infringement be settled quietly, or more commonly simply accepted as a part of the business. The alternative of suing the infringer would be expensive, unpredictable, and likely invite retaliation, particularly if the infringer was a customer.

The industry is abandoning its former restraint. In the last six years, dozens of IP cases have beset the industry. A good example is the recent patent case decided by the Supreme Court, *KSR v. Teleflex*, in which rival automotive suppliers vigorously contested the validity of a patent for an adjustable accelerator pedal. That case, which raised the bar to obtain any patent, highlights two dramatic intellectual property trends in the automotive industry: a large increase in the number of automotive patents granted, and a sharp rise in IP litigation.

Using patent databases and digital court filing records, we researched the number of times that an automobile manufacturer or top supplier filed a patent or trademark lawsuit in federal court against another automotive manufacturer or top supplier, and the number of automotive-related patents these companies obtained over the same period. Our research encompassed the 162 largest current and former automotive suppliers and 12 domestic and foreign OEMs. We were able to access computer records for all issued patents and most of the important trial courts for IP cases since 1990.

As shown in the nearby graph, the OEMs and their top suppliers have greatly increased their patent activity in recent years. Even more interesting is the increased patent and trademark litigation among industry participants. Prior to 2000, IP disputes amongst industry players were seldom litigated. In 2000, the number of

Automotive Patent and Trademark Cases Filed in USA and Auto-related U.S. Patents Issued



intra-industry IP suits shot up from two to seven, peaking at nine in 2004. After dipping last year, case filings this year are on pace to reach the higher levels seen earlier. A line showing a three-year moving average smoothes out these fluctuations. The most striking aspect of the research is that the growth in importance of intellectual property, as measured by the number of automotive patents issued to the OEMs and their suppliers, almost perfectly matches the three-year moving average of patent and trademark litigation between the leading industry participants.

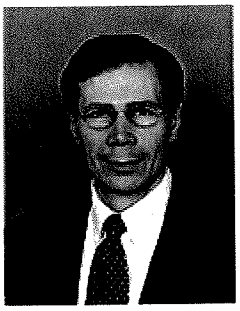
Several factors have combined to overthrow longstanding industry practice. First is the sheer prevalence and importance of technology. Modern automobiles integrate highly sophisticated electronics and control systems with parts made of advanced materials and tools using proprietary methods. David Cole, of the Center for Automotive Research in Ann Arbor, says that the automotive industry is a different world from even a few years ago: "There is now so much more going on in terms of intellectual property. We see it in information technology in the automobile, advances in materials processing and assembly operations, and power train variety. We will continue to see more patents as the industry searches for new technologies."

A second factor in North America is that the stakes have become much higher, justifying the risk and expense of IP litigation. High fixed overhead requires high volumes to make a profit. As the domestic manufacturers lose market share and reduce their purchases, competition for the remaining business assumes critical importance. Unlike the keiretsu system prevalent in Japan, where customers and suppliers routinely have interlocking long-term business interests and loyalties, a stressed U.S. supplier is more likely to abandon earlier restraint and use every tool available to secure what business remains. Excluding a competitor through patent procurement and infringement litigation may be a matter of survival.

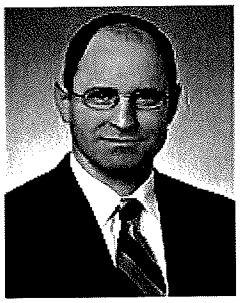
A third factor driving intellectual property protection is a new relationship between the OEMs and their suppliers concerning product development. A recent report from the Original Equipment Suppliers Association (OESA) notes that twenty years ago, nearly all suppliers manufactured parts to specifications provided by their customers, with suppliers performing less than 10% of all automotive research. Today, significantly fewer suppliers perform much more of the automotive research – more than 40% according to OESA. As OEMs have pushed research and development down to their suppliers and subsuppliers, ownership of the patentable technology has become more dispersed and auto manufacturers have less control over enforcement in court. At the same time, a supplier that has many competitors and relatively few potential customers has a strong incentive to patent any new technology that may provide a competitive advantage.

Further, it is now much more common for suppliers and their OEM customers – and even for competing OEMs– to cooperate in researching and developing new technology through joint ventures, such as hybrid power trains. Such cooperative research nearly always includes agreements for protecting and licensing any patentable inventions that may result.

Finally, as the industry has relelentlessly focused on lowering costs, every participant in the automotive industry is attempting to compete on a basis other than price. Developing and protecting intellectual property is one of the best ways a manufacturer can differentiate its products in this environment. Cole is blunt: "In a period of discontinuous change, intellectual property has a higher value. Everyone is working to become an anti-commodity company and to break out of the commodity world." Every indication is that automobile manufacturers and their suppliers will continue their aggressive pursuit of intellectual property rights. Given the competitive stakes, it is not likely that the industry will soon return to the practice of avoiding litigation when those rights are infringed.



Steve Oberholtzer is a Shareholder in the Ann Arbor office of intellectual property law firm Brinks Hofer Gilson & Lione. He specializes in patent procurement and licensing.



Brad Smith is Counsel in the Ann Arbor office of Brinks Hofer Gilson & Lione. He specializes in intellectual property litigation.