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Determining Monetary Relief in Patent Litigation



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Companies that generate revenue through patent enforcement, but do not manufacture or sell any products of their own, are the source of a great deal of controversy.

Although a variety of terms are used to describe these entities (*e.g.*, aggressive patent assertors, patent aggregators, patent speculators, patent trolls, patent licensing and enforcement companies, etc.) and their business models and enforcement strategies vary, they all have one thing in common: they do not practice the patents

that they enforce. To avoid the implicit judgment in some of these terms, they are referred to herein as non-practicing entities (“NPEs”).

Case law attempts to balance the rights of a patent holder with the economic hardship that a defendant may face upon a judgment of infringement. This article discusses unique economic considerations in determining pre- and post-trial damages, as well as awarding injunctive relief, in matters involving NPEs. (The views expressed herein are the author’s alone; the author is a CPA, not a lawyer, and this article should not be construed as legal advice.)

Traditional Damages Remedies in Patent Matters

Two primary forms of damages are available to a patent holder: lost profits and/or a reasonable royalty. Cases such as *Panduit Corp. v. Stahl Bros. Fibre Works, Inc.*, 575 F.2d 1152 (6th Cir. 1978), provide guidance on the elements that a patentee should establish in order to use a lost profits approach. Because NPEs, by definition, do not manufacture or sell products, they are unable to demonstrate that they possessed the sales/marketing capability and manufacturing capacity to meet market demand. Therefore, consistent with 35 U.S.C. § 284 of the patent statute, NPEs are entitled only to damages “adequate to compensate” for infringement, *i.e.*, a “reasonable royalty.”

Cases such as *Georgia-Pacific Corp. v. U.S. Plywood-Champion Papers, Inc.*, 318 F. Supp. 1116 (S.D.N.Y. 1970), prescribe 15 factors that should be considered in determining a reasonable royalty. These 15 factors can be lumped into the following four general categories: (a) licensing/scope of the agreement (Factors 1, 2, 3, 4 and 7); (b) profitability/business considerations (Factors 5, 6, 8, 12 and 13); (c) technical/benefits of the claimed invention (Factors 9, 10 and 11); and (d) overall opinions of experts (Factors 14 and 15).

Consider the following hypothetical scenario involving an NPE.

- In 2000, a patent claiming technology related to semiconductor functionality (“the ‘001 patent”) issues to an individual inventor;
- In 2003, after failed attempts to commercialize or license the claimed invention, the inventor divests the ‘001 patent to an NPE for a non-refundable lump-sum amount of \$1 million;
- In 2005, the NPE sues a computer manufacturer for infringement of the ‘001 patent;
- The defendant has been purchasing computer components that allegedly embody essential claims of the ‘001 patent from a semiconductor manufacturer located overseas since 2002; and
- In addition to injunctive relief, the NPE seeks damages based upon a reasonable royalty approach.

Some questions that arise are: (a) how do the *Georgia-Pacific* factors apply to this fact pattern; (b) what considerations could impact injunctive relief and the terms of a compulsory license; and (c) how could industry practice and the scope of the claimed invention affect the determination of a reasonable royalty?

Georgia-Pacific Considerations

Several *Georgia-Pacific* factors require particular attention in determining a reasonable royalty in matters involving NPEs.

Courts place the parties in a hypothetical negotiation occurring at the time of first infringement in an effort to arrive at a reasonable royalty (Factor 15). In our hypothetical, where an NPE enforces patent rights that were allegedly infringed upon before it acquired the '001 patent, we have a dilemma. One could argue that the inventor should be the licensor in the hypothetical negotiation, because she/he owned the patent in 2002 when infringement first began. If so, the plaintiff would not be a party to the negotiation. Unless the court provides direction, in order to avoid selecting the wrong licensor, damages experts should consider placing both the prior and current patent holders in the hypothetical negotiation and/or consider two negotiations with potentially different outcomes.

In arriving at a reasonable royalty, courts also consider the royalties that the patentee has received by licensing the patent(s)-in-suit (Factor 1). Although the inventor failed to license the claimed invention in our hypothetical, the \$1 million that the NPE paid may help determine a reasonable royalty. The \$1 million may also be considered in connection with the "adequate compensation" criteria stated in the statute. If, for instance, the NPE seeks monetary relief that grossly exceeds the lump-sum payment, does that request represent adequate compensation to the NPE or an inappropriate financial windfall? Also, because infringement first began before the '001 patent was acquired by the NPE, should the parties consider the \$1 million payment during a hypothetical negotiation? The answers to these questions, as well as other issues addressed below, may depend upon who "participates" in the hypothetical negotiation (the inventor, the NPE or both) and if the \$1 million acquisition price is allowed into the record.

Also relevant to the analysis are the hypothetical licensor's established policy on licensing (e.g., has the patent holder maintained its "patent monopoly" or licensed the claimed invention in the past?) (Factor 4) and the commercial relationship between the parties (e.g., are they competitors?) (Factor 5). Unlike practicing entities, NPEs by definition do not have a patented product that would be affected by competition. Also, as addressed in more detail below, NPEs are unlikely to obtain injunctive relief; consequently, their ability to maintain a "patent monopoly" through an exclusionary order is limited. Therefore, an NPE's opportunity costs associated with licensing may be limited to the precedent established in litigation. For instance, in our hypothetical, because the NPE sued only one party, the outcome of the present litigation would likely impact future negotiations and lawsuits involving other alleged infringers.

Courts also consider the portion of product profitability that should be credited to the claimed invention as opposed to the contributions associated with other product characteristics and the commercialization risks assumed by the defendant (Factor 13). Again, given that NPEs do not manufacture products, product profitability will likely be attributable to a defendant's efforts. However, sometimes an NPE has not merely acquired a patent, but has invested significant research and investment in furtherance of developing the claimed invention(s). (Academic or research institutions, for instance, are NPEs that may fit this profile.)

Further, although NPEs do not embody the patented technology in a product, market demand could be adversely affected absent access to the claimed invention(s). These dynamics should not negate the contributions of the defendant, but they may limit the downward pressure this factor could otherwise exert on the determination of a reasonable royalty.

Finally, courts consider the duration of the patent and term of the license (Factor 7). Design-around alternatives to the claimed invention(s) aside, the duration of the license would typically be a function of patent expiration or technological obsolescence, whichever occurs first. Therefore, the term of the license for purposes of the hypothetical negotiation may extend beyond the date of trial. For instance, assume in our hypothetical that the useful life of the patent extends to 2013 and that trial occurs in 2009. The timeframe of the hypothetical license would be from 2002 (the date infringement began) to 2013. If the competitive landscape and market conditions are similar in 2002 and 2009, the royalty resulting from the hypothetical negotiation could be relevant in determining a post-trial royalty if the defendant is not enjoined.

Injunctive Relief and Compulsory Licensing

NPEs are unlikely to obtain permanent injunctions. In *eBay Inc. v. MercExchange, L.L.C.*, 547 U.S. 388 (2006), the Supreme Court ruled that upon a liability finding in favor of the claimant, the patent holder is no longer automatically entitled to injunctive relief. Rather, a plaintiff must satisfy the traditional four-factor equitable test to enjoin a defendant. Although the fact that an entity does not practice its asserted patent(s) may not itself negate its ability to obtain injunctive relief, the competitive relationship between the parties does weigh heavily in the assessment of the four-factor test. Where a patent holder is a direct competitor, it is more likely to obtain injunctive relief. NPEs do not directly compete, thereby greatly diminishing their ability to obtain an injunction against a party found to infringe their patent rights. Indeed, since eBay, very few NPEs have been granted a permanent injunction. Therefore, in our hypothetical, it is unlikely that the NPE would be able to enjoin the computer manufacturer upon a finding of infringement.

When a patent holder is denied injunctive relief, the infringer is typically granted a compulsory license if it wishes to continue to practice the patent(s)-in-suit after trial. As addressed above, the royalty resulting from the hypothetical negotiation could assist in the determination of a post-trial royalty. However, in *Amado v. Microsoft Corporation*, 517 F.3d 1353 USPQ 2D (Fed. Cir. 2008), the Court of Appeals ruled otherwise, reasoning that prior to judgment, liability and validity are uncertain, whereas after a judgment has been entered, "the calculus is markedly different because different economic factors are involved." Damages experts typically assume that a patent is valid, enforceable and infringed. If these conditions are not established and liability is not found in favor of the plaintiff, a quantification of damages is irrelevant. However, damages experts may need to consider differences in the relative bargaining positions of the parties before trial (where there is a presumption of liability) as opposed to during the compulsory licensing phase (where there is an actual liability finding).

In addition, if there are differences between the information considered by the negotiating parties at the time of hypothetical negotiation and the information available after a verdict of infringement, then a disparity in pre-trial and post-trial rates could logically follow. As a result, it is important to understand what information was considered during the hypothetical negotiation (*e.g.*, did the damages experts consider events after the date of first infringement?), and whether the facts and circumstances at the time of the negotiation are similar to those at the time a compulsory license is being determined. Damages experts may wish to comment on the suitability or inappropriateness of applying a pre-trial royalty to a post-trial period during a damages study and should be mindful of the changes in the competitive landscape and market conditions that may have occurred since the date of first infringement.

Moreover, depending on industry practice, it may be appropriate for damages experts to determine a reasonable royalty based upon a lump-sum payment. As opposed to a running royalty, which is typically set at a fixed or varying percentage of sales or dollar amount per unit sold, a lump-sum payment is a monetary exchange that should be based upon the value of the patent(s)-in-suit discounted for time value of money and other considerations over a relevant period of time, such as the useful life of the claimed invention. A lump-sum payment may negate the need for injunctive relief because it typically allows a licensee the right to practice the subject property through patent expiration. However, caution should be used when employing this approach in order to avoid providing the licensor with a potential financial windfall if, for instance, actual sales and profitability of the product under license are dramatically less than anticipated at the time of the hypothetical negotiation.

Industry Practice

NPEs often sue downstream suppliers in the sales channel. The products of a company at the last stage of the supply chain command the highest prices, thereby maximizing the sales or royalty base on which an NPE can claim damages. Legal considerations regarding indemnification between suppliers, patent exhaustion and inducement of infringement should be soundly vetted when determining the appropriate party to target in a patent litigation. Also, one should determine the scope and reach of the patent(s)-in-suit and which supplier(s) allegedly infringe each of the essential claims at issue.

Although these issues are typically addressed by legal counsel and technical experts, damages experts should understand how these considerations may impact the determination of a reasonable royalty. For instance, issues regarding the entire market value rule (“EMV rule”), which permits the recovery of damages based on the value of the entire apparatus containing several features when the patented feature at issue is the basis for customer demand, may need to be addressed, because they may affect the selection of the appropriate sales or royalty base on which to calculate damages.

Industry practice should also be considered. For instance, if technology comparable to the patent(s)-in-suit has historically been licensed based upon the price of a component (*e.g.*, semiconductors), it may be necessary to reduce the royalty rate or apportion the royalty base downward if the accused product(s) at issue are sold further down the sales channel as part of another product that commands a significantly higher price (*e.g.*, a computer).

Although NPEs may contend that the worth of the patent(s)-in-suit should not be measured based upon the value of the component part, if the scope of the essential claims at issue is limited to functionality contained in said component, the component’s sales price should typically reflect the appropriate economic value on which to calculate royalties. Also, component parts (*e.g.*, semiconductors) may be bundled with additional components and associated intellectual property to ultimately comprise a downstream product (*e.g.*, a computer). Damages experts may need to consider this dynamic because it could trigger issues associated with “royalty stacking,” whereby each form of intellectual property may need to be accounted for in order to provide the licensee with a reasonable profit on the subject product(s). The confluence of patent exhaustion, the EMV rule and royalty stacking are issues that patent counsel and damages experts should jointly consider.

There are a variety of unique considerations in determining damages, injunctive relief and compulsory licensing terms in matters involving NPEs. Although case law and the proposed Patent Reform Act of 2009 may attempt to better define the playing field in this area, as unique developments occur – such as the emergence of NPEs – the legal landscape and its impact on determining patent damages will continue to evolve. In litigation involving NPEs, the ultimate goal is generally to place the parties in the financial position that they would have been if they had executed a license agreement. Towards this end, a damages expert may need to be mindful of industry practice and ensure that the correct sales base (*i.e.*, the appropriate product in the sales channel) is used to determine a reasonable royalty.