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PATENT LAW

'A Reasonable Royalty'

By Lewis R. Clayton

SECTION 284 OF the Patent Act provides, in simple and sweeping language, that a patent infringement plaintiff is entitled to "damages adequate to compensate for the infringement, but in no event less than a reasonable royalty for the use made of the invention by the infringer." In setting a reasonable royalty, patent law is guided by market principles. Courts and juries are encouraged to imagine a hypothetical negotiation between the patent owner and the accused infringer concerning a license to practice the patent. "A reasonable royalty is an amount 'which a person, desiring to manufacture and sell a patented article, as a business proposition, would be willing to pay as a royalty and yet be able to make and sell the patented article, in the market, at a reasonable profit.' " *Panduit Corp. v. Stahlin Bros. Fibre Works Inc.*, 575 F.2d 1152, 1157-58 (6th Cir. 1978).

But how large a "reasonable royalty" award should be given to the owner of one of dozens, or hundreds, of patents covering technology embedded in an expensive product? How much would a hypothetical buyer pay to obtain a license and avoid damages and the expense, disruption and loss of market share caused by a possible injunction? Large infringement verdicts involving seemingly small parts of complex products—including a $1.5 billion award against Microsoft Corp. later overturned by the trial court—have motivated Congress to consider "reform" of § 284 of the Patent Act to cure what some critics see as an unpredictable and unruly area of the law. As Senator Patrick Leahy, D-Vt., said, "[a]s products have become more complex, often involving hundreds or even thousands of patented aspects, litigation has not reliably produced damages awards in infringement cases that correspond to the value of the infringed patent."

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'Georgia-Pacific' lists 15 factors to determine royalty

The classic statement of factors to be considered in setting a reasonable patent royalty remains the 1970 district court opinion in *Georgia-Pacific Corp. v. U.S. Plywood Corp.*, 318 F. Supp. 1116 (S.D.N.Y. 1970). *Georgia-Pacific* sets out 15 factors—some of them overlapping and many inapplicable to any particular case—relevant to a royalty determination. They include royalties received by the patentee from existing licenses; royalty rates the defendant pays for comparable patents; the nature and scope of the license; whether the patentee freely licenses, or instead seeks to maintain exclusivity; the commercial relationship between the parties; the effect of sales of patented items on the market for other products of the patent holder; the profitability of products made with the patented technology; and the utility and advantages of the patent over prior art.

Significantly, *Georgia-Pacific* factor 13 refers to the "portion of the realizable profit that should be credited to the invention as distinguished from non-patented elements, the manufacturing process, business risks, or significant features or improvements added by the infringer." Under factor 13, the finder of fact—court or jury—may adjust the award to prevent the patentee from obtaining compensation for the contributions of others to the success of a product embodying the patented technology.

Tugging in the other direction is the "entire market value rule." Under this doctrine, damages may be based on the value of an entire apparatus or product including the claimed technology, provided that the patentee shows that the patent-related feature is the "basis for customer demand" for the entire product. *Rite-Hite Corp. v. Kelley Co.*, 56 F.3d 1538, 1549 (Fed. Cir. 1995) (en banc). When the record fails to show that the patented features drive demand, the court may refuse to allow evidence of the value of the product as a whole.

How well have the courts applied the *Georgia-Pacific* factors and the entire-market rule? A few prominent—and perhaps unrepresentative—cases have received a good deal of attention.

In March 2005, Research In Motion Ltd., maker of the BlackBerry messaging devices, agreed to pay $450 million to settle a patent claim asserted by NTP Inc., which had developed and patented a basic wireless e-mail system in the late 1980s and early 1990s. Arguably, the value of that technology was small in relation to the contributions of others to the huge success of the BlackBerry.

In February 2007, a jury awarded $1.53 billion in damages against Microsoft for infringement of patents related to MP3 music technology. Microsoft had built the technology into Windows Media Player, a software product included in Microsoft's Windows operating system. The Microsoft jury apparently applied a royalty rate of 0.5% to the average price of an entire personal computer, even though the patents at issue encompassed only a tiny component of the software shipped with new machines.

While critics have argued that this case illustrates a problem, opponents of patent reform argue that it actually shows the system is working, because the district court upset the verdict. It found that, because the evidence failed to establish that the patented MP3 music technology drove demand for the entire computer, the jury improperly applied the entire-market value rule. The court also concluded that the 0.5% royalty rate was against the clear weight of the evidence. *Lucent Technologies Inc. v. Gateway Inc.*, 509 F. Supp. 2d 912 (S.D. Calif. 2007).

An older case is *Fonar Corp. v. General Electric Co.*, 107 F.3d 1543 (Fed. Cir. 1997), in which the verdict awarded nearly $70 million in royalties. There, the patented technique enabled a magnetic resonance imaging (MRI) machine to produce multi-angle oblique image slices of a patient in a single scan. The patentee alleged that General Electric Co.'s MRI machines infringed the patent. In computing damages, the jury applied a royalty rate to the entire MRI machine, rather than just the patented component. The U.S. Court of Appeals for the Federal Circuit upheld the award, finding sufficient evidence that the patented feature drove customer demand for the entire machine. The court noted that GE's technical marketing literature emphasized the multi-angle oblique feature.

In *Bose Corp. v. JBL Inc.*, 274 F.3d 1354 (Fed. Cir. 2001), Bose patented a loudspeaker enclosure including a "port tube," and damages were awarded based on the value of the entire system, rather than simply the port tube. Affirming, the Federal Circuit found that the district court properly determined that the patented invention "inextricably worked with other components of loudspeakers as a single functioning unit to provide the desired audible performance." The invention improved performance and "contributed substantially to the increased demand for the products in which it was incorporated." Bose submitted evidence that the improved performance allowed by the patent was a factor in the defendant's decision to go forward with manufacturing certain speakers, and that Bose's sales had increased in the year following incorporation of the invention in its own speakers.

Bill seeks to address entire-market rule's drawbacks

Senate Bill 1145, the Patent Reform Act of 2007, is an attempt to address perceived excesses in the application of the entire-market rule and related doctrines, by sharpening the analytical focus on the contribution of an invention to the success of a product or system. As reported to the Senate, the bill would require a court to make a threshold determination, "based on the facts of the case and after adducing any further evidence the court deems necessary," as to which of three methods of calculating a reasonable royalty should be used in a particular case. Regardless of the method used, the bill would also give the court freedom to consider "any other relevant factors under applicable law."

The patent reform bill would sharpen the analytical focus on the contribution of an invention to the success of a product or system.

The first method, "entire market value," may be applied after a showing "that the claimed invention's specific contribution over the prior art is the predominant basis for market demand for an infringing product or process." On that showing, "damages may be based on the entire market value of that infringing product or process." This provision apparently is meant as a codification of the current entire-market value rule.

The second method, "established royalty based on marketplace licensing," applies on a showing that the invention has "been the subject of a nonexclusive license for the use made" by the infringer. The license must apply to "a number of persons sufficient to indicate a general marketplace recognition of the reasonableness of the licensing terms."

If neither of the showings necessary for application of these two methods is made, then the court "shall conduct an analysis to ensure that a reasonable royalty is applied only to the portion of the economic value of the infringing product or process properly attributable to the claimed invention's specific contribution over the prior art." For combination inventions "whose elements are present individually in the prior art"—a category that describes a very large number of patents—"the contribution over the prior art may include the value of the additional function resulting from the combination, as well as the enhanced value, if any, of some or all of the prior art elements as part of the combination, if the patentee demonstrates that value."

Arguably, the Senate bill would not change the contours of the entire-market value rule. It would, however, force courts to make careful determinations of when the rule may be used, and require more searching review of evidence tying the patented invention to the success of an overall product. Prospects for the bill's passage remain uncertain. As it seeks to raise consciousness more than change the law, however, it may achieve its goal merely by stimulating debate. NLJ