

Damages Ruling Could Spur Patent Reform

It is the most red-hot issue in patent litigation these days: How should courts calculate reasonable royalties as a measure of damages for infringement? Uncertainty about the answer is one of the driving forces behind efforts in Congress to reform the nation's patent laws.

The heat was turned up even higher thanks to a recent decision of the Federal Circuit Court of Appeals. The court overturned a \$500,000 reasonable-royalty award, ruling that the expert testimony on which it was based was speculative and unreliable.

"Because the district court's award relied on speculative and unreliable evidence divorced from proof of economic harm linked to the claimed invention and is inconsistent with sound damages jurisprudence, this court vacates the damages award and remands," the Federal Circuit said.

Impact on Patent Reform

The ruling, *ResQNet.com, Inc. v. Lansa, Inc.*, builds on earlier Federal Circuit cases to drive home the message that the court expects trial judges to closely and carefully scrutinize evidence presented by damages experts in patent cases.

The ruling is likely to fuel further debate over patent-reform legislation pending in Congress. That legislation would formalize the kind of closer judicial scrutiny the Federal Circuit is urging. The legislation would require trial judges to take a more aggressive gatekeeper role to block theories of damages that are not supported by substantial evidence.

Advocates of the bill are likely to argue that *ResQNet.com* underscores the need to formalize judges' gatekeeping role with regard to damage theories. That is essentially the reasoning behind the compromise version of Senate 515 released March 4.

Opponents are likely to say that the Federal Circuit's increasingly strong stance obviates the need for legislation. This position was summed up by lawyers Michael J. Kasdan and Joseph Casino in a guest post at the blog Patently-O. "This more rigorous evidentiary review may alleviate the need for legislative reform in the area of damages," they write.

A Bedeviling Issue

Calculation of reasonable royalty rates is an issue that has long bedeviled judges, lawyers and experts alike. The reason for this is that the standard is amorphous. The law says that the rate should be set based on a "hypothetical negotiation" between the patent owner and the infringer.

Courts would rather base their rulings on facts, not hypotheses. As the Federal Circuit once said, determination of a reasonable royalty seems "often to involve more the talents

of a conjurer than those of a judge." Still, judges are expected to base their determinations on "sound economic proof."

To provide that proof, patent litigators rely on expert witnesses to provide evidence of the patented product's value in the market. Generally, their testimony addresses the so-called Georgia-Pacific factors for calculating reasonable royalties, first spelled out in the case, *Georgia-Pacific Corp. v. United States Plywood Corp.*, 318 F. Supp., 1116 (S.D.N.Y. 1970).

But the concern remains that the hypothetical and speculative nature of this evidence has allowed patent damages to soar out of hand. That concern is a driving force behind efforts on Capitol Hill to rewrite the nation's patent law.

Reliance on Unrelated Licenses

Speculative evidence was precisely the Federal Circuit's concern in this most-recent case. In giving his opinion that a reasonable royalty rate would be 12.5 percent, the expert relied heavily on royalties received by the patentee under its other license agreements. Licensing is one of the factors *Georgia-Pacific* recommends.

The problem in this case, the Federal Circuit said, was that five of the seven licenses on which the expert based his opinion had no relation to the invention at issue. "None of these licenses even mentioned the patents in suit or showed any other discernible link to the claimed technology," the court said.

To make matters worse, the court said, those five unrelated licenses had substantially higher royalty rates – some nearly eight times greater – than the two licenses that were related to the invention. Because of this, the expert's use of those unrelated licenses drove his recommended royalty rates into double digits. The rate he recommended was more than twice those in the licenses that did cover the invention.

The trial court was swayed, in part, by the opposing side's lack of a rebuttal expert. But the party seeking the damages bears the burden of proof, the court said, and the court's determination of a reasonable royalty rate must reflect that proof.

"The trial court should not rely on unrelated licenses to increase the reasonable royalty rate above rates more clearly linked to the economic demand for the claimed technology."

Bill Would Mandate Scrutiny

This decision follows a series of recent cases in which the Federal Circuit has required stricter scrutiny of the evidence used to establish reasonable royalty rates – and particularly of licensing agreements as evidence. Last year, in *Lucent Technologies v. Gateway, Inc.*, it overturned a \$358 million damage award because the patent owner had failed to establish the relevance of various license agreements on which it relied.

The latest version of the patent reform bill in Congress includes compromise language reached by the Senate Judiciary Committee that adopts this approach of heightened judicial scrutiny. The bill would require judges, as "gatekeepers" in advance of trial, to assess the legal validity of the damages theories and jury instructions sought by the parties.

The language of the bill says that judges would be required to "identify the methodologies and factors that are relevant to the determination of damages" and to consider only those methodologies and factors in making their decisions.

As of this writing, Senate leaders were hoping to win approval of S. 515 without floor debate, allowing it to move to the House of Representatives. If debate in the Senate is required, scheduling issues could hinder the bill or block it from moving forward.

Either way, both the proponents and opponents of the bill are likely to have a copy of the *ResQNet* decision close at hand.