

## Defunding The Trolls: Attacking The Damages Claim

*Friday, Mar 14, 2008* --- The objective of every plaintiff bringing a patent lawsuit is to obtain a result he could not obtain without the firm hand of justice – and the prospect of years of expensive litigation – either an injunction or a damages award or both.

Where the plaintiff is a corporation that uses the patent in its products and gains competitive advantage from its monopoly on that technology, its goal is to solidify – or recover – that advantage and to be compensated for the injury its rival’s infringement has caused it in the past.

But what are the economic motivations of a patent troll who manufactures no products and whose “business” is the licensing of his patents? Does he have any economic interest in maintaining his patent royalty? Does he actually suffer any damages from infringement?

The law of patent damages, as it has developed over the past 40 years, is designed to maximize the return for plaintiffs who both use the patented technology and use that patent monopoly to best their rivals in the marketplace.

A plaintiff may recover his lost profits from the defendant’s sales and can even be compensated for having to lower his prices because the defendant competed unfairly by selling an infringing product. The most common award for patent infringement, however, is a “reasonable royalty,” a remedy dictated by the Patent Act.

When it comes to an award of a reasonable royalty, a plaintiff who competes in the marketplace has an advantage. This type of award, based on the royalty which would have resulted from a “hypothetical negotiation” between the plaintiff and defendant at the time the infringement began, is based, in large part, on the actual competitive relationship between the parties.

Many of the “Georgia Pacific factors” (the factors listed by the leading patent damages decision) which are used to determine a royalty award are based on measuring the desire on the part of the plaintiff to license its patent to the defendant versus its competitive need to maintain a monopoly over that technology.

The more resistant the plaintiff is to granting a license to this particular defendant, i.e., the more valuable that patent is to the plaintiff in his business, the higher the “reasonable royalty” will be.

These factors, however, do not apply to a “nonproducing entity” (known as

“NPE” – whether a traditional troll or a university) whose business is not the manufacture of products which use the patent, but in selling the patent itself or, more accurately, the right to use the patent.

These plaintiffs have no economic interest in “walking away from the table” in the hypothetical negotiation for fear their own business will be affected by weakening their monopoly rights or in holding back for a better deal, knowing they can make more money by simply increasing their prices.

How, then, can such nonproducing plaintiffs justify large damages awards in the form of astronomical reasonable royalties? The answer is – they cannot.

The responsibility for the NPEs’ ability to obtain large monetary verdicts – and the leverage these prior verdicts give NPEs in negotiation of prelitigation license agreements – lies at the feet of the defendants who have focused too much on the strength of the NPEs’ liability claims and have largely ignored the economic analysis and strategy which could dramatically decrease the prospect of company-killing damages verdicts.

A full-out attack on the economic underpinnings – or lack thereof – of NPEs’ reasonable royalty claims may bear more fruit than the lobbying dollars sent to Congress for “patent reform” to try to stem their influence.

The most important insight that any patent defendant confronted by an NPE must have is that, economically, the battle has shifted to the defendant’s turf.

All of the Georgia Pacific factors which emphasize the popularity and profitability of the invention will be examined in light of the defendant’s product about which, obviously, the defendant will have encyclopedic knowledge the plaintiff does not possess.

The defendant will be able to present a host of arguments showing that the profitability of the allegedly infringing product is attributable to many factors other than the patented invention, ranging from other technological innovations to its own promotional abilities.

Having no ability to show on its own that its invention is popular, and thus deserves a high royalty, the NPE is put at a substantial disadvantage.

The NPE also cannot show that it would have been resistant to licensing its patent in the hypothetical negotiation for fear of harming its own competitive position in the marketplace, as the NPE has no competitive position to protect and does not participate in the marketplace.

Indeed, since the NPE’s only business is licensing its patents, the defendant can convincingly argue that the NPE would have been eager, even desperate, to license its patents and would have settled for a very modest rate in the hypothetical negotiation.

So, without any real economic tools at its disposal to justify a substantial

---

“reasonable royalty,” what arguments is an NPE left with? There are two, primarily – neither of which is very convincing or, in a normal case, supported by the case law.

The first is Georgia-Pacific factor No. 1 – that there is an “established royalty” for this patent. Use of this factor by an NPE is, however, problematic, as royalties obtained by a patent holder as a result of litigation or the threat of litigation are considered economically suspect and are normally not allowed to be part of the damages analysis.

The second is measuring the profits made by the defendant in selling the infringing product. This quasi-disgorgement remedy, however is disfavored by the courts (assuming it is brought to their attention) and is subject to substantial attack by a defendant who is paying attention, as failing to represent the agreement the parties would have made prior to the infringement and failing to take into account the myriad other factors which contributed to the defendant’s profitability.

Defendants who do not firmly counter these NPE damages theories and are later hit with a substantial damages award get what they deserve – a large judgment.

With NPE’s dramatically reduced ability, after eBay v. MercExchange, to obtain a permanent injunction against an infringer, it is incumbent on defendants who are threatened or sued by trolls to take the economic fight directly to the plaintiff and show that, even if the NPE wins, its likely return will be minimal.

Only in this way can defendants reduce the intimidation factor of the troll’s threats. Only by defunding the trolls can they finally be defeated.

--By Richard F. Cauley, Wang, Hartman, Gibbs & Cauley PLC

*Richard F. Cauley is a senior trial lawyer in Cauley's Mountain View, Calif. office.*