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# Making Patent Litigants Toe The Line On Damages

*Monday, April 21, 2007* --- On April 18, Congress announced yet another attempt to "reform" the patent laws–the Patent Reform Act of 2007. Most observers give this effort a better chance than previous bills, primarily because the technology industry, supporters of the Democratic majority, is in favor of such reforms and the pharmaceutical industry, who has opposed changes in the patent law, has lost influence in Congress after the change in party control.

Accordingly, since there is a substantial likelihood that patent reform will actually pass in some form this term, a close examination of the bill is a priority for any company which is–or may be–involved in patent litigation.

Although much of the publicity surrounding the bill has focused on the "first to file" or "post-grant review" changes in the patent law, this article will focus on one issue that should be of critical interest to litigants–the proposed amendments to the patent law regarding damages.

Although some commentators have viewed these changes as virtually a revolution in the law of patent damages, a defense against trolls or even an "end to massive settlements," a close analysis of the proposed statute reveals that the law would require courts and juries to do nothing more than they are required to do now–base damages awards on the real economic value of the patent.

The recent spate of large patent damages awards–including the $1.5 billion verdict against Microsoft in February–should be laid at the feet of the defendants themselves. Their failure to expose plaintiffs' lack of adequate economic justification for their damages claims–combined with the defendants' failure to provide economic analysis of their own–has resulted in massive awards which often seem virtually arbitrary. Indeed, as recently detailed in an article by the NERA economic consulting group, in the Microsoft-Lucent patent case, neither party's damages presentation met even the minimal standard of economic rigor. Indeed, both parties' damages presentations were based almost entirely on an comparison with other patent licenses for similar technology–without any examination of the actual economic relationship between the litigants themselves.

The proposed Patent Reform Act makes at least a first attempt to compel the parties to apply economics to the awarding of patent damages. It requires that a reasonable royalty be limited "only to that economic value properly attributable to the patentee's specific improvement over the prior art" and exclude "the economic value properly attributable to the prior art and other features or improvements, whether or not themselves patented, that contribute economic value to the infringing product or process." Two other non-controversial amendments would codify the judge-made "entire market value rule" and require the court to take a patentee's existing licensing practices into account in setting a reasonable royalty--already required under existing law.

However, what does this new rule actually mean? Does it change the law? The answer is no.

Just like everything else in our society, a patent is "worth" no more than someone will pay for it. Under existing law a reasonable royalty" is determined by pretending that that the parties engaged in a "hypothetical negotiation" of a patent license when the defendant began infringing. The two major differences between the hypothetical negotiation and a real one is that the patent is assumed to be both valid and infringed and the parties are required to reach an agreement–no walking away from the table.

Thus, based on this hypothetical negotiation, the infringer would not agree to pay the patentholder any more than the patent is worth to him. If the infringer would only gain a minimal amount by using the patented invention over the prior art (which he could use without a license from the plaintiff), the reasonable royalty will be low. If using the patented invention (instead of the prior art) would allow the infringer to raise his price or lower his costs substantially, the royalty would be higher. If the infringer could not sell his product at all without using the patented invention, the royalty would be higher yet. Unless the "entire market value" of the product is tied up in the patented invention, the royalty is limited to the value of the improvement–since, in the hypothetical negotiation, the infringer could simply threaten to remove that feature from his product.

This analysis–which the parties are supposed to be doing already–is all that is required by the proposed Patent Reform Act. For example, assume that the "prior art" is a bicycle and the patented "improvement" is putting a bell on the bicycle. Assume further that the infringer could sell a bicycle without a bell for $100 and a bicycle with a bell for $105 and that the infringer did not need to put a bell on the bicycle to sell it.

Under both current law and under the Patent Reform Act, the reasonable royalty analysis would be the same–the amount the infringer would be willing to pay would be capped by the benefit he received by the amount he could raise his price by including the patented improvement: the bell–his marginal profit on the $5 increase.

Thus, it can be seen, the crisis in "outlandish" damages awards is a problem of the litigants' own making. All the Patent Reform Act would do is to force litigant to perform the economic analysis they are supposed to be performing already. If defendants would the time, money and effort into hiring economists and into taking their damages cases seriously, they might not need the Congress to take care of them.

--By Richard Cauley

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