

A Brief History Of Unreasonable Royalties

Law360, New York (July 21, 2014, 11:00 AM ET) -- While patent infringement causes a legal harm to a patentee, it does not cause actual harm in every instance. Historically, absent proof of "actual loss," only nominal damages were awarded.[1] The same is true for the analogous tort of trespass on land. Unless some actual damage occurs to the land or landowner due to the trespass, no more than nominal damages would be owed.[2] Yet today patentees who suffer no actual harm (most notably, patent assertion entities) are regularly obtaining considerable amounts of money from infringers as purported "reasonable royalty" damages. This state of affairs reveals a need for a fresh reading of the pertinent damages law.



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Section 284 of the 1952 Patent Act, entitled "Damages," provides that "[u]pon finding for the claimant the court shall award the claimant 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." The emphasized language of this statute has been interpreted to set a floor on damages. It has also been assumed that a reasonable royalty is something more than nominal and is necessarily a substantial sum.[3] That assumption is mistaken. Indeed, the Federal Circuit very recently acknowledged that a zero or nominal reasonable royalty award might be appropriate in some cases. It held in *Apple Inc. v. Motorola Inc.* that "[c]ertainly, if the patentee's proof [of damages] is weak, the court is free to award a low, perhaps nominal, royalty, as long as that royalty is supported by the record." [4]

The 1946 precursor statute to Section 284, which allowed for recovery of "damages ... not less than a reasonable royalty," was the first time the concept of a reasonable royalty was codified for patent cases. The notion of a reasonable royalty had long before arisen in the common law as a way patentees could obtain damages when the evidence to prove actual harm or the amount of resulting damages was lacking.[5] While earlier statutes and cases allowed for the measure of reasonable royalty damages to include infringers' profits, the 1946 act was intended "precisely to eliminate the recovery of profits as such and allow recovery of damages only." [6]

In 1952, Section 284 further clarified that "damages" must "compensate for the infringement." As the U.S. Supreme Court explained in *Aro Manufacturing*, "the statute allows the award of a reasonable royalty, or of any other recovery, only if such amount constitutes 'damages' for the infringement," and held that recoverable "damages" can only be losses to the patentee, not gains to the infringer.[7] *Aro* thus definitively held that any restitutional or unjust enrichment theory of damages seeking an infringer's profits was prohibited by Section 284.

Then came *Georgia-Pacific Corp. v. United States Plywood Corp.*, which set forth a 15-factor test that became the prevailing analytical framework for determining a reasonable royalty. Many of those factors sound in restitution, not compensation — e.g., “[t]he effect of selling the patented specialty in promoting sales of other products of the licensee,” “[t]he established profitability of the product made under the patent,” “the benefits to those who have used the invention,” and “the value of [the infringer’s] use [of the invention].”^[8] Post-*Aro*, such restitutional factors should not be considered as part of a reasonable royalty analysis, and yet they persist.

In my working paper, entitled *Ending Unreasonable Royalties: Why Nominal Damages are Adequate to Compensate Patent Assertion Entities for Infringement*, I explore how patent assertion entities receive considerable sums of money as purported reasonable royalty damages. I explain that such entities typically emphasize the improper restitutional factors of *Georgia-Pacific* to recover license fees and damages that are non-compensatory. They generally point to the financial success of the infringer and claim credit for some portion of that success, but can point to nothing showing that they are worse off because of the infringement. While there are surely other situations where patentees are not actually harmed by instances of infringement, I studied patent assertion entities in particular because their business models and damages theories best highlight how existing law is being misread and exploited to support overcompensation. In the paper I argue that for cases lacking proof of actual harm, nominal damages would be more consistent with Section 284’s language, in keeping with congressional intent, and mandated by *Aro*.

A fresh reading of Section 284 would reaffirm its compensatory nature and discard artificial legal constructs (e.g., *Georgia-Pacific*) that restrict the plain meaning of the term “reasonable royalty.” When enacting the first reasonable royalty statute in 1946, “Congress’s attention was primarily focused on the evils attendant on the recovery of ‘profits’ rather than on the obstacle in the path of a patent owner seeking a reasonable royalty.”^[9] The 1946 act was supposed to simplify and streamline patent litigation by replacing cumbersome profit-apportionment procedures with the ability to prove damages “by any relevant and competent evidence just as they can be proved in an action of tort.”^[10]

Thus, while it is clear that Congress was eliminating profits recovery in favor of a general compensatory damages statute, it assigned no special or restrictive meaning to the term “reasonable royalty” or expressed a belief that such relief was required to be more than nominal. Because the common law formulation of reasonable royalty damages at the time reflected consideration of infringers’ profits, it would be wrong to assume that Congress intended that common law meaning to apply. Following the example of the Supreme Court’s recent *Octane Fitness* decision (interpreting Section 285’s “exceptional case” language), the plain contemporary meaning should govern and a reasonable royalty should simply be a royalty that is fair and sensible, provided that it meets the threshold requirement of being compensatory. In appropriate cases where the patentee cannot show that it is somehow worse off due to infringement, nominal damages would constitute a reasonable royalty.

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[1] See, e.g., *Whittemore v. Cutter*, 29 F. Cas. 1123, 1121 (C.C.D. Mass. 1813) (“Every violation of a right imports some damage, and if none other be proved, the law allows a nominal damage.”); *Seymour v. McCormick*, 57 U.S. 480, 489-90 (1854) (“Actual damages must be actually proved The question is not what speculatively he may have lost, but

what actually he did lose.”).

[2] See Restatement (Second) of Torts, §§ 7, 162-166, 902-906.

[3] See, e.g., *Rite-Hite Corp. v. Kelley Co.*, 56 F.3d 1538, 1574 (Fed. Cir. 1995) (Nies, J., dissenting) (“[a] reasonable royalty is in fact a Congressional largesse for cases where a patentee might otherwise receive only nominal damages. A patentee is now statutorily entitled to a reasonable royalty even though it has not suffered or cannot prove a financial loss to its market in patented goods.”); 1-20 *Chisum on Patents* § 20.07[e][iii][A] (expressing the view that awarding nominal damages for patent infringement “runs contrary to the purpose of the reasonable royalty standard, which is to set a substantial minimum measure of monetary recovery or patent owners whose rights have been violated”).

[4] No. 2012-1548, 2014 U.S. App. LEXIS 7757, at *95-96 (Fed. Cir. Apr. 25, 2014).

[5] See generally Erick S. Lee, *Historical Perspectives on Reasonable Royalty Patent Damages and Current Congressional Efforts for Reform*, 13 *UCLA J.L. & Tech.* 2, at 3-31 (2009).

[6] *Aro Mfg. Co. v. Convertible Top Replacement Co.*, 77 U.S. 476, 504-05 (1965).

[7] *Id.*

[8] 318 F. Supp. 1116, 1120 (S.D.N.Y. 1970).

[9] *Georgia-Pacific Corp. v. United States Plywood Corp.*, 243 F. Supp. 500, 547 (S.D.N.Y. 1965).

[10] *Recovery in Patent Infringement Suits*, Hearing Before the Committee on Patents on H.R. 5231, 79th Cong., 2nd Sess., at 9 (January 29, 1946).