Recent U.S. Decisions And Developments Affecting Licensing

By Brian Brunsvold and John C. Paul

REASONABLE ROYALTY AWARD CANNOT BE UPWARDLY ADJUSTED BASED ON LICENSES UNRELATED TO CLAIMED INVENTION

As a remedy for infringement, U.S. patent law allows patentees to receive damages that are not less than a reasonable royalty for the use of the invention by the infringer. Courts derive the reasonable royalty from a hypothetical negotiation between the patentee and the infringer at a time when the infringement began. Many factors, called *Georgia-Pacific* factors after a case of the same name, apply to the hypothetical negotiation. The first factor requires considering past and present royalties that the patentee received from licensing the patent in suit. In *ResQNet.com Inc. v. Lansa Inc.*, Nos. 2008-1365, -1366, 2009-1030 (Fed. Cir. Feb. 5, 2010), the United States Court of Appeals for the Federal Circuit held that it is improper for courts to consider licenses with no relationship to the patented invention to determine the reasonable royalty.

ResQNet.com, Inc. ("ResQNet"), a software development company, owned patents related to screen recognition and terminal emulation processes to display information on personal computer screens. Lansa, Inc., also a software development company, distributed a terminal emulator program called "New-Look," developed by an Australian company, in the United States. ResQNet charged Lansa with patent infringement for this program.

After finding infringement, the district court awarded ResQNet damages of $506,305 for past infringement based on a hypothetical reasonable royalty of 12.5 percent. The court also imposed a 12.5 percent ongoing royalty for future infringement. Lansa appealed the damages award to the Federal Circuit.

On appeal, the Federal Circuit reviewed the district court's application of the *Georgia-Pacific* factors for the hypothetical negotiation. Particularly, the court considered the propriety of applying certain past licenses to the first *Georgia-Pacific* factor. Building on its recent decision in *Lucent Technologies, Inc. v. Gateway*, 580 F.3d 1301, 1327-28 (Fed. Cir. 2009), the court determined that the district court improperly relied on licenses with no relationship to the patented invention, resulting in a speculative and unreliable basis for the award. As it did in Lucent, the court determined that "some of the license agreements [were] radically different from the hypothetical agreement under consideration and the court was unable to ascertain from the evidence presented the subject matter of the agreements."

The district court relied on two types of existing licenses to reach the 12.5 percent royalty rate. The first type included two straight-royalty based licenses for the claimed invention. Both of these licenses resulted from litigation settlements for the patents in suit. One was a lump-sum payment of stock, which could not be analogized to a royalty rate. The other was for a royalty rate, but at much less than 12.5 percent. The second type included five re-bundling licenses at royalty rates between 25-40 percent. These licenses had no relation to the patented invention. Instead of licensing the patent, they licensed software products, software code, and support services. Nonetheless, the district court used the re-bundling licenses to upwardly adjust the straight-royalty based licenses to 12.5 percent. The district court noted that the 12.5 percent rate was "somewhere in the middle" of the two types of licenses.

The Federal Circuit faulted the district court for relying on the re-bundling licenses because they were unrelated to the patented technology. It found two parts of the analysis particularly troubling. First, the court took issue with the "extremely high rates" in the re-bundling licenses. The district court did not convincingly set out how to analogize a rate for the patented technology, when these licenses covered a much broader scope. Second, the court found little evidence in the record linking the re-bundling licenses to the patented technology. The hypothetical negotiation requires a link between the past license agreements and the patent in suit. The court was not satisfied that a link was established. Without legally sufficient evidence to support the 12.5 percent royalty award, the court vacated the decision.

In dissent, Judge Newman argued that the panel majority created a new rule "whereby no licenses involving the patented technology can be considered, in determining the value of infringement, if the patents themselves are not directly licensed or if the licenses include subject matter in addition to that which was infringed by the defendant…" In her

view, the district court took into account the varying facts between the two types of licensing agreements and logically reached the 12.5 percent royalty rate. Rather than mere speculation, she found ample evidence in the record to conclude that the district court made a reasoned decision. She concluded that the majority's new rule essentially allows an infringer to do no worse than the lowest previously accepted royalty rate.

Judge Newman contrasted *Lucent* because the award here was smaller than the average award in the re-bundling licenses. In *Lucent* the award was higher than the average award in the unrelated license agreements. Moreover, the court made clear in *Lucent* that the unrelated licenses could not support the damages award, as a matter of law. Rather, the court determined that the district court's analysis was not logical and thorough, as she believed it was in this case.

PRIOR LICENSE OF AN INFRINGED PATENT DOES NOT BAR PERMANENT INJUNCTION

In 2006, the Supreme Court confirmed that the traditional four-factor test for permanent injunctive relief applies in patent infringement cases. Under this test, before a court may grant a permanent injunction, a patent owner must show that: (1) it has suffered an irreparable injury; (2) remedies available at law (*i.e.*, monetary damages) are inadequate; (3) the balance of the hardships favors the party seeking an injunction; and (4) a permanent injunction would not disserve the public interest. Since the essential attribute of a patent is the "right to exclude" others from infringing the patent, the Federal Circuit has stated that infringement may cause a patent owner irreparable harm that cannot be remedied by a reasonable royalty.

In *Innovention Toys, LLC., v. MGA Entertainment, Inc.*, No. 07-6510 (E.D. La. Jan. 13, 2010), the United States District Court for the Eastern District of Louisiana granted the patent owner's motion for permanent injunction following the court's judgment of patent infringement. This case involves laser board games. A three-man company, Innovention Toys, is the assignee of a patent directed to a light-reflecting board game, and the company's sole product is Khet: The Laser Game, which practices the patent-in-suit. MGA Entertainment is a large toy and game manufacturer that makes, among other things, a game called Laser Battle. Both parties sell their product nationwide, but recently, Wal-Mart and Toys "R" Us, co-defendants in this case, have decided to only stock one laser board game and both chose to stock MGA's game. Prior to filing suit, Innovention had licensed the asserted patent to a third party to develop a video game based on the Khet game.

Innovention filed a suit for patent infringement, and the district court found that Innovention's patent was valid and infringed by MGA's game. Shortly thereafter Innovention requested the district court permanently enjoin all the defendants from selling the MGA game found to be infringing. Innovention argued that its injury could not be compensated by a reasonable royalty or other monetary damages alone. The record before the court showed that Innovention's primary business is practicing the patent-in-suit, that the much-larger MGA was its direct competitor, and that both Wal-Mart and Toys "R" Us had decided to stock only MGA's game and not Innovention's game. Innovention further argued that anything less than a full permanent injunction would force a compulsory license on Innovention against its direct competitor when that competitor kept Innovention from a significant share of the market with its infringing product.

■ Brian Brunsvold,
Finnegan, Henderson, Farabow, Garrett & Dunner, LLP,
Attorney, Washington, D.C., USA
E-mail: brian.brunsvold@finnegan.com

■ John C. Paul,
Finnegan, Henderson, Farabow, Garrett & Dunner, LLP,
Attorney, Washington, D.C., USA
E-mail: john.paul@finnegan.com

MGA countered that an injunction was inappropriate in this case because Innovention had previously licensed its patent, suggesting that monetary damages are adequate. Innovention stated that this was not actually a patent license, but rather a software development license. In addition, MGA pointed out that another retailer, Target, sold both games.

In finding for Innovention, the Court disagreed with MGA, holding that because the parties are direct competitors and the retailer defendants stock only MGA's game and no others, Innovention had shown irreparable injury for which no adequate remedy at law exists. The existence of other license agreements is just one factor for the court to consider, and in certain circumstances, adding a new competitor to the market may create an irreparable harm that the prior licenses did not. Thus, following the Federal Circuit precedent, the district court found that this single prior patent license was not sufficient *per se* to establish a lack of irreparable harm if MGA were licensed. Moreover, the district court found that the fact that defendant could point to one major retailer that sold both games did not ameliorate the

patent owner's irreparable harm, where two other major retailers are only selling MGA's game. In assessing the relative hardships of enjoining MGA's product, the court considered that Innovention is a small company and its sole product practices the patent-in-suit, whereas MGA's Laser Battle is but one of many of its products. The district court found that allowing MGA to continue to infringe would restrict the market for Innovention's game, but even with an injunction, MGA, the much larger company, would be able to stay in business while it develops a workaround game. Finally, while this case entailed no major health or safety issue, the court found that the public, nonetheless, has an interest in maintaining a strong patent system and that the public has no compelling need for more than one patented laser game. Thus, having considered the four-factor test for injunctive relief, the district court granted the patent owner a permanent injunction.

JOINT PATENT OWNER'S CONTROL OVERRIDDEN BY AGREEMENT BETWEEN THE JOINT OWNERS

A patent may be owned by more than one party, termed "joint owners." Under the Patent Act, joint owners of a patent may make, use, offer to sell, or sell the patented invention within the United States or license the patented invention to a third party without the consent of the other owners and without sharing the proceeds with the other owners. The statute, however, provides that a joint owner may give up these rights by entering into an "agreement to the contrary" with the other co-owners. Thus, the general rule controls unless there is an agreement between the co-owners to the contrary.

In *Wisconsin Alumni Research Foundation v. Xenon Pharmaceuticals, Inc.*, No. 08-1351, 06-3901 (7th Cir. Jan. 5, 2010), the United States Court of Appeals for the Seventh Circuit held, among other things, that the agreement between the plaintiff Wisconsin Alumni Research Foundation ("WARF") and Xenon constituted an "agreement to the contrary" under the Patent Act. Thus, the Seventh Circuit found that co-owner Xenon had breached its agreement with WARF when it failed to share royalties on the revenues from a licensing agreement for their shared patent and assigned the license to a third party without WARF's consent.

This case involves a series of agreements between WARF (part of the University of Wisconsin) and Xenon, a Canadian pharmaceutical company. The parties jointly sponsored certain research related to a cholesterol-lowering enzyme and eventually received a method patent on this work. Shortly thereafter, Xenon exercised an option in the parties' joint agreement to take an exclusive license to make, use, and sell products arising from the patent and in exchange agreed to pay WARF a percentage of proceeds, including any royalties received from sublicensing the patent to another party. Xenon used the patented method to develop a set of compounds. Later, Xenon signed a license agreement with a third party purporting to transfer ownership of those compounds. After learning of this agreement, WARF demanded its share of the sublicense fees and Xenon refused, claiming it had a right to license its interest in the co-owned patent without being subject to the parties' license agreement.

Consequently, WARF filed a lawsuit claiming Xenon breached the parties' exclusive license agreement and Xenon should pay WARF a percentage of the royalties received from the third party. The district court found that the parties had "an agreement to contrary," and therefore, the general rule for co-owners did not apply. Accordingly, the district court found that Xenon had breached the agreement by failing to pay royalties, awarding WARF $300,000 in damages. Xenon appealed.

On appeal, Xenon argued that nothing in its agreement with WARF explicitly revoked its statutory rights to license its interests in the co-owned patent freely. The Seventh Circuit noted that this was true, but also found that the agreement required Xenon to pay WARF a share of the fees derived from any sublicense, which plainly undermined Xenon's argument that it had retained its statutory rights unfettered. In addition, the agreement prohibited assignment of the exclusive license between the parties without WARF's consent. The Seventh Circuit explained that WARF agreed to forego its right to separately license the patent in exchange for receiving a share of the profits from Xenon's commercialization of the technology, either directly or from a sublicense to a third party. Accordingly, Xenon received a significant benefit from the agreement and should not be allowed to avoid paying royalties or sublicense fees to WARF simply by labeling the transaction with the third party a "license" rather than a "sublicense." Thus, the Seventh Circuit affirmed the district court's holding, including the damages award.

PENALTIES FOR FALSE MARKING ASSESSED ON A PER-ARTICLE BASIS, NOT A PER-DECISION BASIS

Qui tam actions authorize private individuals to file suit on behalf of the government for fraud committed against it. In the United States, the government au-

thorizes actions by private individuals against parties that falsely mark products with patent numbers under 35 U.S.C. § 292. In these false marking *qui tam* actions, the challenger must prove that a party marked an unpatented article and had intent to deceive the public. If the challenger prevails, the false marker must pay a penalty of up to $500. The challenger splits the penalty with the government.

In *Forest Group, Inc. v. Bon Tool Co.*, No. 2009-1044 (Fed. Cir. Dec. 28, 2009), the United States Court of Appeals for the Federal Circuit held, among other things, that the penalty for false marking is on a per-article basis, not a per-decision basis. That is, the false marker must pay the statutory penalty for each article falsely marked, not for a decision to falsely mark all articles. The Federal Circuit affirmed a decision of the district court that Forest falsely marked its products, but it vacated the district court's decision imposing only a single $500 penalty.

This case involved a patent directed to a spring-loaded parallelogram stilt, commonly used in construction. Forest, which manufactured stilts and owned the patent-in-suit, sued Bon Tool, a competitor, for infringement. Bon Tool had originally purchased stilts from a co-owner of the patent, but started purchasing from a foreign supplier, which manufactured identical replicas without a license from Forest. After Forest filed suit, Bon Tool counterclaimed alleging false marking by Forest.

The patent required infringing devices to include a "resiliently lined yoke," which was understood to mean "a yoke or clamp lined with a material that is capable of being elastically or reversibly deformed." In a parallel litigation in a different court for infringement of the same patent, the defendant was granted summary judgment of non-infringement on November 15, 2007 because they did not have this feature. Interestingly, Forest's own stilts did not have this feature either, and as a result, would not be covered by Forest's own patent

By the time of the November 15, 2007, decision, Forest had hired new patent counsel, who advised Forest to modify its stilts to include a resilient lining. Forest, however, placed at least one order to its manufacturer for marked with the patent number.

The district court here concluded that Forest had the requisite intent to deceive as of November 15, 2007—the date of summary judgment in the parallel litigation. Forest knew its stilts where not covered by the patent at that time. Thus, the district court granted summary judgment on Bon Tool's counterclaim of false marking, fining Forest $500 for a single offense.

Bon Tool appealed the district court's judgment on false marking for two reasons. First, it argued that Forest had intent to deceive before November 15, 2007. Second, it argued that false marking should be charged on a per-article basis. Forest Group did not appeal.

The Federal Circuit held that the district court did not clearly err in finding that Forest lacked the requisite intent to deceive before November 15, 2007. The evidence supported the district court's conclusion that Forest genuinely believed its stilts were covered by the patent before that date. The inventors of the patent and owners of the patent were not well-versed in patent law. They had hired experienced patent counsel to draft their application using an exemplar of their stilt. The court cautioned, however, that it did not suggest that multiple claim constructions or summary judgments are necessary before the requisite knowledge of false marking can be found.

On the second issue, the Federal Circuit agreed with Bon Tool that the false marking statute required penalties on a per-article basis. The court started with the plain language of the statute, which states in relevant part:

> Whoever marks upon, or affixes to, or uses in advertising in connection with any unpatented article, the word "patent" or any word or number importing that the same is patented, for the purpose of deceiving the public… Shall be fined not more than $500 for every such offense.

35 U.S.C. § 292. The court concluded that the phrases "any patented article" and "every such offense" clearly require that each article that is falsely marked with intent to deceive is an offense.

Forest relied on a century old case from *First Circuit, London v. Everett H. Dunbar Corp.*, 179 F. 506 (1st Cir. 1910), which held that false marking carries only a single fine. The London court held that the statute must only impose a fine for a single offense because a penalty for each article would be disproportionate for false marking of small and inexpensive articles. But the Federal Circuit dismissed the argument, for the statute in London was materially different to the current statute. The previous statute imposed a fine of "not less than $100" for false marking. Under the current statute, district courts have discretion to assess the per-article fine at "not more than $500." Because district courts can impose small fines for false marking of small and inexpensive articles, the current statute eliminates the policy concern expressed by the London court.

The Federal Circuit also noted that policy considerations support a per-article interpretation of the statute. False marking deters innovation and stifles competition. Potential competitors may be dissuaded from entering the market or incur expensive design-around costs. They may also incur costs to analyze the validity or enforceability of patent marked on a product with which they would like to compete. False marks could also deter scientific research when an inventor foregoes continued research to avoid possible infringement. These injuries occur each time an article is falsely marked, not one time when a party decides to falsely mark. Moreover, imposing only a single fine, would be insufficient to deter nearly all cases. Congress intended to encourage third parties to bring *qui tam* suits. Having only a single fine would discourage the suits.

The Federal Circuit acknowledged that its holding would encourage "a new cottage industry" of false marking litigation by plaintiffs who have not suffered any direct harm and lead to a possible rise of "marking trolls." The court noted, however, that the statute explicitly allows that outcome. The statute permits *qui tam* actions, providing a monetary incentive for parties to sue on behalf of the government to deter false marking.

The Federal Circuit remanded the case back to the district court so that it could determine the number of articles Forest falsely marked and the amount of the penalty for each article.

DELIBERATIVE INDIFFERENCE SUFFICIENT TO PROVE KNOWLEDGE OF PATENT FOR INDUCED INFRINGEMENT

The U.S. patent laws allow a patentee to recover damages for inducement of infringement. That is, a party who actively induces another to infringe is liable as an infringer. In *DSU Medical Corp v. JMS Co.*, 471 F.3d 1293, 13 (Fed. Cir. 2006) (en banc), the United States Court of Appeals for the Federal Circuit held that inducement requires showing of "specific intent to encourage another's infringement." Thus, to prove this form of indirect infringement, the patentee must show that the alleged infringer knew or should have that his actions would have induced another to infringe. The requirement necessarily includes that requirement that the alleged infringer knew of the patent.

The court in *DSU Medical* did not, however, define the knowledge-of-the-patent requirement. Following up on *DSU Medical*, the Federal Circuit held, among other things, in *SEB S.A. v. Montgomery Ward & Co.*, Nos. 2009-1099, -1108, -1119 that "deliberative indifference" of a patent is sufficient to show knowledge of the patent. The court affirmed a decision of the district court finding Pentalpha Enterprises, Ltd., induced infringement of SEB S.A.'s patent.

The case involved a patent directed to a deep fryer with an insulated, inexpensive plastic outer shell, or skirt. SEB, a front company that specializes in home-cooking appliances, manufactured deep fryers with the patented technology, called "cool touch." Pentalpha manufactured competing fryers, which it sold to other companies, including Montgomery Ward. These companies sold deep fryers with their own trademarks.

In developing its deep fryer, Pentalpha purchased an SEB fryer in Hong Kong and copied its "cool touch" features. Pentalpha hired an attorney to conduct a "right-to-use study." The attorney analyzed 28 patents and concluded that none read on Pentalpha's deep fryer. Pentalpha did not tell the attorney that it had copied an SEB fryer.

SEB accused Pentalpha of inducing Sunbeam, who purchased Pentalpha deep fryers and sold under its own trademarks, to infringe. During trial, Pentalpha argued that it could not have induced infringement because it did not have "any knowledge whatsoever with respect to the existence of the patent." SEB argued that a jury could infer Pentalpha's knowledge of the patent, and thus specific intent, through Pentalpha's actions in copying SEB's deep fryer and failing to disclose that to its attorney. The district court agreed with SEB and allowed the jury to decide the inducement claim.

The jury found, among other things, that Pentalpha induced others to infringe the patent. Pentalpha appealed this and other findings to the Federal Circuit. As for inducement, Pentalpha argued that the district court erred because actual knowledge of the patent is required. Pentalpha contended that the district court applied a "knew or should have known of the patent" standard, alleging that it was inconsistent with the Federal Circuit's decision in *DSU Medical*. That decision explicitly states that the accused infringer "knew of the patent."

The Federal Circuit rejected Pentalpha's contentions and affirmed the district court. It acknowledged that a showing of specific intent is required but stated that specific intent in a civil context is not so narrow as to allow an accused infringer to deliberatively ignore a patent. The court stated that deliberate indifference is not the same as a "should have known" standard. Deliberate indifference may require a subjective determination that the defendant knew of and disregarded an overt risk. "Should have

known" implies a solely objective test. An accused infringer may defeat a showing of subjective deliberate indifference of a patent where it was genuinely unaware of even an obvious risk. More importantly, the court noted that deliberate indifference is not different from actual knowledge, but is a form of actual knowledge.

In this case, the Federal Circuit held that adequate evidence supported the jury's conclusion that Pentalpha deliberatively disregarded the risk that SEB's product was patented. Evidence showed that Pentalpha purchased and copied SEB's deep fryer. Pentalpha failed to inform its attorney about the copying. Evidence also showed that Pentalpha's president was well versed in U.S. patent law.

In contrast, Pentalpha did not produce any exculpatory evidence to prove it genuinely believed a patent did not exist. Pentalpha made no argument that it actually believed no SEB patent existed. The Federal Circuit rejected Pentalpha's argument that it should be excused because the fryer it bought was not marked. The court stated that such an argument lacks credibility because Pentalpha provided no explanation for why one would expect a product purchased in Hong Kong to have U.S. patent markings.

To conclude its decision, the Federal Circuit noted that it was not setting the outer limits of the type of knowledge needed for inducement. Thus, whether other forms of knowledge, e.g., constructive knowledge with persuasive evidence of disregard for clear patent markings, are sufficient for the knowledge-of-the-patent requirement, is still an open question. ■