PATENTS IN THE NEW IDEA ECONOMY: AN OVERVIEW OF MONETIZATION, NON-PRACTICING ENTITIES, AND RECENT FEDERAL JURISPRUDENCE.

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Introduction

As the United States moves from a labor-driven to a knowledge-based economy, our dependence on technology to drive innovation and growth increases. Concomitantly, new methods for managing and transacting intellectual property have emerged, forging the landscape of a new idea economy. For companies in high-growth fields such as software, electronics, telecommunications, and biotechnology, IP assets have superseded traditional, tangible assets in both power and value.[1]

Intellectual property has been "transformed from a sleepy area of law and business to one of the driving engines of a high technology company."[2] This transformation has inspired legal, finance, and technical professionals to pioneer innovative business models and techniques that view intellectual property, particularly patents, as transactional assets ripe for monetization. The number of total patent applications submitted to the United States Patent and Trademark Office (PTO) per year has risen from 109,359 to 482,871 between 1970 and 2009, and the number of total patents issued by the PTO per year has risen from 67,964 to 191,927.[3] There is no doubt

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[1] *See* Raymond Millien & Ron Laurie, *A Survey of Established and Evolving IP Monetization Models*, 984 PLI/PAT 1033, 1037.

[2] Sabra Chartrand, *Patents: A Federal Agency, in Transition, Reaches out to Independent Investors with a New Department*, N.Y. TIMES, Apr. 5, 1999, *available at* http://www.nytimes.com/1999/04/05/business/patents-federal-agency-transition-reaches-independent-inventors-with-new.html?ref=sabra_chartrand.

[3] OFFICE OF ELECTRONIC INFORMATION PRODUCTS/PTMD, U.S. PATENT & TRADEMARK OFFICE, ALL TECHNOLOGIES REPORT, January 1, 1963 - December 31, 2009 (2009), *available at* http://www.uspto.gov/web/offices/ac/ido/oeip/taf/all_tech.pdf.

that patents have played a vital role in protecting the innovation responsible for the maturation of our $5 trillion idea economy.[4] New developments in the arena of patent monetization will have a significant impact on the future of the economy, the patent regime, and the lawyers working to progress the technological vitality of society.

Part I of this paper will discuss patents, valuation and various value extraction methods; Part II will explore the emerging patent intermediary market and the perennial debate surrounding non-practicing entities (NPEs); Part III will discuss and analyze recent court cases likely to have an impact on the prototypical NPE business model; and Part IV provides a short conclusion.

Part I

Patents

The essence of the patent system is rooted in Article I of the U.S. Constitution: "Congress shall have Power...To promote the Progress of Science...by securing for limited Times...to Inventors the exclusive Right to their...Discoveries."[5] Correspondingly, under the Patent Act a patent holder is granted the exclusionary right to stop others from making, using, selling, offering to sell, or importing the claimed technology for a period of twenty years.[6] The quid pro quo for this government-granted monopoly is the requirement that a patent holder disclose the invention for the public's benefit.[7] Progress is promoted and innovation is accomplished as the public learns from and builds upon this new technology.

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[4] Sean Silverthorn, *Monetizing IP: The Executive's Challenge, Q&A with: Josh Lerner*, WORKING KNOWLEDGE (Harvard Bus. Sch., Boston, Mass.), June 9, 2008, *available at* http://hbswk.hbs.edu/item/5925.html.

[5] *See* U.S. CONST. art. I, § 8, cl.8.

[6] *See* 35 U.S.C. § 271 (2008).

[7] *See* Brenner v. Manson, 383 U.S. 519, 534 (1966); 35 U.S.C. § 122(b)(1) (2000).

Patents are inherently complex legal documents that present numerous challenges to anyone seeking to extract value from them. For one, a patent does not grant its owner an affirmative right to *do* anything. In this way, the exclusionary right granted by a patent can also be understood as a negative right to preclude others from "practicing" the claimed technology. However, extrapolating the elements that comprise an invention and identifying the seminal qualities of a claimed invention is challenging, particularly in view of cutting-edge technology. Moreover, the specialized nature of a patent's jargon and structure makes navigating an individual patent's claims and determining its metes and bounds an even more demanding task. Nonetheless, ascertaining the intellectual property rights declared by a patent is a critical step in evaluating a patent's transactional value and determining the extent to which patent holders can benefit from their intellectual property right.

Monetization Methods

Various methods exist for patent owners looking to extract value from their patents, including commercialization, collateralization, securitization, and licensing. The most traditional method of these is commercialization, where a patent owner commercializes a patent by manufacturing a product, taking it to market, and earning revenue through sales. This is a viable option for larger entities with ready resources, but the high costs of manufacturing, distribution, and marketing processes can be extremely prohibitive for smaller innovators.[8] Additionally, the business models of many companies in the high-technology sector derive revenue through strong research and development departments where technology is invented, rather than manufacturing plants where products are made, thereby rendering commercialization as a costly option.

[8] *See* Stephen Bennett, *The IP Asset Class: Protecting and Unlocking Inherent Value*, 5 J. MARSHALL REV. INTELL. PROP. L. 402, 404 (2006).

For the monetization methods of collateralization, securitization, and licensing, the execution of accurate patent valuation is arguably the most difficult and most important aspect for each. As illustrated, valuation is inherently difficult and intricate with patents, and requires a blend of specialized skills, such as technical, legal and business expertise. Patent practitioners, for instance, can inform the valuation process by accurately determining the scope of the exclusionary rights maintained within a patent's claims; a critical step in assessing value. Patent practitioners can also provide insight into the following legal matters, which directly come to bear on risks relevant to the accurate valuation of patents: the prosecution history of a patent before the PTO, the scope of available prior art, the probability of patent invalidation, competitors designing products that obfuscate a related patent patent's claims (i.e., "design around"), and a patent's vulnerability to litigation. Technical experts supplement the valuation process by providing insight into industry trends, technology standards, opportunities for innovation within a given sector, technical implications of patent claim language, and the risks of technology obsolescence for specific inventions embodied in a patent or portfolio. Companies and firms looking to extract value from patents through innovative means must "assemble a set of knowledge that is richer in some ways and more integrated than that of even the largest manufacturing conglomerates." [9]

A patent owner can choose collateralization, a form of debt financing that uses a patent as collateral for a loan through a secured financing transaction with a lending institution. However, Article 9 of the Uniform Commercial Code, which governs secured transactions, lacks clear provisions that address the use of patents as collateral.[10] The ambiguity and unpredictability

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[9] Peter N. Detkin, *Leveling the Patent Playing Field*, 6 J. MARSHALL REV. INTELL. PROP. L. 636, 642 (2007).

[10] *See* Xuan-Thao Nguyen, *Collateralizing Intellectual Property*, 42 GA. L. REV. 1, 44 (2007).

of this particular finance technique calls for the retainment of sophisticated counsel, preferably one with experience in drafting the complex, comprehensive security agreements necessary for beneficial patent-backed secured transactions.[11] These hidden costs have rendered this monetization method costly, especially for innovators who lack the desired resources and relationships.

Patent-backed securitization is another monetization method that has seen some use. Patent-backed securitization follows the same basic procedure as any other asset-backed securitization process, in that cash flows are converted to marketable securities. First, a patent owner must obtain operative licensing agreements, the royalties from which will be used as the cash flow vehicles for securitization. Second, the patents or patent portfolios generating the cash flows are transferred, through a true sale, to a bankruptcy-remote special purpose vehicle (SPV).[12] This allows investors to decide whether they will invest based on the creditworthiness of the patent assets, instead of the creditworthiness of the originating company. Then, the SPV will issue debt securities to willing investors, who gain an ownership in the cash flows stemming from royalty payments but no ownership in the underlying patent assets themselves.[13] In

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[11] *See id.;*

> In reality, patent collateral has been recognized as so complex that, although a description of collateral in a security agreement as "general intangibles" should be sufficient, commentators have advocated a best practice that includes: identify[ing] all patents or patent applications....The collateral description or granting clause of the security agreement should also include all patent infringement claims; all inventions and improvements described in the patents; all inventions; and all continuations, continuations-in-part, divisions, renewals, extensions, substitutions, and reissuances of the patents, patent applications and patentable inventions in the United States or in any foreign country. In addition, it should include all rights to income, profits, royalties, damages, licenses or other rights related to the patents, applications or inventions, including the right to sue for past, present or future infringement; all other rights and goodwill relating to the patents, applications or inventions; and all proceeds, products and supporting obligations whether existing then or in the future and wherever located.

Id. n. 186.

[12] *See* Aleksandar Nikolic, *Securitization of Patents and Its Continued Viability in Light of the Current Economic Conditions,* 19.2 ALB. L.J. SCI. & TECH. 393, 404 (2009).

[13] *See id.*

exchange, the patent owners receive an upfront lump sum of capital; that is, an immediate collection of the value of receivables up front, which is for some a preferable alternative to the delayed and incremental collection of royalty streams over time.[14] This method is especially advantageous for high-technology companies, who can refuel research and development posthaste, thereby having a better chance at remaining competitive within their market sectors. However, the ability of an entity to exploit patent-backed securitization techniques to unlock value is a function of the entity's ability to attain beneficial patent licensing agreements first.

A patent owner who chooses to pursue licensing agreements does so either by seeking out entities willing to commercialize products based on the owner's patented technology, or by hunting down entities who have, without consent, already commercialized products based on the owner's patented technology. Unfortunately, the economics of the patent licensing environment can prove to be discouraging. For instance, small inventors are responsible for roughly one third to one half of all issued patents, while manufacturers usually pay less than a third of their licensing fees to small firms.[15] Instead, the overwhelming majority of licensing revenues are collected by large entities.[16] This disparity can be explained by the substantial market bargaining power provided by the robust patent portfolios and ample capital of larger entities. However, with the emergence of a patent intermediary market, a greater number of patent owners will find it easier to overcome this disparity and benefit from more equitable licensing agreements.

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[14] Clarie A. Hill, *Securitization: A Low-Cost Sweetener for Lemons*, 74 WASH U. L. Q. 1061, 1066 (1996).

[15] *See* Detkin, *supra* note 9, at 641.

[16] *See id.*

Part II

NPEs and Patent Intermediaries

Markets exist to provide systems that facilitate exchange by reducing the costs of conducting exchange transactions.[17] In theory, the patent intermediary market functions in accordance with this market paradigm: it connects patent owners (i.e., producers of technological innovation) with patent users (i.e., consumers of technological innovation) through centralized intermediaries that transact purchase and licensing agreements. In practice, however, this market contains multiple functional imperfections that, in effect, have spawned the formation of a range of different intermediary entities.[18] The cast of characters currently operating as middlemen include a growing number of entities with myriad business models and numerous nomenclatures.[19] One particular breed of patent intermediary that has drawn considerable controversy is the non-practicing entity (NPE), also known pejoratively as the "patent troll."

In July 2001, Peter Detkin, then assistant general counsel for Intel Corporation, first coined the term "patent troll" with the following statement: "We were sued for libel for the use of the term 'patent extortionists' so I came up with 'patent trolls.' A patent troll is somebody who tries to make a lot of money off a patent that they are not practicing and have no intention of practicing and in most cases never practiced."[20] Later, Detkin founded a company called Intellectual Ventures and disclaimed the term "patent trolls," explaining in a 2007 article that "it has become too emotionally charged and too often hurled carelessly as an epithet to disparage

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[17] *See generally,* RH COASE, THE FIRM, THE MARKET, AND THE LAW (1988).

[18] Allen W. Wang, *Rise of the Patent Intermediaries*, 25 BERKELEY TECH. L.J. 159, 186 (2010).

[19] *See generally* Millien & Laurie, *supra* note 1 (separating and characterizing various IP intermediary business models through seventeen different categorizations).

[20] Brenda Sandburg, *Trolling for Dollars: Patent Enforcers Are Scaring Corporate America, and They're Getting Rich - Very Rich - Doing It*, THE RECORDER, July 30, 2001, at 1.

just about every kind of plaintiff in a patent suit." [21] Ironically, Intellectual Ventures has been argued by some to be the exact kind of trolling entity that Detkin derided while at Intel.[22]

After years of careless derogatory usage, the term "patent troll" has evolved into an overinclusive classification.[23] A multitude of other monikers have surfaced in an attempt to address the complex, mitotic development of the myriad business models operating within the intermediary patent market. These include the following: non-practicing entity or NPE, patent aggregator,[24] patent dealer,[25] patent enforcement specialist,[26] patent licensing firm,[27] and many others.[28] This paper adopts the neutral term NPE to refer to an entity that either enforces (i.e., "asserts") its patents without practicing them, or that helps another entity to enforce its non-practiced patents.

Critics of NPEs portray them as opportunists who hunt (i.e., "troll") for patents obtainable "on the cheap," which can then be used to extract excessive licensing fees from manufacturing companies facing the threat of perceived or actual infringement litigation. In this way, NPEs have been accused of exploiting the negative rights under a patent exclusively for

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[21] Detkin, *supra* note 9, at 642.

[22] Raymond P. Niro, *Who is Really Undermining the Patent System - "Patent Trolls" or Congress?* 6 J. MARSHAL REV. INTELL. PROP. L. 185, 188 (2007).

[23] See Marc Morgan, *Stop Looking Under the Bridge for Imaginary Creatures: A Comment Examining Who Really Deserves the Title Patent Troll,* 17 FED. CIR. B.J. 165, 178 (2007) (suggesting that the definition of "trolls" should be narrowed by a bad faith limitation).

[24] *See* Wang, *supra* note 19, at 160.

[25] *See* James F. McDonough III, *The Myth of the Patent Troll: An Alternative View of the Function of Patent Dealers in an Idea Economy,* 56 EMORY L.J. 189, 201 (2006).

[26] *See* Sandburg, *supra* note 21.

[27] *See* Yuichi Watanabe, *Patent Licensing and the Emergence of a New Patent Market*, 9 HOUS. BUS. & TAX L.J. 445, 454 (2009).

[28] *See* Millien & Laurie, *supra* note 1, at 1038-1054.

financial gain, the effect of which is purported to deter innovation.[29] Moreover, NPEs have been lambasted for flooding the courts with unnecessary litigation in an attempt to enforce patents of questionable validity, which burdens the legal system and drives up business costs.[30]

Supporters view NPEs as providing a market-based solution that levels the patent licensing playing field, which is notorious for operating to the benefit of large technology corporations.[31] Furthermore, supporters argue that this unique market position enhances innovation and competition in two ways. First, small businesses and independent inventors are provided access to licensing revenue through NPE-backed bargaining power, as NPEs can supply the capital necessary to create a legitimate threat of litigation. This, in turn, provides inventors with the leverage required to execute an equitable licensing agreement with larger corporations.[32] Second, NPEs increase the liquidity of patents as assets through a centralized, efficient market where information asymmetries are reduced and patent owners can sell their patent rights to NPEs in exchange for cash capital.[33]

Both sides of the ongoing debate over whether NPEs benefit or burden the idea economy have produced their fare share of rational, zealous arguments.[34] Regardless of one's own opinion on the legitimacy of NPEs in the patent intermediary market, the patent system, or the economy in general, it remains that NPEs exist and continue to grow in number and influence.[35] In fact, the

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[29] *See* Sannu K. Shrestha, *Trolls or Market-Makers? An Empirical Analysis of Nonpracticing Entities*, 110 COLUM. L. REV. 114, 1 (2010).

[30] Daniel P. McCurdy, *Patent Trolls Erode the Foundation of the United States Patent System,* SCIENCE PROGRESS (Jan. 12th, 2009), http://www.scienceprogress.org/2009/01/patent-trolls-erode-patent-system/.

[31] *See* Detkin, *supra* note 9, at 641.

[32] *See* McDonough III, *supra* note 25, at 212.

[33] *See* Shrestha, *supra* note 29, at 130.

[34] *See generally* Shrestha, *supra* note 29; Mark A. Lemley & Carl Shapiro, *Patent Holdup and Royalty Stacking*, 85 TEXAS L.REV. 1991 (2007).

[35] *See* McCurdy, *supra* note 30.

U.S. currently has roughly 220 NPEs who have raised approximately $6 billion in capital during the past ten years.[36] At the core of the NPE business model is its ability to raise capital in order to present a legitimate threat of litigation. However, recent case law relating to the calculation of damages in patent infringement cases is likely to have an impact on NPEs and the efficacy of their negotiation strategies.

Part III

Reasonable Royalties and the Invalidation Evidentiary Standard

Although the primary goal of NPEs is to extract a license from the companies they accuse of infringing their patents, litigation plays a key role in their business model. As stated, litigation provides NPEs with leverage over parties who resist licensing patents. NPEs are not gun-shy: between twelve to seventeen percent of patent infringement cases filed between January 1, 2000 and March 21, 2008 were related to NPEs.[37] Furthermore, NPEs file over 80 percent of suits involving the most litigated patents.[38] Interestingly, because NPEs do not commercialize their patents, they are limited to using the reasonable royalty analysis to establish damages in infringement suits.[39] Thus, their vitality is highly dependent upon favorable reasonably royalty rulings and reforms. The final sections of this paper discuss some recent cases that have the potential to adversely affect NPEs in the near future with respect to both reasonable royalties and invalidation proceedings.

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[36] Mark Liang, *The Aftermath of TS Tech: The End of Forum Shopping in Patent Litigation and Implications for Non-Practicing Entities,* 19 TEX. INTELL. PROP. L.J. 29, 33 (2010).

[37] *Id.* at 35.

[38] *Id.* at 36.

[39] Ted Sichelman, *Commercializing Patents*, 62 STAN. L. REV. 341, 405 (2010).

Reasonable Royalty

In order to provide an alternative to the lost profits and established royalty theories of calculating patent damages, the courts developed a doctrine called the "reasonable royalty analysis." When a patentee cannot support their request for damages, either due to evidentiary issues or other reasons, the reasonable royalty analysis is often employed.[40] This alternative analysis seeks to make the patentee whole by assuming the infringement never occurred and attempts to apportion damages according to what the parties would have agreed to had they entered into a licensing agreement.

Courts frequently conduct the reasonably royalty analysis as a hypothetical negotiation between the patentee and the infringing party, on the day the infringement began and assuming the patent is valid.[41] Because the court is essentially attempting to travel back in time to infer what the parties would have agreed to, there are many potential pitfalls in which hind sight can inappropriately seep into the analysis. In order to avoid this from happening, courts have formulated multiple factors over the years to guide the fact finder through an analysis of the reasonable royalty. These factors were summed up in *Georgia-Pacific Corp. v. United States Plywood Corp*., a case which comprehensively covered the factors that courts had formulated over the years.[42] The factors are:

1) The royalties received by the patentee for the licensing of the patent in suit, proving or tending to prove an established royalty.
2) The rates paid by the licensee for the use of other patents comparable to the patent in suit.

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[40] *See* Chisum on Patents § 20.03 [3].

[41] *Id.*

[42] 318 F. Supp. 1116 (S.D.N.Y. 1970).

3) The nature and scope of the license, as exclusive or non-exclusive; or as restricted or non-restricted in terms of territory or with respect to whom the manufactured product may be sold.

4) The licensor's established policy and marketing program to maintain his patent monopoly by not licensing others to use the invention or by granting licenses under special conditions designed to preserve that monopoly.

5) The commercial relationship between the licensor and licensee, such as whether they are competitors in the same territory in the same line of business; or whether they are inventor and promoter.

6) The effect of selling the patented specialty in promoting sales of other products of the licensee; the existing value of the invention to the licensor as a generator of sales of his non-patented items; and the extent of such derivative or convoyed sales.

7) The duration of the patent and the term of the license.

8) The established profitability of the product made under the patent; its commercial success; and its current popularity.

9) The utility and advantages of the patent property over the old modes or devices, if any, that had been used for working out similar results.

10) The nature of the patented invention; the character of the commercial embodiment of it as owned and produced by the licensor; and the benefits to those who have used the invention.

11) The extent to which the infringer had made use of the invention; and any evidence probative of the value of that use.

12) The portion of the profit or of the selling price that may be customary in the particular business or in comparable businesses to allow for the use of the invention or analogous inventions.

13) The portion of the realizable profit that should be credited to the invention as distinguished from non-patented elements, the manufacturing process, business risks, or significant features or improvements added by the infringer.

14) The opinion testimony or qualified experts.

15) The amount that a licensor (such as the patentee) and a licensee (such as the infringer) would have agreed upon (at the time the infringement began) if both had been reasonably and voluntarily trying to reach an agreement; that is, the amount which a prudent licensee-- who desired, as a business proposition, to obtain a license to manufacture and sell a particular article embodying the patented invention--would have been willing to pay as a royalty and yet be able

> to make a reasonable profit and which amount would have been acceptable by a prudent patentee who was willing to grant a license.[43]

It is important to note that each of the above factors have been subjected to significant dispute and thus have a substantial number of cases concerned with explaining their nuances. However, one in particular has proven to be particularly problematic. Factor 13, also know as apportionment, has consistently created problems within patent damages jurisprudence.

Apportionment represents the courts' attempts to deal with improvement patents, or patents that compromise only a part of a product, which account for a portion of the proceeds gained from the sale of infringing products, but not all of them.[44] In some cases, this issue can be resolved through the use of the "entire market value rule." The Federal Circuit has held that "the entire market value rule permits recovery of damages based on the value of a patentee's entire apparatus containing several features when the patent-related feature is the 'basis for customer demand.'"[45] Thus, if the patentee can show that their patented invention is where the infringing product derives all of its value from, he can establish a reasonable royalty based on the cost of the whole infringing product.[46]

Otherwise, apportionment usually results in a relentless battle between both parties as they try to prove what portion of the product's value is attributable to the patent. This situation has created an interesting issue specific to this problem: who has the burden to prove

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[43] *Id.* at 1120.

[44] 7-20 Chisum on Patents § 20.03 [1][c].

[45] Rite-Hite Corp. v. Kelley Co., 56 F.3d 1538, 1549 (Fed. Cir. 1995).

[46] Apportionment has been in the news lately following a string of cases involving high–tech companies where large damages awards were handed down. See Z4 Techs., Inc., v. Microsoft Co., 507 F.3d 1340 (Fed. Cir. 2007); i4i Ltd. P'ship v. Microsoft Corp., 598 F.3d 831 (Fed. Cir. 2010).

apportionment? Two Supreme Court cases that were decided in the first half of the 20th century attempted to answer this question with questionable results. In fact, the difficulties in dealing with this problem led Judge Learned Hand to state that deciding which party bore the burden of proving apportionment, "is in its nature unanswerable."[47]

Recent Federal Circuit Reasonable Royalty Decisions

Some commentators believe that the Federal Circuit has taken it upon itself to reform the reasonable royalty analysis through recent decisions that carefully scrutinized the entire market value rule and the use of prior licenses to establish a reasonable royalty.[48] The decisions in *Cornell University v. Hewlett-Packard Co.*,[49] *Lucent Techs. v. Gateway, Inc.*,[50] and *ResQNet.com, Inc. v. Lansa, Inc.*[51] may signal a shift towards closer scrutiny of damages evidence and may also be evidence of the Federal Circuit's desire to take reform into its own hands. These decisions, and the direction they appear to head in, could have far reaching effects on the patent monetization market, especially with respect to NPEs.

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[47] Cincinnati Car Co. v. New York Rapid Transit Corp., 66 F.2d 592 (2d Cir. 1933).

[48] Michael Kasdan and Joseph Casino, *Federal Courts Closely Scrutinizing and Slashing Patent Damage Awards*, 2010 Patently-O Patent L.J. 24.

[49] 609 F.Supp. 2d 279 (N.D.N.Y. 2009) (Although not a Federal Circuit case, Randall R. Rader, Chief Judge on the United States Court of Appeals for the Federal Circuit, sat by designation on the case.)

[50] 580 F.3d 1301 (Fed. Cir. 2009).

[51] 2010 U.S. App. LEXIS 2453 (Fed. Cir. Feb. 5, 2010).

Cornell University v. Hewlett-Packard Co.

In an opinion laden with contempt for the plaintiff Cornell and its expert witness, Judge Rader sitting by designation, laid out a comprehensive analysis of the evidentiary threshold necessary to apply the entire market value rule in *Cornell University v. Hewlett-Packard Co.* The Patent in dispute in *Cornell* encompassed "a method for instruction issuance within a computer processor."[52] Cornell sued Hewlett-Packard, claiming that HP's server and workstation systems incorporated the Cornell patent and infringed upon its rights.[53] Judge Rader described the claimed invention as, "a small part of the [instruction reorder buffer], which is a part of a process, which is part of a CPU module, which part of a 'brick,' which is itself only a part of the larger server."[54] Despite Judge Rader's characterization, Cornell sought damages on the revenue from HP's entire server and workstation systems, constituting a royalty base of about $23 billion.[55] As a fair warning to future litigants, Judge Rader made it clear that the court was aware of Cornell's tactics from the beginning and was going to be proactive about mitigating them:

> In anticipation that Cornell would assert entitlement to damages beyond the claimed invention, this court repeatedly advised before trial that it would scrutinize the damages proof. With this advance warning, this court expected Cornell to present well-documented economic evidence closely tied to the scope of the claimed invention. To this court's surprise, when the trial commenced, Cornell had not revised its attempts to prove entitlement to damages far beyond the scope of the claimed invention.[56]

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[52] Cornell, 609 F. Supp. 2d 279, 283.

[53] *Id.*

[54] *Id.*

[55] *Id.* at 284.

[56] *Id.* at 283.

At commencement of the trial, Cornell reluctantly shifted away from its server and workstation royalty base, but again overreached by using hypothetical revenues based on the revenues derived from HP's sales of the CPU bricks instead of a more accurate royalty base calculated on processor sales.[57] According to Judge Rader, the CPU bricks were, "just one rung down the price ladder from the excluded servers and workstations", and required Cornell to satisfy the entire market value rule for their inclusion in the royalty base.[58] This decision proved to be Cornell's fatal flaw:

> Simply put, Cornell's failure to connect consumer demand for Hewlett-Packard machine 'performance' to the claimed invention, or to present a single demand curve (or any other economic evidence) showing that the [inventor's] invention drove demand for Hewlett-Packard's products undermined any argument for the applicability of the entire market value rule.[59]

Lacking the required evidence, Judge Rader reduced the jury's $184,044,048 award to Cornell, which used the entire market value rule to establish the royalty base, to $53,494,282 based on a more appropriate royalty base.[60]

Although not a Federal Circuit opinion, Chief Judge Rader's ruling in *Cornell* signals a new emphasis on stricter evidentiary standards for the application of the entire market value rule. This ruling has the potential to affect the monetization market in many ways. First, this ruling has the potential to decrease damages awards, and in turn, the perceived value of patents in general. By increasing the difficulty of extracting large damage awards, the ruling could effectively devalue the patent grant, albeit with the intent of legitimizing the grant as well

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[57] *Id.* at 287-288.

[58] *Id.* at 287.

[59] *Id.* at 289.

[60] *Id.* at 293.

through reduction of erroneous awards. Second, the *Cornell* ruling has the potential to hinder some NPE business models because courts may not give credence to the evidence proffered by NPEs due to a desire to curb NPE-initiated litigation. Raising the evidentiary standard requires the entities, who do not have market data, demand data or supply data of their own, to depend solely on their adversaries to determine whether or not the entire market rule can apply to their patent. Furthermore, NPEs frequently purchase patents that they believe are essential to a standard or patented product with the intention of using the entire market value rule to extract the most value in litigation. The *Cornell* ruling has the potential to curb NPE damage awards on such patents substantially.

ResQNet.com, Inc. v. Lansa Inc.

In a per curiam opinion in *ResQNet.com, Inc. v. Lansa Inc.*, the Federal Circuit expounded on the first of the *Georgia-Pacific* factors concerning the use of prior and current licenses to establish a reasonable royalty.[61] The district court awarded ResQNet $506,305 for past infringement of their patents over screen recognition and terminal emulation processes that download a screen of information from a remote mainframe computer onto a local personal computer.[62] The court calculated the damage award using the 12.5% reasonable royalty rate to which ResQNet's expert testified.[63]

In reviewing the district court's award, the Federal Circuit found fault in the licenses that ResQNet's expert used to establish the reasonable royalty. Specifically, the court stated that the

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[61] *See* ResQNet.com, Inc. v. Lansa Inc., 594 F.3d 860 (Fed. Cir. 2010).

[62] *Id.* at 868.

[63] *Id.*

expert, "based his damages on seven ResQNet licenses, five of which had no relation to the claimed invention" and that, "none of these licenses even mentioned the patents in suit or showed any other discernible link to the claimed technology."[64] The court went on to state that, "the trial court must carefully tie proof of damages to the claimed invention's footprint in the market place."[65] This case came on the heals of the court's recent *Lucent* decision, where the court rejected a patentee's reliance on licenses because the court was "unable to ascertain from the evidence presented the subject matter of the agreements."[66] The court's perceptible frustration with the use of licenses with attenuated subject matter stemmed from its earlier decision in *Lucent* and likely influenced its decision to vacate the damages award and remand to the district court for recalculation of the reasonable royalty.[67]

The ResQNet ruling presents interesting new issues in the patent monetization market due to its seemingly strict requirements for the use of licenses to establish a reasonable royalty rate. Particularly, with respect to NPE's, this ruling could create a problem for a firm that has acquired and is asserting a patent that has never been monetized. Courts following *Lucent* and *ResQNet* may either be reluctant to allow NPEs to use other licenses, or may use these rulings as a means of curbing NPE offensive assertion. On the other hand, NPEs that acquire a strong patent may be able to establish a number of licenses with parties that will provide them with a solid portfolio to use as evidence in court during litigation.

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[64] *Id.* at 870.

[65] *Id.* at 869.

[66] *Infra* pp. 18-20. Lucent Techs., Inc. v. Gateway, 580 F.3d 1301, 1327-28 (Fed. Cir. 2009).

[67] ResQNet.com, Inc. v. Lansa Inc., 594 F.3d 860, 873 (Fed. Cir. 2010).

Lucent Technologies, Inc. v. Gateway, Inc.

In an opinion drafted by then Chief Judge Michel, the Federal Court in *Lucent Technologies, Inc. v. Gateway, Inc.*, vacated a large award against Microsoft due to the jury's misapplication of the reasonable royalty analysis and the entire market value rule. Lucent sued Microsoft claiming that the company's Microsoft Outlook, Microsoft Money and Windows Mobile software products all infringed its "Day" patent through a tool that allows the user to select and enter dates from a graphical object that is formatted as a calendar.[68] The jury returned with a $358 million lump-sum award in favor of Lucent.[69]

The court's analysis focuses on the *Georgia-Pacific* factors: specifically factors 2, 10, 11, and 13. In the analysis under factor 2, of similar licenses proffered by Lucent, the court expressed multiple misgivings:

> First, no evidence of record establishes the parties' expectations about how often the patented method would be used by consumers. Second, the jury heard little factual testimony explaining how a license agreement is probative of a lump-sum payment to which the parties would have agreed. Third, the license agreements for other groups of patents, invoked by Lucent, were created from events far different from a license negotiation to avoid infringement of the patent here, the Day patent.[70]

Echoing many of the concerns the court had in *ResQNet.com* the court concluded that:

> First, some of the license agreements are radically different from the hypothetical agreement under consideration for the Day patent. Second, with the other agreements, we are simply unable to ascertain from the evidence presented the subject matter of the agreements, and we therefore cannot understand how the jury could have adequately evaluated the probative value of those agreements.

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[68] *Supra* note 10, at 29.

[69] Lucent Techs., 580 F.3d 1301, 1308.

[70] *Id.* at 1327.

Furthermore, the court concluded that the jury unjustifiably applied the entire market value rule in order to calculate the damages award.[71] Lucent originally tried to use the entire computer as a royalty base to calculate the damages due just for the date picker feature in the Day patent.[72] Using this base, Lucent's expert testified that a 1% royalty rate would be appropriate, resulting in a substantial award in line with that established by the jury.[73] When the court refused to allow the entire computer system to be used as a royalty base, the expert modified his calculation by using only the software as a base.[74] However, in an attempt to arrive at the same damages award that he originally advocated, the expert increased the royalty rate to 8% to make up for the lost revenue in the reduction of the base.[75] The court took offense to this maneuver, stating that the expert's tactic "cannot be an acceptable way to conduct an analysis of what the parties would have agreed to in the hypothetical licensing context."[76]

Once again, as in *ResQNet* and *Cornell*, the court took on a serious tone as it criticized the use of both the reasonable royalty rate and the entire market value rule in the *Lucent* opinion. The courts willingness to chastise the jury's finding and to conduct a thorough analysis of the case convey the seriousness with which the court is approaching reviews of damages awards. This intensity will likely result in lower awards under the reasonable royalty analysis.

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[71] *Id.* at 1339.

[72] *Id.* at 1338.

[73] *Id.*

[74] *Id.*

[75] *Id.*

[76] *Id.*

i4i v. Microsoft: The Supreme Court and the Presumption of Validity

i4i Ltd. Partnership v. Microsoft Corp.

In 2007, i4i Ltd. sued Microsoft in the United States district court for the Eastern District of Texas alleging that Microsoft infringed its patent concerning a method for processing and storing information about the structure of electronic documents.[77] The patent claims an improved method for editing documents containing markup languages such as the markup language XML.[78] i4i claimed that Microsoft's Word program infringed its patent because it is capable of processing or editing custom XML.[79]

The jury found that Microsoft had willfully infringed i4i's patent and awarded i4i $200 million in damages, which the judge added $40 million of enhanced damages to under the treble damages provision for willful infringement.[80] The Federal Circuit affirmed the district court ruling and Microsoft sought an appeal to the Supreme Court, which was granted on November 29, 2010.[81]

On appeal, Microsoft presented the Court with a novel question: whether the court of appeals erred in holding that Microsoft's invalidity defense must be proved by clear and convincing evidence.[82] Microsoft argues that courts should use the more lenient "preponderance of the evidence" standard in invalidation proceedings when the evidence of invalidity was not

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[77] i4i Ltd., v. Microsoft Corp., 598 F. 3d 831, 839 (Fed. Cir. 2010)

[78] *Id.*

[79] *Id.* at 840.

[80] *Id.* at 840-41.

[81] Microsoft Corp., v. i4i Ltd., P'ship, 131 S. Ct. 647 (2010).

[82] Microsoft Corp., v. i4i Ltd., Petition for Certiorari, (Aug. 27, 2010).

previously in front of the USPTO during examination. Many commentators believe that the Court will agree with Microsoft's position on appeal.[83]

Were the Court to rule in Microsoft's favor, the lower required evidentiary standard could have profound effects on NPEs. Some NPEs are frequently criticized for asserting less-than meritorious patents in order to extract settlements out of litigants.[84] The establishment of a new evidentiary standard would constitute a clear signal from the Court that the presumption of validity is readily challengeable and that these suits should be closely scrutinized. A lower standard would likely embolden defendants to defer settlement in the hopes that their evidence would prevail in an invalidity proceeding at trial. Such actions could actually be good for the NPE market: successful invalidation proceedings will discourage predatory NPE business models, help shed the stigma attached to NPEs and instill more confidence in the patent grant.

Part IV

Conclusion

The foundation of any market is a legal system, which ensure that the laws of the market are enforced and that the rights of its participants are preserved. The premise of the patent intermediary market is derived from the government-granted negative right to exclude others from practicing a declared and delineated technology. As the above analysis indicates, an understanding and appreciation of the evolving intricacies and legal constructs of the U.S. patent

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[83] *See* Dennis Crouch, Supreme Court to Decide Microsoft Patent Case that Could Make it Easier to Invalidate Patents, PatentlyO.com (Nov. 29, 2010), http://www.patentlyo.com/patent/2010/11/supreme-court-to-decide-microsoft-patent-case-that-could-make-it-easier-to-invalidate-patents.html; Gene Quinn, U.S. Supreme Court Accepts Microsoft Appeal in i4i Case, IPWatchdog.com (Nov. 29, 2010), http://ipwatchdog.com/2010/11/29/us-supreme-court-accepts-microsoft-appeal-in-i4i-case/id=13578/.

[84] *Supra* note 35 n. 58.

regime, together with a recognition of the emerging IP-as-assets perspective, is vital for staying competitive in the new idea economy.