

ENDING UNREASONABLE ROYALTIES: WHY NOMINAL DAMAGES ARE ADEQUATE TO COMPENSATE PATENT ASSERTION ENTITIES FOR INFRINGEMENT

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ABSTRACT

According to § 284 of the Patent Act, damages for patent infringement are supposed to be compensatory. The statute only allows for recovery of “damages adequate to compensate for the infringement.” Even though it qualifies that such damages must be “in no event less than a reasonable royalty,” this language cannot be read to avoid the fundamental requirement that, as compensatory damages, any recovery must stem from actual harm suffered by the patent owner. Absent proof of actual harm, only nominal damages should be recoverable. Yet patentees who suffer no actual harm are regularly obtaining considerable amounts of money from alleged infringers as purported reasonable royalty damages. This state of affairs reveals a need to correct the course that damages law has taken.

The most prominent group of patent owners receiving windfalls instead of compensatory damages are patent assertion entities (“PAEs”), also known as “patent trolls.” While there are other situations where patentees are not actually harmed by instances of infringement, PAEs’ business models and damages theories best highlight how existing damages law is being misread and exploited to support widespread overcompensation for infringement.

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† I am tremendously grateful to those who helped me build the foundation for and improve this article. I owe special thanks to Janice Mueller, Bryan Clark, and Christian Ehret, whose comments on earlier drafts of the piece were invaluable. This article also benefitted greatly from various discussions I have had concerning patent infringement damages with J. Derek McCorquindale, Kent Baldauf, Jr., Anthony Brooks, James Bosco, Jr., Steven Johnston, Lee Cheng, W. Christopher Bakewell, and Raji Seshan. The views expressed in this article, as well as any errors, are solely my own and should not be attributed to The Webb Law Firm or any of its clients. Questions and comments are welcome to dbrean@webblaw.com.

PAEs are exclusively in the business of patent assertion, seeking to license their patents via actual or threatened litigation. They make and sell no products or services themselves, having no capacity or infrastructure to do so, nor do they partner with technology companies to develop and bring their patented products or services to market. Having no actual or prospective direct or indirect market participation relating to the technology, PAEs suffer no pecuniary loss from infringement—they are no worse off than they would be if the infringement had never occurred. PAEs are only legally harmed, not actually harmed, by infringement.

The business model of PAEs is lucrative because of the erroneous assumption that substantial reasonable royalty damages must be awarded for any infringement. The statutory language allowing for damages “in no event less than a reasonable royalty” has been twisted and expanded, especially by PAEs in recent years, far beyond its strictly compensatory origin. PAEs emphasize improper restitutional facts instead of compensatory ones to unduly inflate their supposed damages—i.e., they focus on the benefits to the infringer instead of the harm to themselves. They also draw analogies to common law trespass principles to suggest that, just as a trespass interferes with a landowner’s use of real property, substantial damages are owed to patentees merely because they own the patent and the patent was infringed. When properly examined, however, these common law principles reveal that the analogy would support only nominal damages for such legally harmful but actually harmless trespasses.

Nothing in the legislative history of the reasonable royalty statute suggests that a reasonable royalty was required to be a substantial sum. With no evidence that Congress intended a reasonable royalty to be substantial or have a special meaning, under the plain meaning of the statutory text a royalty should be deemed reasonable simply when it constitutes sensible and fair compensatory relief. This allows for case-by-case findings of actual damages without artificial legal constructs that distort the meaning of § 284. Under this fresh reading of the statute, patent owners who suffer no actual harm from infringement would be entitled to recover nominal damages only. In some cases, such as those brought by PAEs, a nominal royalty is reasonable.

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INTRODUCTION

Damages for patent infringement are supposed to be compensatory. The pertinent statute in the Patent Act only allows for recovery of “damages adequate to compensate for the infringement.”¹ Although such damages must be “in no event less than a reasonable royalty,” this language does not take away from the compensatory nature of damages, whereby any recovery must be based on actual harm suffered by the patent owner.²

Upon a finding of infringement, historically only nominal damages—i.e., small sums that represent damages in name only—would be awarded unless the patentee could adequately prove actual harm as a result of the infringement. The reasonable royalty statute did not change this foundational aspect of compensatory damages law. Yet today the law allows patent owners that suffer no actual harm from infringement to obtain substantial sums of money as purported reasonable royalty damages.

This phenomenon appears to stem from the assumption that the “in no event less than” language of the statute requires reasonable royalties to be substantial in every case. That assumption is mistaken. Indeed, the Federal Circuit very recently acknowledged that a zero or nominal reasonable royalty award would be appropriate in some cases.³ It held 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

This Article offers an in-depth historical analysis of the reasonable royalty statute and advocates for a fresh and plain reading that: (1) reaffirms its purely compensatory intentions; and (2) allows for nominal damages to constitute an appropriate reasonable royalty where that result is fair and sensible. To demonstrate how far afield the reasonable royalty law has gone from its compensatory origins, this Article focuses on the behaviors of

1. 35 U.S.C. § 284 (2012).

2. *Id.*

3. *Apple Inc. v. Motorola, Inc.*, 757 F.3d 1286, 1328 (Fed. Cir. 2014). The Federal Circuit commented that “it seems unlikely that a willing licensor and willing licensee would agree to a zero royalty payment in a hypothetical negotiation, where both infringement and validity are assumed.” *Id.* It also noted that “[w]e know of no case where we found that the record supported an infringement award of a zero royalty.” *Id.* at n.7. Examples given for where a zero damages award might be justified were: (1) “in a case completely lacking any evidence on which to base a damages award”; and (2) where a record demonstrated that “at the time of infringement, the defendant considered the patent valueless and the patentee would have accepted no payment for the defendant’s infringement.” *Id.* at 1328.

4. *Id.*

patent assertion entities (“PAEs”), also known as “patent trolls,” and explains why those behaviors mandate awards of only nominal damages.

PAEs are the largest and most prominent group of patent owners receiving substantial royalties despite the absence of actual harm. PAEs are solely in the business of monetizing their patents. Their only commercial activity is their effort to obtain license fees for use of their patents, primarily by threatening or pursuing litigation. They are generally holding companies—essentially, shell organizations that own patents directed to certain technologies but offer no products or services in those technical fields (and lack the capacity to do so).

PAEs also do not partner with technology companies to develop or bring the patented products or services to market—a practice that can be referred to as productive licensing. Rather, PAEs seek license fees to pay for alleged infringement of already-existing products or services. It is a retrospective, not prospective, licensing model, effectively extracting a tax or toll for past and current infringement. One commentator recently analogized PAEs to “parasites” because “both are naturally occurring phenomena that thrive by syphoning resources from hosts . . . mostly without necessarily killing [the hosts].”⁵

Having no actual, prospective, direct, or indirect market participation relating to the technology, PAEs suffer no pecuniary loss from infringement. Put another way, they are no worse off than they would have been if the infringement had never occurred.

5. Yaniv Heled, *Patent Trolls as Parasites*, JURIST (April 28, 2014, 6:00 PM ET), <http://jurist.org/forum/2014/04/patent-trolls-as-parasites.php>. As Professor Heled explained:

A single patent troll usually poses no existential danger to any given company—as trolls are typically only after settlement fees and not their host’s entire cache of resources. Too many patent trolls, however, could eventually bring down even highly successful companies. Similarly, like most species of parasites, patent trolls tend to mount numerous attempts on their hosts with the expectation that only a few of these attempts will be successful, which still guarantees enough resources extracted from hosts to keep the trolls alive and, in many cases, thriving.

. . .

[A]s long as we have prosperous sectors relying on patents as a means of ensuring their success, there will be trolls exploiting such patents to exact a toll on this success.

Id. He concludes that patent trolls should not be left unchecked but, like the existence of biological parasites, some acceptable level of patent trolling exists. *Id.* (observing that “seeking to outlaw patent trolls as such is unlikely to succeed and—like taking too much antibiotics—might backfire,” but that “our inability to design perfect tools for fighting patent trolls should not deter us from taking action to thwart at least some of their harmful behavior and minimize its effects”).

There are patent owners other than PAEs who may not be harmed by infringement of their patents, and § 284 of the Patent Act should likewise award those unharmed patent owners nominal damages. And to be clear, this Article does not suggest that an entity is required to itself practice its patents in the marketplace in order to obtain compensatory damages. Non-practicing entities other than PAEs present a more complex set of considerations, however, making any line-drawing exercise much more nuanced.

For example, an individual inventor having productively licensed a company to make and sell its patented technology is likely harmed by other unauthorized users of the technology in the marketplace. Similarly, a corporation that has a patent and chooses not to use that technology in its products, but that has the capacity to do so for some business advantage, may be harmed by a competitor's infringement. On the other hand, an educational or research institution lacking even an indirect-licensee's participation in the market for the patented technology might not be harmed by infringement. Similarly, a company that acquires a patent that it has no technical capacity or intention to use may not be harmed if a non-competitor is infringing.

Ultimately, the key to properly and uniformly applying § 284 is to recognize actual, demonstrable harm and compensate the patent owner for it. The test for whether harm exists hinges not on the identity of the patent owner but on the patent owner's conduct in relation to the patent and the market for the patented technology. Each case must be considered on its own facts as to whether harm exists and a royalty is reasonable.

PAEs, as defined above, are singled out for particular study in this Article because they are believed to be by far the largest group of patent owners that are not harmed by infringement. Additionally, PAEs' business models almost universally include the above-described conduct by definition—they are far more alike in their behaviors than they are different, making it easier to identify problematic patterns.

Perhaps the best reason to study PAEs for purposes of this Article is that PAEs' business models and damages theories best highlight how existing damages law is being misread and exploited to support widespread overcompensation for infringement. It is the overreaching on damages by PAEs that most directly demonstrates the need for the damages reform suggested by this Article. PAEs advance restitutional damages theories focused on the benefits the invention affords to the infringer instead of proper compensatory damages theories identifying the harm the infringement causes to themselves. They also draw inapt analogies to real property trespass laws to suggest that substantial damages are owed to

patentees merely because they own the patent, and the patent was infringed. Finally, PAEs typically assert patents broadly against end users or sellers of such technology instead of the providers of the technology, in order to strategically obtain larger total recovery than they could if targeting the source of the alleged infringement.

Part I of this Article provides an overview of PAE monetization efforts and damages theories, as well as the incentives at play for PAEs and their targets. Part II explores how reasonable royalty damages came to exist in the common law and to be codified in the 1946 Patent Act. It also shows that the best reading of the statute is to allow for any royalty to be awarded that is sensible and fair. Part III provides an in-depth analysis of the Supreme Court's *Aro Manufacturing* decision and how it concluded that all patent infringement damages must be compensatory in nature. Part IV examines the philosophical implications of *Aro Manufacturing*, revealing the compensatory versus restitutional damages dichotomy, and how, despite *Aro Manufacturing*, restitutional theories of damages are still raised and supportable under existing law. Part V looks to common law tort and trespass damages principles to explore how compensatory damages can be nominal in appropriate circumstances where harm is absent. It explains how analogous circumstances would yield nominal damages for infringement of a PAE's patent. Part VI addresses the fundamental misconception that reasonable royalty damages must be substantial and cannot be nominal. Part VII explains that foregone royalties are not compensatory damages for PAEs. A brief conclusion follows.

I. OVERVIEW OF PATENT ASSERTION ENTITY BEHAVIORS AND INCENTIVES

A. The Status Quo of Patent Assertion Entities

The number of companies PAEs sued roughly doubled from 2006 to 2012, and now PAE targets constitute a steady and strong majority of all patent infringement defendants.

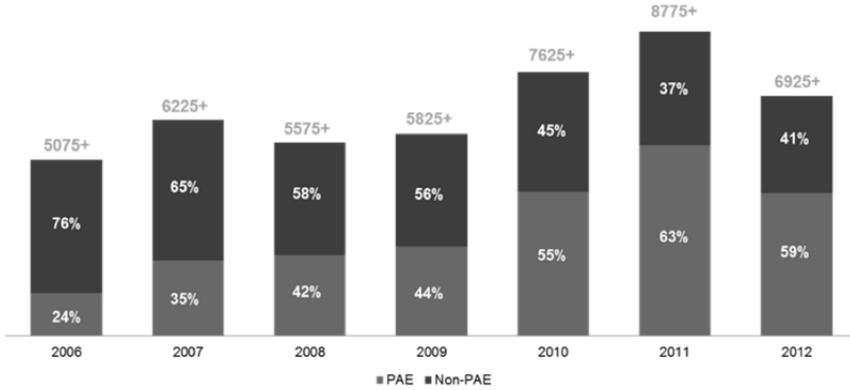


Chart 1: PAE vs. Non-PAE Patent Infringement Lawsuit Filings⁶

About half of these defendants have consistently been non-technology companies (e.g., retailers) rather than technology companies (e.g., electronics manufacturers).

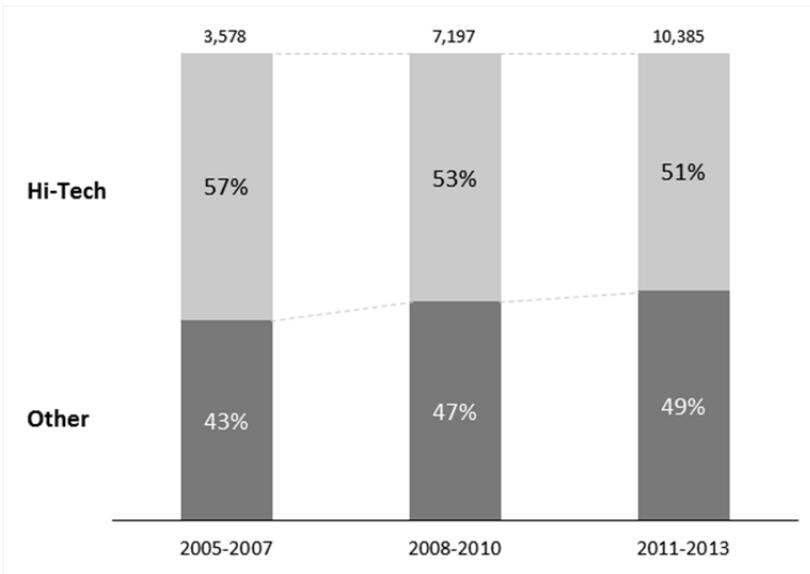


Chart 2: Technology vs. Non-Technology PAE Defendants⁷

6. *Tracking PAE Activity: A Post-Script to the DOJ Review*, RPX CORP, <https://www.rpxcorp.com/2013/01/23/tracking-pae-activity-a-post-script-to-the-doj-review> (last visited Apr. 18, 2015).

7. *The Growing Use of Business Method Patents in NPE Litigation*, PATENTFREEDOM (Sept. 4, 2013), <https://www.patentfreedom.com/about-npes/industry>.

RPX Corporation estimates that PAEs have cost operating companies “\$13 billion per year in legal costs and even more in lost productivity.”⁸ According to a survey conducted by the American Intellectual Property Law Association in 2013, it can cost, on average, about \$500,000 to \$2,800,000 to defend a lawsuit brought by a PAE through the close of discovery.⁹ The range generally depends on the amount of damages at stake, with the low end being less than \$1,000,000 in claimed damages and the high end being greater than \$25,000,000 in claimed damages.¹⁰ For cases to go all the way through trial, the average expense ranges from about \$800,000 to \$4,500,000.¹¹

With the average cost of defense ranging in the millions and the unpredictability of going through trial, the expense and burden of patent litigation makes it an easy choice for most retailers and other non-tech companies to simply pay a PAE’s licensing or settlement demands. The amounts sought by PAEs are typically in the five-figure or low six-figure range—sums that are substantially less than the cost of litigation defense and thus are often referred to as “nuisance value.” Most retailers and non-tech companies targeted by PAEs find it makes more business sense to pay the PAEs than to endure litigation that distracts and diverts resources away from their businesses’ primary objectives, namely, selling products and services.

PAEs can learn who settles quickly and who defends themselves from public litigation records. On average, in this author’s experience, the companies that are known to settle quickly are increasingly targeted and the companies that are known to defend themselves are less often sued, or at least are able to resolve the disputes on more favorable terms. Online retailer Newegg Inc. (Newegg.com),¹² for example, has a well-publicized anti-PAE stance¹³ and has defended itself through trial and on appeal in

8. *Patents Have Become a Significant Operational Risk for Companies. RPX Has the Solution*, RPX CORP., www.rpxcorp.com (last visited Apr. 18, 2015).

9. AM. INTELLECTUAL PROPERTY LAW ASS’N, *AIPLA REPORT OF THE ECONOMIC SURVEY*, (2013), available at <http://www.patentinsurance.com/custdocs/2013aipla%20survey.pdf>.

10. *Id.*

11. *Id.*

12. In full disclosure, as an attorney at The Webb Law Firm, I have represented Newegg in its patent litigation since 2008, including in the cases discussed herein.

13. See, e.g., Lee C. Cheng, Public Comment of Lee C. Cheng, Chief Legal Officer of Newegg Inc., Regarding the FTC and DOJ Investigation of “Patent Assertion Entities” 9 (Dec. 8, 2012), available at <http://www.justice.gov/atr/public/workshops/pae/comments/paew-0004.pdf> (“Patents exist to incentivize innovation and build bridges to new technologies. Trolls stymie such innovation. The United States patent laws should focus on building new bridges, not staffing the old ones with trolls underneath.”); Joe Mullin, *How Newegg Crushed the “Shopping Cart” Patent and Saved Online Retail*,

three patent infringement cases over the past four years.¹⁴ According to PACER records, after Newegg established itself during this period as a defendant that refused to pay quick settlements, the number of PAE lawsuits filed against Newegg dropped precipitously to zero.¹⁵ Most companies cannot afford or justify vigorously defending lawsuits the way Newegg does, and they can get trapped in a cycle of suits and settlements.¹⁶

When the Supreme Court in *eBay, Inc. v. MercExchange, LLC* essentially took injunctive relief off the table for PAEs,¹⁷ it removed

ARSTECHNICA.COM (Jan. 27, 2013), <http://arstechnica.com/tech-policy/2013/01/how-newegg-crushed-the-shopping-cart-patent-and-saved-online-retail> (“We basically took a look at this situation and said, ‘This is bullshit,’ said Cheng in an interview with Ars. ‘We saw that if we paid off this patent holder, we’d have to pay off every patent holder this same amount. This is the first case we took all the way to trial. And now, nobody has to pay Sovereign jack squat for these patents.”). *Id.* (“[Patent trolls] pop up and say, ‘Hello, surprise! Give us your money or we will shut you down!’ Screw them. Seriously, screw them. You can quote me on that.”); *Newegg’s Fight Patent Trolls T-Shirt*, NEWEGG, <http://www.newegg.com/Product/Product.aspx?Item=N82E16800996219> (last visited Apr. 18, 2015) (selling t-shirts reading “Don’t Settle. Settling Feeds Trolls”).

14. *Sovereign Software, L.L.C. v. CDW Corp.*, No. 6:2007-cv-511 (E.D. Tex. Apr. 30, 2010); *Alcatel-Lucent USA, Inc. v. Amazon.com, Inc.*, 6:2009-cv-422 (E.D. Tex.); *TQP Dev., L.L.C. v. Newegg*, No. 2:11-CV-248 (E.D. Tex. Nov. 25, 2013); *Sovereign Software L.L.C. v. Newegg Inc.*, 705 F.3d 1333 (Fed. Cir. 2013); *Alcatel-Lucent USA Inc. v. Overstock.com*, 505 Fed. App’x 957 (Fed. Cir. 2013); *eBay Inc. v. Kelora Sys., L.L.C.*, No. C 10-4947, 2013 U.S. Dist. WL 1402736, at *1–13 (N.D. Cal. Apr. 5, 2013).

15. For example, while Newegg was sued by six different PAEs in 2011 and 2012, PAEs did not sue the company at all in 2013. *See PACER Case Locator*, USCOURTS.GOV, <https://pcl.uscourts.gov/search> (select the “Civil” tab; enter “830 Patent” as “Nature of Suit” and “Newegg” under “Party Name”) (showing 107 search results, of which the following Case numbers are associated with PAE suits: 1:2011-cv-00472 (Gildersleeve); 4:2011-cv-01548 (Kelora); 2:2011-cv-00248 (TQP); 6:2011-cv-00287 (Macrosolve); 5:2011-cv-03306 (SiteUpdate); 6:2011-cv-00399 (SFA); 2-2012-cv-00078 (Stambler); 8:2012-cv-01153 (Digitech); 1:2012-cv-00942 (Data Carriers); 3:2012-cv-02879 (E.Digital); 1:2012-cv-01533 (Pragmatius); 6:2012-cv-00202 (Technological Properties)).

16. Unlike many household-name online retailers, Newegg is not a public company and thus has more leeway to take its principled stance. Public companies are accountable to large numbers of shareholders, which makes it difficult to justify a crusade against PAE lawsuits that could lead to significant short term losses. After all, absent recovery of legal fees, which is rare, it costs millions of dollars to *win* a lawsuit.

17. *eBay, Inc. v. MercExchange, L.L.C.*, 547 U.S. 388, 391, 394 (2006). In *eBay*, the Court held that “the decision whether to grant or deny injunctive relief . . . must be exercised consistent with traditional principles of equity,” which includes consideration of whether the plaintiff “has suffered an irreparable injury” and whether “remedies available at law . . . are inadequate to compensate for that injury.” Post-*eBay*, patentees that do not participate in the market for their own inventions are unlikely to be irreparably harmed by infringement and thus unlikely to obtain permanent injunctions. Justice Kennedy, joined by Justices Stevens, Souter, and Breyer, wrote separately in *eBay* to make the point that injunctions may not be appropriate for entities such as PAEs that “use patents not as a basis for producing and selling goods but, instead, primarily for obtaining licensing fees.” *Id.* at 396–97 (Kennedy, J., concurring). Justice Kennedy was expressing concern about the relatively new “industry” of PAEs that are aggressively enforcing patents, leveraging the possibility of injunctive relief to extort unreasonably high settlement license fees. *Id.*; *see also* *z4 Tech., Inc. v. Microsoft Corp.*, 434 F. Supp.

powerful settlement leverage.¹⁸ But PAEs can still strongly leverage the burden and expense of litigation, as well as the specter of a high damages award, and perhaps do so more post-*eBay* with aggressive litigation techniques and damages theories. These remaining pressure points are related because a larger potential damages recovery tends to expand the scope and cost of the litigation, and thus the incentive to settle.

Professor Colleen Chien has studied, spoken, and written extensively on the phenomenon of PAEs.¹⁹ She correctly observed that a large amount of the PAE phenomenon occurs entirely outside of court in the form of demand letters that only threaten litigation.²⁰ This data is more difficult to track than public court records, but Professor Chien has aggregated some helpful information thus far via surveys and other sources. For example, she shows that fewer than a third of companies threatened with a lawsuit are actually sued, and in some cases the percentage of lawsuits filed in a demand letter campaign is much, much smaller.²¹ Based on her data, “40% of respondents said the demand was based on a technology they were using, not making. Such suits seem hard to justify as anything but nuisance-based.”²²

In or out of court, Professor Chien says that what matters most is the impact PAEs have on businesses, innovation, and the economy.²³ She believes that “there is so much heat on the PAE issue . . . because people

2d 437, 441 (E.D. Tex. 2006) (explaining that monetary damages sufficiently compensated the patent holder based on Justice Kennedy’s concurrence).

18. See, e.g., *Amazon Pays \$40 Million to Settle Patent Dispute*, ZDNET.COM (Aug. 11, 2005), <http://www.zdnet.com/news/amazon-pays-40-million-to-settle-patent-dispute/144171> (explaining that, in August 2005, pre-*eBay*, Amazon paid \$40 million to settle its case with Sovereign Software days before the case was set to begin trial).

19. See, e.g., Colleen V. Chien, *Patent Assertion Entities*, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2187314 (last visited Apr. 18, 2015) (speaking to DOJ and FTC regarding practices of and policy concerns surrounding PAEs); Colleen V. Chien, *Of Trolls, Davids, Goliaths, and Kings: Narratives and Evidence in the Litigation of High-Tech Patents*, 87 N.C. L. REV. 1572, 1577–82 (2009) (describing activities and criticisms of non-practicing entities); Colleen V. Chien, *Startups and Patent Trolls* (Santa Clara U. Legal Studies Research Paper No. 09-12, 2012), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2146251 (explaining the targeting of startups by PAEs, examining related statistics and surveys, and suggesting ways for startups to minimize their attractiveness as targets).

20. Colleen V. Chien, *Patent Trolls by the Numbers*, PATENTLY-O (Mar. 14, 2013), <http://patentlyo.com/patent/2013/03/chien-patent-trolls.html> (“Litigations are only a tiny part of the story.”).

21. *Id.* (“In its RICO complaint against Innovatio, Cisco reported that over 8,000 letters had been sent, even though there were only 26 named defendants, a ratio of 276:1.”).

22. *Id.*

23. *Id.*

who are sued feel they have no ability to anticipate or avoid it.”²⁴ PAE monetization campaigns take an “emotional toll” on the targets involving rage, anger, and stress over the waste of time and money, as well as the strain on personal relationships.²⁵

The topic of PAEs is a divisive one with heated disagreement over how to define PAEs and patent trolls, whether they are good or bad for the patent system, and whether they are good or bad for the economy.²⁶ In any event, all three branches of the federal government see a problem with abusive patent litigation and are taking steps to try to rein in such conduct. Congress has been considering legislation to curb abusive patent litigation for the past few years, with passage of a bill seemingly inevitable.²⁷ The Supreme Court granted *certiorari* on a case concerning the standards for fee shifting and issued an opinion making it considerably easier to obtain an award of attorneys’ fees when prevailing against PAEs.²⁸ President Barack Obama took executive action to promote transparency of patent ownership, improved patent quality, and access to legal information and help for individuals that find themselves on the receiving end of a PAE’s demand or lawsuit.²⁹ Moreover, the Federal Trade Commission recently began the process of a massive investigation into the effects of PAEs on innovation and competition.³⁰

24. *Id.*

25. *Id.*

26. See, e.g., *PatCon 4: The Patent Troll Debate*, PATENTLY-O (Apr. 5, 2014), <http://patentlyo.com/patent/2014/04/patcon-patent-debate.html> (summarizing academic debate over whether hostility to patent troll is justified and whether such views will create bad law).

27. Dennis Crouch, *Patent Reform 2013: Pending Bills*, PATENTLY-O (Oct. 28, 2013), <http://patentlyo.com/patent/2013/10/patent-reform-2013-pending-bills.html>.

28. *Octane Fitness, L.L.C. v. ICON Health & Fitness, Inc.*, 134 S. Ct. 1749, 1756 (2014) (“[A]n ‘exceptional’ case is simply one that stands out from others with respect to the substantive strength of a party’s litigating position (considering both the governing law and the facts of the case) or the unreasonable manner in which the case was litigated.”). Actually recovering those fees is a different matter. Because PAEs are non-practicing entities that are usually just shell companies, there is little reason not to file for bankruptcy upon receiving a monetary judgment against it. See, e.g., *Kelora Systems, L.L.C. v. Target Corp.*, No. 4:11-cv-1548-CW, ECF No. 551 (June 20, 2013) (order vacating appointment of receiver to help prevailing defendants recover costs from *Kelora* in light of bankruptcy filing). Piercing the corporate veil of such shell companies may be required to reach the funds to pay any judgment, which can be an onerous burden of proof. See, e.g., *Taurus IP, L.L.C. v. DaimlerChrysler Corp.*, 726 F.3d 1306, 1337–39 (Fed. Cir. 2013) (affirming district court’s piercing the corporate veil to reach Erich Spangenberg, the notorious owner of many PAEs, including Orion IP and Taurus IP).

29. *Fact Sheet—Executive Actions: Answering the President’s Call to Strengthen Our Patent System and Foster Innovation*, WHITEHOUSE.GOV (Feb. 20, 2014), <http://www.whitehouse.gov/the-press-office/2014/02/20/fact-sheet-executive-actions-answering-president-s-call-strengthen-our-p>.

30. *FTC Seeks to Examine Patent Assertion Entities and Their Impact on Innovation, Competition*, FTC (Sept. 27, 2013), <http://www.ftc.gov/news-events/press-releases/2013/09/ftc-seeks-examine-patent-assertion-entities-their-impact>.

B. Monetary Incentives

The reason PAEs exist is to monetize patents, and the financial incentive to engage in PAE-type monetization is enormous. For example, notorious PAE TQP Development, L.L.C. purchased a patent purportedly covering internet encryption utilizing the ubiquitous SSL protocol and RC4 algorithm for \$750,000, and made \$45 million in litigation settlements in five years.³¹ The patent was asserted against 139 different companies, each paying somewhere between \$25,000 and \$1 million, most in the low- to mid-six-figure range.³² TQP also obtained a verdict of \$2.3 million, as supposed compensatory damages, in the first and only of its cases that has gone to trial.³³

Statistics show that PAEs “win both larger judgments and larger settlements than do ‘practicing entities’—those that practice patents and are not principally in the business of collecting money from others that practice them.”³⁴ According to a recent study by PricewaterhouseCoopers, over the past few years non-practicing entities have obtained, on average, approximately triple the damages awards of practicing entities.³⁵ Simply stated, PAEs are obtaining considerably more money from their patents than those who actually make and sell technology (and thus stand to lose something from infringement).

The rapid growth of such PAE monetization activity appears to be largely fueled by a misapprehension of damages law. The mistaken belief that all patent owners are entitled to substantial damages due to any

31. Joe Mullin, *Newegg on Trial: Mystery Company TQP Rewrites the History of Encryption*, ARSTECHNICA.COM (Nov. 21, 2013), <http://arstechnica.com/tech-policy/2013/11/newegg-on-trial-mystery-company-tqp-re-writes-the-history-of-encryption/>. TQP has sued hundreds of companies for alleged patent infringement for using the SSL protocol and RC4 encryption algorithm for secure HTTPS communications over the web.

32. *Id.*

33. Verdict Form at 3, TQP Dev., LLC v. 1-800-Flowers.com, Inc., No. 2:2011-cv-00248 (E.D. Tex. November 25, 2013), ECF No. 407 (answering \$2.3 million to the question: “What sum of money, if paid now in cash, do you find from a preponderance of the evidence would fairly and reasonably compensate TQP for its damages resulting from Newegg’s infringement of the ’730 Patent?”).

34. Mark A. Lemley & A. Douglas Melamed, *Missing the Forest for the Trolls*, 113 COLUM. L. REV. 2117, 2119–20 (2014).

35. *2014 Patent Litigation Study*, PRICEWATERHOUSECOOPERS (July 2014), at 2–3, available at http://www.pwc.com/en_US/us/forensic-services/publications/assets/2014-patent-litigation-study.pdf (“Our statistics indicate that only 20% of identified decisions in 2013 involved NPE patent holders, reflecting the much higher tendency for NPE-filed cases to settle or be dismissed. However, as further detailed in this year’s study, NPEs’ median damages award in recent years has been triple that of practicing entities.”).

infringement provides the financial incentive that motivates PAEs to acquire and assert patents. After all, without the ability to generate money from one's patents, there is no point to being a PAE.

This Article shows that extracting money from infringers who have caused no actual harm is abusive in that it opportunistically misreads the law to justify claims of absolute substantial monetary entitlement. Thus, if the PAE business model is abusive, such abuse is largely a symptom of the failure of the courts and the bar to correctly read and enforce the damages law. To be sure, PAEs will be most directly affected by the course correction advocated in this Article, but this is fitting since PAEs have most regularly and prominently reached beyond the scope of recoverable damages.

As explained below, the apparently forgotten core principle of patent infringement damages is that the law precludes significant damages recovery where actual harm does not exist. If this were recognized as the correct governing law that it is, PAE cases might still survive Rule 12(b)(6) challenges³⁶ because proof of damages is not an element of a patent infringement claim,³⁷ but the litigations could be quickly concluded with a zero or nominal damages judgment on the pleadings via Rule 12(c).³⁸ At a minimum, summary judgment of no or nominal damages could be readily obtained.

Judge Rader of the Federal Circuit, along with professors Colleen Chien and David Hricik, presented a different but related suggestion for curbing abusive patent litigation by PAEs. In an op-ed in the *New York Times* entitled *Make Patent Trolls Pay in Court*, they expressed the view that the tools exist for judges to award attorneys' fees to prevailing defendants, and encouraged district judges around the country to utilize those tools to financially disincentivize abusive litigation by PAEs.³⁹

36. On the other hand, Judge Gilstrap in the Eastern District of Texas recently dismissed an indirect infringement claim under Rule 12(b)(6) because the damages, if any, were "*de minimis* on their face," due to the fact that infringement "lasted three to six days *at the maximum*." *Babbage Holdings, L.L.C. v. Activision Blizzard*, 2014 WL 2115616, at *1, *2 (E.D. Tex. May 15, 2014). According to Judge Gilstrap, such a case "does not justify or support the use of this Court's limited resources." *Id.* at *2.

37. 35 U.S.C. § 271 (2012).

38. For a Rule 12(c) strategy to work best, a defendant could include as part of its answer a declaratory judgment counterclaim seeking a declaration of no damages or nominal damages. Such a pleading would force the PAE to admit or deny facts showing that it does no business other than license its patents. Fed. R. Civ. P. 8, 12, 13.

39. Randall R. Rader, Collen V. Chien & David Hricik, Op-Ed., *Make Patent Trolls Pay in Court*, N.Y. TIMES (June 4, 2013), <http://www.nytimes.com/2013/06/05/opinion/make-patent-trolls-pay-in-court.html>.

One sign of potential abuse is when a single patent holder sues hundreds or thousands of users of a technology (who know little about the patent) rather than those who make it—or when a patent holder sues a slew of companies with a demand for a quick settlement at a fraction of the cost of defense

Other indications of potential bullying include litigants who assert a patent claim when the rights to it have already been granted through license, or distort a patent claim far beyond its plain meaning and precedent for the apparent purpose of raising the legal costs of the defense.

Judges know the routine all too well, and the law gives them the authority to stop it. We urge them to do so.⁴⁰

This proposal strikes close to the heart of the issue in that it removes some of the monetary incentive to abusively assert patents. Because PAEs do not engage in any business other than patent assertion, there are generally no ways to bring claims against them other than to seek sanctions or fees for litigation misconduct. Especially where a PAE’s counsel is retained on a contingency fee basis, which is common, there is little financial downside to bringing abusive infringement lawsuits designed to coerce nuisance value settlements.

Increasing the ability for defendants to recover fees will certainly make some PAEs think twice before pursuing weak or frivolous cases. However, fees are only available to a “prevailing party,” and prevailing parties typically must spend millions of dollars to prevail on the merits in litigation. Further, even when they do prevail, the recovery of fees is far from guaranteed.⁴¹ Although the U.S. Supreme Court recently made it much easier to obtain attorneys’ fees,⁴² it is a tough sell to convince a defendant to take a case through to judgment with only the potential to recover their fees, and only if they win.

If, however, PAEs were properly deemed not to be entitled to substantial damages, the potential for fee shifting would become a far more serious concern. Pressing a case forward to leverage a higher settlement amount with no reasonable hope of injunctive relief *or* significant damages

40. *Id.*

41. 35 U.S.C. § 285 (2012); *Eon-Net LP v. Flagstar Bancorp*, 653 F.3d 1314, 1323–24 (Fed. Cir. 2011).

42. *Octane Fitness, L.L.C. v. ICON Health & Fitness, Inc.*, 134 S. Ct. 1749, 1756 (2014) (“[A]n ‘exceptional’ case is simply one that stands out from others with respect to the substantive strength of a party’s litigating position (considering both the governing law and the facts of the case) or the unreasonable manner in which the case was litigated.”).

would strongly support an exceptional case finding and fee shifting—further taking away from the incentive to abusively assert patents.⁴³

*C. Problems with Restitutional Theories, Trespass Analogies,
and Strategic Overcompensation*

If the law requires non-harmed patentees like PAEs to be limited to nominal damages, why is this law ostensibly ignored by judges and attorneys? For one, the unfortunate phrasing of the damages statute arguably hinders this type of damages reform at the judicial level. On its face, § 284 of the Patent Act prescribes that all patent owners are entitled to “damages adequate to compensate” for the infringement, “*in no event less than a reasonable royalty.*”⁴⁴ It is assumed (incorrectly, as shown herein) that this language requires all patent owners in all cases where infringement is found to receive at least substantial damages in the form of a reasonable royalty.

Moreover, this language is subject to substantial judicial gloss known as the *Georgia-Pacific* hypothetical negotiation framework seeking to calculate a royalty that would have been reasonable and agreed to by the parties.⁴⁵ PAEs argue in essence that they are entitled to receive the amount

43. A case can be declared exceptional where there has been “misconduct during litigation, vexatious or unjustified litigation, conduct that violates Federal Rule of Civil Procedure 11, or like infractions.” *MarcTec, L.L.C. v. Johnson & Johnson*, 664 F.3d 907, 916 (Fed. Cir. 2012) (quoting *Serious Indus., Inc. v. Plastic Recovery Techs. Corp.*, 459 F.3d 1311, 1321–322 (Fed. Cir. 2006)). Even without misconduct, district courts may award attorney fees under 35 U.S.C. § 285 if the litigation is: (1) brought in subjective bad faith; and (2) objectively baseless. *Old Reliable Wholesale, Inc. v. Cornell Corp.*, 635 F.3d 539, 543–44 (Fed. Cir. 2011) (quoting *Brooks Furniture Mfg., Inc. v. Dutailier Int’l, Inc.*, 393 F.3d 1378, 1381 (Fed. Cir. 2005)); see also *Eon-Net LP*, 653 F.3d at 1324. “Factors such as the failure to conduct an adequate pre-suit investigation, vexatious or unduly burdensome litigation tactics, misconduct in procuring the patent, or an oppressive purpose are factors which can be indicative of bad faith.” *Kilopass Tech., Inc. v. Sidense Corp.*, 738 F.3d 1302, 1311 (Fed. Cir. 2013). While the foregoing situations are still sufficient to render a case exceptional, such proof is no longer necessary under the new relaxed standard for exceptionality of *Octane Fitness*, which held that “an ‘exceptional’ case is simply one that stands out from others with respect to the substantive strength of a party’s litigating position (considering both the governing law and the facts of the case) or the unreasonable manner in which the case was litigated. District courts may determine whether a case is ‘exceptional’ in the case-by-case exercise of their discretion, considering the totality of the circumstances.” *Octane Fitness*, 134 S. Ct. at 1756.

44. 35 U.S.C. § 284 (2012) (emphasis added) (“Upon 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, together with interest and costs as fixed by the court.”(emphasis added)).

45. *Ga.-Pac. Corp. v. U.S. Plywood Corp.*, 318 F. Supp. 1116, 1120 (S.D.N.Y. 1970) (providing a 15-factor test for the evaluation of a reasonable royalty, including the license fees paid by others and the benefits and value of the invention to the infringer).

of a foregone license fee that the infringer avoided paying.⁴⁶ The very first factor to be considered under *Georgia-Pacific* is “[t]he royalties received by the patentee for the licensing of the patent in suit, proving or tending to prove an established royalty.”⁴⁷ While licensing consistency may help set settlement pricing outside the courtroom, in litigation PAEs will distance themselves from their own licensing histories because those licenses are mostly cost-of-defense nuisance value settlements, which means that they are for amounts much smaller than would be worth going through trial to obtain as damages.⁴⁸ Rather than look at what actual negotiations by similarly situated defendants have yielded in license fees, showing an established license fee of sorts, in court PAEs claim credit for the financial success of the defendant to grossly inflate their damages demands.⁴⁹ They say, in effect, that a substantial amount of the defendant’s profits are due to PAE’s patented technology.

As explained in Part IV, these arguments are made by exploiting certain factors in the *Georgia-Pacific* framework that focus on the benefits derived by the infringer from use of the patented technology.⁵⁰ PAEs seek

46. *Wordtech Sys., Inc. v. Integrated Networks Solutions, Inc.*, 609 F.3d 1308, 1319 (Fed. Cir. 2010) (“The hypothetical negotiation ‘attempts to ascertain the royalty upon which the parties would have agreed had they successfully negotiated an agreement just before infringement began’”) (quoting *Lucent Tech., Inc., v. Gateway, Inc.*, 580 F.3d 1301, 1324 (Fed. Cir. 2009)).

47. *Ga.-Pac.*, 318 F. Supp. at 1120.

48. *See, e.g.*, Transcript of Jury Trial at 66, *TQP Dev., L.L.C. v. Newegg*, No. 2:11-CV-00248 (E.D. Tex. Nov. 20, 2013), ECF No. 415 (transcribing TQP’s damages expert opining that of the 90-plus licenses entered into by TQP, “none of those agreements are of the nature that would give us a relevant data point to this hypothetical negotiation . . . because all of those licenses are settlements”); *id.* at 66, 104–05 (opining that Newegg should pay a reasonable royalty of \$5.1 million even though Newegg’s biggest competitor, Amazon.com, paid only \$500,000 for a license to the patent-in-suit); Transcript of Trial at 101–05, *Soverain Software L.L.C. v. CDW Corp.*, 836 F. Supp. 2d 462, No. 6:2007-cv-511, (E.D. Tex. May 13, 2010), ECF No. 392 (quoting Soverain’s expert opining that Newegg should pay \$34 million despite other licenses for lump sum amounts of \$30,000 or less).

49. Settlement licenses have been deemed admissible by the Federal Circuit twice in recent years. *See LaserDynamics, Inc. v. Quanta Computer, Inc.*, 694 F.3d 51, 57–58, 79, 80–81 (Fed. Cir. 2012) (considering settlement licenses as proof of reasonable royalty, and holding that “[a]ctual licenses to the patented technology are highly probative as to what constitutes a reasonable royalty for those patent rights because such actual licenses most clearly reflect the economic value of the patented technology in the marketplace”); *ResQNet.com, Inc. v. Lansa, Inc.*, 594 F.3d 860, 870–72 (Fed. Cir. 2010) (explaining that a settlement license was “the most reliable license in [the] record” compared to other licenses that did not “even mention[] the patents-in-suit or show[] any other discernable link to the claimed technology”). Because the PAEs’ settlement licenses are for nuisance or cost-of-defense amounts, if those licenses established a royalty rate it would greatly diminish the incentive to engage in abusive patent litigation because the potential recovery after trial would, by definition, be much less than the cost to get there.

50. *See, e.g.*, Transcript of Jury Trial at 51, *TQP Dev., L.L.C. v. Newegg*, No. 2:11-CV-248, (E.D. Tex. November 20, 2013), ECF No. 415 (TQP’s damages expert opining and emphasizing that Newegg’s highly successful online retail business makes the patented security functionality “very

infringers' profits because they suffer no actual harm or pecuniary loss that requires payment of the compensatory damages contemplated under § 284. Even outside of litigation, demand letters sent by PAEs frequently offer licensing pricing that is based on the revenues of the target, often in a tiered structure to increase the price depending on the target's sales volume. The fact that these profit-seeking positions are routinely allowed demonstrates that *Georgia-Pacific* supports restitutional theories of damages (e.g., unjust enrichment) are being pursued under the guise of compensatory damages. As discussed below, applying *Georgia-Pacific* in this manner is in clear violation of the Supreme Court's decision in *Aro Manufacturing Co. v. Convertible Top Replacement Co.*, which underscored the compensatory nature of patent infringement damages under § 284.⁵¹

Beyond exploiting *Georgia-Pacific*, PAEs will often harp on an analogy to real property rights and trespass laws to inflate damages claims. Anthony Brown, the founder and CEO of Cascades Ventures, and the man who "has the dubious distinction of being the person for whom the term 'patent troll' was initially coined,"⁵² recently justified his business model as follows:

If you've got a good patent and it has value, it doesn't matter if the patent is owned by Apple or an NPE. When you rent a building, does it matter who the landlord is? Should that matter in terms of the landlord's ability to rent his office building? He's not allowed to rent it if he's not a nice guy? If you take away the licensing rights, it's like saying to an owner of a building, 'OK. You can live in the building, you can sell the building, but you can't rent it.' What's that going to do to the value of your building? Who's going to want to build a building?⁵³

important" to Newegg); *Ga.-Pac.*, 318 F. Supp. at 1120 (allowing consideration of "the benefits to those who have used the invention," and "the value of [the infringer's] use [of the invention]"); *Soverain Software L.L.C.*, No. 6:2007-cv-511, ECF No. 392, at 117–20 (transcribing Soverain's damages expert opining that 25 to 33% of profits from Newegg's online sales is a reasonable royalty for a patented shopping cart functionality).

51. *Aro Mfg. Co. v. Convertible Top Replacement Co.*, 377 U.S. 476, 504–05 (1965).

52. David A. Haas et al., *The Great Patent Troll Debate—2 Perspectives: Part 2*, SRR JOURNAL (Jan. 2014), at 1, 7, <http://www.srr.com/article/great-patent-troll-debate-two-perspectives>. According to Mr. Brown, the term "patent troll" was coined by Intel's patent counsel because "[a]n Intel spokesman had previously called my company a patent extortionist and we sued for defamation." *Id.* at 7.

53. *Id.*

Living rent-free on a landlord's property—essentially, squatting—certainly legally harms a landlord's interests regardless of who the landlord is. Just as every landlord with rental property should be entitled to rent it, every patent owner should be entitled to license its patents. But the issue is about the value of the license, not the right to license it. Mr. Brown's analogy presupposes that the landlord is putting the land to productive use by providing valuable rental space on it. Property owners that do so make the land far more valuable to renters (and to the landlord) than an empty lot, and rental properties that are better-maintained warrant more rent than derelict properties. The harm to a property owner can be greatly divergent depending on what action the owner has taken with respect to the property—a squatter who puts up a tent on a vacant lot causes negligible harm compared to one who refuses to pay rent for a luxury penthouse apartment. Thus, Mr. Brown's argument is a red herring—it is not the *identity* of the owner but the owner's *conduct* with respect to the property that affects the value of the property rights.

Returning to Mr. Brown's analogy, if a patent owner is not putting the patent to productive use (i.e., making and selling products under the patent, or licensing others to do so to bring the patented products to market), the harm caused to that patent owner by another's infringement is far less than that of one who is productively practicing the patent. A patent owner selling products made under its patent or licensing others to do so is actually harmed by another's infringement in a way that a non-practicing patent owner is not—e.g., lost profits, loss of market share, loss of royalties owed, damage to reputation, etc. Infringement of an unused patent, owned by an entity that has no business to make, use, or sell the patented technology even if it wanted to, does not put the patent owner in any worse position than before the infringement occurred. While patents could be licensed in either scenario, the compensation owed to the patent owner under the latter should be much, much less, if anything.

The recent *TQP Development, LLC v. Newegg Inc.* trial in the Eastern District of Texas presented a similar analogy where TQP's counsel used a trespass analogy in the following salient exchange during jury selection:

Mr. Fenster: [I]f someone owns property and someone's trespassing on it, do you think that they have the right to enforce it?

Juror Watkins: Yes, they have a right.

Mr. Fenster: Okay. And do you think that they have the right to collect damages if someone's trespassing or infringing on their land or on their property rights?

Juror Watkins: If they've done something to cause the damage, yes. I mean –

Mr. Fenster: What do you mean by that?

Juror Watkins: Someone next to you in another pasture is doing a logging business, you know, and they're cutting some other tree that they ain't supposed to be cutting, that's your tree, I mean, I understand people—you can't put a price on a tree, but some people just don't want them cut down –

Mr. Fenster: Yeah.

Juror Watkins: —you know. And then you go through them pastures or whatever, tear the pasture up, they use that for cows and they eat, you know, and graze, that farm owner has to fix that pasture. So, yeah, stuff like that.⁵⁴

As this exchange reveals, the PAEs want jurors to believe that there is a harm—a harm that should be paid for—simply because infringement occurred and they own the patent. This analogy is a poor one, however, because real property can be appropriated leaving the owner with less than he or she began—cutting down a tree leaves the owner with one less tree and thus demonstrably harms the owner. This actual harm is plainly the type of harm that Juror Watkins had in mind—when Mr. Fenster asked about trespassing and collecting “damages,” the juror’s mind immediately jumped to notions of actual harm because that is what is intuitively and naturally connoted by the concept of damages. But intellectual property is inexhaustible. As Thomas Jefferson famously wrote, “he who lights his taper at mine, receives light without darkening me Inventions then cannot, in nature, be a subject of property.”⁵⁵ Unlike physical or real property, intellectual property can be shared or duplicated infinitely without depletion. For a PAE, this inexhaustibility makes the trespass analogy especially inapt unless the trespass is a harmless one, where a trespass has occurred but no damage to the property results from the trespass. But that is not the kind of trespass that invokes the idea of damages, and so the PAEs do not bring up this finer point of their trespass analogies.

54. Transcript of Jury Selection at 35:4-36:1, TQP Dev., L.L.C. v. Newegg, No. 2:11-CV-248, (E.D. Tex. Nov. 18, 2013), ECF No. 411.

55. *Graham v. John Deere Co.*, 383 U.S. 1, 9 n.2 (1966) (quoting Letter from Thomas Jefferson to Isaac McPherson (Aug. 13, 1812), in 13 THE WRITINGS OF THOMAS JEFFERSON 334 (Albert Ellery Bergh ed., Definitive ed. 1907)).

In addition to guarding against restitutional damages theories and inapt trespass analogies, courts must be vigilant concerning another abusive “routine” highlighted by Judge Rader and Professors Chien and Hricik—“when a single patent holder sues hundreds or thousands of users of a technology (who know little about the patent) rather than those who make it.”⁵⁶ Along these lines, patent reform advocate and Congressman Jason Chaffetz recently quipped: “When J.C. Penney gets sued for being innovative in technology, we’ve got a problem.”⁵⁷

Professor Gaia Bernstein observed that “end users lack technological sophistication” to defend themselves on the merits of the cases, which “puts them at a significant disadvantage in patent conflicts.”⁵⁸ She further notes that:

End users . . . are surprised to find themselves involved in a patent dispute. In most cases the patented technology is ancillary to their business or may be substituted by other technologies on the market. As one-time players, they not have an incentive for a long-term resolution. Therefore, independent of the merits of the case, most end users will take the least costly option, which is often settlement or withdrawal from use of the technology.⁵⁹

Professor Bernstein concludes that the law should “include end user status as a factor that weighs in favor of fee shifting when an end user is the prevailing party.”⁶⁰

Strategic enforcement that preys on faultless and ignorant end users or purchasers of technology also lends itself to double recovery. This is because enforcing patents against end users of a technology avoids patent exhaustion and implied license effects. If a PAE sued and settled with a software vendor, for example, the vendor’s customers and end users would be immune from suit because the patent rights as to that software was either

56. Rader, Chien & Hricik, *supra* note 39.

57. Joel Stein, *Tolls for Trolls*, TIME MAG., June 9, 2014 (quoting Congressman Chaffetz). Congressman Chaffetz was a co-sponsor of an anti-PAE bill that passed in the House of Representatives “with unusual bipartisan support (325 to 91).” *Id.*

58. Gaia Bernstein, *The Rise of the End User in Patent Litigation*, 55 B.C. L. REV. 1443, 1463–64 (2014), available at <http://ssrn.com/abstract=2440914>.

59. *Id.* at 1466.

60. *Id.* at 1498 (“[T]he incorporation of end user status as a factor that weighs toward fee shifting, whether legislatively or judicially, would be particularly effective in sending a clear signal to end users that pursuing litigation is a legitimate option.”).

exhausted⁶¹ or impliedly licensed.⁶² Thus, when the patented article or functionality is widely dispersed by manufacturers and vendors, PAEs will typically blanketly sue the end users and customers to demand a license from each, rather than seek a single license from the manufacturer that would extinguish all infringement at once.⁶³ Choosing not to engage with the source of the infringement shows the total absence of competitive harm for PAEs, and reveals the opportunism of their strategies. Targeting end users allows infringement to widely and knowingly continue, effectively yielding recovery far above and beyond that which is “adequate to compensate” for the infringement.

* * *

For all of these reasons, a deeper understanding of the history and jurisprudence of patent infringement damages, and as it applies to PAEs in particular, will elucidate how the damages law is supposed to be interpreted. Such a searching inquiry can expose the legal, logical, and policy-based flaws that allow awards of excessive damages and windfalls to entities such as PAEs that are not actually harmed by infringement.

II. THE ORIGIN AND BACKGROUND OF REASONABLE ROYALTY DAMAGES

The modern authority for reasonable royalty damages dates back to the 1946 Patent Act, which permitted patentees to recover from infringers “general damages which shall be due compensation for making, using, or

61. *Quanta Computer, Inc. v. LG Elecs., Inc.*, 553 U.S. 617, 625 (2008) (“The longstanding doctrine of patent exhaustion provides that the initial authorized sale of a patented item terminates all patent rights to that item.”).

62. *Anton/Bauer, Inc. v. PAG, Ltd.*, 329 F.3d 1343, 1350 (Fed. Cir. 2003) (“[A]n implied license stems from the exhaustion of a patent right.”).

63. See, e.g., *PACER Case Locator*, *supra* note 15 (select the “Civil” tab and search for “Pragmatum Telecom” under “Case Title” and “830 Patent” under “Nature of Suit”) (showing 78 lawsuits brought by Pragmatum Telecom around the United States accusing various online retailers of infringing patents allegedly covering live customer service chat over the Internet). In these cases, the software vendors, most likely in response to pressure to indemnify the various customer defendants, brought declaratory judgment actions to minimize their own exposure, proceeded to settle with Pragmatum, and forced Pragmatum to dismiss their customers. See *LogMeIn, Inc. v. Pragmatum Telecom, L.L.C.*, No. 1:2012-cv-01507-RGA (D. Del. May 25, 2013) (showing filing for declaratory judgment); *eGain Corp. v. Pragmatum Telecom, L.L.C.*, No. 13-897-RGA (D. Del. Sept. 9, 2014) (“Plaintiff Pragmatum Telecom, LLC brought suit against multiple Defendants asserting infringement of the patents in suit.”); *LivePerson Inc. v. Pragmatum Telecom, L.L.C.*, No. 1:2012-cv-00147-RGA (D. Del. Mar. 7, 2014) (finding in declaratory judgment); *Moxie Software, Inc. v. Pragmatum Telecom, LLC*, No. 1:13-cv-01993 (D. Del. Dec. 4, 2013) (showing complaint for declaratory judgment filed).

selling the invention, not less than a reasonable royalty.”⁶⁴ Prior to 1946, statutory provisions for patent damages went through various iterations, but the statutes often allowed for recovery of either “damages” or infringers’ “profit.”⁶⁵

This Part will examine the common law genesis of the reasonable royalty concept, the legislative history of its codification, and the plain contemporary meaning of the term. Through a detailed historical analysis, it is shown that: (a) the common law’s concept of reasonable royalties reflected recovery of sums based on the benefits or profits to the infringer; (b) the common law formulation of reasonable royalties was not intended to be encompassed by the statute; and (c) the best reading of the statute is to flexibly deem any fair or sensible royalty reasonable. Each issue will be taken in turn.

A. The Common Law Evolution of Reasonable Royalties

Reasonable royalty damages arose in the common law as a way to award some damages to patentees who could not sufficiently prove their damages or the infringer’s profits, rather than give such patentees only nominal damages upon proof of infringement.⁶⁶ Whether the patentee sought damages or infringers’ profits, the reasonable royalty doctrine relaxed the patentee’s burden of proof and broadened the scope of evidence that could establish a supportable amount of monetary relief. Additionally, either form of relief could be awarded as long as the sum being sought was apportioned to reflect only the amount attributable to the invention.⁶⁷ Prior

64. Act of Aug. 1, 1946, ch. 726, 60 Stat. 778 (codified at 35 U.S.C. § 70 (1946)).

65. See, e.g., Act of Feb. 18, 1922, ch. 58, § 8, 42 Stat. 389, 392 (codified at 35 U.S.C. § 4921 (Supp. 1922)) (providing for recovery of “a reasonable sum as profits or general damages for the infringement”); Act of July 8, 1870, ch. 230, § 55, 16 Stat. 198, 206 (providing that patentees were “entitled to recover, in addition to the profits to be accounted for by the defendant, the damages . . . sustained”).

66. For a very helpful and thorough discussion of the older statutes and the common law development of reasonable royalty damages, see 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).

67. E.g., *Garretson v. Clark*, 111 U.S. 120, 121 (1884).

When a patent is for an improvement, and not for an entirely new machine or contrivance, the patentee must show in what particulars his improvement has added to the usefulness of the machine or contrivance. He must separate its results distinctly from those of the other parts, so that the benefits derived from it may be distinctly seen and appreciated.

Id. (“The patentee . . . must in every case give evidence tending to separate or apportion the defendant’s profits and the patentee’s damages between the patented feature and the unpatented features.”). See

licensing history was especially useful to show a properly apportioned amount. Selected cases are helpful to show these developments over time.

Early cases insisted on strict proof of actual damages showing quantifiable harm to the patentee. In the 1813 *Whittemore v. Cutter* decision, for example, Circuit Justice Story held that the “actual damages” language from the statute was intended to compensate a patentee only for “actual loss,” and explained that actual damages are limited to those “the plaintiffs can actually prove and have in fact sustained, as contradistinguished to mere imaginary or exemplary damages”⁶⁸ Absent sufficient proof of actual loss, Justice Story would limit patentees to nominal damages.⁶⁹ In rejecting the argument that a “making” of a patented product alone “cannot be an offence,” he explained that there is a difference between legal damage and actual damage: “where the law gives an action for a particular act, the doing of that act imports of itself a damage to the party. *Every violation of a right imports some damage, and if none other be proved, the law allows a nominal damage.*”⁷⁰

Similarly in *Seymour v. McCormick* (1854), the Supreme Court emphasized that “[a]ctual damages must be actually proved, and cannot be assumed as a legal inference The question is not what speculatively he may have lost, but what actually he did lose.”⁷¹ In that case, the trial court awarded the patentee relief based on the defendant’s entire profit.⁷² Because the jury verdict was considerably larger than “the usual license price,” and “[b]eyond the refusal to pay the usual license price, the plaintiff showed no actual damage,” the Court discarded what it deemed an “enormous and ruinous verdict.”⁷³ The Court explained that because the patentee’s licenses

Seymour v. McCormick, 57 U.S. 480, 490–91 (1854) (“[P]atentee is entitled to all the profits made in the manufacture of [the patented invention] by those who may have used his improvement without his license. Such a rule of damages would be better entitled to the epithet of ‘speculative,’ ‘imaginary,’ or ‘fanciful,’ than that of ‘actual.’”); *id.* (rejecting jury instruction that “the same rule [of damages] is to govern, whether the patent covers an entire machine or an improvement on a machine”).

68. *Whittemore v. Cutter*, 29 F. Cas. 1123, 1125 (C.C.D. Mass. 1813).

69. *Id.* at 1125 (“If the jury are of opinion, that a making of the machine only is proved, as there is no evidence in the case, to show any actual damages by the making, they ought to give nominal damages to the plaintiffs. For where the law has given a right, and a remedy for the violation of it, such violation of itself imports damage; and in the absence of all other evidence, the law presumes a nominal damage to the party.”).

70. *Whittemore v. Cutter*, 29 F. Cas. 1120, 1121 (C.C.D. Mass. 1813) (emphasis added).

71. *Seymour*, 57 U.S. at 490.

72. *Id.* at 489.

73. *Id.* at 491. More specifically, “[t]he jury gave a verdict for nearly double the amount demanded for the use of three several patents, in a suit where the defendant was charged with violating one only, and that for an improvement of small importance when compared with the whole machine.” *Id.*

“established the market value of his improvement, as separate and distinct from the other machinery with which it is connected, he can have no claim in justice or equity to make the profits of the whole machine the measure of his demand.”⁷⁴ Even though the patentee could not establish the proper profit apportionment “by clear and distinct evidence,” the Court would have allowed for recovery of foregone royalties based on the typical license fee.⁷⁵ Notably, Seymour and McCormick were competitors in the same reaping machine market space,⁷⁶ and the Court did not endorse a blanket entitlement to a pre-set license fee.

The Court in *City of New York v. Ransom* (1860) subsequently reemphasized that “actual damages should be actually proved,” but allowed the jury to “infer” those actual damages based on the advantages or gains received by the defendant such as savings afforded to the defendant by using the invention.⁷⁷ The Court reasoned that:

“[T]he possible advantage or gain made by the use of plaintiffs’ improvement on their machines, is made the measure of his loss. If the plaintiffs, unable to furnish any other data for a calculation, had proved that the defendants had made a certain amount of money by [using the invention], which the plaintiffs would otherwise have made . . . he might with some reason contend that this was a proper measure.”⁷⁸

Absent other proof of actual harm, *Ransom* allowed for recovery of an infringer’s profit as long as the profit was proven to be linked to the infringing feature.⁷⁹

In *Philip v. Nock* (1873), the Court, along the lines of *Seymour*, essentially made existing license fees the benchmark for recovery of actual damages, holding that “[w]here the plaintiff has sought his profit in the

74. *Id.* at 490.

75. *Id.* at 490.

76. *See id.* at 488 (explaining that the plaintiff did not show he “was injured in any way by the competition of the defendants, or hindered from selling all he made or could make” (emphasis added)).

77. *Corp. of New York v. Ransom*, 64 U.S. 487, 490 (1859) (“In order to find out the plaintiffs’ loss or damage, the jury were allowed by the court to *infer* that the defendants have saved all the money indicated by the comparative powers of the engines with and without the improvement; and after having made this inference, they may *presume* that the defendants would have paid this amount to the plaintiff for the use of his improvement.” (emphasis in original)).

78. *Id.* at 490–91.

79. *See id.* at 491 (“[I]f [the patentee] fails to furnish any evidence of the proper data for a calculation of his damage, he should not expect that a jury should work out a result for him by inferences or presumptions founded on such subtle theories.”).

form of a royalty paid by his licensees . . . the amount to be recovered will be regulated by that standard.”⁸⁰ Absent an established license fee, the patentee would be limited to recovering “an amount which will compensate him for the injury to which he has been subjected.”⁸¹ In calculating such actual harm, the Court held that the jury may consider “the profit made by the defendant and that lost by the plaintiff,” but that if the patent covers only an improvement and not an entire product, “recovery must be limited accordingly.”⁸²

In *Dowagiac Manufacturing Co. v. Minnesota Moline Plow Co.* (1915), the patent owner sought recovery of the infringer’s profit but was unable to apportion the profit attributable to the invention from the total profit.⁸³ In reviewing a decision to award only nominal damages, the Court explained that “mathematical exactness . . . is not required but only reasonable approximation” when apportioning the defendant’s profits.⁸⁴ There, the patent owner “neither submitted evidence calculated to effect an apportionment nor attempted to show that one was impossible,”⁸⁵ and so the Court affirmed the nominal damages award.⁸⁶ But it also went further and held that absent an established royalty “it was permissible to show the value by proving what would have been a *reasonable royalty*, considering the nature of the invention, its utility and advantages, and the extent of the use involved.”⁸⁷ This reasonable royalty was a calculation to be made where there was not only no established royalty, but also an “absence of proof of lost sales or injury by competition.”⁸⁸ *Dowagiac* was a milestone decision that marked the acceptance of reasonable royalty damages, at least “where a patent had been kept as a close monopoly, and there was no established royalty”⁸⁹

As can be seen in these selected cases, the increasing evidentiary flexibility of proving damages correlated to a de-emphasis of requiring actual harm to the patentee. The Court progressively considered benefits to

80. *Philip v. Nock*, 84 U.S. 460, 462 (1873).

81. *Id.*

82. *Id.*

83. *Dowagiac Mfg. Co. v. Minn. Moline Plow Co.*, 235 U.S. 641, 646 (1915).

84. *Id.* at 647.

85. *Id.* at 646.

86. *Id.* at 647 (“[W]e think the masters and the courts below were right in holding that the evidence did not present sufficient data to justify an assessment of substantial damages.”).

87. *Id.* at 648 (emphasis added).

88. *Id.* at 649.

89. *Merrell Soule Co. v. Powdered Milk Co. of Am.*, 7 F.2d 297, 299 (2d Cir. 1925).

the infringer and prior license fees obtained as proof of damages before eventually allowing a more abstract “reasonable royalty” to be recovered.

When the Patent Act of 1946 later included an express statutory basis for reasonable royalty damages, it also moved any reference to recovery of profits. Congress’s using the phrase “reasonable royalty” might be read to import the common law consideration of benefits to infringers when assessing such damages. The legislative history does not support such a reading, as is discussed in the following sub-Part.

B. Legislative History of the 1946 Act

As a reaction to the challenges of infringers’ profits recovery, the thrust of the 1946 Act was to eliminate such relief. Congress did not purport to explain how one should determine a reasonable royalty, however. As one court observed, “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.”⁹⁰ Congress did not restrict or impose on the definition of reasonable royalty damages beyond the plain meaning of the text.

Both the House and Senate Reports for the 1946 Act summarized the state of affairs before the Act by sharply criticizing the process of proving damages in the form of profits as an “evil attendant upon ‘the law’s delay.’”⁹¹ The proper accounting of profits was typically litigated before a master, which slowed and complicated the process considerably.⁹² Particularly for the majority of cases where a patent covered “only an improvement in a complex machine, and it [was] impossible to apportion profits due to the improvement,”⁹³ the proceedings, “which [we]re conducted in accordance with highly technical rules and [we]re always

90. *Ga.-Pac. Corp. v. U.S. Plywood Corp.*, 243 F. Supp. 500, 524–25 n.22 (S.D.N.Y. 1965).

91. H.R. REPRESENTATIVE NO. 1587, 79th Cong., 2d Sess., 1 (1946); S. REPRESENTATIVE NO. 79-1503, at 2 (1946).

92. H.R. REPRESENTATIVE NO. 1587, 79th Cong., 2d Sess., 1; S. REPRESENTATIVE NO. 79-1503, at 2.

93. The Supreme Court had long ago recognized that the failure to properly apportion the value of a patented invention to the profits sought to be recovered resulted in an award of nominal damages. *Garretson v. Clark*, 111 U.S. 120, 120–22 (1884) (endorsing the rule of the court below that “[t]he patentee . . . must in every case give evidence tending to separate or apportion the defendant’s profits and the patentee’s damages between the patented feature and the unpatented features, and such evidence must be reliable and tangible, and not conjectural or speculative; or he must show, by equally reliable and satisfactory evidence, that the profits and damages are to be calculated on the whole machine, for the reason that the entire value of the whole machine, as a marketable article, is properly and legally attributable to the patented feature”).

expensive, [we]re often protracted for decades and in many cases result[ed] in a complete failure of justice.”⁹⁴ The 1946 Act’s “mak[ing] the basis of recovery in patent infringement suits general damages . . . not less than a reasonable royalty” was intended to avoid the need to delve into such complex and burdensome proof of recoverable profits.⁹⁵

The House Committee on Patents held hearings on the 1946 Act and received extensive testimony from Conder C. Henry, the Assistant Commissioner of Patents. Mr. Henry, an employee of the Patent Office for thirty-four years and a valued advisor to Congress on various patent issues, began by explaining to the committee the injustice of proving recoverable profits in practice—i.e., an accounting before a master.⁹⁶ In his view, the *status quo* of proving an infringer’s profits was manifestly unjust, and the burden of defending against such relief was used by patentees to oppressively force competitors out of the market without an injunction. Mr. Henry explained:

[H]olding an infringer liable as a wrongful trustee for the patent owner “is not workable or practicable and is used by plaintiffs and their counsel to beat and bludgeon a competitor until he, or it, be exterminated. It is not damages that are sought, but the extermination of a competitor.”⁹⁷

Mr. Henry’s testimony in these respects was clearly very important and persuasive, as much of it was adopted nearly verbatim into the House and Senate committee reports.⁹⁸

In Mr. Henry’s view, the general damages and reasonable royalty provisions would “greatly simplify procedure” in proving damages as compared to the lost profits proceedings before masters.⁹⁹ He explained: “What are damages? Damages in a legal sense means the compensation which the law will award for an injury done. Damages in an infringement

94. S. REPRESENTATIVE NO. 79-1503, at 2.

95. *Id.*

96. *Recovery in Patent Infringement Suits: Hearing on H.R. 5231 Before the H. Committee on Patents*, 79th Cong., 2d Sess. 5–8 (Jan. 29, 1946) [hereinafter *House Hearings*]; see also *id.* at 12 (quoting Edwin B. H. Tower, Jr. explaining the accounting proceedings before a master and outside the court).

97. *Id.* at 7 (quoting Judge Evan A. Evans, U.S. Court of Appeals for the Seventh Circuit, Address Delivered Before the Patent Law Association in Pittsburgh (1944)).

98. Compare H.R. REPRESENTATIVE NO. 1587, at 1 and S. REPRESENTATIVE NO. 79-1503, at 2 with *House Hearings*, *supra* note 96, at 7.

99. *House Hearings*, *supra* note 96, at 10.

suit can be proved by any relevant and competent evidence just as they can be proved in an action of tort.”¹⁰⁰

Here, Mr. Henry not only emphasized the compensatory nature of damages—intended to address “injury” to the patentee—but also compared the framework of damages in patent infringement cases to damages of ordinary tort lawsuits. This included reasonable royalty damages. As John Stedman of the Department of Justice testified, “[i]n essence, the reasonable royalty approach is more consistent with the general doctrine of damages in other cases.”¹⁰¹ This suggests that the new damages statute was intended to reflect the flexibility of the common law of torts¹⁰² to reach a just result on the facts of a case, including awarding no damages without proof of harm.

The 1946 legislative history makes no mention of non-practicing entities or nominal damages, but much was said to suggest that Congress had only contemplated patent infringement lawsuits between competitors at the time. Already noted above were comments about patentees suing to “exterminate” competitors.¹⁰³ Mr. Henry also expressed serious concerns about compulsory licensing and emphasized the importance of injunctive relief in patent infringement cases.¹⁰⁴ In another statement that the Committee Reports later adopted verbatim, he testified that “the relief a patent owner needs against an infringer to protect his right in his patent” is not only damages for past infringement, but “an injunction to prevent future invasion of his right.”¹⁰⁵ In a hypothetical he offered where “a little fellow is manufacturing,” Mr. Henry explained that “[i]f you have compulsory licensing under this reasonable royalty theory he may be ruined as a manufacturer because of his inability to compete with well entrenched industries.”¹⁰⁶ Because the bill “retain[ed] the power of the courts to grant injunctions” and thus did not create a compulsory licensing system in exchange for reasonable royalties, Mr. Henry endorsed the bill and

100. *Id.* at 9. Mr. Henry later clarified that “[t]he author of the bill made the words ‘damages’ and ‘compensation’ almost synonymous—that the damages will be the compensation for infringing the rights inherent in the patent itself.” *Id.* at 11.

101. *Id.* at 20.

102. *See infra* Part V.

103. *Id.* at 7 (quoting Judge Evan A. Evans, U.S. Court of Appeals for the Seventh Circuit, Address Delivered Before the Patent Law Association in Pittsburgh (1944)).

104. Mr. Henry went so far as to “make the suggestion that this committee reject every compulsory license provision regardless of how it is hidden or in whatever disguised form it may be submitted to this committee. It has been rejected by every Congress that has considered the matter for the past 20 years, often after voluminous testimony.” *Id.* at 20.

105. *Id.* at 7.

106. *Id.* at 19.

recommended that it be passed.¹⁰⁷ While this discussion reveals something of what reasonable royalties are not—an end run around the right to exclude—it provides no affirmative explanation of what they are.

Mr. Henry's example of a small manufacturer having trouble competing in the marketplace provides no analogue to PAEs because PAEs are not seeking to compete. The business model of a PAE is to widely and non-exclusively license its patents. Compulsory licenses are what they want, not what they would seek to avoid. Even if *eBay* would permit such relief, there is no competitive advantage to a PAE achieved by obtaining an injunction.

If Congress were to insist that a reasonable royalty be substantial, it would have made sense to comment as such when discussing injunctive relief because Congress knew that, as under *eBay*, “the granting of an injunction is not mandatory” but is an equitable discretionary function.¹⁰⁸ Absent an injunction, a patentee might be left with damages as the only available relief, but despite Congress's serious concern about diminishing patent remedies it never saw fit to limit the plain meaning of reasonable royalties, suggesting that it intended no specific limits and created a clean slate. There is no reason to conclude that Congress's adoption of reasonable royalty damages was intended to preclude an interpretation that nominal or zero damages are reasonable and just compensation in appropriate cases.

To be sure, in general “where Congress uses a common-law term in a statute, we assume the ‘term . . . comes with a common law meaning, absent anything pointing another way,’”¹⁰⁹ and “reasonable royalty” was a term created in the common law.¹¹⁰ However, it would be erroneous to assign the common law meaning to the term here because reasonable royalties in the common law could be based on profits, and Congress's intent was clearly to remove any such relief from the statute. Furthermore, the only discussion in the legislative history of the common law surrounding reasonable royalties provided no explanation or definition of reasonable royalties and barely even mentioned the concept.

107. *Id.* at 9. During floor debates, Representative Lanham later had to reassure Representative Craven that the availability of reasonable royalty damages would not result in “the enforced compulsory licensing of patents.” 92 CONG. REC. 1857 (Mar. 4, 1946).

108. *House Hearings, supra* note 96, at 6, 19 (statement of Assistant Comm’r of Patents Condor C. Henry).

109. *Microsoft Corp. v. i4i Ltd. P’ship*, 131 S. Ct. 2238, 2245 (2011) (quoting *Safeco Ins. Co. of America v. Burr*, 551 U.S. 47, 58 (2007)).

110. As Mr. Henry observed, “the law as it now is authorizes the court to assess general damages[.]” and the Supreme Court in *Dowagiac* already contemplated that “where damages cannot be readily ascertained, a reasonable royalty may be awarded.” *House Hearings, supra* note 96, at 6, 8.

Specifically, in his remarks to Congress Mr. Henry sharply criticized *Westinghouse Electric & Manufacturing Co. v. Wagner Electric & Manufacturing Co.*,¹¹¹ a case decided under the law when profits were recoverable. In that case, Westinghouse was awarded damages of \$1 even though Wagner's profits from the infringement were \$132,000 because Westinghouse "failed to separate the profits attributable to the improvements covered by its patent from the profits attributable to the improvements added by Defendant Wagner."¹¹² The Supreme Court agreed that apportionment must be proven, but held that because the defendant "wrought the confusion" by adding improvements other than the patented one, once the patentee showed any profits attributable to the invention the burden shifted onto the defendant to show the proper apportionment.¹¹³ If the defendant could not carry the burden, all its profits could be recovered by the patentee.¹¹⁴ According to Mr. Henry:

Manifestly, that rule of law is unjust, because today mechanisms and processes are so complex that most patents that we grant are on improvements on something that existed before. . . . No one should be able, in my judgment, to capture the profits made on the manufacture of an entire automobile or locomotive, for example, merely because he patented an improvement on either.¹¹⁵

By contrast, Mr. Henry explained, the Supreme Court in *Dowagiac Manufacturing Co. v. Minnesota Moline Plow Co.*,¹¹⁶ on essentially the same facts as *Westinghouse*, kept the burden of proof on the patentee.¹¹⁷ He mentioned that *Dowagiac* also held "where damages cannot readily be ascertained, a reasonable royalty may be awarded."¹¹⁸

The injustice Mr. Henry sought to remedy was the placement of the burden of apportioning profits on defendants, not the absence of a

111. *Westinghouse Elec. & Mfg. Co. v. Wagner Elec. & Mfg. Co.*, 225 U.S. 604 (1912).

112. *House Hearings*, *supra* note 96, at 7.

113. *Westinghouse*, 225 U.S. at 621–22; *House Hearings*, *supra* note 96, at 8.

114. *House Hearings*, *supra* note 96, at 8 ("The Court says that where the infringement is of an improvement in a somewhat complex device, the burden of proof is on the plaintiff to prove the profits made by the infringer which are attributable to the improvement; but if he could not do it, the burden then shifted to the defendant, and if the defendant could not do it, then the complainant is entitled to all of the profits attributed to the device which was sold.")

115. *Id.* at 8.

116. *Dowagiac Mfg. Co. v. Minn. Moline Plow Co.*, 235 U.S. 641, 646 (1915).

117. *House Hearings*, *supra* note 96, at 8.

118. *Id.*

reasonable royalty form of damages, and so it is hard to say that the reasonable royalty formulation of *Dowagiac* was even of significant importance to his argument to get rid of profits recovery. He mentions reasonable royalties almost entirely in passing when discussing *Westinghouse* and *Dowagiac*.¹¹⁹ As explained above, *Dowagiac*'s reasonable royalty framework could be calculated based on profits to the infringer (e.g., the “utility and advantages” of the invention and the “extent of use”), which is fundamentally inconsistent with the 1946 Act’s language. This again suggests that Congress was not adopting any particular formulation of the reasonable royalty framework, but was merely setting a minimum measure of damages of that form.

C. The Plain Meaning of “Reasonable Royalty”

The first and foremost canon of statutory construction is that a provision of a statute should be construed “in accordance with [its] ordinary meaning.”¹²⁰ Following the example of very recent Supreme Court patent precedent, the ordinary meaning of “reasonable royalty” should be adopted by the courts to merely require that the royalty be fair and sensible. This fresh reading of the statute would do away with artificially restrictive legal constructs (e.g., *Georgia-Pacific*) and expectations (e.g., that a reasonable royalty is always substantial) that have since arisen.

In the recent *Octane Fitness* case, the Supreme Court interpreted what § 285 of the 1952 Patent Act meant when prescribing that attorneys’ fees would be available to prevailing parties in an “exceptional case.”¹²¹ It began by explaining:

In *Brooks Furniture Mfg., Inc. v. Dutilier Int’l, Inc.*, 393 F.3d 1378 (2005), the United States Court of Appeals for the Federal Circuit held that “[a] case may be deemed exceptional” under § 285 only in two limited circumstances: “when there has been some material inappropriate conduct,” or when the litigation

119. *Id.*

120. *Octane Fitness, L.L.C. v. ICON Health & Fitness, Inc.*, 134 S. Ct. 1749, 1756 (2014) (quoting *Sebelius v. Cloer*, 133 S. Ct. 1886, 1893 (2013)); *Microsoft Corp. v. i4i Ltd. P’ship*, 131 S. Ct. 2238, 2245 (2011) (“We begin, of course, with ‘the assumption that the ordinary meaning of the language’ chosen by Congress ‘accurately expresses the legislative purpose.’” (quoting *Engine Mfrs. Ass’n v. S. Coast Air Quality Mgmt. Dist.*, 541 U.S. 246, 252 (2004))).

121. *Octane Fitness*, 134 S. Ct. at 1756.

is both “brought in subjective bad faith” and “objectively baseless.”¹²²

The Court held that “[t]his formulation superimposes an inflexible framework onto statutory text that is inherently flexible.”¹²³ The plain meaning of “exceptional case” was decided using the “ordinary, contemporary, common meaning” of the term, which was “simply one that stands out from others with respect to the substantive strength of a party’s litigating position (considering both the governing law and the facts of the case) or the unreasonable manner in which the case was litigated.”¹²⁴

Likewise, the simple phrase “reasonable royalty” has taken on an unduly restricted meaning under *Georgia-Pacific*, discussed *infra* Part IV, which serves to artificially inflate damages to the point that they are no longer compensatory and no longer reasonable. Applying an *Octane Fitness*-like common sense and plain meaning approach, the following are applicable contemporary definitions (from around the time that the 1946 Patent Act was enacted) to guide how these terms should be interpreted:

- **Reasonable:**¹²⁵ “sensible,” “not absurd,” “not greatly less or more than might be expected,” “inexpensive,” “not extortionate,”¹²⁶ “tolerable,” “fair,” “not excessive”

122. *Id.* at 1752 (quoting *Brooks Furniture*, 393 F.3d at 1381).

123. *Id.* at 1756.

124. *Id.* at 1756.

125. THE POCKET OXFORD DICTIONARY OF CURRENT ENGLISH, OXFORD UNIVERSITY PRESS [hereinafter POCKET OXFORD DICTIONARY] 672 (4th ed., rev. 1960); THE AMERICAN COLLEGE DICTIONARY [hereinafter AMERICAN COLLEGE DICTIONARY] 1009 (1947).

126. This contemporary “not extortionate” definition for “reasonable” is ironic because many people, even President Obama, view abusive patent enforcement conduct by PAEs as little more than legalized extortion. *See, e.g.*, Mike Masnick, *President Obama Admits that Patent Trolls Just Try to ‘Extort’ Money; Reform Needed*, TECHDIRT (February 14, 2013 2:45 PM), <https://www.techdirt.com/articles/20130214/14351821988/president-obama-admits-that-patent-trolls-just-try-to-extort-money-reform-needed.shtml> (quoting President Obama as saying that “[PAEs] don’t actually produce anything themselves. They’re just trying to essentially leverage and hijack somebody else’s idea and see if they can extort some money out of them”); Rich Steeves, *Are ‘Patent Trolls’ Guilty of Racketeering?*, INSIDECOUNSEL (September 19, 2013), <http://www.insidecounsel.com/2013/09/19/are-patent-trolls-guilty-of-extortion-and-racketee> (describing FindTheBest’s extortion-based RICO counterclaim against PAE Lumen View). Even the Federal Circuit has agreed that PAE conduct can be extortionate. *See Eon-Net LP v. Flagstar Bancorp*, 653 F.3d 1314, 1326 (Fed. Cir. 2011) (affirming award of attorneys’ fees where “the district court found that Eon-Net’s case against Flagstar had ‘indicia of extortion’ because it was part of Eon-Net’s history of filing nearly identical patent infringement complaints against a plethora of diverse defendants, where Eon-Net followed each filing with a demand for a quick settlement at a price far lower than the cost to defend the litigation” (citations omitted)).

- Royalty:¹²⁷ “payment to patentee for use of patent,” “a compensation or portion of proceeds paid to the owner of a right, as a patent, for the use of it”

The benchmarks for reasonableness of a royalty under these contemporary definitions are essentially sensibility and fairness. As explained above, these types of benchmarks guided the common law to award nominal damages in patent cases for more than 100 years if the result was sensible or fair—i.e., when no proof of actual harm was offered to support a claim for damages. The same sensibility and fairness is reflected by the common law’s awarding nominal damages for harmless trespasses to real property, which is discussed in Part V.

* * *

Nominal damages are in some circumstances reasonable royalties for infringement. Nothing in the text or legislative history of the 1946 Act requires any contrary result but in fact encourages a flexible fact-based approach to determine what royalty, if any, fairly and sensibly compensates for the infringement.

The language of the 1946 Patent Act was slightly rephrased in the 1952 Patent Act, which allowed patentees to obtain “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.”¹²⁸ This provision has not changed since 1952.¹²⁹

About a decade after the 1952 Patent Act, the Supreme Court explained that the revised statutes’ elimination of profits recovery required a reasonable royalty to constitute “compensation” for “damages” caused by the infringement. In the 1965 landmark *Aro Manufacturing* decision, the Court effectively overruled the *Ransom*, *Nock*, and *Dowagiac* lines of cases, returning the meaning of patent damages to something more aligned with *Whittemore*’s “actual loss” standard.¹³⁰ The next Part discusses the *Aro Manufacturing* case in detail.

127. POCKET OXFORD DICTIONARY, *supra* note 125, at 714; AMERICAN COLLEGE DICTIONARY, *supra* note 125, at 1059.

128. Act of July 19, 1952, ch. 950, § 284, 66 Stat. 792, 813.

129. 35 U.S.C. § 284 (2012).

130. *Whittemore v. Cutter*, 29 F. Cas. 1123, 1125 (C.C.D. Mass. 1813).

III. *ARO MANUFACTURING* AND THE MEANING OF “DAMAGES”

Interpreting § 284 of the 1952 Patent Act, the Supreme Court in *Aro Manufacturing Co. v. Convertible Top Replacement Co.* first explained that while prior to 1946 patent remedies might include recovery of an infringer’s profits, the 1946 Act eliminated such profits as recoverable.¹³¹ In *Aro*, the parties and courts below had all assumed that upon a judgment of infringement, § 284 would allow the “reasonable royalty” to be a royalty on the infringer’s profits.¹³² “It is presumably the language ‘in no event less than a reasonable royalty’ that has led to the assumption,” the Court explained.¹³³ But the Court held that “the statute allows the award of a reasonable royalty, or of any other recovery, only if such amount constitutes ‘damages’ for the infringement.”¹³⁴

First, the Court reasoned that under the plain meaning of the statutory language, “[i]n patent nomenclature what the infringer makes is ‘profits’; what the owner of the patent loses by such infringement is ‘damages,’” and only “damages” are recited in the statute.¹³⁵ Second, “[p]rior to 1946, the statutory precursor of the present § 284 allowed recovery of both amounts,” providing for recovery of “the profits to be accounted for by the defendant, the damages the complainant has sustained thereby.”¹³⁶ In the 1946 Act, however, “the statute was changed to approximately its present form, whereby only ‘damages’ are recoverable.”¹³⁷ According to the Court, “[t]he purpose of the change was precisely to eliminate the recovery of profits as such and allow recovery of damages only.”¹³⁸

The state of affairs before 1946, when recovery of an infringer’s profits was permitted, was such that it was “‘immaterial that the profits made by the defendant would not have been made by the plaintiff.’”¹³⁹ In instances of joint infringement, although a patentee could not obtain double recovery of *damages*, it was still permissible for “‘every infringer of a patent right . . . to give up whatever profits he has derived from the

131. *Aro Mfg. Co. v. Convertible Top Replacement Co.*, 377 U.S. 476, 504–05 (1965).

132. *Id.* at 504 (“[A]ll involved in this litigation have apparently assumed, that a judgment holding Aro liable for contributory infringement will result in recovery of such a royalty on Aro’s sales.”).

133. *Id.*

134. *Id.* at 505–07 (“[T]he present statutory rule is that only ‘damages’ may be recovered.”).

135. *Id.* at 505 (quoting *Duplate Corp. v. Triplex Safety Glass Co.*, 298 U.S. 448, 451 (1936)).

136. *Id.* (quotation marks omitted).

137. *Id.*

138. *Id.*

139. *Id.* at 506 (quoting Anthony William Deller, *WALKER ON PATENTS* § 845 (Deller ed. 1937)).

infringement,” allowing for total recovery far, far greater than actual damages.¹⁴⁰

The *Aro* Court viewed such recovery as conclusively foreclosed by the governing damages-only statute and the Court’s own precedent:

[Damages] have been defined by this Court as “compensation for the pecuniary loss he [the patentee] has suffered from the infringement, without regard to the question whether the defendant has gained or lost by his unlawful acts.” *Coupe v. Royer*, 155 U.S. 565, 582 [(1895)]. They have been said to constitute “the difference between his pecuniary condition after the infringement, and what his condition would have been if the infringement had not occurred.” *Yale Lock Mfg. Co. v. Sargent*, 117 U.S. 536, 552 [(1886)]. The question to be asked in determining damages is “how much had the Patent Holder and Licensee suffered by the infringement. And that question [is] primarily: had the Infringer not infringed, what would Patent Holder-Licensee have made?” *Livesay Window Co. v. Livesay Industries, Inc.*, . . . 251 F.2d [469,] 471 [(5th Cir. 1958)].¹⁴¹

Thus, *Aro* made clear that § 284 strictly allowed for recovery only of “pecuniary loss” to the patentee.

A. Strategic Incidental Infringement Litigation and Overcompensation

The *Aro* case provides a helpful discussion of the problem of overcompensation and how strategic patent enforcement can be used to derive excessive damages. In *Aro*, the patentee was deemed to be overreaching and seeking “damages” that were non-compensatory. Basically, *Aro* was accused of infringement by providing infringing replacement fabric components for convertible tops to Ford Motor Company, which in turn used the infringing components to repair its customers’ convertible tops.¹⁴² The patentee’s predecessor had already licensed Ford and Ford’s customers for their infringement in exchange for \$73,000, but the patentee was now seeking additional damages from *Aro* as a contributory infringer under 35 U.S.C. § 271(c).¹⁴³

140. *Id.* at 506–07 (quoting *Hazeltine Corp. v. Atwater Kent Mfg. Co.*, 34 F.2d 50, 52 (E.D. Pa. 1929)).

141. *Id.* at 507.

142. *Id.* at 485.

143. *Id.* at 494, 508–09.

Because Ford and its customers were already licensed, the Court questioned: “Are there indeed any actual damages that CTR can recover from Aro after receiving \$73,000 from Ford?”¹⁴⁴ The Court answered this question as follows:

*The answer depends on whether [the patentee] suffered any loss by Aro’s infringement—which depends in turn on how much they would have made if Aro had not infringed. But in view of the merely contributory nature of Aro’s infringement, this leads in turn to the question how much CTR and AB would have made if Ford had not infringed; for in that event . . . with respect to the post-agreement Ford car sales—Aro could not have contributorily infringed. If Ford had not infringed, [the patentee] would have made a royalty on Ford’s sales of the patented top-structures The amount that would thus have been received must be compared, however, with the amount that AB in fact received from Ford. [Assuming that \$73,000 is what the patentee] would have received had it licensed Ford in the first place to produce the same number of convertible tops[,] . . . [the patentee] is just as well off now as it would have been if Ford had never infringed the patent. And since if Ford had not infringed, Aro could not have contributorily infringed, it follows that [the patentee] would have made if Aro had not infringed was precisely what they did make by virtue of the Ford agreement. Their pecuniary position was not rendered one cent worse by the total infringement to which Aro contributed, and hence they are not entitled—on the assumption stated above as to the payment by Ford—to anything more than nominal damages from Aro.*¹⁴⁵

In essence, the Court held that if Ford’s payment was adequate compensation for any infringement by Ford, it would necessarily subsume any damages incurred due to Aro’s conduct as well. Any other result giving the patentee additional compensation “would not only disregard the statutory provision for recovery of ‘damages’ only, but would be at war with virtually every policy consideration in this area of the law.”¹⁴⁶ In particular, the Court found that it would be egregious for the patentee to

144. *Id.* at 509.

145. *Id.* at 509–10 (emphasis added and omitted).

146. *Id.* at 510.

achieve [double recovery] by the simple tactic of not licensing or suing the manufacturer in the first place, but rather standing by while the direct infringement occurs, thus allowing contributory infringements to spring up around him, with the result of bringing within the reach of his monopoly unpatented items that would never have been there if the manufacturer had been licensed from the start.¹⁴⁷

Here, the Court is expressing serious concern about patent owners idly allowing direct infringement to occur so that more contributory infringers and thus more damages will arise. Under this logic, the patentee in *Aro* should not be permitted to sit back and let Ford and its customers directly infringe to run up the damages that could potentially accrue as *Aro* and other contributory infringers.

As the Court clarified, “the notion is intolerable that by such delay [patentees] could entitle themselves to collect from *Aro* what they could not have collected had Ford been licensed from the start.”¹⁴⁸ Implicit in this reasoning is a belief that patentees cannot collect more damages than would be appropriate from the source of the infringement, when the infringement is first discovered, if the amount of infringement has increased due to the patentee’s strategic decision to not enforce its patent against the source and allow infringement to continue.¹⁴⁹ Indeed, the Court sharply criticized the patentee’s effort to stretch the contributory infringement doctrine “so as to enforce the patent a second time and obtain a reward that it could not extract from a direct infringer alone,” and emphasized “the rule that full satisfaction received from one tortfeasor prevents further recovery against another.”¹⁵⁰

It would probably go too far to read this portion of *Aro* as precluding the recovery of damages against end users despite the Court’s strong language condemning such conduct. Indeed, the dissent in *Aro* took a harder

147. *Id.*

148. *Id.* at 511.

149. The Court noted that “[t]o achieve such a result through use of the contributory infringement doctrine would be especially ironic, in view of the purpose of that doctrine as set forth in case law and commentary and as presented to the Congress in urging passage of § 271 (c). That purpose is essentially, as was stated in the earlier versions of the bill that became § 271 (c), ‘to provide for the protection of patent rights where enforcement against direct infringers is impracticable,’ H. R. 5988, 80th Cong., 2d Sess.; H. R. 3866, 81st Cong., 1st Sess.” *Id.*

150. *Id.* at 512.

line and contended that fundamental fairness *obligated* patentees to target the source of the infringement to recover damages.¹⁵¹

Justice Black, joined by Chief Justice Douglas and Justice Clark, dissented in *Aro*. He disagreed with the “unjust result” caused by the majority’s decision to remand the case to give the patentee “an opportunity to try to prove, if it can, that it settled with Ford for less than the full amount of its damages.”¹⁵² The reasoning for this disagreement was fully in line with the letter and spirit of the majority opinion, however. Justice Black agreed that “a patentee can get only one recovery for one infringement, no matter how many different persons take part in the infringement.”¹⁵³ He further observed that “[t]here is considerable merit and fairness in the idea that completely releasing from liability one of several persons, all of whom are obligated to another, releases them all.”¹⁵⁴ He elaborated that this result is compelled by the policy rationale behind the contributory infringement doctrine:

This is particularly so in the area of patent law, where the doctrine of contributory infringement is rested on the belief that a direct infringer may sometimes be collection-proof, and that in such a situation the patentee should be given a chance to collect its damages from a more solvent company which knowingly aided the infringement. The original infringement, if there was infringement here, was Ford’s. *Fairness would require that if recovery can be had from the chief wrongdoer, here Ford, the first obligation of the injured person is to try to hold Ford completely responsible.*¹⁵⁵

In other words, where it is economically more efficient to enforce patents against “chief wrongdoer[s]” rather than the incidental infringers, justice requires that patentees do so to extinguish the infringement at the source.

The foregoing discussion focuses on upstream incidental infringers—i.e., the providers of the convertible top components that contributed to Ford’s infringement. The dissent went further and condemned the practice of enforcing patents against downstream incidental infringers, or situations

151. *Id.* at 523–24 (Black, J., dissenting) (“I can think of nothing much more unfair than to visit the infringement sins of a large manufacturer upon the thousands of ultimate purchasers who buy or use its goods.”).

152. *Id.* at 523 (Black, J., dissenting).

153. *Id.* (Black, J., dissenting).

154. *Id.* (Black, J., dissenting).

155. *Id.* at 523–24 (Black, J., dissenting) (emphasis added) (footnote omitted).

“where one company infringes a patent and sells goods which enter into the channels of trade throughout the Nation, thereby subjecting an untold number of innocent dealers, future purchasers, and even repairmen to damages.”¹⁵⁶ In such situations

[t]he statutory right to sue for infringement—involving treble damages, punitive damages, attorney’s fees, etc.—should not be construed in a way that permits unnecessary harassment of people who have bought their goods in the open market place. *I can think of nothing much more unfair than to visit the infringement sins of a large manufacturer upon the thousands of ultimate purchasers who buy or use its goods.*¹⁵⁷

Aro mandated that patent infringement damages law must vigilantly guard against overcompensation that can result from suing customers and end-users of technology instead of the creators and suppliers of the technology. The Federal Circuit has similarly held that obtaining actual damages from end-users where damages have already been paid by suppliers exceeds what is adequate to compensate for infringement.¹⁵⁸ Even if the provider of the technology’s conduct is not already licensed, *Aro* would cabin the scope of damages by looking at what is really necessary to compensate a patentee in light of the patentee’s actions and omissions

For a PAE like Pragmatum Telecom, which sues end-users,¹⁵⁹ under *Aro* the filing of lawsuits and collection of royalties from all end-users while intentionally avoiding the vendors is simply an improper way to enforce one’s patent. In the remarkably strong words of the *Aro* majority, such a litigation strategy “would not only disregard the statutory provision for recovery of ‘damages’ only, but would be at war with virtually every policy consideration in this area of the law.”¹⁶⁰ In any event, all royalties collected must not exceed what is reasonable in light of the total number of users of the technology at issue, on a usage or market share *pro rata* basis,

156. *Id.* at 524 (Black, J., dissenting).

157. *Id.* (Black, J., dissenting) (emphasis added).

158. *Glenayre Elecs., Inc. v. Jackson*, 443 F.3d 851, 864 (Fed. Cir. 2006) (“[A] party is precluded from suing to collect damages for direct infringement by a buyer and user of a product when actual damages covering that very use have already been collected from the maker and seller of that product.”); *Shockley v. Arcan, Inc.*, 248 F.3d 1349, 1364 (Fed. Cir. 2001) (“Each joint tort-feasor is liable for the full amount of damages (up to a full single recovery) suffered by the patentee.”) (citing *Birdsell v. Shaliol*, 112 U.S. 485, 488–89 (1884)).

159. *See supra* note 63 (discussing Pragmatum Telecom, L.L.C. infringement lawsuits and declaratory judgment actions).

160. *Aro*, 377 U.S. at 510.

taking into account existing licenses. For example, if ten users of a technology product were sued and the reasonable royalty value of a license to the vendor would be \$100,000, *Aro* would suggest that the proper measure of damages might be \$10,000 for each end user. This result is reasonable and strictly compensatory under § 284 and *Aro*—any other rule would yield multiple recovery.¹⁶¹

Although *Aro* might not preclude recovery outright against end users when the vendors are known, practically speaking the recovery would be severely limited. Whether the patent is being asserted from the “bottom up” or “top down,” the total aggregate damages would be the same.

* * *

In sum, *Aro* drew a hard line between compensatory damages and recovery of infringers’ profits. The *Aro* Court, including the dissenting Justices, expressed serious concerns about undue or double recovery of “damages” where the patentee’s enforcement strategy would target incidental infringers instead of the parties most directly responsible for the infringement, thereby seeking damages that go far beyond what is appropriate as compensation for the infringement.

The next Part will examine the philosophical implications of *Aro* in terms of how patent infringement damages are to be viewed and will question whether the *Georgia-Pacific* framework for reasonable royalty damages is consistent with *Aro* and § 284.

IV. COMPENSATORY DAMAGES VERSUS RESTITUTION AND THE *GEORGIA-PACIFIC* FALLACY

When the *Aro* Court emphasized the compensatory nature of reasonable royalty damages under § 284, it did more than simply reject the notion of recovering an infringer’s profits. Any plain reading of *Aro* reflects a fundamental philosophy that damages are to be compensatory, not restitutional. Restitution damages are “awarded to a plaintiff when the defendant has been unjustly enriched at the plaintiff’s expense.”¹⁶² An infringer held liable for restitutional damages will be stripped of ill-gotten gains, primarily gauged by the profits earned from the use or sale of the infringing device or functionality. In a restitutional theory of damages the

161. *Id.* at 507, 509–10. Such recovery would also typically be prohibited due to patent exhaustion. *Quanta Computer, Inc. v. LG Elecs., Inc.*, 553 U.S. 617, 625 (2008) (“The longstanding doctrine of patent exhaustion provides that the initial authorized sale of a patented item terminates all patent rights to that item.”).

162. BLACK’S LAW DICTIONARY 396 (7th ed. 1999).

focus is thus on the benefit to the infringer, rather than the harm to the patentee that would justify compensatory damages.

In a situation where a market-participating patentee sues a market competitor for infringement, compensatory and restitutional damages may be one and the same if, for example, the competitor's profits from its sales are lost profits to the patentee. For PAEs, however, there is a wide disparity between the two forms of damages. PAEs suffer no actual harm, whereas arguably the accused infringers benefit greatly from the use of the invention. Whether couched as a reasonable royalty or otherwise, as noted above, the damages sought by PAEs are always, in essence, restitutional.

Post-*Aro*, how can PAEs seek and obtain restitutional damages? Despite being strictly compensatory, reasonable royalty damages under § 284 are determined under a manipulable analytical framework. And the courts just could not seem to let go of the notion that infringers' profits should somehow be paid as damages.

One district court (incidentally, the same court that decided *Georgia-Pacific* discussed below, and involving the same parties) stated shortly after *Aro* that “[t]he size of an infringer's profits is often an influential factor in the determination of the amount of a reasonable royalty.”¹⁶³ Ironically juxtaposed with its extensive discussion and quotation of *Aro* and its emphasis on § 284's compensatory nature, the court decided that “[t]he interpretation which we have placed on § 284 of the 1952 Act ensures that, where relevant, in certain cases, the infringer's *profits* will be an evidentiary element in the factual determination of the patent owner's compensatory *damages*.”¹⁶⁴

In this court's view, profits would not be relevant in the determination of a reasonable royalty unless the patent owner could establish “the foundation fact that he would have made a measurable portion of the infringer's sales, if the infringer had not entered the field.”¹⁶⁵ In other words, if the patent owner can prove that it lost sales to the infringer, the infringer's profits are relevant to the reasonable royalty determination. The court does not explain why damages in the form of lost profits—which are discussed in several places throughout the opinion—would not be the exclusive remedy in such situations. The court even openly acknowledged

163. *Ga.-Pac. Corp. v. U.S. Plywood Corp.*, 243 F. Supp. 500, 529 (S.D.N.Y. 1965). According to the court, “[t]his is another way in which the infringer's profits may function factually as an evidentiary element of the patent owner's damages.” *Id.*

164. *Id.* at 529–30 (emphasis added).

165. *Id.* at 530.

that its construction of § 284 would not eliminate the profits apportionment proceedings that the 1946 Act expressly set out to eliminate.¹⁶⁶

Then came the landmark *Georgia-Pacific* case, which went further and essentially made profits-related considerations part of every reasonable royalty determination, not just “in certain cases” involving lost profits. The reasonable royalty analytical framework of *Georgia-Pacific* includes no fewer than fifteen distinct and “comprehensive” factors to consider, many of which sound in restitution rather than 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].”¹⁶⁷ Damages experts can unduly emphasize these factors to effectively seek restitutional damages under the guise of a reasonable royalty, erasing the hard-line drawn by *Aro*.

As discussed above, typical PAE damages models focus on increased sales and profits made by the defendant due to the invention, distancing the PAEs from their own settlement licensing histories where previous defendants paid far less for a license to the patents. The Federal Circuit has been clear that “[a]ctual licenses to the patented technology are highly probative as to what constitutes a reasonable royalty for those patent rights because such actual licenses most clearly reflect the economic value of the patented technology in the marketplace,”¹⁶⁸ and that settlement licenses can be “the most reliable license[s]” for evaluating a reasonable royalty.¹⁶⁹ Indeed, the very first *Georgia-Pacific* factor is “the royalties received by the patentee for the licensing of the patent in suit, proving or tending to prove an established royalty.”¹⁷⁰ By nevertheless dismissing their cost-of-defense licenses as unreliable and tainted by litigation, the PAEs are able to look to the remaining *Georgia-Pacific* factors to paint a skewed picture that has little to do with compensation and much to do with alleged unjust enrichment.

Because PAEs have no business aside from patent assertion, they shift the fact finder’s focus onto the success of the accused infringer instead of the harm to themselves. Soverain Software, LLC, an infamous PAE whose

166. *Id.* (stating that its interpretation of § 284 would only “effect[] a sharp reduction in the number of proceedings before masters and avoid[] the frequently insoluble problems of apportioning profits” (emphasis added)).

167. *Ga.-Pac.*, 318 F. Supp. at 1120.

168. *LaserDynamics, Inc. v. Quanta Computer, Inc.*, 694 F.3d 51, 79 (Fed. Cir. 2012).

169. *ResQNet.com, Inc. v. Lansa, Inc.*, 594 F.3d 860, 872 (Fed. Cir. 2010).

170. *LaserDynamics*, 694 F.3d at 79 (quoting *Georgia-Pacific*, 318 F. Supp. at 1120).

“shopping cart” patent claims have been widely asserted¹⁷¹ against online retailers, made the following argument to a jury concerning damages in its case against Newegg Inc.:

We tried, over the last four days, to bring to you the evidence to show you that Sovereign deserves the help we’re asking from you now through your verdict, that help to require Newegg to pay a reasonable royalty damages provided by the law for over 56 million transactions during the damages period, 56 million transactions worth of infringement without which Newegg would not be grossing well over \$2 billion per year from its customers.

...
\$34 million. Yeah. That’s real money. That’s a lot of money. And why is it so much? Because this is the engine that their business runs on, and they’re making a lot of money and doing a lot of business; 28 million transactions, totaled 12 million, I believe, last year and a couple of billion dollars.

So the number value here is high, not because we’re trying to steal from people. It’s because of the use they’ve made of the licensed technology.¹⁷²

Sovereign’s arguments here have nothing to do with any harm that has befallen it due to Newegg’s alleged infringement—they have everything to do with attempting to tax Newegg’s success because Sovereign believed its patents contributed to that success. These arguments, to the exclusion of § 284 and *Aro*, sound firmly in restitution. Sovereign got away with this because a few *Georgia-Pacific* factors make facts such as “profitability” and “extent of use” relevant. No patentee should be able to rely on a few cherry-picked *Georgia-Pacific* factors to do an end-run around the undisputedly compensatory nature of patent damages, but that is what PAEs typically do.

Similarly, in the *TQP v. Newegg* trial, TQP’s damages expert testified concerning the “benefits the [patented internet encryption] technology provides” to Newegg and found it important to note that “Newegg is the second largest online-only retailer in the U.S.” with “18 million registered

171. According to PACER records, Sovereign has sued several dozen online retailers since 2004. After prevailing at trial against Newegg, Sovereign’s claims were ultimately invalidated on appeal. *Sovereign Software L.L.C. v. Newegg Inc.*, 705 F.3d 1333, 1347 (Fed. Cir. 2013).

172. Transcript of Trial at 52, 79, *Sovereign Software, L.L.C. v. CDW Corp.*, 836 F. Supp. 2d 462, No. 6:2007-cv-511 (E.D. Tex. May 13, 2010), ECF No. 395.

users.”¹⁷³ He went on to emphasize the extent of Newegg’s alleged use of the patented encryption method as a huge “benefit[] to Newegg,” explaining that a total of 68.2 million sales orders were completed by Newegg during the damages period that allegedly used the infringing encryption method.¹⁷⁴ None of these facts sound in compensation, however. They are restitutional facts plainly intended to show what Newegg gained from allegedly using the invention, not what TQP lost from Newegg’s alleged usage. Because TQP does not make or sell any patented product, emphasizing Newegg’s success and benefits from using encryption could only increase the potential damages a jury would award. Indeed, TQP obtained a \$2.3 million verdict against Newegg as purported compensatory damages.¹⁷⁵

Professor Caprice Roberts recently advocated for restitution and unjust enrichment remedies to be available for patent infringement.¹⁷⁶ According to Professor Roberts, “[m]uch as patent law serves certain societal goals, restitutionary disgorgement serves unique remedial goals.”¹⁷⁷ The offered justification for restitution appears strongest when the patentee has lost the ability to obtain for itself the infringer’s gains—i.e., for market-participating patentees who could have made the infringing sales themselves. As Professor Roberts explains, “[r]estitution prevents the wrongdoer’s unjust enrichment and returns the gains to the party who held the substantive *right to make the income* but was divested of that opportunity by the wrongdoer.”¹⁷⁸ While there is overlap in such relief with ordinary lost profits damages such that recovery of both would constitute double recovery, a restitutional theory would enable the patentee to recover “net profits [that] exceed the damages recoverable for the same violation.”¹⁷⁹ Again, this reasoning presupposes that the patentee is practicing the patent—albeit less profitably than the infringer. Whether restitution is ever appropriate in a patent infringement context, this justification for restitutional damages does not support such relief for PAEs.

173. TQP Dev. L.L.C. v. Newegg, No. 2:11-CV-248 (E.D. Tex. Nov. 20, 2013), ECF No. 415.

174. *Id.* at 59, 64–65.

175. Verdict Form at 3, TQP Dev., LLC v. 1-800-Flowers.com, Inc., No. 2:2011-cv-00248 (E.D. Tex. November 25, 2013), ECF No. 407 (answering \$2.3 million to the question: “What sum of money, if paid now in cash, do you find from a preponderance of the evidence would fairly and reasonably compensate TQP for its damages resulting from Newegg’s infringement of the ‘730 Patent?’”).

176. Caprice L. Roberts, *The Case for Restitution and Unjust Enrichment Remedies in Patent Law*, 14 LEWIS & CLARK L. REV. 653, 656 (2010).

177. *Id.*

178. *Id.* at 678 (emphasis added).

179. *Id.* at 679.

An article by Amanda Frye also advocated for a movement back to restitutional damages for patent infringement, but would scale back such unjust enrichment remedies where patents are asserted abusively or against innocent infringers.¹⁸⁰ The article recognized, as it must, that *Aro* rejected any restitution-based recovery under § 284. Ms. Frye contended that “[g]iven the traditional emphasis in restitution on fairness, a restitution approach could also take into account additional factors in the case where a patentee is using the patent abusively.”¹⁸¹ For PAEs that sue “innocent” infringers lacking culpable intent to infringe, Ms. Frye suggested that the fairness considerations would remove enhanced damages from the equation, and would limit recovery to a reasonable royalty, leaving restitution “off the table.”¹⁸² While Ms. Frye’s proposal purports to limit PAEs’ damages to reasonable royalties instead of potentially larger restitutional amounts, it does not impose a meaningful cap due to the fact that the reasonable royalty analysis of *Georgia-Pacific* still includes restitutional factors.

In 1965, the Supreme Court resolved any doubt that patent infringement damages are supposed to be purely compensatory, and yet the *Georgia-Pacific* framework continues to allow for opportunistic restitutional damages theories to get to the jury. Absent a more extensive overhaul to simplify the meaning of “reasonable royalty,”¹⁸³ at a minimum the restitutional factors in *Georgia-Pacific* should no longer be used because they are irreconcilable with *Aro* and § 284.

To further show why the restitutional *Georgia-Pacific* factors are improper and *Aro* is correct, it is helpful to examine how the common law would treat compensatory damages in tort and trespass actions more generally. The next Part considers patent infringement damages from this perspective.

180. Amanda Frye, “*Inextricably Intertwined*”: *A Restitution Perspective in Patent Remedies*, 26 HARV. J. LAW & TECH. 669, 676 (2013) (“Justice Brennan made it clear that patent damages depended only on the patent owner’s loss, not the infringer’s gain.”). Ms. Frye contends that the legislative history of the 1946 Patent Act suggests that Congress intended to allow for “recovery of profits as an element of general damages,” criticizes Justice Brennan’s reaching the damages issue even though the parties and the courts below did not raise it, and notes that the decision was supported by a bare majority of five justices. *Id.* at 676–77. Ultimately, Ms. Frye’s arguments are grounded primarily in policy rather than existing law, arguing that “[e]ven if the [*Aro*] opinion were legally correct, the no-profits rule does not create the correct economic incentives.” *Id.* at 677.

181. *Id.* at 691.

182. *Id.* at 692.

183. See *supra* Part III.C.

V. COMMON LAW TORT AND TRESPASS DOCTRINES AWARD NOMINAL DAMAGES FOR HARMLESS CONDUCT

Patent infringement is essentially a tort. Indeed, in 1946 Congress viewed the new damages statute as allowing flexible proof of infringement damages “by any relevant and competent evidence *just as they can be proved in an action of tort.*”¹⁸⁴ This Part explores the tort law principles relating to damages to determine how the common law would award compensatory damages for torts involving no actual harm to the plaintiff. As the tort most analogous to patent infringement,¹⁸⁵ trespass law provides perhaps the best guidepost for how to handle compensatory damages where a patentee is not actually harmed by the infringement.¹⁸⁶ As Judge Easterbrook wrote:

184. *House Hearings*, *supra* note 96, at 9 (emphasis added).

185. The Federal Circuit has expressly analogized patent infringement to real property trespass on several occasions. *See, e.g.*, *Commil USA, L.L.C. v. Cisco Sys.*, 720 F.3d 1361, 1374 (Fed. Cir. 2013) (“A trespass can be committed despite the actor’s mistaken belief that she has a legal right to enter the property.” (internal quotation marks and citations omitted)); *Momenta Pharm., Inc. v. Amphastar Pharm., Inc.*, 686 F.3d 1348, 1361–62 (Fed. Cir. 2012) (Rader, J., dissenting) (“Consistent with property principles, an infringer of a valid patent is an unlawful trespasser. The remedy for trespassing, in this area of property law as well as others, is removal of the trespasser.”); *Hoechst-Roussel Pharms. v. Lehman*, 109 F.3d 756, 759 (Fed. Cir. 1997) (“[T]he claims define the patent owner’s property rights whereas infringement is the act of trespassing upon those rights.”); *King Instruments Corp. v. Perego*, 65 F.3d 941, 958 (Fed. Cir. 1995) (“The right to exclude is not ‘injured’ by an infringer, anymore than a landowner’s right to exclude is ‘injured’ by a trespasser. The right to exclude remains enforceable to its fullest. A trespasser can inflict injury only on the property on which the trespass is committed, for example by cutting the trees. Similarly, a patent infringer cannot injure the patent itself, but only property rights protected by the patent, namely, the patentee’s exclusive market for patented goods.”); *see also* Nathaniel C. Love, *Nominal Reasonable Royalties for Patent Infringement*, 75 U. CHI. L. REV. 1749, 1768 n.107 (2008) (“[T]he Federal Circuit refers to the patent examination process as a progression ‘toward defining the metes and bounds of the invention to be patented.’” (quoting *In re Buszard*, 504 F.3d 1364, 1367 (Fed. Cir. 2007))).

186. Some scholars find an intellectual property analogy to real property inapt and the reliance on general tort principles inappropriate when considering patent damages. *See, e.g.*, Mark A. Lemley, *Property, Intellectual Property, and Free Riding*, 83 TEX. L. REV. 1031, 1036 (2005) (arguing that a real property metaphor is improper and misused when considering the economic differences between intellectual and real property); Ted Sichelman, *Purging Patent Law of “Private Law” Remedies*, 92 TEX. L. REV. 518, 554 (2014) (arguing that “tort law principles should be excised from patent law remedies” because “tort law concepts immediately lead to a distinction in the types of remedies that are awarded to manufacturing and nonpracticing entities that is not always economically justified”). As the Federal Circuit has observed, however, patent infringement is in essence a tort, and the Federal Circuit has looked to general principles of tort law for guidance in resolving difficult statutory construction and policy questions. *See Akamai Techs., Inc. v. Limelight Networks, Inc.*, 692 F.3d 1301, 1312–13 (Fed. Cir. 2012) (“The analogy to tort law is particularly telling because for induced infringement under section 271(b) the courts look to the common law principles of joint tortfeasance.”); *id.* at 1312 (“Section 271(b) was enacted to codify that doctrine, which in turn was based on the old common law doctrine of joint tortfeasors.” (quotation marks omitted)). Moreover, in a statute like § 284, Congress is

Patents give a right to exclude, just as the law of trespass does with real property. Intellectual property is intangible, but the right to exclude is no different in principle from General Motors' right to exclude Ford from using its assembly line

Old rhetoric about intellectual property equating to monopoly seemed to have vanished [at the Supreme Court], replaced by a recognition that a right to exclude in intellectual property is no different in principle from the right to exclude in physical property. . . .

Except in the rarest case, we should treat intellectual and physical property identically in the law—which is where the broader currents are taking us¹⁸⁷

At common law, “[d]amages’ means a sum of money awarded to a person injured by the tort of another.”¹⁸⁸ “Injury” means “the invasion of any legally protected interest of another.”¹⁸⁹ “Compensatory damages’ are the damages awarded to a person as compensation, indemnity or restitution for harm sustained by him.”¹⁹⁰ In this context, “the word ‘harm’ denote[s] the existence of loss or detriment in fact of any kind to a person resulting from any cause.”¹⁹¹ One could not receive compensatory damages for “harm to property”—e.g., a “wrongful taking”—unless there was proof of “pecuniary loss.”¹⁹² To summarize, at common law one could receive compensatory damages for a loss or detriment pertaining to the wrongful taking of property only if one could prove pecuniary loss from that wrongful taking. While foregone royalties for patent infringement might qualify as compensatory damages under these broad provisions (which, unlike *Aro*, include restitution as compensatory damages¹⁹³), a deeper

generally presumed to have legislated in light of common law tort liability principles. See *Meyer v. Holley*, 537 U.S. 280, 285 (2003) (citing *Monterey v. Del Monte Dunes at Monterey Ltd.*, 526 U.S. 687, 709 (1999)).

187. Frank H. Easterbrook, *Intellectual Property is Still Property*, 13 HARV. J.L. & PUB. POL’Y 108, 109, 112, 118 (1990).

188. RESTATEMENT (SECOND) OF TORTS, § 902.

189. *Id.* § 7(1).

190. *Id.* § 903.

191. *Id.* § 7(2).

192. *Id.* § 906(a). Comment b to this section provides that “[h]arm to property includes the destruction, physical impairment or wrongful taking of any thing that is the subject of ownership.” Absent proof of pecuniary loss, compensatory damages will only be available for bodily harm or emotional distress-type torts. *Id.* § 905.

193. *Id.* § 903 (“‘Compensatory damages’ are the damages awarded to a person as compensation, indemnity or restitution for harm sustained by him.”).

understanding of common law damages in the specific context of trespass law reveals otherwise.

For the tort of trespass on land, the common law has generally recognized that unintentional or accidental trespasses should not give rise to liability.¹⁹⁴ This is important because patent infringement has no scienter requirement—it is a strict liability tort.¹⁹⁵ Most entities sued by PAEs are not aware of the patents being asserted against them until the lawsuit is filed and would thus be considered unintentional or accidental infringers.

One could argue that those sued by PAEs are reckless, or at least negligent, in not being aware of patents in force that could be asserted against them and taking steps to license or avoid those patents. First, because most targets are not in the business of making the technology for which they are sued, but are end users or resellers of such technology, the “take responsibility” rationale behind such a suggestion quickly breaks down because the targets have no ordinary business interest or incentive in monitoring patents in the technology space. Second, there are approximately two million patents in force,¹⁹⁶ with the number of new patents being issued each year (now more than 250,000) continually increasing.¹⁹⁷ The amount of time and effort to seek out and either license or avoid every patent for every technology implicated in one’s business would constitute an impractical and grueling effort—one that would be exorbitantly expensive and disruptive to businesses, and where the complexity and unpredictability of patent law would make it nearly impossible to steer clear of all infringement.¹⁹⁸ The far more efficient model, which happens to be the predominant business practice in the United States, is to allow those companies who supply the technology to worry

194. *Id.* § 166 (“Except where the actor is engaged in an abnormally dangerous activity, an unintentional and non-negligent entry on land in the possession of another, or causing a thing or third person to enter the land, does not subject the actor to liability to the possessor, even though the entry causes harm to the possessor or to a thing or third person in whose security the possessor has a legally protected interest.”).

195. 35 U.S.C. § 271(a) (2012). While active inducement of infringement and contributory infringement under § 271(b)–(c) include scienter requirements, those go beyond the scope of this Article.

196. Dennis Crouch, *How Many US Patents are In-Force?*, PATENTLY-O (May 4, 2012), <http://patentlyo.com/patent/2012/05/how-many-us-patents-are-in-force.html>.

197. Dennis Crouch, *Patent Grant Numbers*, PATENTLY-O (Apr. 11, 2014), <http://patentlyo.com/patent/2014/04/patent-grant-numbers.html>.

198. For example, changing one’s website to avoid one patent could cause it to infringe three others. Even if one manages to avoid all currently issued patents, thousands of new ones issue every week that would require perpetually updated analysis.

about patent infringement issues and to provide appropriate warranties and indemnities as needed to give assurances to customers.

Nevertheless, at common law even reckless or negligent trespass only gives rise to liability if there is “harm to the land” as a result¹⁹⁹—i.e., “an impairment of the physical condition of the land or an invasion occurring on the land of some other legally protected interest of the possessor, connected with his interest of exclusive possession.”²⁰⁰ Thus, a reckless or negligent trespass is only actionable if the trespasser somehow depletes or impairs the land, or interferes with the owner’s rights stemming from exclusive possession. The former type of harm to the land is not one that can occur in patent infringement because intellectual property is inexhaustible—as Thomas Jefferson said, “he who lights his taper at mine, receives light without darkening me.”²⁰¹

At first glance, the latter type of harm to land is more analogous to patent infringement in that just as a landowner has the right to exclusively possess the land, a patent owner has the right to exclude others from using the patented invention. However, the analogy loses force when one considers that a patent owner has no affirmative right to exclusively possess an invention like a landowner can exclusively possess real property—a patent is purely a “right to exclude others from making, using, offering for sale, or selling the invention throughout the United States.”²⁰² The kinds of rights a landowner has for recourse against an “invasion . . . connected with his exclusive possession” are along the lines of quiet enjoyment, and include “bodily security and freedom from confinement, and in the possession and physical condition of his chattels and the physical condition of the members of his family and the servants belonging to his household.”²⁰³ Patent infringement does not threaten the quality of a patentee’s ability to enjoy or use the patent, at least not in the PAE context where the PAE’s only aim is to widely license the patent across a particular industry. While a patent-practicing patentee might lose some enjoyment of

199. RESTATEMENT (SECOND) OF TORTS, § 165 (“One who recklessly or negligently, or as a result of an abnormally dangerous activity, enters land in the possession of another or causes a thing or third person so to enter is subject to liability to the possessor if, but only if, his presence or the presence of the thing or the third person upon the land causes harm to the land, to the possessor, or to a thing or a third person in whose security the possessor has a legally protected interest.”).

200. *Id.* § 165, cmt. c.

201. *Graham v. John Deere Co.*, 383 U.S. 1, 9 n.2 (1966) (quoting Letter from Thomas Jefferson to Isaac McPherson (Aug. 13, 1812), *in* 13 THE WRITINGS OF THOMAS JEFFERSON 334 (Albert Ellery Bergh, ed., Definitive ed. 1907)).

202. 35 U.S.C. § 154(a)(1) (2012).

203. RESTATEMENT (SECOND) OF TORTS, § 165, cmt. c.

the patent due to an infringing competitor's sales (via lost sales and reputation, for example), a PAE has no such interest in market or license exclusivity. Thus, even under analogous negligent or reckless trespass standards, infringement would not appear to cause any harm to a PAE.

Finally, turning to intentional trespasses, at common law an intentional trespass gave rise to liability “irrespective of whether he thereby causes harm to any legally protected interest.”²⁰⁴ Thus, even an intentional but completely harmless trespass still creates liability for trespass.²⁰⁵ The *extent* of such liability is limited to the actual harm done to the property, however.²⁰⁶ Accordingly, even if infringement were wanton and willful, as established in the preceding paragraph, the analogous harm done to a PAE via infringement is effectively zero.

A harmless trespass, while still an actionable trespass, only entitles the landowner to recover nominal damages.²⁰⁷ As one court explained, upon a trespass “[t]he law implies damage to the owner, and in the absence of proof as to the extent of the injury, he is entitled to recover nominal damages.”²⁰⁸ Similarly, § 284 implies that every patent owner suffers damages from infringement, but that does not require that these damages—i.e., the “reasonable royalty” floor—be something substantial, let alone excessively restitutive. Nominal damages are a reasonable result in cases of trespass where “the owner is not substantially injured,”²⁰⁹ and should be a reasonable result where a patentee likewise suffers no substantial injury. A landowner does not receive a substantial “toll” for right of passage due to a harmless and innocent trespass, just as a PAE should not receive substantial license revenue due to a harmless and innocent infringement.

204. *Id.* § 158.

205. *Id.* § 163.

206. *Id.* § 162 (“A trespass on land subjects the trespasser to liability for physical harm to the possessor of the land at the time of the trespass, or to the land or to his things, or to members of his household or to their things, caused by any act done, activity carried on, or condition created by the trespasser, irrespective of whether his conduct is such as would subject him to liability were he not a trespasser.”).

207. *Id.* § 163, cmt. e (“The fact that the actor knows that his entry is without the consent of the possessor and without any other privilege to do so, while not necessary to make him liable, may affect the amount of damages recoverable against him, by showing such a complete disregard of the possessor’s legally protected interest in the exclusive possession of his land as to justify the imposition of punitive *in addition to nominal damages for even a harmless trespass*, or in addition to compensatory damages for one which is harmful.”) (emphasis added); *see, e.g.*, *Foust v. Kinney*, 80 So. 474, 476 (Ala. 1918) (“[T]hough the plaintiff sustained no actual or appreciable damages, still he was entitled to maintain the action, and have a verdict for nominal damages.” (quoting *Appleton v. Fullerton*, 1 Gray 186, 194 (Mass. 1854))).

208. *Pfeiffer v. Grossman*, 15 Ill. 53, 54 (Ill. 1853).

209. *Id.*

The next Part discusses why prescribing patent infringement damages to be “in no event less than a reasonable royalty” does not require substantial damages in every circumstance, but allows for nominal damages.

VI. NOMINAL DAMAGES ARE CONSISTENT WITH MINIMUM REASONABLE ROYALTY DAMAGES

Renowned patent commentator Don Chisum has expressed 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 [f]or patent owners whose rights have been violated.”²¹⁰ Consistent with this view is that of former Federal Circuit Judge Nies, who once wrote that “[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.”²¹¹ No binding Federal Circuit or Supreme Court decision has ever expressly endorsed an interpretation that a reasonable royalty must always be “substantial,” or more than nominal, however.

Nathaniel Love previously looked into this issue and concluded that while the reasonable royalty statute purports to set a floor for damages, that floor can also be set by a ceiling where there are other damages principles at issue that would limit recovery.²¹² He was specifically interested in analyzing situations involving non-infringing alternatives that were available to the accused infringer at minimal cost. Such alternatives would tend to set a ceiling above which a royalty payment would become unreasonable.²¹³ Mr. Love concluded that, at least “[w]hen noninfringing alternatives are available, zero (or nominal) reasonable royalty awards in

210. 1 Donald S. Chisum, CHISUM ON PATENTS: A TREATISE ON THE LAW OF PATENTABILITY, VALIDITY AND INFRINGEMENT § 20.07[e][iii][A] (Matthew Bender 2014) (1978).

211. *Rite-Hite Corp. v. Kelley Co.*, 56 F.3d 1538, 1574 (Fed. Cir. 1995) (Nies, J., dissenting).

212. Love, *supra* note 183, at 1751.

213. *Id.* at 1751 (“While *Grain Processing* suggests that the presence of noninfringing alternatives provides a damages ceiling, the Federal Circuit has elsewhere indicated that a reasonable royalty serves as a damages floor. . . . [W]hen a noninfringing alternative to a patented invention is available, with a minimal cost difference from the patented invention, does the patent damage statute permit or even require an award of nominal damages based on this minimal cost difference? In other words, what happens when *Grain Processing*’s reasonable-royalty ceiling falls through the Federal Circuit’s reasonable-royalty floor?” (footnote omitted)).

patent infringement suits are supported by the patent statutes and by Federal Circuit jurisprudence.”²¹⁴

Mr. Love argued that windfalls to a patentee should not be viewed as reasonable royalties:

Because the reasonable royalty calculation is conducted only when the patentee is unable to prove any actual injury (foreclosing a lost profits recovery), a transfer from the infringing party (who values the patent at zero) to the patentee can only be characterized as a windfall. The patentee has not been injured, and the infringer has gained no value by infringing since she could have achieved the same end product through noninfringing technology at no additional cost. It is difficult to see how a windfall to the patentee can be characterized as “reasonable.”²¹⁵

While these comments were made assuming that a low-cost noninfringing alternative existed for the accused infringer, the notion that a windfall is not compensatory cannot be seriously disputed. Indeed, Judge Nies even characterized the reasonable royalty provision of § 284 as a “largesse”²¹⁶—i.e., a generous “act of giving away money”²¹⁷ to a patentee—“even though it has not suffered or cannot prove a financial loss.”²¹⁸ But *Aro* squarely held that patent infringement damages are “compensation for pecuniary loss [the patentee] has suffered,”²¹⁹ which can only mean that if a reasonable royalty would be tantamount to a windfall it is not compensable as damages under § 284. *Aro* thus contradicts Judge Nies’s view precluding nominal damages under § 284.²²⁰

214. *Id.* at 1772.

215. *Id.* at 1767–68.

216. *Rite-Hite Corp.*, 56 F.3d at 1574 (Nies, J., dissenting).

217. *Largesse*, MERRIAM-WEBSTER.COM, <http://www.merriam-webster.com/dictionary/largesse> (last visited Apr. 28, 2015).

218. *Rite-Hite Corp.*, 56 F.3d at 1574 (Nies, J., dissenting).

219. *Aro Mfg. Co. v. Convertible Top Replacement Co.*, 377 U.S. 476, 507 (1965) (quoting *Coupe v Royer*, 155 U.S. 565, 582 (1895)).

220. As Nathaniel Love observed, this is certainly true in the context of low-cost noninfringing alternatives. Love, *supra* note 183, at 1768–69 (“The Supreme Court’s pre-*Georgia-Pacific* cases also support the possibility of zero-damage reasonable royalty awards. In *Aro*, the court suggested that damages should be tied to ‘the difference between [a patentee’s] pecuniary condition after the infringement, and what his condition would have been if the infringement had not occurred.’ If low-cost, noninfringing alternatives could have substituted for the infringer’s use of the patented invention, the patentee’s ‘pecuniary condition’ would be the same with or without the infringement.” (quoting *Aro*, 377 U.S. at 507)).

Consistent with Part V above, Mr. Love observed that “[a]wards of zero or nominal damages are entirely unremarkable elsewhere in the law where there is no actual injury”; trademark law, for example, he explained is “entirely unapologetic about the prospect of no recovery” in appropriate circumstances.²²¹ He also provided other examples in contract law, tort law, and trespass to real property where liability exists but only nominal damages are awarded.²²²

Finally, Mr. Love considered the legislative history cited by Judge Nies in support of her suggestion that patent infringement damages must be substantial. Mr. Love explained:

Judge Nies provided a quotation from Congressman Frederick Lanham prior to the revision of the patent statute in support of her argument against nominal damages, but Lanham’s words seem to cut the opposite way: “Of course, in a case of an innocent infringement, it is to be presumed that the court would assess no more than a reasonable royalty for such time as the patent infringed by the innocent user.” While Congressman Lanham’s “no more than a reasonable royalty” language is inverted in the statute as adopted in 1952, in which a patentee is entitled to “no less than a reasonable royalty,” his language supports the notion that reasonable damage awards shrinking to zero might comport with congressional intent.²²³

While Representative Lanham’s “*no more than a reasonable royalty*” comment might suggest that damages could in some circumstances (e.g., innocent infringement) be less than a reasonable royalty, looking at the full context of Representative Lanham’s testimony it is clear that he was not endorsing nominal damages for infringement. Rather, he was contrasting innocent infringement with willful infringement, where enhanced damages were available under the statute.²²⁴ Representative Lanham explained that

221. *Id.* at 1768 (“If the plaintiff in a trademark infringement case has no provable injuries and the infringement did not contribute to the defendant’s profits, the plaintiff recovers nothing.”).

222. *Id.* (citing *Shepard v. State Auto Mut. Ins. Co.*, 463 F.3d 742, 748 (7th Cir. 2006); *McClaran v. Plastic Indus., Inc.*, 97 F.3d 347, 357 (9th Cir. 1996); *Boule v. Hutton*, 328 F.3d 84, 94–95 (2d Cir. 2003); RESTATEMENT (SECOND) OF TORTS § 569, cmt. c (1965); *Id.* § 907; *Id.* § 163, Reporter’s Notes).

223. Love, *supra* note 183, at 1761–62 (citations omitted).

224. Act of Aug. 1, 1946, ch. 726, 60 Stat. 778 (codified at 35 U.S.C. § 70 (1946)) (“The court shall assess said damages, or cause the same to be assessed, under its direction and shall have the same power to increase the assessed damages, in its discretion, as is given to increase the damages found by verdicts in actions in the nature of actions of trespass upon the case.”).

“in the case of an innocent infringer who had infringed without notice and without knowledge that it would be unreasonable to collect from him more than the reasonable royalty . . . [b]ut if there has been a willful infringement, then the damages as set out in the bill can be collected.”²²⁵ Representative Lanham even agreed with Representative Cole that “the effect of this bill is to make a reasonable royalty for infringement the measure of *minimum damages* to any holder of a patent whose patent has been infringed.”²²⁶ The best way to view Representative Lanham’s comments would be to simply reinforce the notion that the floor for damages is a “reasonable royalty.”

Neither the text of the bill nor Representative Lanham purported to qualify or quantify what a reasonable royalty was, as discussed *supra*. In that respect, this author agrees with Mr. Love that “reasonable damage awards shrinking to zero might comport with congressional intent.”²²⁷ The amount that constitutes a reasonable royalty for a PAE might be nominal.

The following Part discusses whether and how foregone royalties can be considered compensatory and shows that, at least for PAEs, they are not and thus cannot be recovered as damages.

VII. FOREGONE ROYALTIES ARE NOT DAMAGES FOR PATENT ASSERTION ENTITIES

Since at least 1854 it has been said that a failure to pay “the price which [the patentee] has put on his license” is a supportable damages amount.²²⁸ This was held in *Seymour v. McCormick* where the patentee and infringer were competitors and the patentee was a market participant.²²⁹ Even the landmark *Dowagiac* case has been characterized as allowing for reasonable royalties only “where a patent had been kept as a close monopoly” and there was no established royalty.²³⁰ Neither situation is applicable for PAEs that do not practice but widely license their patents.

225. 92 CONG. REC. 1857 (Mar 4, 1946) (statement of Representative Lanham).

226. *Id.* (emphasis added). Representative Lanham confirmed: “That is the purpose of the bill as brought out before the committee.” *Id.*

227. Love, *supra* note 183, at 1761–62.

228. *Seymour v. McCormick*, 57 U.S. 480, 489–90 (1854) (reversing damages award that was substantially greater than “the usual license price”). *See id.* at 490 (“Where an inventor finds it profitable to exercise his monopoly by selling licenses to make or use his improvement, he has himself fixed the average of his actual damage, when his invention has been used without his license.”); *see supra* Part III.A (discussing *Seymour*).

229. *Id.* at 488 (explaining that the plaintiff did not show he “was injured in any way by the competition of the defendants, or hindered from selling all he made or could make” (emphasis added)).

230. *Merrell Soule Co. v. Powdered Milk Co. of Am*, 7 F.2d 297, 299 (2d Cir. 1925).

Under *Aro*, a foregone license fee is not compensable for a PAE because it is not a “pecuniary loss” to such an entity.²³¹ A practicing patent owner receiving license payments from some competitors is likely harmed by infringing competitors who have the advantage of not paying royalties and thus have the ability to offer lower prices. Similarly, an indirect market participant engaged in productive licensing or a corporation not using but capable of using a patent at issue could be harmed by non-payment of royalties from infringers.²³² In those situations, a failure to pay foregone license fees may well damage the patent owner. By contrast, a PAE is no worse off due to infringement. Anything more than nominal damages would be unreasonable and would overcompensate the PAE. To the extent cases along the lines of *Seymour* or *Dowagiac* could be read to suggest any absolute entitlement to foregone or established royalties, they are incorrect and/or abrogated by intervening law discussed above.

In the related injunction context of proving irreparable harm, injury to a licensing program is deemed a cognizable injury that might support the entry of an injunction.²³³ One could argue that this similarly supports a finding of harm to a PAE in the form of damages. The notion of harm to a licensing program appears to stem from the Supreme Court’s *eBay* decision, where the Court held that a “willingness to license [] patents” and a “lack of commercial activity in practicing the patents” would not by themselves suffice to show an absence of irreparable harm.²³⁴ The Court explained:

[T]raditional equitable principles do not permit such broad classifications. For example, some patent holders, such as university researchers or self-made inventors, might reasonably prefer to license their patents, rather than undertake efforts to secure the financing necessary to bring their works to market themselves. Such patent holders may be able to satisfy the traditional four-factor test, and we see no basis for categorically denying them the opportunity to do so.²³⁵

231. *Aro Mfg. Co. v. Convertible Top Replacement Co.*, 377 U.S. 476, at 507.

232. *See supra* Part I.

233. *See, e.g., Commonwealth Scientific & Indus. Research Org. v. Buffalo Tech. (USA), Inc.*, 492 F. Supp. 2d 600, 604 (E.D. Tex. 2007) [hereinafter CSIRO] (finding harm to a licensing program sufficient to establish irreparable harm where the patent holder research institution relied heavily on its ability to license to finance its research and development for frontier projects).

234. *eBay v. MercExchange, L.L.C.*, 547 U.S. 388, 393 (2006) (quoting *MercExchange, L.L.C. v. eBay*, 275 F.Supp.2d 695, 712 (E.D. Va. 2003)).

235. *Id.*

Thus, while a licensing program can potentially be harmed by infringement, the examples given by the Court suggest that such harm exists where it springs from a productive licensing program to “bring . . . works to market” rather than a licensing program that merely extracts a tax for already-existing usage of the patented technology, as the PAEs employ.²³⁶ Indeed, at least “in the first three years after *eBay*, no district court, in a published opinion, granted a permanent injunction to a non-practicing entity whose business model consisted solely of acquiring and licensing patents, i.e., the licensing-only patent-holding company.”²³⁷ Thus, from an injunction standpoint as well, a foregone licensing opportunity should not be viewed as harming a PAE.

Other examples of patent owners who are likely unharmed by the non-payment of foregone royalties may include non-practicing entities like individual inventors, educational/research institutions, and corporations owning but not using (and incapable of using) certain patents (*see supra* Part I).²³⁸ Just as with PAEs, applying § 284 to such entities would require proof of actual, demonstrable harm. Finding harm hinges on the patent owner’s conduct in relation to the patent and the market for the patented technology. Each case must be considered on its own facts as to whether harm exists and whether a foregone royalty constitutes reasonable compensation for that harm.

CONCLUSION

There can be no substantial recovery for harmless patent infringement. Where actual harm cannot be shown, § 284, the Supreme Court’s *Aro* decision, and common law tort principles would award only nominal damages because any substantial recovery would be a windfall, not compensatory damages. Nothing in the language of § 284 or the legislative history of the statute requires damages—including reasonable royalty damages—to be substantial.

236. *See id.* at 392–93 (“[T]his Court has consistently rejected invitations to replace traditional equitable considerations with a rule that an injunction automatically follows a determination that a copyright has been infringed.”).

237. Robert J. Matthews, Jr., *Legal Nuances When a Patent Holding Company Seeks to Enforce a U.S. Patent*, 49 IDEA 549, 565 (2009) (“A few district courts have denied permanent injunctions after finding that the patentee failed to show that the refusal of an injunction would irreparably harm the patentee’s licensing program.”). Mr. Matthews further commented that “while theoretically licensing-only patent-holding companies have the right to seek a permanent injunction, the ability of such a company to demonstrate the requisite irreparable harm to obtain an injunction seems remote under the current case law.” *Id.* at 566.

238. *See supra* Part I.

A fresh reading of the statute reveals that Congress did not intend to award patent owners anything more than what is a fair and sensible measure of compensatory damages under the facts of a case. By focusing on proof of actual harm and pecuniary loss, lingering restitutional notions of patent damages can be weeded out, and a more reasonable measure of damages will arise where infringement is harmless.

With respect to PAEs or any other patent owners, the courts and the bar must return to these first principles so that substantial damages are only awarded when the kind of harm exists that requires compensation. PAEs, which lack any productive conduct or business activity with respect to their patents, are no worse off because of another party's infringement, making nominal damages the only royalties that are reasonable for those entities.