Are patent damages really what they seem?

Reviewing a PricewaterhouseCooper report, Quarles & Brady’s Christopher J Fahy examines various issues affecting the increase in the number of patent infringement case filings, as well as the decrease in the median damages award.

A study by PricewaterhouseCoopers (PwC) released in July 2014 reported that the number of patent lawsuits filed in the US jumped 25% in 2013. The rise in the number of patent lawsuits filed is nothing new. Patent litigation has been on the rise for decades. However, what is new is the rate at which the number of patent lawsuits filed has increased over the past few years and the amount of attention this rise as engendered. Although the number of patent litigation cases filed in 2013 is at the highest level ever recorded, the numbers alone do not tell the whole story. The PwC analysis also reported that the median damages award in patent cases is decreasing, but there have been numerous recent historical high damages awards and in certain technology fields, the median damages award is actually increasing.

The many forms of litigation

Patent litigation comes in a number of different forms: ‘traditional’ litigation between competitors practising their patents, such as the recent smartphone litigation between Apple and Google; litigation brought by non-practising entities (NPEs); and cases filed by hybrids - companies that may have practised the asserted patents at one time but are no longer doing so, instead bringing suit to monetise their patent portfolios. With the increase in the number of NPEs and the controversy surrounding the morality associated with a patent system that allows such litigation, patent litigation today is a hot topic and has entered the public’s lexicon.

Non-practising entities

One area given significant attention in the PwC report is NPEs. Over time, NPEs have evolved from the likes of the individual inventor who obtains patents, files lawsuits and collects millions of dollars in settlements and licences. In more recent times, entire companies, sometimes even publicly traded ones, have emerged whose business model is to purchase patents and enforce them without practising the patents themselves.

Much has been written about the debate surrounding the affect NPEs have on the US patent system and whether there is a need for reform. In fact, President Barack Obama specifically referenced NPEs when he announced various legislative recommendations and executive actions less than a year after signing a sweeping patent reform law in September 2012. Indeed, certain provisions of the 2012 America Invents Act were designed to combat the perceived growing NPE problem.

What is clear, is that patent infringement cases filed by NPEs are on the rise. By some accounts, NPEs account for approximately 67% of all patent lawsuits filed in 2013, an increase in almost 40% over the last five years. The question of whether NPEs are driving the increase in patent litigation and in fact whether the increase in patent litigation is outside historical trends, is more complicated and difficult to answer.

America Invents Act anti-joinder provision

For example, the PwC paper acknowledges the role of the so-called ‘anti-joinder’ provision of the America Invents Act (AIA), in the rise of patent lawsuits being filed. The AIA was passed by the US Congress in 2011 and signed into law by President Obama in 2012. Among a number of changes to the prior patent laws, the AIA included an ‘anti-joinder’ provision. This provision limits the number of defendants that can be named in a patent infringement lawsuit by prohibiting the joining of accused infringers in one action as defendants, based solely on allegations that each defendant has infringed the asserted patent or patents. Under the ‘anti-joinder’ provision, one can only join multiple accused infringers as defendants if the right to relief arises out of the same transaction and is based on the same question of fact. One analysis showed that just prior to the enactment of the AIA with its ‘anti-joinder’ provision, lawsuits filed by NPEs had on average five defendants per suit, immediately after, that average dropped to two per suit, since the defendants did not meet the joinder threshold prescribed in the AIA. Accordingly, the ‘anti-joinder’ provision accounts for much of the increase in the number of lawsuits filed since its enactment.

Increase in issued patents

The PwC study also illustrates a striking correlation between the number of patents granted and the increase in patent cases filed. It reports that the number of patents granted by the US Patent and Trademark Office (USPTO) has also grown steadily, increasing at a compound annual growth rate (CAGR) of 5% since 1991. The factors associated with the increase in the number of issued patents are numerous and not addressed in the study, but it does address the correlation between the rise in the number of issued patents and the rise in patent litigation. Specifically, the PwC study states, “[t]he number of cases has increased at an overall CAGR of 8% since 1991.”

However, the PwC study does not delve deeper into these numbers. Notably, the 94% number is merely a correlation that does not
necessarily imply causation. Also, it shows patents granted as compared to litigation, not the amount of applications applied for or the amount of active patents that could form the basis of a lawsuit. Presumably, the lag between a patent application and its issuance as well as expiring patents could affect these numbers. Also, the 94% correlation does not take into account that patent suits can be brought anytime during the lifetime of a patent. Accordingly, it is unclear exactly how much of a role the increase in issued patents has had in the increase in patent litigation cases filed.

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Other factors
There are likely many other factors at least partially responsible for the increase in patent litigation. For example, over the last few years, search engine giant Google purchased Motorola Mobility and its extensive patent portfolio for $12.5bn in August 2011. Apple and Microsoft led a consortium in a purchase of thousands of patents from Nortel Networks, a bankrupt Canadian telecommunications company, for $4.5bn in July 2011, and a bankrupt Eastman Kodak Company sold its digital imaging patents for $527m in February 2013. Some of the increase in litigation, therefore, could be attributed to the increased value and awareness of patent portfolios as companies now see patents as key business assets and their value is at an all-time high.

Decline in damages
Another observation addressed in the PwC report is that the median damages award in patent infringement cases is decreasing.

Money damages in patent cases are awarded to compensate the patent owner upon a finding of infringement.\textsuperscript{16} Money damages in a patent case can be in the form of lost profits, a reasonable royalty, or a combination of both. Because money damages in patent cases can literally reach the billions of dollars, they form an important part of any discussion of patent litigation.

Lost profits are the difference between the profits the patent owner actually made and the profits the patent owner would have made but for the infringement. A royalty is a payment made to the owner of a patent by someone else so that she can make, use, sell or import the invention. A “reasonable royalty” is the amount the patent owner and infringer would have agreed upon had they negotiated a royalty immediately before the infringement began.

The PwC research reports that the annual median damages award has been dropping, specifically, “the annual median damages award between 1995 and 2013 ranged from $2.1m to $16.7m, with an overall median award of $5.5m over the last 19 years (the 2013 figure was $5.9m).”\textsuperscript{17} This overall trend likely reflects the Federal Circuit Court of Appeals adoption of stricter standards for affining damages awards and the resulting change in district courts’ behaviour. The Federal Circuit and the US district courts have increasingly scrutinised the evidence and rationale required to support a proper damages determination in patent infringement cases. For example, a number of recent Federal Circuit cases have constrained parties from using the cost of the entire infringing product to determine damages when only a portion of that product is the subject of the patent at issue.\textsuperscript{18} Moreover, the courts have all but eliminated the use of “rules of thumb” in determining damages.\textsuperscript{19}

Despite this general overall trend, there are numerous instances where the median damages award is actually increasing. The PwC study addresses many of these. For example, despite the downward trend in median damage awards, there have been numerous damage awards exceeding a billion dollars.\textsuperscript{20} There is an increasing disparity between damages awarded in bench and jury trials.\textsuperscript{21} Although bench awards are decreasing, jury awards are increasing. Damages awards in cases brought by NPEs are also increasing as compared to practising entities. Finally, certain industries, for example, the telecommunications industry, had higher median damages awards than others.

Summary
Although the numbers reported in the PwC report and others provide many interesting and even helpful observations, they often do not tell the whole story and can be manipulated for the gain of the proponent of virtually any argument. For example, opponents of NPEs will use the study to decry the explosion in patent litigation and yet, others will show the rate of patent litigation over time belies this assertion. And despite the overall decrease in median damages awards, if you find yourself up against a NPE, in an industry such as the telecommunications industry, or in front of a jury, then your experience may be different. What remains missing from the reporting of patent litigation statistics is a truly reliable illustration of the cost of patent litigation to companies and the overall economic impact, if any, as a result.

Footnotes
3. Id footnote 1, p3.
5. Id footnote1, p2-4.
6. See, Acacia Research Group (ACTG).
7. http://1.usa.gov/1vzmOGH
8. http://wapo.st/1r1hdqv
9. Id footnote 1, p5.
11. Id footnote 1, p5.
12. Id.
14. Id footnote 1, p5.
15. Id.
16. 35 USC Section 284.
17. Id footnote 1, p6.
18. See, LaserDynamics, Inc v Quanta Computer, Inc, 694 F3d 51 (Fed Cir 2012); Uniloc USA, Inc v Microsoft Corporation, 632 F3d 1292 (Fed Cir 2011); ResQnet.com v Lana Inc, 594 F3d 860 (Fed Cir 2010); Lucent Tech, Inc v Gateway, Inc, 580 F3d 1301 (Fed Cir 2009).
19. Id.
20. Id footnote 1, p3.
21. Id.

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