

Infringement Licensing, a Practical Approach

Frank S. Farrell
F.S. Farrell, LLC
7101 York Ave., So.; Suite 305
Edina, MN 55435
Phone: (952) 921-3260
Fax: (952) 216-0106
e-mail frank@fsfarrell.com
Infringement Licensing: A Practical Approach

Infringement licensing is the process of attempting to generate revenue by licensing intellectual property to an organization or individual who is arguably infringing the owner's intellectual property rights. This article is focused on licensing patents, but much of this information is applicable to licensing other forms of intellectual property.

There are many myths about infringement licensing. The most dangerous myth goes something like "Once you have an issued patent, and a plausible infringement argument, licensing revenue will follow". The following is based on the University of Houston Law Center's analysis of reported U.S. patent cases in the year 2002. When issues of validity were litigated, the patent owner had their patents declared invalid in more than 40% of the cases. When issues of infringement were litigated, the patent owner lost in 70% of the cases.

In the author's view there are three cardinal rules in infringement licensing.

Those rules are:

1. Pick your battle ground, don't let the battle ground pick you.
2. Do your homework.
3. Have realistic financial expectations.

Choosing Your Battle Ground

When it was enacted in 1934 the Declaratory Judgment Act created a new remedy. After its enactment this new remedy found almost immediate application in patent disputes. Simply stated, a potential defendant in a patent infringement suit may, under appropriate circumstances, be allowed to take the initiative and file an action requesting a court declare that the patent in question is not being infringed or that the

patent is invalid. This presents obvious problems for the patent holder. A patent holder who finds itself on the wrong end of a declaratory judgment suit will in effect be the defendant and not the plaintiff, and will in all likelihood be required to litigate in a venue that is at best inconvenient.

In addition to the requirement that the Declaratory Judgment Action have a federal question (i.e. the patent dispute), the Declaratory Judgment Act also requires that there be an actual controversy between the Parties 28 U.S.C § 2201. The “actual controversy” language in the Declaratory Judgment Act has been problematic and often litigated over the years. In the case of B.P. Chemicals Ltd. v. Union Carbide Corp. 4 Fed.3d 975, 977, 28 U.S.P.Q 2d 1124-1126 (Fed. Cir. 1993) The Courts stated that “*the purpose of the Act is to enable a person who is reasonably at legal risk because of an unresolved dispute, to obtain judicial resolution of that dispute without having to await the commencement of legal action by the other side. It accommodates the practical situation wherein the interest of one side to the dispute may be served by delay in taking legal action. However, the controversy must be actual, not hypothetical or upon certain prospective occurrence....There must be a definite and concrete dispute between the Parties, appropriate to immediate and definitive determination of their legal rights*”.

Cases where the Courts have found a sufficient charge of infringement to support a Declaratory Judgment Action are numerous. Facts and circumstances which have been held sufficient to sustain a Declaratory Judgment action have included: (1) A history of litigation between the Parties Interdynamics Inc. v. Firma Wolfe, 698 Fed.2d 157, 217 U.S.P.Q. 117 (3rd Cir. 1982); and, (2) Threats or statements to customers Societe Day Conditionnement v. Hunter Engineering, 655 Fed.2d 938, 210 U.S.P.Q. 344, (9th Cir.

1981); and (3) Commencing a Patent Infringement Suit Against a Customer, Joseph Bancroft & Sons v. Spanaize Co. of America, 268 Fed.2d 522, 122 U.S.P.Q. 110, (2nd Cir. 1959); and (4) A General Announcement in a Trade Publication that a Company Owned “1600 patents in a field and had virtual control over the industry and would sue all infringers” A Federal Telephone and Radio v. Associated Tel and Tel., 169 Fed.2d 1012, 78 U.S.P.Q. 1, (3rd Cir. 1948); and (5) an opinion of infringement by Counsel for the patent owner, A Hawley Prod. Co. v. U.S. Trunk Co., 259 Fed.2d 69, 118 U.S.P.Q. 424, (1st Cir. 1958).; and (6) Assertions of infringement made during licensing negotiations, Millipore Corp. v. Universities Patent, Inc., 682 Fed. Supp. 227, 4 U.S.P.Q.2d 1946 (D. Del. 1987); and (6) Suits filed in other countries on analogous foreign patents BASF Corp. vs. PPG Industries, 23 U.S.P.Q.2d 1193 (D. N.J. 1991)

The cases finding an insufficient charge of infringement to sustain the Declaratory Judgment Action are also numerous. Cases that have held the fact pattern insufficient to sustain a Declaratory Judgment action have included: (1) a patent owner telephoning the other Party and requesting of a sample of their product so the patent owner can determine whether there was an infringement American Needle and Novelty Co. v. Shuchuessler Knitting Mills, Inc., 379 Fed.2d, 376, 154 U.S.P.Q. 128 (7th Cir. 1967); and (2) a case where the potential infringer contacted the patent owner submitting product information and requesting a confirmation from the patent owner that the product would not infringe, with the patent owner refusing to provide that information International Harvester Co. v. Deere & Co. 623 Fed.2d, 1207, 206 U.S.P.Q. 722 (7th Cir. 1980); and (3) statements made by a patent owner that the other Party is infringing its patents, when those

statements were made in the course of negotiations involving a possible purchase by the patent owner of the other Party's assets, Solenoid Devices, Inc. v. Led Ex, Inc. 375 Fed.2d 444, 153 U.S.P.Q. 327, (Fed. Cir. 1967); and (4) a case where the patent owner had stated at a business conference that it would maintain its exclusive position by enforcing its patents against other companies developing competing products, refused to license its patent to the other party, which caused the other party's business partner to withdraw financial support for their product development. Cygnus Therapeutic Systems v. Alza Corp., 92 Fed.3d 1153 (Fed. Cir. 1996).

The most helpful case in this area is SRI International, Inc. v. Advanced Technology Laboratories, Inc., 127 Fed.3d 1462, 44 U.S.P.Q.2d 1422 (Fed. Cir. 1997). In that case the Federal Circuit held that the patent owner's letter offering a license was sufficient notice for purposes of the patent marking statute but was insufficient to sustain a Declaratory Judgment action. In that case the Courts stated: "*The criteria for actual notice under §287(a) are not co-extensive with the criteria for filing a Declaratory Judgment Action. These statutory purposes are distinct, served different policy, and are governed by different laws. The requirement of actual notice under §287(a) is designed to ensure that the recipient knew of the adverse patent during the period in which liability accrues, when constructive notice by marking is absent. Actual notice may be achieved without creating a case of actual controversy in terms of 28 U.S.C. §2201 i.e. (The Declaratory Judgment Act).*"

The previously cited case law, although somewhat confusing, does offer clear guidance to anyone attempting to license their patents to potential infringers.

When dealing with potential infringers in cases where litigation has not been commenced, the patent owner should always do the following:

- (1) When you initially contact the potential infringer, always attach complete copies of any patents you think are being infringed.
- (2) Always make a clear offer to license.
- (3) Never directly threaten litigation.
- (4) Only discuss infringement in general terms.
- (5) Never disclose infringement analysis information to the potential licensee.

By providing copies of the patent you are putting the other party on notice without running risk of a declaratory judgment action. Putting them on notice then puts you in a position in the future to argue that any infringement from that point forward was willful. Making a very clear offer to license should enable you to successfully argue that there is not at that point and time actual controversy between the parties, but that you are simply attempting to negotiate a business deal. In fact, in all contacts prior to litigation, I would say nothing more than you had viewed product X and you think that the other party “may” require a license to the XYZ Patent.

Avoid setting deadlines, because that can be viewed as an implied threat. If you need to specify a time frame, “requesting” a response by a specified date is certainly more advisable than “demanding” a response by a specified date.

Avoid the topic of litigation whenever possible. This is not only in any documents you send, but in the course of negotiations with the other side. Avoiding controversial topics can often be difficult especially when dealing with lawyers but I would follow the first rule of sales which is “always circle back to the business deal”.

Do Your Homework

It is always advisable to obtain as much hard information about potential infringement claims, as soon as possible in this process. This will involve at least the following:

- (1) Identify all patents that are being infringed.
- (2) Map all independent claims of the patents identified in step 1.
- (3) Obtain the file histories of the identified patents.
- (4) Attempt to identify validity and prior art problems with the identified patent.
- (5) Attempt to identify chain of title problems.
- (6) If possible, obtain the infringing articles for analysis.

The claim map is your primary infringement analysis tool and those maps should be carefully drafted to ensure that all the required elements of the independent claims are clearly identified.

A file history should be obtained and read carefully, particularly in light of the information contained in the claims map. Particular attention should be paid to information in the file history which resulted in restriction or narrowing the claims in of the patent.

Process patents can be a particularly problematic area. If it at all possible it is best to obtain as much information about the process being practiced by the potential infringer before putting them on notice. Once notice has been given, it will be more difficult to obtain that information.

You should also be aware of the Process Patent Amendments Act of 1988. That Act designates the importation, sale or use of a product made by a patented process as infringing acts under United States Law, even if the manufacturing is done outside of the United States. There are a number of limitations and conditions in the Process Patent

Amendments Acts of 1988. The infringement provisions will not apply to foreign manufacturers who do not themselves import the alleged infringing product into the United States. Liability will only arise under that Act if the importation, sale or use occurs during the process patent's term. Liability will not extend to importation, sale or use prior to the date the U.S. patent actually issued, or before the Process Patent Amendments Act became effective.

Information regarding related foreign patents and patent applications should also be identified and analyzed. Understanding the scope of protection outside of the United States is important information, and can be very helpful in licensing negotiations.

Have Realistic Financial Expectations

It is important for the patent owner to understand what their potential claim for damages would be in litigation in order to make a reasonable and realistic demand in licensing negotiations.

Generally speaking in patent infringement matters, the appropriate measure of compensatory damages will be either: (1) lost profits; or (2) an established royalty; or (3) a reasonable royalty. Which of these three is the appropriate measure of damages will depend largely on the facts and circumstances of any individual case.

For a patent owner to have a legitimate claim for lost profits, the patent owner must establish a factual basis for causation. This means that the patent owner must prove that but for the infringer's improper acts the owner would have: (1) made greater sales; and /or (2) been able to charge higher prices; and/or (3) incurred lower expenses. Causation need only be proved as a reasonable probability and inferences can be drawn

that the patent owner's sales would be equal in quantity to the sales of the infringer if there are very limited number of suppliers for the product in question. Causation will be more difficult to prove when the patent in question only covers an improvement or a small part of the product sold by the infringer.

It should also be noted that the Federal Circuit has established a foreseeability requirement in addition to that of causation. *A Rite-Hite Corp v. Kelley Co., Inc.*, 56 Fed.3d 1538, 35 U.S.P.Q.2d 1065, (Fed. Cir.1995). In that case the court stated: *We believe that...the balance between full compensation, which is the meaning that the Supreme Court has attributed to the statute, and the reasonable limits of liability encompassed by general principles of law can best be viewed in terms of reasonable, objective foreseeability. If a particular injury was or should have been reasonably foreseeable by an infringing competitor in the relevant market, broadly defined, that injury is generally compensable absent a persuasive reason to the contrary. Here, the court determined that Rite-Hite's lost sales of the ADL-100, a product that reasonably competed with the infringing product, were reasonably foreseeable. We agree with that conclusion. Being responsible for lost sales of the competitive product is surely foreseeable; such losses constitute the full compensation set forth by Congress, as interpreted by the Supreme Court, while staying within the traditional meaning of proximate cause. Such lost sales should therefore clearly be compensable.*

Although it may not be realistic in a licensing negotiation to expect that the license fee will be as high as a potential award of lost profits would be in the event of litigation, if the patent owner does have a legitimate claim for lost profits, it does put them in a position to claim a higher license fee than they would otherwise be able to.

Established royalty refers to a measure of damages which is based on the royalty rate paid by prior actual licensees for acts comparable to those engaged in by the infringer. An established royalty rate may only be established based on licenses freely negotiated and paid for, and it generally needs to be a case where there are multiple licensees. Any license fees agreed to under threat of suit, or in settlement of litigation, generally will not be considered to determine an established royalty. The existence of an established royalty will usually set the minimum recovery by the patent owner but it does not necessarily establish the maximum potential recovery by the owner. However, the existence of an established royalty will preclude the patent owner from recovering a greater sum of damages for lost profits, based on the theory that an owner who exploits its patent by nonexclusive licenses with an established rate, cannot then logically complain of lost sales in its capacity as manufacturer seller. The possibility of an established royalty calculation is something all potential licensors should be cognizant of in cases where they are considering granting multiple nonexclusive licenses. In short, what you agree to today can have substantial effect on what you may recover from other licensees in the future.

The most likely royalty calculation you will be required to make for purposes of preparing for licensing negotiations, is to calculate what would be a “reasonable royalty”. A reasonable royalty for use of a patented invention has been defined as the amount which would have been set in hypothetical negotiation between a willing patent owner and a willing potential licensor. In determining this license rate the Courts will consider a variety of factors or categories of evidence.

Factors which will be considered in determining a reasonable royalty are as follows:

1. Royalties received by the patent owner for the licensing of the patent involved from other licensees.
2. Royalty rates paid by the licensee for use of other patents comparable to the patent in question.
3. The nature and scope of the license, exclusive versus non-exclusive, restrictions in terms of territory or restrictions with regard to whom the products may be sold.
4. The patent owner's policy with regard to using the patent to maintain a monopoly by not licensing to other third parties or the granting of limited or specialized license to design to preserve that monopoly.
5. The commercial relationship between the patent owner and the licensee within the same line of business.
6. The effects of selling the patented products have in promoting the sales of other products sold by the licensee.
7. The duration of the patent and the term of the license.
8. How the profitability of the patented product including its commercial success in popularity.
9. The commercial advantages obtained by practicing the patented invention over the prior art.
10. The benefits to those who have used the invention.
11. The extent to which the infringer has made use of the invention and the value of that use.
12. The portion of the profit or the selling price of the patented product that may be customary in that particular business to allow for the use of the invention or similar inventions.
13. The portion of the profit that should be credited to the invention as opposed to non-patented elements of the product.
14. The opinion testimony of qualified experts.

15. The amount that the patent owner and the infringer would have agreed upon if both had been reasonably and voluntarily trying to reach an agreement.-----
In other words, what would a prudent licensee be willing to pay as a royalty to enable it to still make a reasonable profit and been acceptable by a prudent patent owner willing to grant such a license.

Conclusion

If litigation becomes necessary, the patent owner should do what it can to ensure that litigation takes place in a venue and with Defendants selected by the Owner. The patent owner should analyze infringement, validity and enforceability issues as early in the licensing process as possible. Finally the patent owner should have a good understanding of what its likely measure of compensatory damages would be in the event of infringement litigation when it enters into negotiations.