FEDERAL TRADE COMMISSION

THE EVOLVING IP MARKETPLACE

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the Berkeley Center for Law & Technology,
and the Berkeley Competition Policy Center

Held at the
The Haas School of Business, Cheit Hall
University of California, Berkeley
2220 Piedmont Avenue, Wells Fargo Room
Berkeley, California 94720

FEDERAL TRADE COMMISSION

I N D E X

P R O C E E D I N G S

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MS. MICHEL: If you'll take your seats we'll get started.

All right. Thank you. We are going to start the last panel of the last day of this series of hearings for the FTC's Project on the Evolving IP Marketplace. We'll be talking about remedies, including damages and reasonable-royalty calculations, so we're hoping to go out with a bang. I think this will be an interesting panel. We have a lot of ground to cover.

So, my name is Suzanne Michel, I'm Assistant Director for Policy at the FTC, and I will turn it over to Bill to introduce our panelists.

MR. ADKINSON: Hi. My name is Bill Adkinson. I'm an attorney in the Office of Policy in the Office of General Counsel at the FTC.

This panel is going to discuss damage awards, the current standards governing patent damages, and their impact on patent value and innovation. We'll look at damage calculations and the evidence used in calculating damages, particularly in the context of reasonable-royalty determinations. We'll also look at permanent injunctions after the *eBay* case and the doctrine of willful infringement.

We've got a really great panel for today's last

panel, and I tried to figure out a way to do them justice and keep this short enough, and failed. So I'm just going to give you a name, rank, and serial number.

Yar Chaikovsky is a partner at Sonnenschein Nath and Rosenthal;

Mary Doyle is a Senior Vice President and General Counsel at Palm;

Rich Gilbert is Professor of Economics here at Berkeley;

Mark Lemley is William H. Neukom Professor of Law at Stanford Law School;

Vince O'Brien is Managing Partner at OSKR, here in the Berkeley area;

Bill Rooklidge is a partner at Howrey;

John Schlicher is an attorney in Lafayette, California;

And Marty Simpson is Managing Counsel, Business and Land Use, Office of General Counsel, at the University of California.

MS. MICHEL: All right. I'd like to start out with a broad general question that would give the panelists to give a little background on their perspective on these issues by asking you: Why is it important that we get the legal rules governing damages right. Why were you -- and this probably goes to also: Why does it matter? Why were you willing to take time out of your busy schedules and come here today?

If panelists would like to respond throughout the day, you can turn up your table tents, and we'll call on you, and we'll move our way around the table.

Rich.

DR. GILBERT: Well, Suzanne, it's really not an easy question because you have to ask what is -- what's right first and then you have to ask, well, do we want to get it right.

In terms of what's right, ideally or at least theoretically you would like to choose a reward that provides incentives for the right amount of investment in research and development. So you would like to align the rewards to call forth the right amount of R and D. That could imply more than the incremental value of the patent or less than the incremental value of the patent. And it depends on the opportunities and technology for research and development, so it's likely to differ from industry to industry.

So getting patent rewards exactly right is very complicated, very industry-specific. I'm not sure it's really the objective that we want to shoot for in patent policy.

And other issue which is -- well, a couple of issues of course is that reward to one innovation can be a cost to a second innovation, to the extent that innovations build on each other.

And another issue that we don't think about much

but I think we should think about is how do rewards affect incentives for conduct that we might think is pro competitive, like licensing and like forming and holding together patent pools, which can be very much affected by the type of rewards to individual patent suits.

MS. MICHEL: Thank you.

Mary.

MS. DOYLE: My perspective is very much born, Suzanne, of the work that I do as a general counsel at Palm. And so I am focused more on what's wrong than what's right. And I think these statistics might illustrate best my experience and what I likely think about the subject of damages in patent cases.

Currently Palm has 17 cases pending against it and all but two of those cases have been brought by nonpracticing entities. The vast majority of those cases have been brought in 2008 and 2009, with a few hangers on from earlier years.

And those 17 cases compare quite unfavorably, from my point of view, to the 30 that I understand Chip Lutton described as the patent caseload pending against Apple, we have more than half that number, obviously, and we are 1/32 of their size.

The other statistic I would like to share with you is our total expense on patent litigation over the last -- since 2000. We do have a case that was filed against us in 1997 by Xerox -- it's widely reported -- which we settled

after 2000 for 22.5 million. That particular case skews the results. So if you want to add the data in for your own purposes, certainly do. That was settled for 22.5 million, and the fees involved in that case over the course of seven years of litigation, three trips to the appellate courts and no trial, was $7 million.

Without counting that case, of the cases filed against Palm, there are 21 since 2000, the total fees expended other than I said Xerox, in the Xerox case, were $21.6 million and the total settlements were $6.8 million. So we spent more than three times as much, as you can see, on defending cases, which now you understand why I'd say they're worthless, the median settlement: $250,000. And by that I mean there were about ten cases settled for less than that and ten for more.

But the highest number in that list and the only one in the millions range is a $2.9 million figure that was paid with respect to a case many years ago, before we got smart about these things.

So what's wrong in my view is that Palm, which is a little company, barely a billion dollars in revenue at the present time, has over the last five or six years, spent $21 million on defending this litigation. It's relatively unmeritworthy. In every case we spent, with one exception, we spent less to settle than we spent litigating. And we have nothing to show for it other than licenses to patents that we don't think were implicated by our products in the

first place.

So you can imagine what my perspective would be then on the damages issue.

MS. MICHEL: So your concern then is that if the legal rules over reward or grant damage awards that are too high, it just encourages litigation?

MS. DOYLE: It encourages what I would consider opportunistic litigation that has little relation to the value of a patent, its patentworthiness, its validity, let alone whether or not it's infringed.

MS. MICHEL: All right. John.

MR. SCHLICHER: I want to repeat something Rich said which I think is very important: Remedies for patent infringement depend on what you're trying to accomplish. My view, I think I share with Rich, is that the purpose of granting patents is to encourage companies to do R and D projects that they would likely not undertake if they did not have patent rights.

The purpose is not to induce people to disclose inventions that they would have made with or without patents. The incentives that the rights will create obviously depend on the remedies. In my view an injunction is and always has been and should be the preferred remedy. The reason is that an injunction, unlike a damage remedy, forces people who know the most about the technology and the business to attach a price to an invention based on economic reality. It also prevents activities, namely infringement,

that distort the activities of patent owners and the licensees while they're exploiting inventions. Distortions that will have longlasting effect that damages will never remedy.

The third main point I think for me at least is that the patent system works only if people make agreements regarding these rights. It doesn't work to the extent that the courts have to make decisions about these rights or decide who uses what invention at what time and how much they pay for it.

To the extent that the system relies on agreements, patent owners and potential users of invention can make agreements only if they know how the courts are going to behave if they don't make an agreement. And that means patent owners have to know the likelihood that if they win they will get an injunction and the approximate amount of damages they'll get if they win. Potential patent infringers and potential licensees have to know the same thing.

If the law is such that you cannot -- that those groups of people can't predict in advance what will happen to them if they go to court, then the law on remedies is defeating the very agreements on which the whole system relies. And my view is that current damage rules and rules on granting injunctions in patent cases fail that test fairly miserably.

MS. MICHEL: Thank you.

Marty.

MR. SIMPSON: The University of California is an inventing, nonpracticing. As an outgrow of research we have inventions. One of the things we're doing in our mission of teaching research and public service is trying to get this technology out so the public can get the benefit of the research.

To do that you have a patent as a tool. If the patent is not an effective tool, then you inhibit that ability to get it out and used. You come back to predictability. That was mentioned earlier. And you come back to Professor Gilbert's statement earlier.

Two-thirds of our cases are licensed to small business in a given five-year period. Those small businesses need to be able to get funding. There has to be predictability in the system so that they can go get that funding in order to take the risk to try the new technology. If there's not enough predictability in what a patent means, whether it's damages or injunction, then what happens is that they don't get funded and that technology doesn't get a chance. That's where our concerns are.

MS. MICHEL: Okay. Thank you.

Mark, and also if anyone would like to address the problems of both over compensation and under compensation, that would be interesting.

MR. LEMLEY: Sure. Yeah, look, I mean I think the important thing to keep in mind is patents are government

interventions in the marketplace. All right, they are government changes to what would otherwise have happened. They are government interventions in a good -- for a good purpose and I think they are desirable, right. But what that means is that, like any other government intervention in the marketplace, it's going to distort what would otherwise be a free and competitive market. And if you get the numbers wrong, if you grant patents to the wrong people or don't grant patents to the right people, or if you grant remedies for infringement of patents that are too high or too low, you end up distorting economic behavior, all right.

Right. So I mean one of the concerns, clearly as Rich and Marty say, is predictability of outcomes, and I agree with that. But we could have predictability of damages outcomes quite easily, right. We could say everybody gets a million dollars, but that's absurd, right? Nobody would even contemplate such a system. The reason we don't contemplate such a system is that it does actually matter that we calibrate the patent damages rules to a normative baseline that's designed to achieve the goals Rich is talking about, right, to try to improve research and development incentives.

I mean it seems to me that we currently don't -- we seem even now to argue about what that normative baseline is or ought to be. I mean it seems to me that the logical starting point is what is the value that the patent contributes to the world that we didn't have before, right,

and what's the incremental value of the -- of the world with the invention versus the world without the invention, that even that has turned out to be extraordinarily controversial in congressional efforts to reform patent damages. But we've got to have, I think, some measure of what it is we're trying to achieve in order to figure out compensation, because if we do over compensate, if we do under compensate, we're distorting the free market.

MS. MICHEL: Okay. Vine.

MR. O'BRIEN: Yes. I mean in the broadest sense what you're really trying to do is minimize enforcement costs while maximizing the preferred behavior. And I'm talking about compensation damages. There's also deterrents that go into that equation as well. And compensation really goes to what people would often call fairness. You know: I've been harmed, I deserve to be compensated for that.

But if you get it wrong, if you get damages too high you have excess of litigation and you have licensing at excessive rates. And you probably have less innovation, especially improvements on patented items. Because if you get close to a patent you're likely to be sued and get bitten, so you'll stay away from those.

On the other hand, if you're under compensated you get investment in nonproductive activities. You probably would get more emphasis on trade secrets, onerous contracts with employees. At the extreme you get the mafia to help you enforce your intellectual property rights. It sounds

funny, but that's what's happening in countries like Russia. These people serve an economic function. And if you get it wrong, this is what happens.

And I come at it from the standpoint, well, when it comes to compensation in patents your goal really ought to be able to mimic the marketplace. To measure what would be the incremental value in the marketplace of this technology. And it's interesting, because as Mark points out that's controversial. And the fact is you often get a debate going on for hours where that's not even mentioned and it's quite shocking. But, anyway, that to me is why you need to get this right.

MS. MICHEL: Okay. Oh, yeah, Rich.

DR. GILBERT: Can we circle around a little bit on this. I think what Vince said is something I would agree with, although not because it's the right answer. I think what --

(Laughter.)

DR. GILBERT: Mark said that what we want to do is have a patent system that compares the world with the patent to the world without the patent and moves us in the right direction. And that's not necessarily the same as giving a reward equal to the incremental value of the patent. I mean you could have a patent where everybody knows it's worth a million dollars. There's just no -- there aren't many that are that clear, but you could have one, let's just suppose, everyone agrees it's worth a million dollars. But it might

be for a technology that's going to get invented no matter what, that doesn't need a million dollars to promote research and development. And you could ask the question why are we then rewarding it with a million dollars if it's not going to actually produce any research and development.

I, for one, think that a reasonable starting point is to say: Let's figure out what the incremental value of the invention is and try to steer patent rewards in that direction. It's a good starting point. It's not necessarily the right answer, but it's I think better than where we are now, where you often get rewards that are unrelated to the incremental value of the patent.

MS. MICHEL: Well, let's lay down this groundwork. Mark talked about the measure of what we're trying to achieve. I want to start with the words of the statute, at least as it's currently formulated. And, in fact, how I think it's even in some of the proposed changes, which is the damages should be adequate to compensate the patentee. And that has sometimes been discussed in the framework of putting the patentee in a position he would have been but for the infringement.

Is that a starting basis that makes sense?

Mark.

MR. LEMLEY: So, yes, and in the vast majority of cases it's also going to be the ending basis that makes sense. So I mean the alternative -- patent law, unlike other areas of intellectual property law, doesn't involve

disgorgement of defendant's profits, it doesn't involve measures with the exception of willful infringement designed to punish defendants. And there's a good reason for that.

The reason for that is that patent law, unlike other areas of intellectual property, doesn't punish people who steal things, or at least it doesn't only punish people who steal things. In fact, Chris Cotropia and I have studied the question of whether the defendants in actual litigated patent cases are accused of actually copying the technology from the patent or the patent owner, or whether they were in fact independent inventors. And what we find is that while there are major industry-specific differences, the actual incidences of even allegations of copying is very small, it's under ten percent, and that in the industries that seem to spark the most damages concerns, the IT industries, it's on the order of two or three percent.

So it doesn't make sense, I think, to talk of punishing people who turn out in almost every case to be independently developing technology on their own or having made the mistake of independently developing the technology that someone else patented.

Now I think there are cases in which there really is theft of an idea. In those cases probably punishment is an appropriate because we are -- we don't want, I think John said earlier, right, to just displace the contract and licensing system with a court system, right. We prefer people who know that they are taking someone else's

technology to go and do a deal firsthand. But it's important to keep in mind that that's a pretty rare part, a pretty small part of modern patent litigation.

MS. MICHEL: Okay. John.

MR. SCHLICHER: Just to respond quickly to what I understood Rich to say, Rich is proposing -- well, let me back up.

I think we have had a hard enough time creating a set of rules under which judges and juries award damages that approximate the economic value of the invention in the particular case. If we ask them in addition to make a judgment about the extent to which that award would create proper R and D incentives in that industry given the research opportunities that will exist in the future and the costs of risk in undertaking them, we're asking them to do something that they are simply incapable of doing. And, while I admire the test, --

DR. GILBERT: That wasn't my proposal.

MR. SCHLICHER: Okay. Then I misunderstood it.

The short answer is: The patent in the case you posited should be invalid. If the invention would have been made anyway, that there should have been -- there should be no patent.

To the more general point, the question -- the words "Put the patent owner in the financial position it would have been but for the infringement" come out of the *RO* case. That's a Supreme Court case in the 1960s. It wasn't

a damage decision, so you can't tell what they meant, if they meant anything.

My answer is that damages never put a patent owner in a position it would have been but for the infringement. Only injunctions do that. During the period of infringement, the price at which products are sold are distorted. The people that sell them are distorted. The investments that are made by patent owners and licensees to enhance the values of the inventions are distorted. Damages paid by an infringer to a patent owner can never undo that damage.

To the extent that you're talking merely about the monetary effects on those two people, the answer of course depends on how it's applied, and that's the $64 question. If you ask the question: What is the amount of money the patent owner would have made if the infringer didn't infringe and vanished from the face of the Earth, you get one number: But for this person doing this activity, how much would the patent owner have made.

For most inventions, in my mind, that's way, way too much, because the question's too simplistic. The question ought to be: How much money would the patent owner have made if it used the invention or something it had available to it that was better and other people used the next best thing available to them, including the infringer, and the amount of money the patent owner would have made if everybody infringed. It seems to me that that is the

difference, that is a test which will allow you to put in the hands -- or the pockets of the patent owner in an amount of money that approximates the economic value of the infringement.

MS. MICHEL: So Rich, and then Bill.

DR. GILBERT: Well, the question is should patent rewards make the patentee whole for infringement.

MS. MICHEL: That's right.

DR. GILBERT: Well, at one level, of course yes. And then we have to worry about deterrents and all of that.

MS. MICHEL: Right.

DR. GILBERT: But particularly for reasonable royalties, there's a fundamental problem with this analysis in that it's all circular. If I ask what is a reasonable royalty, well, what's a reasonable royalty is a value such that if I turn it down and go to court, the court will say that's what I owe you. Well, what is the court going to say I owe you, it's going to be the reasonable royalty that you calculated in the marketplace. So I mean this can wind up anywhere.

You can have a situation where a high damages result in high royalties, which then reinforce high damages. Or you can have a situation where a low royalty or low damages result in low royalties which then reflect low damages in court.

The only way you can get around this is to actually look at the underlying value of the patent and

that's a more complicated question.

MS. MICHEL: All right. We will go into that complicated question in just a couple of minutes.

And, Bill, any comments on -- what's our touchstone here, what are we trying to achieve with damages?

MR. ROOKLIDGE: Well, that's the flipside of the question that Mary started this whole session with, is what's wrong. And from her perspective what was wrong is that her company is spending too much money defending what she described as opportunistic litigation.

I agree that that is wrong, but I don't agree that that is the problem. I believe that that is a symptom. And I think everyone here has expressed a different perspective, as if we were the seven visually-challenged individuals and the elephant. I tend to look at it from where from my perspective the rubber the meets the road. Mary's perspective is the rubber meets the road on her budget. My perspective is the rubber meets the road in litigation, the results of which are what are causing this behavior.

So when I ask what's wrong, I recently sat down with my partner, Martha Gooding, and we undertook to study a couple of things. One, we undertook to study review mock jury trials in patent damages cases. And we watched a lot of them.

And then we undertook to sit down and read the Federal Circuit decisions in this area and we found some really surprising things. And one of the things that we

found was it's not really the law that has a problem, that very often what we're seeing in these jury deliberations is the jurors going off the rails for reasons that are wholly unrelated to the law.

And the answer there is for trial lawyers to understand how jurors are likely to run off the rails in patent infringement cases and to use their skills to bring them back and to keep them on track. So I see the problem from a very different perspective.

Now John looked at this and said the current rules, he said, are failing miserably. I don't believe, frankly, that that is necessarily the case, at least I haven't seen that demonstrated from my reading of all the Federal Circuit cases. We've got to take a look at the trends. And when you sit down and look at the trends, the early Federal Circuit cases were very problematic on damages. The court was very loose on that kind of thing, but it's gotten a lot better. And Judge Rader is leading the charge to make it a lot better.

There is a common perception that was expressed in the House Report on the 2007 Patent Reform Act that damage awards are seldom overturned on appeal. That is just not the case. If you read the reported decisions, if you read the nonprecedential decisions, you'll see that the Federal Circuit has shown a lot of willingness to overturn damage awards, even damage awards that result from jury verdicts. The --

MS. MICHEL: Bill, in your reading of those cases do you see the court striving to fulfill this concept of reasonable compensation to the patentee and defining that as putting the patentee in the position he would have been but for the infringement or are they trying to do more, create deterrent, something else?

MR. ROOKLIDGE: I don't think they're trying to create deterrents. I think the Federal Circuit has hewed very closely to the line that deterrence is what enhance damages and attorney fees are all about. And what I've been focusing on are simply compensatory damages.

And the Federal Circuit seems to have been very clear to the extent that the arguments of the lawyers, the arguments of the parties in the case before it, allow the court to do that. I think the court's been very good about that. And what it's been trying to do is make sure that there is a basis in the record before the trial court to award those compensatory damages.

MS. MICHEL: Certainly calculated compensatory damages is an extremely difficult concept, and I want to, after laying this groundwork, dive into the nitty gritty of how to do that.

Yar.

MR. CHAIKOVSKY: So I guess my comment was going to be Bill's point, is he exactly pointed out that it takes the Federal Circuit to get it right with respect to compensatory damages. And so we have a system where whether

you follow the *Georgia-Pacific* factors or what-have-you, how is a jury supposed to get it right? I mean we don't have juries getting it right. They have factors laid out in front of them that, quite frankly, they don't follow or they don't pay attention to. And they may make their determination based on some other aspect of the case. And I don't think they get enough guidance, quite frankly, from the lawyers.

And so right now we have a system that if you go to trial, you don't know what the result will be. And, going to Mary's point earlier, even prior to that, how do we know how to value this invention? I mean what value do we know to provide? And I don't think currently we have that guidance. And, quite frankly, even what's in the patent reform, I don't think that alone gets us that guidance.

Now do I have a perfect mathematical formula to get us there? I don't. I don't have that solution. And I'd love it. I'd love to have it. I mean I'd love to have it, but we don't have that mathematical solution. And the realities are that, you know, anything we come up with, whether it's what we have today or whether it's what we have in the reform that exists, we're going to be litigating it no matter what. And it's going to be obtuse and the problems that Mary has are going to continue.

MS. MICHEL: Uh-oh. Well, let's hope not. So I'm hearing pretty broad consensus then that the point of damages is to be compensatory, not punitive. No

disagreements there.

Vince.

MR. O'BRIEN: Well, the only comment I had is, you know, I liked the *Arrow* wording.

MS. MICHEL: Okay.

MR. O'BRIEN: The only trouble is is these cases where the judge or the jury or even the CFC is way off base, start out quoting *Arrow*, so it isn't helpful to us. I mean it's what we ought to be doing, but clearly it isn't giving guidance to any of the decisionmakers.

The other thing is I would agree with the prior commentators. There seems to be a cultural bias toward high damage awards in infringement cases. I think the average juror -- it's been my -- you know, from testifying and seeing the outcome, the average juror I think thinks that you have a patent, you get rich, and that infringers are very nasty people. When, in fact, as we know there's a lot of what I would call innocent infringement going on.

So when I'm working on the defendant's side of a case and the defendant likely infringed, I know I have a tough road to hoe. And I just pray that the plaintiff's expert gets greedy, so I can destroy his or her credibility, because it's hard to get the jury away from a big number once they decide infringement.

MS. MICHEL: Okay. Mary, and then we'll dive into reasonable-royalty nitty-gritties.

MS. DOYLE: Well, I suspect that I was going to go

there anyway. The issue for me, and I find a lot of the remarks made actually consistent in many ways, I think we agree on one other thing which is that presently the rules do not provide any kind of certainty. It would provide it with injunctions. I would say to you that that would distort the marketplace much, much more than anything that's happening today and, in fact, before *eBay* it did, in my -- again, in my experience.

But for me the problem is looking at a given patent and in the real world convincing the holder of that patent that at least in the case of my products, which have been referred to as complex products, that as everyone here knows, a Palm incorporates many, many different components, 800 or 1,000, and certainly implicates in the view of patent holders, hundreds if not thousands of patents, most of which would be very hard for us to identify from the start.

But to ascribe to each patent holder who would claim that their patent implicates our product or to arrive at an agreement with that person about what they are entitled to, each and every one of them thinks that they're entitled to two to five percent of the entire value of this product. We have in that set of circumstances an impossible mathematical problem. Certainly there will be no investment in this product or in the innovation that led to it if that kind of math is going to rule the day.

MS. MICHEL: All right. So we have some agreement then that our goal here is compensation, but that it's

difficult to figure out how to do that. So we wanted to start out by talking about reasonable royalties and how that's done.

Any thoughts on whether the hypothetical negotiation is the right framework to be thinking about what a reasonable-royalty award ought to be? Rich.

DR. GILBERT: Well, I think Mary gave a very good example which says that a hypothetical negotiation is not generally going to get you to the right place.

MS. MICHEL: Is that because there's a problem in the fundamental concept or is the problem the way that it's working out in court?

DR. GILBERT: There is a fundamental problem about the way the market works for complementary innovations, at least. The complex product that Mary was talking about. To give you an example, suppose you have two licensors -- suppose there's a product that requires a hundred patents. And there's one licensor who has 99 patents and another licensor has one patent. And they both negotiate over how much they should get.

Well, under a plain theory of bargaining, if all of those patents are essential the person with one patent has as much of a claim as the person with 99 patents. It really makes no sense. But that is what the market is going to do. And that also creates a centrifical, centripical, whatever the right force is to get people to, in effect, disburse their patents and have more people negotiating more

patent rights, as is what happened with the *Alcatel-Lucent* case, where they spun off a separate negotiator for three patents and then brought a case with an argument that their three mp3 patents should get a very large share, a very significant share of the value of a computer.

So we cannot really rely on market negotiations to set the standard for what is the right determination of value, at least for complex products.

MS. DOYLE: May I ask a question about that?

MS. MICHEL: Sure.

MS. DOYLE: Why is that true, when a device like this that has hundreds of components and is the result of literally hundreds of negotiations to get the right price assigned to each and every component, all of which are necessary to the product?

MS. MICHEL: Mark and then Yar.

MR. LEMLEY: Let me start by just a brief answer to Mary's question. I think the dynamic that Rich is identifying works because of the threat of injunctive relief, right. So if the owner of any one of those patents can shut down the whole thing, right, then they do have just as much power and, therefore, in some abstract that's right --

DR. GILBERT: Yes, exactly. That's a necessary --

MR. LEMLEY: And so that's part of the reason why injunctions in these cases are so problematic, so --

MS. DOYLE: But not why negotiations shouldn't

work.

MR. LEMLEY: Well, no, but -- right, well, though the problem is -- right now we're back to Rich's circularity point, right. So what are people willing to accept in negotiations? They're willing to accept in negotiations something that's a function of what they could get in court if they didn't get it at the table, right. So if we gave them in court the power to shut down the whole product, then they can get a pretty substantial amount of money in negotiations.

MS. DOYLE: That's true, but if you assign the value to the actual component in question, you may then get a much more reasonable result --

MR. LEMLEY: Well, and I think that's right, but I think -- right. And now I think we're moving -- and I think that's a move away from a hypothetical negotiation, at least as it's conceived right now. So the problems I have I think Rich has identified the theoretical problems with the hypothetical negotiations.

I just wanted to add a couple of practical problems, right, which are you're -- to talk about a negotiation between parties who by hypothesis not only didn't come to terms but just spent $5 million a side in legal fees to take the case all the way to trial, rather than come to terms, right. There's probably a reason for that, right.

There may well be a case -- maybe the reason is,

you know, idiosyncrasy, right, particular rationality by a plaintiff or a defendant. But it may also be the case not all deals would get made in a world without the lawsuit as a backstop, right. I mean some patentees wouldn't license their patents for anything that a patent licensee is willing to pay. Those deals --

MS. MICHEL: Well, yeah, but why? I mean we got assume economically-rational actors in this hypothetical.

MR. LEMLEY: Oh, well, so here's -- I mean so the short example -- answer to why is: If I'm in the marketplace -- let's say I'm a pharmaceutical company. I will make more money by selling the product at a monopoly price than I will make by licensing it to a generic competitor.

MS. MICHEL: So I should get lost profits, then we shouldn't be having a reasonable-royalty calculation, right?

MR. LEMLEY: I agree. I -- I -- yeah, --

MS. MICHEL: Okay.

MR. LEMLEY: All right. So that -- so I don't think it works in that circumstance.

The other problem is I think we need -- because we need to assume that the patent is valid and infringed, which is something that no one in fact does assume in any ex ante licensing negotiation, we've introduced an artificiality to the negotiation that's really hard to mimic.

MS. MICHEL: All right. Yeah, well, Yar, and we'll come back to that.

MR. CHAIKOVSKY: I think the only thing I'd add to that and it's consistent with what Mark just added: I mean how do you get to this hypothetical negotiation when you could take the *Alcatel-Lucent Microsoft* case when Alcatel-Lucent is nowhere in the business of what Microsoft's in, so how is Microsoft supposed to sit there, irrespective of what factors you use, and take a look at them and go: What should I reasonably pay them in a negotiation and what's reasonable. You know, yes, they could look at the previous frown off licenses and go: Well, maybe that was reasonable. But, sure, that wasn't reasonable to Alcatel-Lucent. And I can tell you there are other similar instances.

I was doing a negotiation this morning where we were trying to avoid litigation, where it's not the core line of business of the patentee that's asserting the patents. And how do I value those patents when they say they've got patents in another line of business. They're not in the line of business of, let's say Palm, for example, they're in some other line of business. It's not a nonpracticing entity. It's a going concern. And all of a sudden they reach out and they say: Well, by the way, you know what, we do have patents on your product.

How do I know how to value that? I don't know how to value that because all I know how to value that is the cost of litigation. You know, and I want to avoid litigation, and that's going to be a significant driver.

If I look at those numbers that Mary cited, I mean

21.6 million in legal fees and $6.8 million to settle cases, I mean that has nothing to do -- I mean she's driving -- it's all legal fees. I mean the cost of her for the settlements here are kind of ridiculous, I mean.

MS. MICHEL: Okay. But if we place the hypothetical negotiation at some other point in time, you're talking about a time when the parties are facing litigation and have sunk cost, right. If we place the hypothetical negotiation at a point during the design stage for the production and why -- would it be the case in that sense where the accused infringer then is only willing to pay in relationship to the cost of an alternative? Can we deal with the problem you're talking about by placing the hypothetical negotiation at an appropriate place in time in the past?

MR. CHAIKOVSKY: Perhaps there's an appropriate place, but I would have a hard time saying where that appropriate place is. Right now, again, the negotiation I had this morning, we're trying to avoid -- I mean if you're in negotiation, right, you're hoping to not get into litigation. You're hoping that the person, let's say the net plaintiff that actually has more in the way of patent weight, doesn't bring a lawsuit. And you are attempting to avoid that lawsuit.

Well, in that situation, again in any situation where there's a license negotiation, that there is going to be that component that you can get sued on these patents.

And so you necessarily have to be thinking and avoiding that and that cost.

In the situation I was describing, in particular when the person is a nonpracticing entity in a certain field, but on the other hand is a significant entity with significant funds in the area of its core business, what am I to do in that area and what am I to do let alone and hypothetical negotiation situation, then if I get into litigation, any test that I have seen proposed doesn't necessarily ascribe to me how do I value that.

MS. MICHEL: Okay.

MR. CHAIKOVSKY: How do I value that technology.

MR. ADKINSON: Just to interject one further question that's broader, is whether there's ways to impose additional structure on this amorphous hypothetical negotiation, beyond just particularly the time at which it's set, that might break Rich's circularity problem by having more of an objective basis and provide some way of limiting damages.

Perhaps something like -- John had mentioned something about looking at the value versus the noninfringing alternative, I think, as one measure. Let me throw that into the equation.

MR. COHEN: So John's had his tent up. Let's go to John, and you've thought about this.

MR. SCHLICHER: Bill said I think damage law fails miserably. I think we do a reasonably good job on lost

profits, which is where the *RO* words are invoked. I don't think we do a good job in other areas in the sense that you can't tell going in what the award is likely to be. There is simply too wide a range of possible results that the law permits.

The best I -- I, by the way, do not like the hypothetical negotiation rule, if that is the exclusive way to determine damages. It doesn't work at all in situations where the patent owner wouldn't have granted this personal license because the person owner could make more money using the invention than the infringer could, which is what happened in *Georgia-Pacific* which is why that's not what the district court or the court of appeals actually did in *Georgia-Pacific*. All the court of appeals did is note in passing at the end: Oh, by the way, the award we've arrived at in the other way happens to actually be what you might have gotten through a hypothetical negotiations. Almost the side light.

The same thing happens if there's another licensee who is better placed.

My main problem with the hypothetical negotiation rule is that it presupposes -- well, let me say it this way. It asks about an amount of money people would have paid in the future. That's what licenses do, and that's when people talk about it.

For purposes of damages they ought to be based on the economic value the invention had in the past. We know

what -- with know a lot about what happened, because we ought to look backwards.

And to the extent the hypothetical negotiation says: Let's look at what these people would have agreed to pay in the future based on their best guess of how the economics are going to work out.

It seems silly to me to rely on that when we know actually how things worked out. So I have a whole bunch of problems with the hypothetical negotiation rule. That being the one.

The best I can do to impose a better rule on it is to do what I think the Supreme Court said to do when it created the rule in 1915 and that is: Try to identify an amount of money, if it's going to be do the value of the invention had when used by an infringer, try to identify an amount of money that's the difference between the profits using this invention allowed that person to get at, and the profits that person could have gotten at if they used the next best noninfringing thing available to them during that period. And that amount of value may change during the period. That's about the best I can do to try to impose some other rule.

MS. MICHEL: Vince.

MR. O'BRIEN: Well, I think that I actually like the hypothetical because I can't think of any other construct that would help me get to a number, but there are some things with it and it does have its limits. The

biggest one is the time of negotiation. And they obviously picked the date of first infringement because it's an easy time to determine.

But you end up in the pharmaceutical industry where because of the safe harbor laws you're not infringing until you've got an approved FDA product out on the marketplace, so some with an embryonic technology comes in and says: Oh, I want the 30-percent rates that you would license at this level. And that does not make sense.

And then you get the holdout because people are locked in to technology or they've had to have sunk costs. I think if you take it back in then when the decision was made, you'd get around a lot of these things. And because of the book of wisdom you really get back in time when you know what happened. And so you factor that in as well. So I would say with that part of it would help out a lot if you could do that.

MS. MICHEL: Well, would you think, Vince, that the cost to the defendant of the closest-noninfringing alternative might be brought into play in the hypothetical negotiation as the maximum amount that an accused infringer would pay?

MR. O'BRIEN: Well, it's not necessarily the maximum, but it's a benchmark, because obviously there's time, there's risk inherent in that that you would have discussed at the time of the hypothetical.

Now one thing I want to make clear too is the next

best alternative isn't just a noninfringing way of providing that feature. It could be just provided different mix of features or cut your price or --

MS. MICHEL: Just not include the feature you mean.

MR. O'BRIEN: Pardon?

MS. MICHEL: Just not include -- leave the feature out.

MR. O'BRIEN: Leave the feature out all together and maybe enhance your product some other way or, for that --

MS. MICHEL: We could all live without the pop-up calendar.

MR. LEMLEY: In the broadest instance, not even make that investment and pick your next-best investment.

MS. MICHEL: Okay.

MR. LEMLEY: Can I say something to that?

MS. MICHEL: Yeah, mark.

MR. LEMLEY: So I think this is the least-worst of the alternatives, right, so what John suggests and Vince is talking about, the approach of the closest-available, noninfringing alternative, that's a test that gets adopted, interestingly, in lost profits in *Grain Processing*, but that the Federal Circuit has not really moved into reasonable royalties, which is where I think it actually could do its most good.

I do want to note one limitation which makes life

a little more complex. The next-best, noninfringing alternative, that is an alternative that does not infringe this patent, may well infringe another patent. And then you're in an interesting circumstance, right, because if we really mean an alternative that doesn't infringe or even arguably infringe any patent anywhere, well, that's going to be almost nothing in the modern world. If we mean only if we can prove that it really doesn't infringe anybody's patent, then we're in collateral litigation over whether the alternative really was not infringing.

I think what we mean is that in that circumstance where what I had was a choice between two alternatives, both of which turn out to be patented by different people, that I wouldn't have paid a monopoly price because there were two alternatives, right. There would have been bargaining that reflected the fact that if your price was too high, I could turn to this alternative. But the model starts to become more complex because we can't just say: Here's the difference, it's a three-percent difference in price and, therefore, that's the number. It depends a little bit on what the parties would have negotiated.

MS. MICHEL: Marty.

MR. SIMPSON: We've had the case where the closest available alternative was covered by another patent of ours.

(Laughter.)

DR. GILBERT: Which means by definition you're entirely free to go ahead.

MR. SIMPSON: Well, also I wanted to come back a little bit on the time. We have had copyist. And, essentially, what happens is that our small business typically, or our licensee takes the big risk of a new technology, proves it out, gets the market done, and then what happens is somebody comes along and says: Oh, that's a good idea, I will copy it because you're making money and you're successful. And we have had people where we finally get into a lawsuit with them and it turns out they were just plain out and out copyist.

MS. MICHEL: Do you think the willful infringement doctrine is insufficient to deal with that problem?

MR. SIMPSON: We have never seen a willfulness award. Now with respect to how the suppositious negotiation works, though, if this copyist has let all the high risk go out of the new product development, so what they're doing is they're just copying a product that's a proven product, they're going to be paying a higher royalty in that negotiation than our licensee, who started off, had to prove the product to get it on the market and prove to people that this was something that was worthwhile.

And in the medical industry it's even worse than that because you not only have to start off with a new product that they turn into something that actually can be used commercially, what they also have to do is get it accepted in the medical community, and that can be very hard with as conservative as doctors can be, and you also have to

get the insurance industry realizing that it's something that would be good for patients that they should reimburse for. And that is a long process.

MS. MICHEL: I'll keep going around the table, but I want to throw out another question. You know, feel free, I don't want to stop any comments, but I will throw out there into the mix. So in thinking about the hypothetical negotiation or the reasonable-royalty calculation, how do we avoid the nondeterrence problem, the 'Why should I put a quarter in the parking meter if the fine's only a quarter problem'? Is there a way to deal with the doctrine to address that without becoming punitive?

And, also, any other comments you were planning to make, John, on reasonable royalties.

I'll go to John next.

MR. SCHLICHER: I'm not sure I understand --

MS. MICHEL: Okay.

MR. SCHLICHER: -- the parking meter metaphor, so I have no comment on it.

MS. MICHEL: Oh, well, then that won't be a problem --

MR. SCHLICHER: The only thing I wanted to say is that *Grain Processing*, where Frank Easterbrook, for purposes of lost profits, did indeed do something really similar to what I described. He also actually did the same thing in doing the final award, although he didn't explain it that way.

The award in that case was indeed reasonable-royalty damages. Judge Easterbrook arrived at that amount of money by comparing the cost to the infringer of making the product the patented way and the somewhat larger cost, the -- excuse me, the infringer, the somewhat larger cost the infringer would have had if it had made the noninfringing way, subtracted those two numbers, and that was the damage award without one single, solitary word about whether that would have been the result of a hypothetical negotiation.

I don't mind if you call that difference-in-profits test an aspect of hypothetical negotiation, because it seems to me in the real world no person asked to license a patent will pay more than that, subject to what I think of as the sum-cost bargaining problem, which we ought to spend some time on because I think it's enormous and difficult. I mean I think Mary alluded to it in connection with injunctions. I think it's pervasive, so I agree.

But I don't see any necessarily -- if you want to say hypothetical negotiations, I don't mind. I simply think that test allows you to focus better.

MS. MICHEL: All right. Bill.

MR. ROOKLIDGE: I don't think you are going to see in today's economic environment somebody just willing to plug the parking meter and say: Go ahead infringe. The costs of infringement -- the costs of defending infringement litigation is so high, particularly when you factor in the

costs of discovery, that nobody undertakes defensive patent litigation for recreational purposes.

The other thing I wanted to point out was that we've got to be careful not to lay down over rigid rules by say, for example, that defining the value of the infringement by comparing the infringing product to the next-best alternative may very well work in the vast majority of cases, but in some cases there may be alternate evidence that's available. For example, evidence of what the infringer's own contribution to that product was and there may be an easy way to value that contribution that would end up resulting at coming at it from a different angle that would be a different way to do it. And we've got to make sure, especially if we go into any kind of legislation, that we don't unfairly tie the hands of the parties and the courts in what they present to get to a number that is reasonable as far as compensating for the infringement.

MS. MICHEL: Mary.

MS. DOYLE: It seems to me that you don't want to tie their hands, on the one hand; but on the other you want certainty, because it's just the lack of certainty that has got us in this mess as far as I'm concerned.

I can also -- I would like to comment on the hypothetical negotiation in the context of standards, where there -- John, there is no reasonable alternative, there's only that one. So in the absence of a better-regulated

standard space where patents can't just be declared by the holder as essential whether they are or are not. I think this approach that you've been talking about doesn't quite work.

MS. MICHEL: Could we move the timing back to the standards-setting body decisionmaking, when there were alternatives available?

Anybody got a comment on that?

MR. CHAIKOVSKY: I've got a comment there because --

MS. MICHEL: Yeah.

MR. CHAIKOVSKY: -- the reality is in the current world: No.

MS. MICHEL: Okay.

MR. CHAIKOVSKY: I mean you have too many nonpracticing entities. I mean right now you've got Weiland (phonetic), you've got PACid --

MS. MICHEL: I meant as a manner of law, that we define the hypothetical negotiation to occur at a time when the standard setting -- when there are still alternatives available so we don't have that kind of lock-in problem.

MR. LEMLEY: And I think the answer's yes.

MS. MICHEL: Yes.

MR. LEMLEY: I mean I think actually you solve a lot of the hold-up component of damages problems in multi-component industries if you don't allow somebody to capture value that's not the value intrinsic to their technology but

value that's the result of an irreversible investment made after that technology was chosen.

DR. GILBERT: I think subject to Vince's comment, though, that there might be risk and timing issues where you don't -- where you do want to give a preference to the patent owner for creating a fertile environment in which the product can be developed and to get some share of that, I think Marty's point on that was a valid point.

MS. MICHEL: And, Mary, I cut you off. I'm sorry about that.

MS. DOYLE: That's all right. I'm enjoying the rest of the conversation, so I'll chime back in when it's important.

MR. CHAIKOVSKY: No, but if you add -- going back to the hypothetical negotiation being the time, let's say, prestandard as a matter of law, I mean again I guess I would say Rich's comments, too, your potential of cutting off in terms of what's the economic value of this when the inventors came up with this, especially if you're talking about solo inventors, they came up with something. And why shouldn't they be entitled to the value of this if it continues to grow and grow in value at a later point in time?

MR. O'BRIEN: Well, it depends on whether it grows --

MS. MICHEL: Yes.

MR. O'BRIEN: -- as a result of the standard or

because of the inherent value of the technology.

I would say one thing, if you do go back in time before the standard, I think you still -- I mean and I've actually testified that that's appropriate, so I'm not being hypothetical here, I think you still have to take into account the fact that it was chosen as the standard shows some value, inherent value over the next-best technology and you should factor that part in, no.

MS. MICHEL: All right. John.

MR. SCHLICHER: Suzanne, the reason I haven't sent in my written comments on your notice is that I regard this on-cost bargaining problem and the standard problem to be by far the most difficult in this whole area: On injunctions, big time; on damages, to a lesser but significant extent.

And I've never spoken out on that because I was never sure I had anything useful to contribute or knew the answer, but I'm probably going to do that. But the current draft of my comments say that when there is an invention that is a standard, however defined, de facto or real, and because of -- for that reason and that reason only, the infringer during the period of infringement could not have switched to something else, even though back on day one, before anybody built a product, it could have.

And what I would do in that situation is compare the profits a company would make selling whatever product, satisfy the standard, to the profits that company would have made selling the next-best production that could have become

a standard way back on day one. That amount of money in a lot of cases may be zero, --

MS. DOYLE: Zero, exactly.

MR. SCHLICHER: -- which to my mind is a perfectly appropriate damage award in lots of those cases.

MS. MICHEL: Bill.

MR. ROOKLIDGE: Well, just as a practical matter, the Federal Circuit has been dithering on that. And I think it'd be more accurate to say $1 would be perfectly accurate under the law.

(Laughter.)

MR. ROOKLIDGE: Set -- adjusting the timing of that decision is not going to change the fundamental problem that both John and Mary have referred to, and that is the uncertainty in the damage awards that come from a court decision and the resulting effect of that on the negotiation. That can only be done within the litigation process, not by setting the timing.

MS. MICHEL: That's a good point, yeah.

Rich, did you have a comment?

DR. GILBERT: I think I do. If we're on this issue of sunk costs, --

MS. MICHEL: Yeah.

DR. GILBERT: -- I mean the problem of expectation, damages and expectations has come into many, many damage situations, not just patents. And do you measure damages at the time of the act or how do you

incorporate developments that have come since that time. I think there's this Janice Joplin's yearbook example of if you had a signed copy of Janice Joplin's yearbook and somebody took it way back then, do you get the value of the yearbook then or do you get the value of the yearbook now.

So it's not unique to intellectual property, but of course the intellectual property does typically invoke sunk costs and standardization much more. And there I think I hear agreement among the panelists that the reward should not incorporate sunk, irreversible investments that were unrelated to the patent other than the fact that the patent reads on the technology that people made sunk investments in.

MS. MICHEL: Okay.

DR. GILBERT: I think I would agree.

MS. MICHEL: Vince.

MR. O'BRIEN: Getting back to your original question about worrying about whether there would be an incentive to infringe if all you ended up with was what you would have gotten in the first place, --

MS. MICHEL: Yeah.

MR. O'BRIEN: -- I think this is a bit of a strawman. I mean, first of all, the hypothetical has a bias upwards because you're assuming then that the patent is valid and infringed, so it could be higher. And then the biggest thing is the damage award is not a license. You still have to negotiate a license going forward. So all

you're doing, as John pointed out, is you're paying for past use of the patent. And in some cases that may be enough. You know you infringed while you came up with a noninfringing alternative, maybe. But most of the time it's just not going to be an issue. You're going to have to sit down with that plaintiff and negotiate a license going forward.

MS. MICHEL: Okay. Mary.

MS. DOYLE: But nothing saves you having come up with a noninfringing alternative from an argument that that too infringes someone else's patent in the end.

MR. O'BRIEN: Correct.

MS. DOYLE: It seems to me that we're looking for a rule that applies everywhere universally, and I still can't bring myself to understand or to fully comprehend a rule that would accomplish that. It seems to me that different rules apply with respect to products that implicate maybe two or three patents, principally in the pharmaceutical and biotechnical spaces or, you know, no more than a handful, or products like ours that implicate -- I'm told there's an Intel study that dates back many years now that says a microprocessor implicates as many as 10,000 patents in a single -- excuse me -- in a single microprocessor. I haven't had that problem yet, thank heavens.

But the fact is that I think a different rule may need to apply where account is taken of the value of all of

the contributing components, particularly patented components.

MR. COHEN: Okay. Bill.

MR. ROOKLIDGE: I think there is plenty of precedent in the law for dealing with appropriationment and royalty-stacking issues like that. I think what people's concern has been, that there hasn't been any kind of extended treatment from the Federal Circuit on that. The Federal Circuit was presented with that issue in *Integra v. Merck*, and vacated the district court's damages ruling and sent it back for reconsideration on precisely that point. The Federal Circuit is sensitive to that issue, but it hasn't yet been presented with a case that's squarely on point on that that it can give a real extended treatment to.

My guess is that with the current attention on patent damages in this economic climate, that people are waiting for that case and we're going to see a lot of amicus briefs when it comes along. And the Federal Circuit, I think, is going to be well able to address that based on what I've seen is a lot of tough love for patentees both in the Supreme Court and some of the Federal Circuit cases on apportionment and royalty stacking.

MS. DOYLE: Though the correspondence from Judge Michel to the Senate Judiciary Committee two years ago would belie that.

MR. ROOKLIDGE: Well, and I think if you see what Judge Rader has been doing, for example, in the *Cornell*

versus Hewlett-Packard cases, where he's sitting by designation and out there serving as an example for district court judges on how to both serve as a gatekeeper, how to come back after a jury verdict and look at it very carefully, that is a great example. And if you look at the --

MS. DOYLE: Certainly he inspires us, but I think that we've been waiting rather too long for the result.

MS. MICHEL: Well, this would seem to be a good time to move into some of the litigation issues that Bill raised as really the place we need to think about and deal with if we want more predictable decisions.

So how helpful is *Georgia-Pacific*?

(Laughter.)

MS. MICHEL: Are the *Georgia-Pacific* factors helpful to courts and juries in reaching predictable awards? If yes, explain. You know, if no, what else can we do?

Bill, you're our litigator.

MR. ROOKLIDGE: Okay. I think *Georgia-Pacific* is very helpful when used for its correct purpose, which is that the lawyers and the judges have a framework so that they can very carefully limit what goes to the jury through Rule 56 summary judgment motions, *Daubert* motions, in limine motions. It sets a framework to see how jurors respond to different factors through voir dire. It helps you think about the kind of things that you want to put on your jury form. It helps you in framing your objections, in to

keeping the evidence that's before the jury limited to what's truly relevant.

It helps you frame your jury instructions. It helps you teach the points that you need to teach the jurors in order to make them want to rule for your client. But, most importantly, where it is helpful and where you see it time and time again is on motions for new trial, motions for judgment as a matter of law, and on appeal.

MS. MICHEL: Bill, let me just ask from your experience, when the damage award goes to -- when the damage decision goes to the jury, do the instructions tend to list all 15 factors, here they are, or are courts better at picking out and instructing the jury as they go?

MR. ROOKLIDGE: You know it's very much decided I think in part by the feedback that the lawyers give to the judge. A lot of judges, the knee-jerk response is to use the form instructions that have all 15 or 16 factors and not to tailor it to the case.

A good instruction will in fact be tailored to the case, but I have to admit, as an admission against interest for my position, that having looked at a lot of mock jury tapes, you will never see the jurors sit down with the instruction and go through the *Georgia-Pacific* factors. It simply is not done.

MS. MICHEL: So what are they doing?

MR. SIMPSON: You would be shocked at the things that jurors do.

MS. MICHEL: Well, I'm curious. Can you give us any insight into that? Surely, because --

MR. ROOKLIDGE: Oh, absolutely. Because what happens is that jurors tend to get -- to be presented with numbers, and that's why it is so critical to file motions in limine and to object at trial to keep out evidence of the kind that plaintiffs' lawyers like to get in: The gross revenues of Palm; the sales, dollar sales of Palm of its accused product. Because if you give the company's gross revenues or market capitalization, those kind of numbers are the numbers that jurors immediately leap to. It has nothing to do with the laws of damages. It has everything to do with what's presented to them. And if you give them a number, jurors particularly in this economic climate will leap to the highest number that they were given and sometimes talk about smaller numbers.

MR. CHAIKOVSKY: So my --

MS. MICHEL: Okay, let's go to Yar.

MR. CHAIKOVSKY: So my comment there would be to Bill's is that I would agree with him, that the *Georgia-Pacific* factors are an excellent framework for litigators as they go to the courtroom, but I would agree with him. In having seen so many mock jurors, it's all about the numbers. I'm not going to necessarily say they leap to the highest number.

I mean obviously they may leap to the highest number, but we have a set of rules that they are not looking

at, they do not pay attention to, and that's whether you actually look at mock juries or actually poll a real jury after the case, and that has nothing to do with the award that they are granting. They are looking at the infringement, who's the good guy, whether's the bad guy, who's got the white hat, who's got the black hat; and then the numbers coming out of them. I mean that's all that's happening.

And so for those that are testifying as to these hypothetical negotiations and using these factors and maybe picking out four or five factors that they find to be the most relevant and, you know, let's get to this highest number, it's a number. And that number sticks in their head. And if they then determine that there is an infringement, well, that number stuck in their head. And if some reason they say, well, the infringement was as bad, well, maybe we'll go with the lower number that defense counsel had. Quite frankly, maybe we'll even go with a number in the middle.

But my point here is we can have this academic discussion, which is great to have in these hearings, but the realities are is we have a system, and quite frankly even have changed, I mean a juror is not going to necessarily -- because we can all play with these numbers, Bill and myself, others, Mark can play with these numbers in front of jurors, et cetera, and/or in front of the Federal Circuit and play with these numbers and come up with numbers

that are, you know, whatever we would like them to be. And that's where we live in currently right now.

And, as Bill pointed out earlier, yes, the Fed Circuit's doing a better job. And, as Mary pointed out, it's not all the Fed Circuit, it's specific judges on the Federal Circuit, as we have splits. I mean Judge Michel's letter is a perfect example.

So we don't have any predictability and I don't know if we necessarily have a different rule we're going to get that predictability.

MS. MICHEL: So what do we do?

MR. ADKINSON: Can we get all the methodologies for both apprising and combining the *Georgia-Pacific* factors so that there are in fact rules that can in fact not perfectly define and give perfect predictability that would be desirable, but at least would restrict the heights to which juries could leap and the depths to which they could go.

MR. CHAIKOVSKY: So in the *Markman* -- so Bill and I use -- we discussed this before. You know, the next-best infringing alternative, where we were before, and if we could put a little bit -- and I hate to say it -- but a little bit more mathematics to it where it's a little bit more predictability, the rules and not the *Georgia-Pacific* factors where I have so many factors and anyone can kind of pick or choose and it's great for damages expert and lawyers that I have such diversity to choose from in the process, if

I limit that process, that will still -- obviously we can play with it, we can argue, but if I limit that process and provide more precision, you're right. Do I have that answer -- and maybe Mark does.

MS. MICHEL: So --

MR. ADKINSON: Can I -- okay.

MS. MICHEL: Yeah. Let me ask Yar one question first and Bill too, if you have a thought. So if we design these new rules, right, to limit what could go to the jury, what is your faith in the courts and the judges willingness to act as a strong gatekeeper? Do you ever hear, 'Counsel, that's your problem. Take care of it on cross. I'm going to let it into the jury'? Do you see courts being active in --

MR. CHAIKOVSKY: It depends --

MS. MICHEL: -- keeping evidence out?

MR. CHAIKOVSKY: It depends on the judge. You know, some are going to be gatekeepers, some are not going to be gatekeepers. The realities are, as Bill has mentioned, you also have the opportunity in motions for new trial or JMAL (phonetic) for the court to actually take an opportunity there to overturn a jury's verdict.

I wouldn't count on it. That's just not a place where I would say, oh, okay, let's -- judges today could be stronger gatekeepers with respect to the evidence that is being provided in damages cases and say: Well, look, I'm not going to let this in, whether it's a motions in limine

or even during the course of the trial. The judges could be greater gatekeepers than they currently are. Are they? No, I don't think they are.

And we see these -- and, again, it depends on venue. It depends on the judge. It depends on a lot of things, but we see a lot of stuff get in that I don't think necessarily should get in.

MS. MICHEL: Bill, what's your experience in how willing judges are to be gatekeepers?

MR. ROOKLIDGE: It's mixed. I think like Yar has observed, it's mixed. But I think what we are seeing also is in the past lawyers have not been as active in attempting to keep this stuff out, not perceiving that they have the tools to do so.

It was very much like the pre-eBay cases. A lot of patent lawyers had been practicing their entire careers and had no idea that there was this case out there, *Weinberger versus Romero-Barcelo*, that identified what the standards were for an injunction, and were blithely moving along as if a statement out of the Federal Circuit law about the standard rule was the be-all and end-all of injunction law.

If lawyers get sensitized that they have a job to do in presenting evidence and defending against damages cases, combine that with the fact that the Federal Circuit being more active, and it is being more active in damages cases, I think we're going to see a great improvement and I

think we're already seeing a great improvement because of the increasing attention paid to these issues.

MS. MICHEL: Okay. Mark, you've had your tent up for a while.

MR. LEMLEY: Let me raise one other thing that I think contributes to the problem and then two solutions. The other thing that I think contributes to the problem is not too much evidence coming in but on the defendant's side too little.

As a litigator you do not want to spend a substantial portion of your case in a unified presentation on: Here's why you shouldn't make me pay very much money, as opposed to: Here's why the patent is invalid or not infringed, right.

So two solutions, one of which flows from that, is bifurcation of damages. Right. I think one -- the single thing we could do that would get more rigor into damages is separated out from the rest of the trial and make people actually try just the damages case.

The second thing I think that we ought to do comes out of what Yar and Bill are saying. The problem with the *Georgia-Pacific* factors is not that they don't encompass the interesting questions, right, it's that there are 15 of them.

Now really there are three of them, right. Really three things matter. And if you parse *Georgia-Pacific* down, you can get them into three, right. One is what's the value

of the technology compared to the next-available alternative. The second is how many different things have to be combined to make that technology. That is the appropriationment question, right. Are there other patents that have to be included, other contributors, so forth. And third is what has the market actually done, right. Have people in other similar cases negotiated a particular royalty, and so forth.

If you structure the damages inquiry not as: Here's 15 factors, jury, pick some and choose a number, but as: These are the things you have to determine in order to get to the number, you might or might not actually persuade a jury to walk through those three factors, I don't know. Bill may be right, that the jury's going to pick a number based on who they like or don't like. But you will do is you will enable judges to grant judgment as a matter of law. You will enable the Federal Circuit to reverse in cases where a jury verdict clearly can't be supported in that structured environment as opposed to: Well, you know what, if they just chose Factors 11 and 14 and disregarded all the rest, maybe they could have come to this number.

MS. MICHEL: Okay. Rich, then John -- oh, yeah, Rich, then John. Bill, okay.

DR. GILBERT: Well, I didn't expect such fuzzy feelings about *Georgia-Pacific*. And it's nice to hear that some people like it.

I guess a couple of things. One is even though

you have these 15 factors and you can read different things into these 15 factors, it seems like it would be nice to have another factor, one more saying something about not attributing value to sunk investments and things -- the discussion that we've had here, which I guess you can read in *Georgia-Pacific*. It admits a lot of interpretation, but I think a lot of the points that we're trying to make here are not in the *Georgia-Pacific* factors.

MS. MICHEL: Okay.

DR. GILBERT: The other thing, Mark mentioned bifurcation of liability and damages, so it just -- I can't resist making one of my favorite suggestions, which I'm sure will be torpedoed on constitutional grounds, which is I don't know why we have juries doing this stuff. I mean I understand that juries can be just as qualified as judges or anybody else in determining liability on various issues, but damages? I mean that's not what a typical jurist does. And it seems to me there's a lot of reason to have some sort of specialized or tells that court-appointed expert or somebody who can add and subtract and do things like that and figure out what damages are.

MS. MICHEL: John.

MR. SCHLICHER: Any rule that says consider 15 things and anything else you think is relevant and arrive at a number permits any number. *Georgia-Pacific* factors are simply what the district judge said they were: A list of things that the judge or, more likely, the judge's clerk

found in the earlier reasonable-royalty cases, period.

Now how that became a test for determining damages in patent cases is a historical tragedy. And we would do well to simply get rid of them entirely because they don't allow you to articulate a rule that focuses a judge's and, if the lawyers really insist on it, a jury to the facts and the theory that will let you figure out the economic value that you wanted to put in the patent owner's pocket.

It seems to me if you -- if you articulated a separate rule, which I thought -- you know, I've told you the best I can do, then at least you have a chance. And then at least you have the possibility of dealing with the problem of companies whose profits are enormous and whose revenue are enormous. You could, ignoring one subtle detail, require a jury, for example, to figure out damages based on a single unit, okay. There's no reason they need to know the total number of units to do reasonable-royalty damages with one exception that the law doesn't recognize anyway.

So I think -- I really think it's -- obviously if you include all the *Georgia-Pacific* factors, then they do get to know about the infringer's total profits and they do get to know about the extent of total use and they get to know about the only revenue. So I think in order to arrive at a place, at a system that allows us to get a reasonable amount of money, we simply have got to get rid of them, with all due respect to Bill.

MS. MICHEL: Bill. And, Bill, what do you think about bifurcation?

MR. ROOKLIDGE: Well, I think bifurcation -- well, first of all, let's make sure we're using our terms correctly.

MS. MICHEL: Okay.

MR. ROOKLIDGE: Bifurcation is a misnomer. What we're talking about is separate trials, a damages trial following a liability trial. That's not bifurcation as it's used in litigation.

The other thing I just wanted to mention briefly, of course it is beyond the FTC's purview and that of Congress to jettison the Seventh Amendment without a nasty political fight, but I can guarantee you it will not happen during my career. But, turning to the *Georgia-Pacific* factors, the Supreme Court emphasized very early on that determination of damages has to necessarily be a very flexible determination.

The *Georgia-Pacific* factors were culled from a lot of cases over many years. And I suggest to you that you do not want to jettison all those decades of experience until you find a framework that everyone can agree is a framework that's going to move us forward to providing the kind of clarity and predictability that is going to make business happy and is going to make the other constituents in the patent system happy as well. And I think we are a long way off from that.

MS. MICHEL: All right. Do you want to go?

MR. ADKINSON: Beyond the structural question of having a general structure to impose *Georgia-Pacific*, we also have questions about specific factors. And Mark usefully reduced the number of factors dramatically. I wanted to ask, A, the general question of whether there are particular factors that people think can be misused or are misused in the process and, in particular, I wanted to focus on average royalty rates for an industry, which are sometimes proposed or rates on comparable licenses and whether you really can have licenses that are comparable given the heterogeneity in licenses and rates on different types of different patents, where the patents may be heterogenous.

And, Vince, you had had your tent up before, so with that and whatever else you were --

MR. O'BRIEN: Well, let's go onto your question. I think royalty rates on industry -- industry rates or so-called comparable licenses are -- when I work for the defendants it's one of the few ways you have of dealing with this throwing numbers around the jury room. This is one thing out bring them back into reality, you know.

And now, sure, they're not comparables, but if I have an industry, say, semiconductors where licensing is always done at less than one percent or some lump sum or cross-licensing, and the other side is proposing an eight-percent royalty rate, I need to be able to look at other

licenses. And I think right now, if anything, the courts are too restrictive. They try to peel back, you know, the number of licenses you can work at.

Now the other thing on *Georgia-Pacific*, though, that I think is problematic is its emphasis on the profitability of the product. I mean the value of a component has little to do with the profitability of the product. You know, if I'm building a house, it doesn't -- you know the profit I make on that house isn't going to affect what I pay for a hammer. And it gets us misguided. It gets us into the big-numbers problem, because the plaintiff always talks about gross margin and the defendant says net. And it just gets us off on the wrong -- we're off on the wrong foot.

And I would back up to part of what John said but also what Mark said, is it would be much better having a conceptual framework, the three things you look -- the three areas you should examine, as opposed to this list of things we marched through, which is also missing the single most important thing of all, and that is the next-best alternative. Often that just throws *Georgia-Pacific* right out of the window. And without it, G-P's untethered.

MR. ADKINSON: Marty.

MR. SIMPSON: Well, I would be cautious about throwing out the *Georgia-Pacific* factors when we're not replacing them with something. I think you need something that's practical for a jury or a judge who's sitting on the

bench.

And now if you want to group them, or something like that, like Mark was suggesting, to rearrange them, you can do that, to say: Consider this group together, consider this group together, something like that. You might do something that you think improves it, but you have to have something to focus the discussion on when the trier of fact is trying to figure out what do I do with this.

And one of the things I come back to is we do license negotiations all the time and what we're asking is: Give us a business plan, we want to see what your profitability is. That's the question. And it's a profitability based on what we're licensing.

Now typically in the areas we work in, we are licensing them, the main idea, that is the product. So our focus on profitability is -- that really is the problem. And then you work down from there on what a reasonable royalty is.

So I think you need to have something in mind, whether it's the suppositious negotiation, or, if you can't get there, say: Okay, here are some factors. If you want to regroup them, regroup them. But you need to focus the discussion in some way.

MR. ADKINSON: Mark, I got the impression actually much earlier that you were suggesting that we might focus on the noninfringing alternative as an alternative to the hypothetical negotiation itself. Is that --

MR. LEMLEY: Right. So I mean my worry about the kind of actual comparables, I think actual comparables have a place. The difficulty is -- well, the first difficulty is that they don't take account of actually -- the assumption that the patents are valid and infringed, right.

So if every -- if no one pays more than one percent for a patent in the semiconductor industry, that has only, based on the court statistics, a 24-percent chance of being held valid and infringed if it makes it to court, it doesn't follow that the patent that has actually been held valid and infringed is only worth one percent, right. It might be worth four percent or it might be worth, you know, somewhere in between.

And so I think that that's a concept that's both correct in the law and really hard to explain to the jury. So now we have the alternative to the throw-around, big numbers and get it into the jury box, we have the sort of throw around the small numbers. If you get up and tell someone: Hey, nobody's paid more than one percent, even though logically that should imply that you should pay four percent in this case, people aren't likely to get it in the jury box, right. And so I worry a little bit about how those numbers can mislead.

You also see those numbers -- there are all sorts of inconsistencies depending on circumstances, right. So there are lots of circumstances in which people pay for a nonexclusive license in a particular field of use for a

patent more than the purchaser of that patent paid for the entire patent. And that suggests that there's an instability in the choice of the number you're going to use as to what the right comparable royalty is in this negotiation.

MR. ADKINSON: Mary.

MS. DOYLE: Well, there are a number of kind of -- the assumption that the patent is infringed invalid I think does go into -- you wouldn't pay anything that you didn't think was infringed invalid. So in my view I do think that similar agreements reached between parties absent negotiation is good evidence of what the defendant ought to be paying in a case where the plaintiff has prevailed.

And I think we continue to struggle here with defining how patents -- damages should be calculated. We have -- I know you argue that lawyers should get better, well, I'll tell you this $21 million thinks that lawyers think they're pretty good, doing the right thing already, and they're many people that you know.

So it seems to me that 'lawyers should get better' isn't an adequate solution. It seems to me that injunctions should be issued in every case where infringement and invalidity are proved doesn't seem to me to work either because it works very nefarious, results in settlement negotiations in my experience.

And I think the hypothetical negotiation in the end seems -- I mean I think *Georgia-Pacific* is trying to

approximate all the things you might think about in such a negotiation, but *Georgia-Pacific* is notoriously empty of any real meaning here. It certainly hasn't led to predictability of results. It's led to, in my view, grossly inflated -- or a willingness to settle cases that shouldn't be settled at all because you can't afford to pay 42 million instead of $21 million in the course of your defending yourself over a number of years.

So I have to say that I find myself back to apportionment. And it seems to me that apportionment, just by itself, as a rule standing alone is the only thing that anyone's come up with that has half a chance of focusing the discussion.

MS. MICHEL: Okay. We are going to -- John, then Bill briefly. We will come back to apportionment and the entire market value rule right after break. So if you have any -- we want to be fresh for that discussion, I think.

So, John or Bill, if you have any comments on what's just been said.

MR. SCHLICHER: I'm going to sound like a lawyer now. What Mary said is what the law ought to be. In 1915, when the Supreme Court said it's okay to do it this way, it said: Well, when there aren't lost profits and you can't prove the infringer's profits attributable to the invention and you got to do something else, make an approximation of the value of the invention given its advantages.

If you read the Supreme Court cases, the word

"advantages" is used in dozens and dozens of apportionment cases. That's a very important word. That decision led to the change in the Patent Act in 1922, to put that measure of damages in the statute. In about 1933 or 1935, the only other time the Supreme Court's had a crack at this, it said it's okay to do it that way, but the measure of damages -- measure the damages by the -- I forget the exact words -- but increase in revenue or amount of cost savings, essentially, which is the same concept in others.

And that formula is Factor 9 of *Georgia-Pacific*. The utility and advantages of the patent over old modes and devices, if any, that have been used for working out similar results. That's what the Supreme Court said the test was. If you want to keep the list, fine. Narrow it down to nine. And I think you have to think 13, Mark. I'm not sure of the other one you want to include. And then you have a reasonable standard that's entirely consistent with the law, entirely consistent with the intent, and it allows you to do something that has some focus.

MS. MICHEL: Bill.

MR. ROOKLIDGE: Apparently I didn't make my position clear enough. My position is not solely that lawyers should get better but that trial judges should get better and appellate judges should get better at this.

I agree with John that there is plenty of authority in the existing case law for apportionment. Obviously apportionment is a concept that's not applicable

to all cases. Once again, the Supreme Court recognized that that flexibility was necessary. But I think that flexibility being necessary has unfortunately left us somewhat unmoored. But the bottom line is there's plenty of authority to do what we need out there in the case law. And what we ought to address this afternoon is how to get there.

MS. MICHEL: Okay. Great. With that we'll take about a ten-minute break.

(Recess taken from 3:10 p.m. to 3:28 p.m.)

MS. MICHEL: We're back and we're going to continue with reasonable royalties and, in particular, the problem of how to assess damages, reasonable-royalty damages in a situation where the invention is a component of a larger product. This could be the feature on the processor that is incorporated on a CPU brick, which is incorporated into a work station, for instance. And, in particular, an area of recent debate has been the role that apportionment or the entire-market-value rule should play in that reasonable-royalty calculation.

So I'd like to get the panelists' thoughts on how to approach that question. I'm going to start with Mark Lemley.

MR. LEMLEY: Because I have a very defined view on this question, which is to say the entire-market-value rule has no place whatsoever in reasonable-royalty analysis.

The entire-market-value rule is a concept that says: Well, if my part of the -- my component of the larger

invention is the really important component, it's the reason people buy the product, then people would have bought the product from me. And because they would have bought the product from me they also would have bought all these other components from me and not from the infringer.

And that makes a certain amount of sense. There are issues will the, but it makes a certain amount of sense in a lost-profits context, right. So if I would have the made the sale of the whole product, not just the component, because I've got the really valuable feature, and you wouldn't have made the sale, then all the profits you made from the sale in some sense belong to me. But it doesn't make any sense at all in a world in which there is not a plaintiff's product being sold at all, right. A patent owner who is a nonpracticing entity would never have made the sale of some entire product. They don't make the product.

And so the concept of the entire-market-value rule gets accidentally transported over from lost-profits cases, where it makes sense, to reasonable-royalty cases via a Federal Circuit -- a dictum in a Federal Circuit case involving lost profits that says: Why don't we do this in both lost-profits and reasonable-royalty cases. In fact they didn't do it in both, but after they said in their opinion that we do it in both, then they started to do it in both.

And the problem is unless you believe that this is

really the only thing that contributes any value to the success of the product, if you give the first patent owner a hundred percent of the value of the defendant's entire product, there's no percent left over, right.

The next -- the second patent owner who shows up and says, well, I have a value component too, they're going to get paid something. Maybe it should be a dollar. I'm kind of with John on this question, right. You know, sometimes the answer should be the royalty ought to be nominal, but as a practical matter that's just not what the law does. And so we end up punishing companies, right, basically engaging in royalty stacking by definition whenever we do entire-market-value rule in reasonable-royalty cases.

MS. MICHEL: Mark, given that, if you're right, what does that mean about how we should think about apportionment in the context of reasonable royalties?

MR. LEMLEY: Well, I think the answer is your -- you've got to do apportionment. And to some extent, of course courts always already do apportionment in a reasonable-royalty case, they just don't do it very well, right. So there's a reason you get a percentage of the value of the production as your royalty award and not a hundred percent, right. That reason presumably is we recognize that there are other contributors to the success of the product that need to go into the calculus.

But if you just phrase it as a percentage number,

if you just say as somebody was saying here: Well, Microsoft Windows and Microsoft Office together have made a quarter of a trillion dollars over the last 17 years, all I want is one percent of that or 2.5 billion, you don't get a sort of very clearly articulated reasoning, right. You don't get any thinking about what it is that this patent contributes relative to all of the other contributors to the success of the production.

MS. MICHEL: Okay. How are you defining apportionment in that context? I'm wondering if one of the reasons I'm so confused about the ongoing debate is apportionment's being used by different ways and by different people.

What do you mean by apportionment there? Is it defining the base differently? Is it apportioning --

MR. LEMLEY: Right, so --

MS. MICHEL: -- that the whole product doesn't get the entire royalty? What is apportionment?

MR. LEMLEY: Well, right. So I mean apportionment broadly is, right, dividing out the percentage of the production that is attributable to the patent and, therefore, ought to be paid to the patent owner.

MS. MICHEL: Is that about the base?

MR. LEMLEY: Well, right. So, as currently done, it ends up basically being about the base, because we're not very good at affirmatively pulling out, we don't -- it's one of the *Georgia-Pacific* factors, but we never really pay a

lot of attention to it.

I think the fight over legislative reform on apportionment is about the question of whether we ought to specifically call out and require courts to engage in a process of saying: Okay, the patentee is -- the patent is one component of the product that contributes to its success, but there are others as well. And we need to pay attention to those others in deciding how much the patentee should get paid. I think that's the right thing to do, because if you don't do that, then you just end up fighting over broader versus narrow royalty bases and what the right percentage of that royalty base is without any context, without any specific evidence about what the other contributors to the value of the product are.

MS. MICHEL: Okay, Vince.

MR. O'BRIEN: Yeah. I think that in the reasonable-royalty context if you start talking about the entire-market-value rule you've made a mistake right there. You know, you should just look at industry practices, I think is the best thing to do. if they're using -- and it gets back to this base issue. And, you know, if the royalty rates you've been looking at are based on the component base, then that's what you apply it to. if it's based on the full product, you do it to that.

Now it seems to me, though, you can -- if you get rid of the holed-up problem, you've solved I think the apportionment problem in almost every case except where you

have the, you know, say ten features that are necessary to sell the product but not sufficient by themselves. And so the guy is sitting there, he's got nine of the features, either they developed themselves or they licensed. And somebody shows up with the tenth one and says: Hey, without your -- without my -- without a license from me, you can't sell your product. And he wants to grab all the value of that. And that's the difficult problem at that point.

In the real world, most of the time everybody's in the industry and they solve the problem through cross-licensing and they work it out. It's when you introduce the nonpracticing entity into that equation, which would also include people who practice in another area but not in that area, then you've got someone who can sit there and hang in there and say, no, I want it all.

And, quite frankly, I don't have an answer for it because I don't like ten features, you know, divide the value by the ten, and I don't like any of the suggested alternatives, but it is a serious problem.

MS. MICHEL: Okay. Rich.

DR. GILBERT: Well, at one level this issue of the total-market-value rule versus apportionment is like saying do I pay in yen or do I pay in dollars. I mean just the different, as we put it in economics, a different *numerare*, it's the same price either way, except for transaction costs --

MS. MICHEL: Did you mean -- do you mean by that

the size of the base can vary and we just adjust the rate accordingly and the total damages ends up in the same place or did you mean something else?

DR. GILBERT: If it's -- I mean just that: If it's done correctly. Really, apportionment is about doing the analysis correctly. And I don't think the answer in terms of getting people to do the analysis correctly is a particular rule but, rather, somebody, hopefully Court of Appeals for the Federal Circuit or maybe the Supreme Court, or a little scary to think about Congress doing this, but someone should note that because you have one patent, it doesn't necessarily mean you have a claim on the entire product if there are many, many sources of value.

MS. MICHEL: But can I -- can I push back a little? When you say you don't have a claim on the entire product, I'm trying to understand what people mean by that in the sense of does that mean the base can't be the entire product, or does that mean that the patentees shouldn't be allowed to extract royalty value from the whole product? I don't know what that means.

DR. GILBERT: No -- well, I don't think the base matters so much.

MS. MICHEL: It's not about -- okay.

DR. GILBERT: Because how you calculate it, if I have -- I can do a calculation. I think what went on with the *Alcatel-Lucent* calculation, damage calculation -- this is very instructive. I mean the jury came up with a very

fanciful calculation and then the judge came back and said: No, you have to apportion. The apportion could have been done many different ways.

In that case the analysis was done on the price of a computer, but it could have been adjusted for the number of patents or other sources of value on the price of the computer. It could have been applied just to the value of the Windows Operating System that incorporated the mp3 patents, or it could have been done in many different ways. And I think the judge in that case pointed out a number of mistakes that were made and how a more reasonable number could have been created.

I don't think there's a magic formula to doing this anymore than I think there is a particular formula for doing any damage calculation, even if you don't have a complicated, complex technology. Even though some people will try to sell you formulas for doing damages; but in any serious, complicated case it's going to have to be an individual investigation of the factors.

But what I would like to see is something along the lines of a warning label on a pharmaceutical product, saying that do this damage calculation incorrectly, it can be hazardous to our collective health, and some advice that one patent doesn't mean you have a claim on the entire product.

MS. MICHEL: This apportionment concept described the way you described it seems to involve taking into

consideration the contribution that the invention makes to the entire product. Is it anything more than that?

DR. GILBERT: Well, it's certainly going to be more than that in any specific analysis, but the underlying principle I feel is what is the contribution, much of what we've discussed earlier: What is the incremental contribution relative to the next-best noninfringing alternative.

MS. MICHEL: Okay. I'm just wondering if we need a fancy word for that. That seems to be upsetting people.

DR. GILBERT: A buzzword.

MS. MICHEL: Right.

DR. GILBERT: The delta.

MS. MICHEL: Okay.

MS. MICHEL: Let's call it the delta. Okay, what is your dealt.

MS. MICHEL: Okay. All right, Mary.

MS. DOYLE: I guess I'm struggling with the following proposition that I've raised a couple times and perhaps haven't explained as well as I can or ought to. The product I have in my hand is a Palm Centro and it has 800 or 900 components in it. And we negotiate a value assigned to every one of those components --

MS. MICHEL: Right.

MS. DOYLE: -- that has something to do of course -- you know, there's always a question of how much does it cost to produce the component versus, you know, what is the

value. And so there's always some negotiation between those two different approaches to valuing a commodity or an item that goes into a decision on the price. But ultimately the price is decided. And right now today the value of this device and the relative value of each of its components has already been decided by a very complex set of negotiations over a long period of time.

And I haven't run into a patent yet that doesn't really relate to one of the smaller components in here, unless it's, you know, one of those over claiming things where you say the very small component in a mobile computer. Well, so the value of the actual invention is something we want the judge to focus a jury on.

But, in the end, the discussion's already happened. So when I say apportionment I'm thinking about what actually was patented here, was it a change in the touchscreen or the keypad? What actually was patented here and how much did that cost? How much do you pay to have a keypad on a device.

And, in the end, then the percentage, a percentage, whatever is commonplace in the industry ought to be applied to that device to satisfy -- I mean to that component to satisfy the question. But, as you say, you could come to the same number by disregarding the base, you know, the base of any given component. You could look at the whole device and try and figure out what contribution one small invention made to the whole device. But everyone

gets themselves all tangled up in their underwear, so to speak, by saying: Well, I would never buy a car without a windshield wiper or an intermittent windshield wiper, whatever the variation on the theme is today. Well, okay, you wouldn't, but you wouldn't buy a car without tires and an engine and 1700 other things either.

MS. MICHEL: Right.

MS. DOYLE: So people keep trying to claim, as Rich says, the entire value. You know, that they've made something by adding a windshield wiper that was worthless to begin with. That's just not accurate or fair. So in the end I think there's already an economic process, a series of very real negotiations that have occurred over time to define the value of this product, what a consumer is willing to pay, what we are willing to pay. And if you simply attach the patent to what it's clearly designed to -- or the source of the invention, the invention -- in other words, you've got to -- when you read any patent, almost any patent, it relates to a small thing. It doesn't relate to the whole thing.

MS. MICHEL: Okay. Let me --

MS. DOYLE: -- been around for 30 years.

MS. MICHEL: Right. Okay. So you're -- I want to pack that a little bit.

MS. DOYLE: Okay. Sorry.

MS. MICHEL: No, that's very helpful.

Okay. So say the patent relates to a small

feature within the entire device there, and you want to apply the damages to the small feature. How mechanistically -- because, as you point out, those kinds of negotiations and thought processes have already occurred. How mechanistically do we go through that damages calculation. Are you talking about make the base of the reasonable-royalty calculation just that -- just that feature and then applying a rate to that or are you talking about something else?

MS. DOYLE: I think I'm talking about the former, only because in my simplistic world what I would like to do is to ask the inventor to go talk to the person who produces the product to which their invention relates.

So I get knocking on our door all the time people who have invented something that relates to a chip. Nobody at Palm knows anything about the chip other than what it ultimately will do. Doesn't know anything about the guts of a chip. We are not qualified to say whether or not Palm infringes or the supplier of that chip infringes. We'd like the person to go visit the chip vendor.

But they resolutely refuse to do that, which of course renders negotiations almost impossible. No one has the information necessary to do it. And they're driven to do that because they are entitled to attach whatever royalty rate they think is appropriate to the entire value of the product. They can go to any place in the chain they want, so long as it incorporates their component. And of course

they're going to go to the end.

MS. MICHEL: So is the complaint is that they're trying to make the entire product the base and apply the --

MS. DOYLE: The complaint is that --

MS. MICHEL: -- raise the satisfaction --

MS. DOYLE: -- they're trying to benefit from the inventions of many, including Palm, --

MS. MICHEL: Okay.

MS. DOYLE: -- in seeking recompense, compensation for the invention they made, which may and often is trivial or, if not trivial, but it may be valid, but I haven't seen one yet.

MS. MICHEL: Okay. At some point when we're thinking about how to measure this royalty, do the calculation and identify the space, don't we need to identify some kind of measurable product. Maybe it's just a chip, but something that we can identify and associate a cost with. If the invention is only a circuit on the chip, we can't have the base be a circuit because that's not something we value.

We sell the chip. The chip is a product in commerce and, therefore, we can assist a price with it and come up with a base; does that make sense --

MS. DOYLE: And perhaps that's the product in commerce made -- I haven't thought this through. But I can see that the apportionment argument could be reduced to an absurd point, where you could never negotiate anything. But

I guess I think about it because of the world I come from in terms of the components, yes.

MS. MICHEL: Okay. All right.

Bill.

MR. ROOKLIDGE: Well, under the current law of course the patentee bears the burden of providing apportionment for improvement inventions. But I have never seen a case where a court has really held let patentee to that burden and poured them out for nominal damages, saying you haven't -- at least I haven't seen a modern case -- you haven't proven that.

Traditionally we prove apportionment by deductions of the infringer's contribution or comparison to next-best alternative. The problem I think with what you've described is it focused not on the value but the cost of individual component. And typically cost and value to the overall device can be different.

I think what's proper -- and we need to get this right because royalty stacking -- excessive royalty stacking is a problem. It's a problem in your industry and it's a problem in other industries. And the courts need to get this right. The way to do that seems to be not to focus on the value of the invention but the value of the use made of the invention by the infringer.

MS. MICHEL: All right. Let's -- John.

MR. SCHLICHER: "Apportionment" is a word that was used in the cases for from about 1820 to, roughly, 1966 to

describe how damages are determined when they are measured by an infringer's profits. And the word was used to do what I have said so many times, that the value, the additional value -- that we should have a word for it. Rich had a good one: Incremental value.

MS. MICHEL: "Delta", he said.

DR. GILBERT: Delta.

MR. SCHLICHER: Or delta, that's even shorter. The incremental-value rule. The portionment in the law never had anything to do with figuring out how to separate out from the selling price of a product some portion of the price, which we will start from, to then go to a number. Apportionment was always take what actually happened, infringer sold a product, it made a certain amount of money. How much of that money was the result of using this invention, compared to doing it the next-best way. The next-best way might have added a penny to the selling price. It might have reduced -- or the next-best way might mean selling price was a penny less. And, if so, you take the revenue, multiply it by the number of units times a penny, and that's the damages.

So -- and I use apportionment. And what happened was the Supreme Court wrongly said, in my mind, that that's not available anymore. So people stopped reading those cases. In *Grain Processing*, the Federal Circuit cited all those cases, so I think they're still relevant.

But, anyway, when I say apportionment I mean the

rule. What do you do when the invention is a small component? The law is that if there is a component in Mary's product and the claim says a memory chip in a PDA, if that's the right, --

MS. DOYLE: It's good enough.

MR. SCHLICHER: -- the current right term. But all of the novelty in the invention is in the memory chip. Then it shouldn't be too hard for a lawyer to say to themselves: Well, a noninfringing alternative to that invention is a PDA with a different kind of memory chip.

So if -- and actually the way it should work in practice is if the patent owner has sued the PDA seller, damages ought to be the difference between the profits that company would have made selling a PDA with that memory chip minus the profits the company would have made, and I would use net profits for both, using the next-best kind of memory chip it would have.

And when you're doing that -- let me just say the other thing, if they sue the memory chip seller, then the test ought to be it's the difference between the price of that memory chip with the invention minus the price of the next-best chip that company could have made without the patented feature.

In the first case, where the PDA seller is the defendant, a piece of evidence that is extraordinarily valuable and absolutely, positively always ought to be considered is the price at which the memory chip seller sold

that chip to the PDA manufacturer if it's a single-use chip or if the parties know that that's the use that's going to be made of it, because while it's -- and Rich is way better at this than I am, but economically that price by definition will reflect to some extent the value of that invention to the PDA buyer, I think.

It might be a little more, but it's not going to be very much more, because you'll pay -- you know, you'll pay a little less than its real value to you. So in -- in Mary's case, when she is faced with these people, the number she is talking about, and I don't know if you were talking about a different thing, but the price at which Palm, if we're using them as an example, bought that little component, ought to be very important in determining damages.

Now it's not all the total --

MS. DOYLE: It's never mentioned.

MR. SCHLICHER: -- it's not the total price of that chip, it's a part of it, but that's really good -- a good starting place.

MS. MICHEL: Okay, Marty

MR. SIMPSON: In license negotiations you deal with royalty stacking as a normal topic. And what the parties are doing is taking a look at, okay, what else applies in the economic situation, coming out with, again, what's a profitability and then coming back from that and getting a reasonable royalty.

If they're paying a lot of royalties to other people, the profitability will be less. And the parties can choose their royalty base. The Supreme Court has let the parties choose a royalty base larger than the claimed invention. In this discussion that's an analog to the entire-market-value rule. The parties can choose a royalty base smaller than the claimed invention if, again, it's for their convenience. In this discussion that's apportionment, but that's part of a negotiation on trying to find for the parties to come to a negotiation about what a reasonable value is.

MS. MICHEL: So what you're suggesting then is the base ought to be driven by what would have happened in the hypothetical negotiation rather than a legal rule?

MR. SIMPSON: If you can get the hypothetical negotiation in a way that is given to the trier of fact, that will actually, I think, answer the question.

If, on the other hand, you can't get that and you have to have factors that go to the jury, then I'm looking at it and thinking, well, the parties can choose a royalty base larger than or smaller than. So it seems to me that what the *Georgia-Pacific* factors are telling you is something that's common sense in a normal negotiation. You can do that, however, as a patent attorney for over 30 years, you will always start with the claimed invention and then you will work from there.

MS. MICHEL: Let me ask about that. The claimed

invention, there have been voices in the debate that suggest the base needs to be coterminous with the invention as claimed, the scope of the claim. How do we deal with the issue of the invention is a feature on a processor? But I can write a claim, a work station, including a processor having this feature. Now the scope of my claim is now the work station, not the processor. Does that legal construct therefore drive the base to be the work station? Just because I've claimed it that way --

MR. SCHLICHER: Mary, -- can I interject --

MS. MICHEL: Well, actually let me hear from Marty.

MR. SIMPSON: Well, first, if that's the claimed invention, you can take a look at it if you want to choose that as a royalty base and the parties look at it or the trier of fact looks at it and says this is minuscule compared to the value of what you're selling. Then you got a 0.000 something as the royalty rate if that's your base.

MS. MICHEL: But -- Mark.

MR. LEMLEY: So I mean I think that's -- and this goes back to Richard's point about equivalency, which is entirely true in economic theory and just doesn't work in practice, right?

DR. GILBERT: Lots of things --

MR. LEMLEY: Because it's much easier to persuade somebody to give a very small percentage of a very large base, because people, you know, jurors but also judges don't

understand the kind of law of small percentages, right. It's why people buy lottery tickets.

And it can't be the case that the way you write your patent claim to an otherwise identical invention should give you a different royalty.

MS. DOYLE: Result.

MR. SIMPSON: Right. The fact that I chose to claim a car containing an intermittent windshield wiper rather than an intermittent windshield wiper should not give me a larger royalty at the end of the day, but, as a practical matter, it tends to do so.

MS. MICHEL: Should it drive the math? Should the --

MS. DOYLE: No.

MS. MICHEL: -- way I wrote -- and explain why -- should the way I wrote the claim, if I recite the car, mean that I have to have the base be the car and the royalty be something -- the rate be something really small? Can we disconnect those?

MR. SIMPSON: Yeah, I think we have to disconnect them, right, because in the real world those two numbers will not be equivalent, right. It should -- you're right, it should be .0000 whatever of a really high number or one percent of a much smaller number, but, as a practical matter, those aren't going to be the same.

And so I think the focus has got to be on what we've been talking about is the incremental contribution of

the patented invention. What that means is that the -- you know, the Federal Circuit repeatedly intones: You can never under any circumstances focus on the point of novelty of the invention. But, as a practical matter, there are five or six different legal doctrines in which we already focus on the point of novelty of the invention. And this is one I think where, as a practical matter, you have no choice but to focus on the point of novelty of the invention.

You can't just say: Oh, this is a patent on a car, so we'll give damages for the car. You've got to say the only novel feature of this patent claim is the intermittent windshield wiper.

MS. MICHEL: Okay. When we do that, when we try to determine our base based on the convenience of the parties, what makes sense in commerce, and the invention itself, when that leads you to a base of a windshield wiper rather than a car, but my claim is written as a car, is that apportionment? Is that what people are meaning by apportionment? Any --

MR. SIMPSON: I mean I guess it involves apportionment, right. I mean that is -- well, so if you're measuring the base of the car, if you're -- I mean I think of it as -- I think of apportionment as actually not worrying not so much a problem in that situation. If people are selling windshield wipers separately, right, and I invented this thing, you don't need to apportion. You've got the patent, -- you know, the thing you're patenting --

measuring is now covering the product that's actually in the market, right. So if Mary's got a separate component, then we're in good shape, right.

Apportionment's what's necessary when you've got that same situation but: We only sell the thing as an integrated product, right. So it's not the chip that Mary happened to import, it's one of the six cool features of the screen, right. The sort of way you move your fingers to cause some particular thing to happen. But we don't sell, you know, screens with five of the six cool features and screens with six of the six cool features. We sell screens. And so we've got to figure out, well, all right, how much did that one value, that one move add relative to all these other things, and we've got to do it in a world, in a circumstance in which we don't have the market signal of people paying just for that one individual piece.

MS. MICHEL: Okay.

MR. SIMPSON: And that I think is where apportionment matters.

MS. MICHEL: All right. Rich.

DR. GILBERT: Yeah. I think on the issue of the base, we could interpret apportionment to mean: Apply the royalty to the smallest standalone -- or potential standalone product. In your case, for example, an integrated circuit inside the Palm.

In the *Alcatel-Lucent* case it would be the Windows Operating System instead of the computer, and the judge in

that case pointed that out.

That's one issue. I do feel that if you -- I mean subject to Mark's, I think, informed judgment that if you do the analysis correctly, as John pointed out, I don't think it should make a huge difference on where you come out, although I do recognize that in practice it very well may.

There's another apportionment issue which even as a theoretical matter is a real apportionment problem and has to be dealt with. And that is I'll bet in your Palm there is a bunch of patents that if you did not have the rights to use them you couldn't sell the Palm. And they are all absolutely essential, do not have a replacement, do not have a next-best alternative. The next-best alternative is you don't sell your Palm. And how do you --

MS. DOYLE: A radio chip.

DR. GILBERT: So I mean it's certainly true, I mean obviously it's clearly true for, say, a microprocessor. There are many, many technologies in the microprocessor. You have to have them or you don't make a microprocessor. And how do you apportion in that case. And there it's my view that you have to figure out some way to divide value among different essential patents to go back. Our delta in that case can be the entire value of the patent.

Now what Marty says is fine. If you got everybody into the room, say there were a hundred essential patents, and you got everyone into the room and said: Let's work this out and let's figure out what each one of us should

have as a reasonable royalty, you might get to a reasonable number where if it has the product as a value of $100 and there's a hundred patents, each one gets a dollar, or something like that, or minus whatever else is needed to produce the product.

But the problem gets, I think, particularly difficult when one person pops up and says: I don't care that you have a hundred essential patents to make that product, I have one, and you can't sell this without my patent, because I can perhaps get an injunction against your sales of your product, and I think I should get half because I really like my patent, and that's our starting point. That's a conceivable market outcome, but I don't think it's a market outcome that provides the right incentives for innovation.

MS. MICHEL: All right. Vince, I'm going to stop worrying about what apportionment means. Vince.

MR. O'BRIEN: Oh, okay. The situation you were just describing, why wouldn't that be handled with the Palm? You look at those 50 features that are necessary but not sufficient. You can say what was paid in the past for those. And then you say why isn't this fifty-first feature in that same group, and you look at the range and you pick a number out.

DR. GILBERT: Well, Vince, because of circularity again. Remember, somebody could have gotten a really good deal --

MR. O'BRIEN: No, but that's better than just -- that's better than be untethered, where you say: I want all of your profits.

DR. GILBERT: Well, I'll agree to that, yeah, but it's not the best outcome.

MS. MICHEL: John, and then I'll ask a wrap-up question.

MR. SCHLICHER: As I understand the law there is no rule that says the form of the claim requires that the base for determining reasonable royalty damages be anything. I think a court is free to do. There was an old rule in some infringer lost-profits case that might lead people to believe that, but I have never seen it in the reasonable-royalty cases. In early reasonable-royalty cases in the start of the last century, courts confronted that problem, solved it, and it went away.

MS. MICHEL: Thank you. That's helpful.

MR. SCHLICHER: It should have gone away. Apparently it didn't.

MS. MICHEL: Maybe it came back.

All right. I think we had some consensus on some concepts here, if we don't worry too much about terminology. That's where I'm coming down on this.

So let me ask as a wrap-up on reasonable royalties: Given where we are now in this discussion that we had, do juries and courts and parties need better guidance on how reasonable royalties ought to be calculated?

And, if so, what should be the source of that guidance, legislation, judges, FTC reports, and any thoughts on where do we go from here?

Bill.

MR. ROOKLIDGE: Well, I'm advocate of the common law process. I think the beauty of that is that instead of dealing with hypotheticals we are dealing with concrete facts of real cases. I think the Federal Circuit is in the process of addressing this. I think we all bear a responsibility whether through representing our own clients in front of the court, filing amicus briefs, or whatever, to speed that common law process along. And I think we can make a dramatic improvement in the law of patent infringement damages through that process.

MS. MICHEL: Mark.

MR. LEMLEY: What he said.

MS. MICHEL: Really?

MR. LEMLEY: Really.

(Laughter.)

MR. O'BRIEN: I agree with that, too. I'll throw in my two cents here. It's interesting when you get into these cases, the difference between the plaintiff's number and the defendant's number usually comes down to about three assumptions or three factors. Just a handful. And, you know, some of those could, I thought, maybe along what Rich designed, you know the judge might want to decide. We've talked percentages, but is a lump sum more appropriate in

this matter. That would bring the parties together really fast.

Are there substitute -- is there no other way of making and selling this product or not? That would bring them together.

At a minimum, I'd like to see a court just simply say: Okay, you get your two experts in the room, have them list the four key things they differ on, and that's what we're going to present to the jury.

MS. MICHEL: Okay. John.

MR. SCHLICHER: I have written an article describing a bill pending in the Congress that I found well intentioned but problematic as leading to a better world. And I said at that time and still believe I would leave it to the courts. On the other hand, I wouldn't have infinite patience with the courts.

Courts are limited by the cases they get and the arguments the lawyers make. I think for too long the courts have not had lots of opportunities to do things much differently because the lawyers never asked them to do anything differently and the lawyers don't necessarily put in the evidence needed to permit them to do something different, and that's a lawyer problem. We haven't done as good a job helping the courts do their job. So I am strongly inclined not to ask Congress to solve this problem. On the other hand, if in ten years people are still having this same discussion, then I would run the risk of allowing

Congress to solve it. Or ask -- I should say -- not allowing, asking Congress to solve it.

MS. MICHEL: Yar.

MR. CHAIKOVSKY: Well, I'm generally in agreement with the comments just made by everyone. Having said, I don't know if ten years is the right period of time, because I don't think Mary could wait ten years. And there's a lot of other technology companies here that can't wait ten years. So if we don't get a resolution to the problem in some time less than that, whatever that time that is, and whether it's five years or what-have-you, through the courts, then we're in trouble.

I would say and whether we go into an ongoing royalty discussion that cases such as the *Amato* case in terms of ongoing royalties and the additional factors that they set forward there, and one of them being the infringer's likelihood of success on appeal, doesn't give me a lot of hope that the Federal Circuit's going to be getting it right or certain panels of the Federal Circuit are going to be getting it right any time soon, because all they did is muck that up even further.

And so I'm in favor of the common law. You know, I'm a proponent, I'd like to see the solution there, but I recognize that high-technology companies here in the valley can't necessarily wait. And if see things like *Amato* come down and that coming down in the future, I don't have a lot of hope.

MS. MICHEL: Mary.

MS. DOYLE: So to speak as a member of that industry, I think we've now waited for six years and if we must wait another four I think you'll see companies go out of business because there are nonpracticing entities out there that are poised upon the failure of this legislation to take advantage of the vacuum and leverage huge and perhaps extraordinarily unaffordable for some of us settlements by virtue of huge patent portfolios that may or may not be infringed, who knows.

So in my view we've waited long enough. I have, in general, every confidence in the common law, but I look to the legislature to remedy abuses that are outstanding as long as these have. You know the venue issues that are involved here, but perhaps, most importantly, at least from my perspective, the lack of clarity around damages. The longer we wait the more money is going to be spent on transaction costs, which add value to nobody, benefit no one other than the source of those services, and many of whom are sitting around this table, so it's sort of, you know, no offense intended. But, in the end, we're not creating value.

And so I have looked to the legislature. Our company has, our industry has. And I think at this point we will be sadly disappointed because the legislative process isn't perfect either.

MS. MICHEL: All right. Just one question on lost

profits. Are the standards for establishing lost-profit damages too strict? And if you think they might be, why might that be a problem?

Mark, this is your cue.

MR. LEMLEY: My cue? All right. Well, I mean so this is -- I have argued that one of the reasons we got into the reasonable-royalty mess is that we created a bunch of rules, including the entire-market-value rule but including a bunch of others, convoyed sales, various got things imported into reasonable royalties, because there were cases that were really lost-profits cases but where the patentee couldn't satisfy the fairly rigorous standards of proof that have been set out in lost-profits cases.

I mean the most extreme examples involve cases in which I've demonstrated -- a patentee who's a competitor in the market has demonstrated the demand for the product. They've demonstrated there isn't a noninfringing substitute, that they would have made the sale, could actually have manufactured the goods, but there was insufficient evidence as to distinguishing out particular parts of their cost structure to determine what the profit was. And so the court said: Oh, well, so you haven't proven lost profits because we don't know what the exact profit number is, so we'll send you into the reasonable-royalty category.

And then when you get into the reasonable-royalty category, you say: Well, oh, but, you know, boy, the royalty should be pretty large because if you just give a

small two- or three-percent royalty, it means they're not making much money and, in fact they would have lost a lot.

And so we add kickers to compensate for the seemingly low reasonable-royalty numbers. Or we add entire-market-value rule or we add convoyed sales or various other things. And I think if we could more readily distinguish between companies whose claim of injury was, 'I lost a sale in a market in which I participate,' from companies whose claim of injury is, 'I lost licensing revenue from a transaction that I would have made,' we could have a more rational set of damages rules for each of those cases separately.

MS. MICHEL: Thank you.

Any thoughts on that? We'll move onto injunction.

MR. SCHLICHER: I don't --

MR. CHAIKOVSKY: See Seymour Wemley's (phonetic) paper from 2007.

MS. MICHEL: Yar is in agreement then. Okay.

John.

MR. SCHLICHER: I don't think you could make the standards for proving lost profits any more lenient if you tried. I'm not aware of the case Mark's talking about, but I think the standard is extraordinarily lenient. Indeed, the only thing you can't do is prove a number by speculation and guess work. Anything else seems to be okay. So I'm not so sure that I think that we are having too many reasonable-royalty cases because people are having trouble proving lost

profits, although I defer to Mark, I mean if he's seeing them.

The only lost-profits issue that I think is important is the extent to which the *Grain Processing* decision applies to all lost-profits cases, not simply what actually happened there, namely, an infringer who sold a product and had an absolutely perfect substitute available if it hadn't used the invention. The issue is whether if it had an imperfect substitute, the same analysis would have applied. I have seen one case that suggests to me maybe the Federal Circuit doesn't know the answer to that question.

Frank Easterbrook knew the answer and he wrote it. The answer is: The same approach applies to imperfect substitutions, but I have yet to see a case that actually says it. And if that's not -- if that's not the way cases are being decided, then we have exactly the same problem in lost profits that we've been talking about in reasonable royalties. And I don't know whether the reality is that we do, but I fear there is a risk that we might.

MS. MICHEL: Bill.

MR. ROOKLIDGE: I would just say that like John I have a difficult time wrapping my mind around the concept of loosening up damages in one area to solve damage problems in another. And I'm just not there.

MS. MICHEL: Okay. All right. Permanent injunctions. We did have a day in D.C. when we talked about the four factors in great detail. One topic we'd like in

the short amount of time we have left today is to talk about what ought to happen if a court denies the permanent injunction. What then? How do we determine the ongoing royalty, what kind of factors should we think about? Any thoughts?

Yar.

MR. CHAIKOVSKY: Well, as I already mentioned, I think we've already been provided some factors by the Federal Circuit in terms of what should be thought about in terms of ongoing royalty. I don't know if I'm necessarily in agreement. In particular, there was one I pointed out where it was kind of nonsensical in my book.

You know that being said, I think you saw something in *Pace versus* -- you know, when you have *Pace* and you have a model from the Federal Circuit where there was a suggestion at least from Rader, you know, coming on early that the parties should enter into negotiations first and actually have negotiations as opposed to necessarily having a court decide that ongoing royalty. And you've seen most of these decisions post the *Pace* and the *Amato* decisions with these nonpracticing entities coming down from the Eastern District of Texas, although you've got a case from Massachusetts, et cetera, but you've got, for example, the *Telcordia* case in Delaware where actually the judge did say, 'Hey, parties, why don't you go negotiation and actually see what you guys are able to come up with post this finding of infringement.'

And maybe that is an answer, to see if the parties can negotiate a result before we actually have a court determine what the ongoing royalty should be.

MS. MICHEL: But parties can always go off and settle. You don't have to have a court telling them to do that.

MR. CHAIKOVSKY: Parties can. But, one, will they? Two, if we then let them -- if we let them go and have an ongoing royalty and, in particular, in light of -- we'll see what happens with *Pace* after it came back down with $98, you know, $25 going up, not enough evidence to support 25, 'Well, I'm going to come back down and give you 98.' You know, so when we have that, well, where's the settlement likely to end up?

So, yes, the parties can go off and have their settlement negotiation, but if you allow the court to establish an ongoing royalty and that ongoing royalty is based on: If we follow the case law as it exists, now we already did, the expert's assuming that we've got infringement and validity, but now, okay, we've got this heightened -- well, now we got a jury verdict that actually says that there's infringement and validity, and somehow in *Amato* we're saying that's different, there's a jury verdict, and even though we already made this assumption.

And, in fact, we've got Judge Clark in Texas actually saying: I'm not going to listen to that, and we'll see what happens with that. But we have other judges that

are actually listening to that because that's the law of the Federal Circuit. And what I'm suggesting is, well, I'm not sure there should be a difference. Why should there be this difference, and we're going to end up with this heightened awards and we're already seeing $98, I mean, like I said, coming out of *Pace*.

And all I'm coming down is to I don't know what the factors should be, but why is it not necessarily having the parties perhaps enter into a discussion before we have just more factors to discuss and we've already spent time today discussing how these factors are already creating a problem in and of themselves.

MS. MICHEL: Mark.

MR. LEMLEY: Well, it seems to me if we get the damages rules right for retrospective damages, those damages rules are just right as prospectively if we've decided that injunctive relief is not appropriate, right. In some cases of course injunctive relief is going to be --

MR. CHAIKOVSKY: Big assumption.

MR. LEMLEY: -- appropriate, but if -- well, but -- well, all right. So then the question is: If we think there's some uncertainty, maybe we got the damages numbers wrong, should we systematically change them now that we know there's been -- you know, now that we're in a going-forward royalty rather than a retrospective damages for the finding of infringement and, if so, how should we change them?

Most of the discussion here has been I think

pointing in the direction that the problem with reasonable-royalty damages is that they are too high in many-component-industry cases for a variety of reasons. It is therefore particularly odd to say, anyhow, well, if we think we don't have a particularly good handle on the retrospective damages, and maybe they're all too high, we'll use that as a floor for the number going forward.

What the court in *Amato* says is the royalty on an ongoing basis should be somewhere between the minimum of whatever the jury awarded as past damages and the maximum of whatever the patentee asked for. And if the parties don't come to a deal, 'Well, Judge, choose a number somewhere between those two.'

And in that particular case, *Amato*, the numbers they used were what the jury actually awarded was four cents a unit, what the patentee asked for was $2 a unit, so there's a 50-times difference between those two numbers.

At that point, if we start effectively making this punitive, if we start saying, all right, we're going to have a higher number just because this is a going-forward royalty, we are granting an injunction, right. And that's just bizarre, having just gone through the four-factor test and saying we don't want to stop the defendant from doing this. We think it's actually efficient for the defendant to continue to infringe on the payment of a royalty, but we'll set the damages award so high that the defendant can't afford to do it.

MS. MICHEL: The Texas Court mentioned the infringement going forward would be willful. Should that play into the discussion?

MR. LEMLEY: I think this is actually really a hard question. So the Federal Circuit hasn't resolved it. They suggest in *Amato* that it's not willful, but what they really suggest is willfulness is just not the right question.

So it is the case that, going forward, the defendant knows that they are infringing a valid patent, right. On the other hand, it's also the case that the district court has weighed the four-factor test of injunctions and decided we shouldn't stop this active infringement. So it is once again I think very odd to say but will punish it, right.

And there are plausible arguments on both sides. I think it is a bit odd to punish having not granted injunctive relief, but I can see the argument on the other side.

MS. MICHEL: Rich.

DR. GILBERT: The answer is delta. Otherwise, --

MS. MICHEL: Good economics.

DR. GILBERT: The answer to all. Otherwise you are trapped in an endless loop in which royalties equals damages which equal royalties, and that can be any number you choose. So you really have to nail it down by trying to figure out what the underlying contribution is of this

technology.

a few complications. Well, first of all, if there are many essential technologies, you are necessarily involved in apportionment of some kind. It could come about through self-regulation of all the licensors getting around and saying: Let's license this and divide the value among us. But if you don't have that, it could very well require a court to determine how much this patent is worth when there are 99 others that are also necessary for the pump.

There are other complications as well, such as how much of delta should go to the licensor and how much should the licensee capture as consumer surplus, if you will. There are probabilistic issues, there are timing issues. But I think the bottom line is you need to start with delta.

MR. CHAIKOVSKY: If you answer it with you need to start with delta, then the question I would have is why do we have *Pace* and *Amato* and why is there the difference between -- again, you know, the heightened focus on the jury verdict's finding of infringement and -- you know.

DR. GILBERT: The court got it wrong.

MR. CHAIKOVSKY: Yeah. I mean and that's where we are. And so that will harken me back to Mary's point of how long is she going to wait for the common law, because this is where the common law is going in the post *eBay* world, at least with respect to damages ongoing royalty. This is going to be a big issue as it goes going forward. This doesn't bode well for the damages issue in general and

reasonable royalties in general coming out of the Federal Circuit.

MR. ADKINSON: Vince.

MR. O'BRIEN: It's always interesting when you look at the schizophrenia in these cases. But by not granting an injunction hasn't the court really said that we have economically-efficient infringement going on here? So why not worry about infringement. Let's just forget about that. Let's come up with a rate that's reasonable going forward. You can do it the way Rich says and have a hearing and the court decide what the value is. Or you can say: Go negotiate. Three months from now, if you haven't had an agreement, you each come in with a hearing. Each of you present a number, and I'll pick one or the other.

You can come up with all sorts of structures like that to solve this problem, instead of coming up with these crazy decisions. To an economist it's frustrating to look at them flounder around on this issue.

MR. LEMLEY: But we already did solve this problem, right. There's -- you know, outside of the pharmaceutical *Anda* (phonetic) cases, there is no case in which you find validity and infringement where you haven't already gone through a damages analysis, right. We've had economic expert testimony to --

MR. O'BRIEN: Well, I mean you could do that. I mean I just say it so that you have -- you put some pressure on them to reach some kind of an agreement, hopefully that

they might be a little bit better than the trial outcome.

MR. ADKINSON: But they need to know what they're negotiating in the shadow of.

MR. O'BRIEN: Yes. And you have to define that before you send them off on their own.

MR. CHAIKOVSKY: And you've got a situation right now where you've got, for example, certain venues that are now emboldened. They in the past were giving out injunctions, that injunctive risk is now gone. Well, let's come out with a decision that will embolden plaintiffs to continue to file here, in particular in light of some other venue cases that may have come out recently.

So there's a lot of incentives for decisions to come out the way they were are, if one were to be cynical about it.

MS. DOYLE: The injunction risk isn't gone if you look at the ITC as another venue, incidentally.

MR. CHAIKOVSKY: The injunction risk is a hundred percent there. So, yes, it's not gone at all.

MS. DOYLE: Right. And NPEs are now resorting to that venue on the grounds that their business in the United States is licensing.

MR. CHAIKOVSKY: And we're going to see more of that: *Zaxxon Innovations*, Gertrude Rothschild, et cetera, they're all going to take part into -- until we get to a hearing, and that's with Zaxxon and that's with Gertrude, until we get the result that actually has a domestic

industry, we have the case law from the '90s really on forward that a licensing component is sufficient, is the *Zaxxon* case, which I know you guys having played a part in, is that enough, where you've got two employees and two part-time employees and you're holding to build up your license program; is that enough? I don't know, but, yes, you're going to see them run there.

If they're not going to get relief elsewhere, NPEs are going to run to the ITC because of the speed, because of the injunctive risk. I can sue 40 people at once. Not beyond the scope here, but there's a lot of places for them to go, and the ITC is a beautiful place.

MR. ADKINSON: John.

MR. SCHLICHER: Only one comment. I mentioned injunctions earlier and I might have -- what I said might be understood to imply that I believe injunctions should issue in all patent cases. I'm going to submit written comments in which I will explain as best I can the cases in which I think an injunction should be denied and what I think ought to happen after an injunction is denied. So I will deal with this in writing. This is not a simple problem.

On the question of willful infringement, I trust it will occur to lawyers to ask the judge to enter -- to specify in the order denying the injunction that the judge has authorized the defendant to continue to sell that product under whatever conditions the court specifies in the order or the parties otherwise agree to, so that willfulness

-- willful infringement absolutely positively disappears, because if you don't do that, of course you've totally defeated the whole purpose of the judge in denying the injunction.

MR. ADKINSON: Just to quickly go right up, if we could, and ask people if could react, since we didn't have a time to talk about injunctions generally, just quickly what your thoughts are on the impact of *eBay* and on the impact of the ITC on the effectiveness of *eBay*.

MR. CHAIKOVSKY: So the impact of *eBay*, well, I mean I think you had something -- I don't know, pre *eBay*, maybe someone else here has the statistics in terms of 90, whatever, percent. But we've done an analysis of the decisions post *eBay* and I think you're getting competitor versus competitor. You're ending up with 80 percent, so you're still, you know, more likely than not, four out of five times, to be getting an injunction in a competitor-versus-competitor situation.

In a noncompetitor situation you've only had one out of eight that I'm aware of be granted, that one being CSIRO getting the injunction. That doesn't mean that CSIRO's going to get. I mean it's only gone up on validity issues. It's come back down on validity issues. We'll see if CSIRO does continue to get it. Obviously there's a concurring opinion that research institutes, et cetera, universities should be entitled to perhaps getting injunctions, and that's what the Eastern District of Texas

relied upon there, so we'll see CSIRO.

And, quite frankly, we're seeing the proliferation of universities now suing the likes of high-tech companies and lots of plaintiffs' attorneys looking for universities to sue high-tech companies because they think they're going to get an injunction.

So that's the world we're ending up with, with *CSIRO* being out there until it's overturned by the Federal Circuit or until the Federal Circuit blesses it, and that'll just make research institutes go forward.

That being said, also the ITC, I already commented on the fact, I mean if I'm an NPE I take advantage of that currently. There's absolutely no reason not to take advantage of it given the current case law. I mean if you've got not licenses you can even take the time during the course of the hearing, during the ten months to get up enough licenses so by the time you get to the hearing, absent a summary determination motion on DI, that you actually might have a chance to actually prove up the DI if someone doesn't take it to task early.

MR. ADKINSON: Anyone else on *eBay*?

MR. LEMLEY: I think I think it's a substantial step in the right direction. It's helped significantly. As Yar suggested, it's actually mostly parsed out into competitor cases versus NPE cases, despite the reference to no generalized rules. I think there are some things that are -- there are some decisions that are problematic.

CSIRO, I think -- the district court decision in *CSIRO* is a crazy outlier. It's already been reversed on other grounds. Maybe it will be reinstated as a crazy outlier, but hopefully not.

On the other side, the Federal Circuit decision in *Voda versus Cordis* I think unfairly lumps in exclusively licensors with the nonpracticing entities who cannot get injunction relief, and I think that's a mistake. It's just a kind of bad application of equity law.

MS. MICHEL: One question about the *CSIRO* case. My understanding is that the research institute had made a RAND commitment to a standard-setting body.

MS. DOYLE: Yes.

MR. LEMLEY: Yes.

MS. MICHEL: And any thoughts on whether an injunction should ever be available in that context?

MR. LEMLEY: Yeah. So I mean I am of the view that if you enter into a RAND commitment that is properly structured in the standard-setting organization, that you've entered into an enforceable contract, right. If you remember your first-year contract law, one of the things you do not have to have an enforceable contract is a price term. And so I think if you've entered into a RAND deal you have licensed your patent and it remains to be discussed -- remains to be decided by a court what a reasonable price is at which you've licensed that patent.

MR. ADKINSON: Marty.

MR. SIMPSON: Well, I wanted to point out that you may have a research institute or a university that may be the only party with standing to sue. And if that's the case, then there may be a restricted number of licenses as opposed to -- and there may be some field-abuse licenses in there. So you may have the research university needed in there. So I think injunction ought to be available to the judge when they look at it and they think, okay, if that's --

MR. LEMLEY: Right, and that's the *Voda versus Cordis* problem, right, that the Federal Circuit said, no, sorry, you can't do it. But I think that's wrong.

MS. MICHEL: We're about out of time. I'll give everybody a chance for any last comments.

Thank you. You've been a wonderful panel. I think this is has been very informative and has actually advanced the debate, which was the goal. Thank you very much.

And the record remains open till May 15th. We'll take your comments and give us a call. Thank you.

(Applause. Whereupon, the hearing was concluded at 4:34 p.m.)

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HEARING DATE: MAY 5, 2009

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