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# When Nominal Is Reasonable: Damages for the Unpracticed Patent

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# WHEN NOMINAL IS REASONABLE: DAMAGES FOR THE UNPRACTICED PATENT

OSKAR LIIVAK\*

**Abstract:** To obtain a substantial patent damage award a patentee need not commercialize the patented invention; the patentee need only show that its patent was infringed. This surely incentivizes patenting but it dis-incentivizes innovation. Why commercialize yourself? The law allows you to wait for others to take the risks, and then you emerge later to lay claim to “in no event less than a reasonable” fraction of other people’s successes. It is rational to be a patent troll rather than an innovator. This troll-enabling interpretation of patent law’s reasonable royalty provision, however, is wrong as a matter of patent policy. Surprisingly, it is also wrong as a matter of patent history. The courts created the basis for reasonable royalties in the nineteenth century, thereby marking a significant change to patent damages. But this precedent was nowhere near as sweeping as today’s interpretation would suggest. Up to the mid-1800s, the existing routes to patent damages were strict, available only to patentees who had already commercialized their patented invention. Budding innovators who were starting to commercialize but who could not yet prove an established royalty or lost profits were left out. Courts developed reasonable royalties for them. Those cases never extended reasonable royalties to those who simply sat on their patents waiting to extract payment from others. Starting in the 1970s, however, reasonable royalties came unmoored from that historical foundation. Infringement alone, without any evidence of commercialization, now creates a presumption of compensable harm. Today’s view of reasonable royalties is unsupported by patent history and sits in tension—if not outright conflict—with binding Supreme Court cases. Properly understood, some efforts to commercialize or some evidence of copying are still necessary for significant reasonable royalties. As a result, nominal damages are still reasonable to compensate for infringement of an unpracticed patent when asserted against independent inventors.

## INTRODUCTION

Even a casual glance at the news confirms that patent trolling is the most visible and controversial issue in patent law today.<sup>1</sup> “Patent trolls” represent

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<sup>1</sup> See Greg Stohr & Susan Decker, *The Supreme Court Takes on Patent Trolls*, BLOOMBERG BUS., Feb. 13, 2014, <http://www.bloomberg.com/bw/articles/2014-02-13/fighting-patent-trolls-tech->

half of all patent lawsuits,<sup>2</sup> yet President Barack Obama described them as extortionists.<sup>3</sup> This raises numerous questions: how could half of the litigants utilizing a system that has existed for hundreds of years suddenly be compared to criminals? What exactly is the problem? Is there a problem at all? Are specific entities—trolls—the problem, or are specific behaviors—trolling—the problem? These are just questions of framing and definition. What about solutions? Proposals range from back-end litigation reforms like fee-shifting to front-end reforms focused on initial patent quality.<sup>4</sup>

Some legal scholars suggest that the problem is worse than we realize. They argue that patent trolls themselves are not the problem. Rather, they should be understood as the outgrowth of “more complex and fundamental problems with the patent system.”<sup>5</sup> This Article agrees with that view. Understanding the deeper roots of the problem is important because “[t]reating the symptom will not solve the problems.”<sup>6</sup> In other words, it is shortsighted to stop trolls by adding another layer to patent law; we should instead first understand why trolls exist.

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giants-seek-to-recover-legal-costs, archived at <http://perma.cc/8NHK-HZWK>. See generally *Patents*, ELEC. FRONTIER FOUND., <https://www EFF.org/patent>, archived at <https://perma.cc/HD6Z-GC2E?type=source> (last visited Apr. 21, 2015). A patent troll is a patent owner who is not engaged in active dissemination of the underlying invention but who is nonetheless actively asserting his or her patent’s exclusive rights against independent inventors. More technically, trolls are those who are engaged in ex post licensing of their patent rights rather than ex ante licensing of their technology. See FED. TRADE COMM’N, *THE EVOLVING IP MARKETPLACE: ALIGNING PATENT NOTICE AND REMEDIES WITH COMPETITION* 7–8, 31–72 (2011) [hereinafter *FTC REPORT*], available at <https://www.ftc.gov/sites/default/files/documents/reports/evolving-ip-market-place-aligning-patent-notice-and-remedies-competition-report-federal-trade/110307patentreport.pdf>, archived at <https://perma.cc/D5FZ-BSK9>.

<sup>2</sup> See Brian Fung, *Patent Trolls Now Account for 67 Percent of All New Patent Lawsuits*, WASH. POST, July 15, 2014, <http://www.washingtonpost.com/blogs/the-switch/wp/2014/07/15/patent-trolls-now-account-for-67-percent-of-all-new-patent-lawsuits/>, archived at <http://perma.cc/QF9U-5V5X>. See generally PRICE WATERHOUSE COOPERS, 2014 PATENT LITIGATION STUDY [hereinafter *PATENT LITIGATION STUDY*], available at [http://www.pwc.com/en\\_US/us/forensic-services/publications/assets/2014-patent-litigation-study.pdf](http://www.pwc.com/en_US/us/forensic-services/publications/assets/2014-patent-litigation-study.pdf), archived at <http://perma.cc/BFU8-RS7W> (discussing the general trends in recent patent litigation).

<sup>3</sup> See Gene Sperling, *Taking on Patent Trolls to Protect American Innovation*, WHITE HOUSE BLOG (June 4, 2013, 1:55 PM), <http://www.whitehouse.gov/blog/2013/06/04/taking-patent-trolls-protect-american-innovation>, archived at <https://perma.cc/Z7MR-UWMT>.

<sup>4</sup> See Daniel Fisher, *Patent Trolls Face Higher Risks as Supreme Court Loosens Fee-Shifting Rule*, FORBES, Apr. 24, 2014, <http://www.forbes.com/sites/danielfisher/2014/04/29/patent-trolls-face-higher-risks-as-supreme-court-loosens-fee-shifting-rule/>, archived at <https://perma.cc/Q2VY-LGTJ?type=pdf>; Randall R. Rader et al., *Make Patent Trolls Pay in Court*, N.Y. TIMES, June 4, 2013, at A25, available at <http://www.nytimes.com/2013/06/05/opinion/make-patent-trolls-pay-in-court.html>, archived at <https://perma.cc/C9RY-GE5E?type=pdf>.

<sup>5</sup> Mark A. Lemley & A. Douglas Melamed, *Missing the Forest for the Trolls*, 113 COLUM. L. REV. 2117, 2117 (2013).

<sup>6</sup> *Id.* at 2121.

For example, an op-ed suggested thinking about patent trolls as a biological phenomena.<sup>7</sup> Viewed as an ecosystem, we should examine the conditions that enable trolls to exist and thrive.<sup>8</sup> To flourish, flora and fauna need an abundant food supply. This Article argues that patent law has created those necessary conditions—that “food supply”—by granting near automatic, significant patent damages in every patent lawsuit. A patentee may receive substantial damages for patent infringement whether or not he or she has done anything to commercialize the patented invention. With our modern understanding of patent damages, there now exists a mandated, substantial floor for patented damages in all cases. Patent law presumes that infringement alone causes real compensable harm. If you have a valid, enforceable, and infringed patent, then you may generally collect significant patent damages. This should be a central focus of our understanding of the troll phenomena.

For some time, those targeted by trolls have implored us to avoid “feeding the trolls.” We should stop enabling them and we should resist settlement and negotiation. What if we applied that advice, not to individual lawsuits, but instead to the whole patent ecosystem? What if significant patent damages,<sup>9</sup> even reasonable royalties, were made contingent on efforts to commercialize the patented invention? Such a rule would surely reduce patent troll activity and would likely incentivize beneficial acts of commercialization and innovation. That is, rather than suing and forcing ex post licensing, patentees would be channeled towards socially beneficial ex ante technological transfer.<sup>10</sup>

This Article argues for exactly such a rule.<sup>11</sup> Not only would it make for better patent policy but, perhaps surprisingly, such a rule is the correct under-

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<sup>7</sup> See Yaniv Heled, *Patent Trolls as Parasites*, JURIST, Apr. 28, 2014, <http://jurist.org/forum/2014/04/patent-trolls-as-parasites.php>, archived at <https://perma.cc/4J8U-H954?type=pdf>.

<sup>8</sup> See Colleen Chien, *From Arms Race to Marketplace: The Complex Patent Ecosystem and Its Implications for the Patent System*, 62 HASTINGS L.J. 297, 320–32 (2010) (describing the patent troll problem as an “ecosystem”).

<sup>9</sup> As used throughout this Article, “significant damages” refers to damages greater than nominal. “Non-nominal damages” is perhaps the most precise term but this phrasing is awkward.

<sup>10</sup> The distinction between ex ante versus ex post licensing is critical for the normative position taken here. The Federal Trade Commission (FTC) first broadly articulated the distinction in a report. See FTC REPORT, *supra* note 1, at 7, 31–72. As used here, innovation and commercialization focus on ex ante licensing and the transfer of technology to those that have not yet independently invented it. Ex post licensing is a type of licensing but no technology is transferred. The only transfer is a promise not to sue. See Oskar Liivak, *Establishing an Island of Patent Sanity*, 78 BROOK. L. REV. 1335, 1351 (2013).

<sup>11</sup> See Daniel Harris Brean, *Ending Unreasonable Royalties: Why Nominal Damages Are Adequate to Compensate Patent Assertion Entities for Infringement*, 39 VT. L. REV. (forthcoming 2015) (making a similar normative point as this Article though using a different statutory interpretation for reaching that objective). Brean, though reaching a similar normative objective as this Article, argues for nominal damages as a reasonable royalty by putting emphasis on the plain meaning of the statutory directive for the royalty to be “reasonable.” See *id.* This Article relies not

standing of our current patent damages statute. Though there has been recent, important scholarly research on reasonable royalties in general,<sup>12</sup> the presumption of compensable harm has received far less scrutiny. In reviewing the history of patent damages, this Article explains that significant damages at law were granted only when the patentee had undertaken some efforts to commercialize or if the infringer had copied from the patentee. For other cases where a patentee could not demonstrate the fact of harm, that patentee would receive no more than nominal damages. The statutory codification of reasonable royalties has not changed this traditional rule.<sup>13</sup> Although it is certainly true that the modern patent statute mandates that a successful patentee be awarded “no less than a reasonable royalty,” nothing in the statute or case law demands that a reasonable royalty be more than nominal in all cases.<sup>14</sup> The statute simply states that a successful patentee will be compensated for any actual damages that he or she can prove using all generalized evidence.<sup>15</sup> Without cognizable harm—which a patent troll will be unable to provide—nominal damages are reasonable.<sup>16</sup>

In particular, this Article argues that a nominal reasonable royalty is proper where the patentee has not undertaken any efforts to commercialize the invention and the patent is asserted against an independent inventor. As detailed below, after examining the factual background of many pivotal pa-

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on the plain meaning of reasonable but instead argues that “reasonable royalty” is a term of art that is best understood in light of the case law that led to its statutory codification. Though this Article agrees with most of Brean’s analysis, he argues for disregarding the common law meaning of reasonable royalties. This Article asserts that this particular step in his argument is hard to support (though it agrees with his ultimate goals). Instead, the common law-developed meaning of reasonable royalties from the mid-1800s through 1915 reinforces the normative objective both articles aim to support. In this Article’s reading, a defendant’s profits can be a part of the evidence used to prove the *amount* of harm *as long as the fact* of harm has been proven in some other way, for example by showing that the patentee was expending efforts to commercialize the invention. In this reading the common law-developed meaning of reasonable royalties entered the statute via its recognition in the U.S. Supreme Court’s 1915 decision *Dowagiac v. Minnesota Moline Plow Co.* See 235 U.S. 641, 641 (1915). For another view on the history of reasonable royalties, see Erick S. Lee, *Historical Perspectives on Reasonable Royalty Patent Damages and Current Congressional Efforts for Reform*, 13 UCLA J.L. & TECH. 2, 3–31 (2009).

<sup>12</sup> See generally Daralyn J. Durie & Mark A. Lemley, *A Structured Approach to Calculating Reasonable Royalties*, 14 LEWIS & CLARK L. REV. 627 (2010) (addressing the *Georgia-Pacific* factors approach to calculating reasonable royalties); Mark A. Lemley, *Distinguishing Lost Profits from Reasonable Royalties*, 51 WM. & MARY L. REV. 655 (2010) (drawing a distinction between two key doctrines of recovery for patent infringement); David O. Taylor, *Using Reasonable Royalties to Value Patented Technology*, 49 GA. L. REV. 79 (2014) (advocating the use of the reasonable royalties doctrine to value patented technology).

<sup>13</sup> Reasonable royalties first explicitly appeared in the patent statute in 1922 and reached their current form via amendment in 1946 and 1952. See DONALD CHISUM, CHISUM ON PATENTS § 20.02[2][d] (2010).

<sup>14</sup> See 35 U.S.C. § 284 (2012). See generally Brean, *supra* note 11 (making a similar point).

<sup>15</sup> 35 U.S.C. § 284.

<sup>16</sup> See *id.*

tent damage cases, there appears to be no support for the modern position that there is a presumption of compensable harm when an unpracticed patent is infringed by independent inventors. In that case, even when allowed to present generalized evidence, there is simply no cognizable harm. Not only will recognition of that rule reduce—if not eliminate—patent assertion activity, it will also re-emphasize the importance of commercialization and innovation as a central policy aim of the patent system.<sup>17</sup> In so arguing, this Article challenges today's presumption of significant reasonable royalties even for unpracticed patents. Upon examination, in fact, today's assumption is unsupported by a thorough reading of patent history and sits in considerable tension with binding Supreme Court cases.

Patent law is, for the most part, a statutory creature. This is especially true for patent damages. The current damages statute reads as follows:

Upon finding for the claimant the court shall award the claimant damages adequate to compensate for the infringement, but in no event less than a reasonable royalty for the use made of the invention by the infringer . . . .<sup>18</sup>

This Article addresses the proper interpretation of the statutory command to award damages. Does the mandate that a court “shall” award “in no event less than a reasonable royalty” require a court to award more than a nominal award in every case where infringement is proven?<sup>19</sup> The modern view says yes, while this Article argues that no, not every case should provide more than a nominal award.

There are three increasingly sophisticated ways to justify the modern understanding of reasonable royalties. None of them are convincing. The most basic view argues that reasonable royalties are not a type of damages at all, but rather they are a guaranteed minimum reward akin to a type of statutory damages. With that view, there is no need at all to consider whether the

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<sup>17</sup> See Michael A. Greene, Note, *All Your Base Are Belong to Us: Towards an Appropriate Usage and Definition of the “Entire Market Value” Rule in Reasonable Royalties Calculations*, 53 B.C. L. REV. 233, 235 (2012) (stating that “the goal of patent law is to incentivize innovation”). See generally Liivak, *supra* note 10 (arguing that innovation via ex ante licensing is the only defensible activity that patent law should aggressively protect). Recent theoretical patent scholarship has been exploring commercialization and innovation. The consensus has been that the current system (with its automatic damages) is a reward for *inventing*. If commercialization and innovation are important, then some argued that additional incentives need to be created on top of the existing patent system. See John Duffy & Michael Abramowicz, *Intellectual Property for Market Experimentation*, 83 N.Y.U. L. REV. 337, 395–407 (2008); Ted Sichelman, *Commercializing Patents*, 62 STAN. L. REV. 341, 355–80 (2010). The doctrinal argument presented here is clearly a commercialization-based argument, but it is one where the existing system becomes one that focuses on commercialization.

<sup>18</sup> 35 U.S.C. § 284.

<sup>19</sup> See *id.*

patentee has established the fact of harm. Whether the patent has been practiced is just irrelevant. Indeed, the Federal Circuit's emphasis on reasonable royalties as a "floor," as a guaranteed amount of recovery supports such an understanding. But this cannot be correct as the U.S. Supreme Court in 1964, in *Aro Manufacturing Co. v. Convertible Top Replacement Co.*, made clear that, as with lost profits, reasonable royalties are compensation for actual damages.<sup>20</sup>

A second, more sophisticated view notes this inherent conflict with *Aro*. Under this second view, reasonable royalties are understood as a form of compensation for actual damages, *but* a successful patentee that proves infringement need not establish the fact of harm separately. Infringement of a valid patent establishes the fact of harm *even* if the patent has never been practiced. At the very least, so the argument goes, the patentee has lost out on a licensing opportunity, and reasonable royalties aim to compensate the patentee for that loss.<sup>21</sup> As explored more fully below, however, this explanation is suspect because this presumption of harm conflicts with the U.S. Supreme Court's holdings in *Rude v. Westcott* and *Coupe v. Royer*. These cases involved infringement of a valid patent but nonetheless the Court held that there was no evidence of any compensable harm. These Supreme Court decisions support the notion that infringement alone does not establish compensable harm for all patentees.

Finally, in the last and most nuanced defense of the status quo, reasonable royalties are indeed actual damages and admittedly there is conflict between the modern rule and cases like *Rude* and *Coupe*. The conflict is resolved, however, by arguing that those two cases are outliers that can now be ignored. This view notes the clear trend to recognize cognizable harm based on infringement alone. Moreover, this third understanding regards *Rude* and *Coupe* as at most transient aberrations in that they were effectively overruled by the U.S. Supreme Court's 1916 decision in *Dowagiac v. Minnesota Moline Plow Co.* Accordingly, these decisions can be safely relegated to history, as Congress has codified *Dowagiac*'s liberal understanding of reasonable royalties into the modern patent statute.

This Article argues that none of these arguments support the modern view of reasonable royalties. In particular, this Article argues that this last understanding of cases like *Rude* and *Coupe* is incorrect. The jurisprudential history does not support this broad interpretation that these important cases

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<sup>20</sup> See 377 U.S. 476, 505 (1964) (noting "the fact—clear from the language, the legislative history, and the prior law—that the statute allows the award of a reasonable royalty, or of any other recovery, only if such amount constitutes 'damages' for the infringement").

<sup>21</sup> See *Lindemann Maschinenfabrik GmbH v. Am. Hoist & Derrick Co.*, 895 F.2d 1403, 1406 (Fed. Cir. 1990).

have been overruled.<sup>22</sup> The cases can instead be better understood consistently without conflict by carefully considering the factual background of the patentees and defendants in these cases. In particular, as shown below, the 1916 *Dowagiac* case is entirely consistent with the Court's earlier rulings in *Rude* and *Coupe*. Infringement alone did not, and still does not, prove the existence of any compensable harm. The case law that laid the foundation for reasonable royalties did expand the ways in which a patentee could prove the existence of harm and the ways a patentee could prove the amount of that harm. In particular, the cases recognized compensable, quantifiable harm in two scenarios beyond the traditional cases of lost profits or lost established royalties: patentees who were just starting to commercialize their products or infringers who had copied the invention from the patentee. As explained below, these recognitions of compensable, quantifiable harm certainly did liberalize patent damages, but they were nowhere near as sweeping as today's rule would suggest. Importantly, on careful examination of the case law, there is no support for recognizing actual harm for an unpracticed patent when infringed by an independent inventor. For such cases, the jurisprudence supports at most nominal damages.

In essence, the understanding of patent history argued for here will impact patent damages in only one scenario: an unpracticed patent asserted against an independent inventor. For a pirated invention or for a patentee that is starting to commercialize, the case law recognized those scenarios as establishing the fact of harm and an award of a substantial reasonable royalty is appropriate for them. No support exists, however, for a presumption of cognizable harm where an unpracticed patent is asserted against an independent inventor. Although this may seem like a small change, its importance should not be underestimated. Independent inventors are the target of nine out of ten patent lawsuits.<sup>23</sup> Today nearly half of all patent lawsuits involve patents that are not being actively practiced. Thus, if courts awarded nominal damages as the maximum reasonable damages award for infringement of an unpracticed patent by an independent inventor, then it would greatly reduce the financial incentive driving most of today's troll lawsuits.

Part I of this Article begins with a discussion of the current understanding of reasonable royalties.<sup>24</sup> It examines the doctrinal support for this view and concludes by showing how this view enables the current patent troll ecosystem. Disagreeing with that current understanding of reasonable royalties, Part II then reviews the history of reasonable royalties and shows that the reasonable royalties doctrine was created to allow substantial damages for patentees

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<sup>22</sup> See *infra* notes 117–127 and accompanying text.

<sup>23</sup> See 35 U.S.C. § 284; Christopher A. Cotropia & Mark A. Lemley, *Copying in Patent Law*, 87 N.C. L. REV. 1421, 1424 (2009).

<sup>24</sup> See *infra* notes 27–49 and accompanying text.

who are engaged in some early commercialization activities but still fall short of qualifying for lost profits or established royalties.<sup>25</sup> Part III summarizes the impact of the historical argument from Part II and outlines the proposed understanding of patent damages. Finally, Part IV provides contemporary policy support for eliminating substantial damages for the unpracticed patent.<sup>26</sup>

### I. REASONABLE ROYALTY AS A SUBSTANTIAL FLOOR

This Part outlines the modern understanding of patent damages via reasonable royalties. Most importantly, today, infringement of a valid, enforceable patent alone is enough to guarantee the patentee a substantial damages award. Efforts to commercialize by the patentee are not necessary for such an award.

Today's patent statute instructs the courts that "[u]pon finding for the claimant the court shall award the claimant damages adequate to compensate for the infringement, but in no event less than a reasonable royalty for the use made of the invention by the infringer."<sup>27</sup> The modern understanding of patent damages provides two routes for patentees: lost profits/established royalties or reasonable royalty. For those patentees that manufacture and sell the invention, they can claim damages computed via lost profits. For patentees that license their technology, they can claim damages via established royalties. The patentee can be awarded the attendant lost profits or lost royalty. Patentees that do not sell their patented invention or license it are generally not able to claim lost profits or established royalties. But the statute provides a minimum of a reasonable royalty. A reasonable royalty is the "floor" below which patent damages cannot fall.<sup>28</sup>

Today the award of a substantial reasonable royalty does not require the patentee to have undertaken any efforts to commercialize their patented invention. Rather, courts award a substantial reasonable royalty as long as the patent has been found to be valid, enforceable, and infringed. In other words, whenever a valid, enforceable patent is infringed, the patent owner can sue and know that they "shall" receive a fraction of the value derived from the use of the patented invention even if the patentee never risked any resources to develop or commercialize that use.<sup>29</sup>

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<sup>25</sup> See *infra* notes 50–161 and accompanying text.

<sup>26</sup> See *infra* notes 173–177 and accompanying text.

<sup>27</sup> 35 U.S.C. § 284.

<sup>28</sup> *Bandag, Inc. v. Gerrard Tire Co.*, 704 F.2d 1578, 1583 (Fed. Cir. 1983).

<sup>29</sup> It should be noted that a reasonable royalty as currently understood can be a nominal award where the hypothetical negotiation would return only a nominal valuation for the patented invention. This Article aims to show that a reasonable royalty cannot be more than a nominal award in a larger subset of fact patterns particularly when the patentee has not undertaken any efforts to commercialize. See generally Nathaniel C. Love, *Nominal Reasonable Royalties for Patent In-*

In fact the patentee need not show anything beyond infringement to establish the fact of compensable harm. An influential treatise outlines this modern understanding of reasonable royalties.<sup>30</sup> It notes that in considering “an award of a reasonable royalty, one should distinguish between (1) the existence of damage to a patentee which will support any award and (2) the evidentiary support for a particular rate or quantity as a reasonable royalty.”<sup>31</sup> It follows by declaring that “[a]s to the first issue, no specific proof should be required. *The premise of the reasonable royalty measure is that a holder of a valid and infringed patent has inherently suffered legal damage at least to the extent of a lost license royalty opportunity.*”<sup>32</sup>

In supporting that proposition the treatise highlights a pivotal case, the U.S. Court of Appeals for the Seventh Circuit’s 1972 opinion in *Zegers v. Zegers, Inc.*<sup>33</sup> In *Zegers*, a patentee brought suit for infringement despite not making any attempt to commercialize his patent. The defendant argued that the plaintiff should recover only nominal damages because he had not proven that he was actually damaged by the infringement through, for example, lost sales. In other words, the defendant alleged that the plaintiff had not established the existence of any real damage.

The Seventh Circuit disagreed and awarded substantial damages as a reasonable royalty:

[D]eprivation of royalty income which a patentee is entitled to receive from one who practices his invention constitutes a form of damages compensable under § 284 of the Patent Code. If the patentee is a manufacturer, he may prove his damages by evidence of lost sales and profits. But if such proof is inadequate, or if he does not himself sell the product, he may nevertheless be injured by the unlicensed practice of his invention. The reasonable royalty which he might lawfully have collected from the infringer if he had been a licensee may then be the measure of damages.<sup>34</sup>

*Zegers* was ultimately cited by Judge Markey in the U.S. Court of Appeals for the Federal Circuit’s 1990 decision in *Lindemann Maschinenfabrik*

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*fringement*, 75 U. CHI. L. REV. 1749 (2008) (arguing that a “reasonable royalty” should only entail nominal damages when there are low cost non-infringing substitutes).

<sup>30</sup> See CHISUM, *supra* note 13, § 20.07[1] (outlining the doctrine of reasonable royalties); see also Robert Merges, *An Essay on the Legacy of Chisum on Patents*, WRITTEN DESCRIPTION (Apr. 7, 2014, 11:15 AM), <http://writtendescription.blogspot.com/2014/04/merges-essay-on-legacy-of-chisum-on.html>, archived at <http://perma.cc/5K9P-33NZ>.

<sup>31</sup> See CHISUM, *supra* note 13, § 20.07[3](a).

<sup>32</sup> *Id.* (emphasis added).

<sup>33</sup> See 458 F.2d 726, 729 (7th Cir. 1972).

<sup>34</sup> *Id.* at 730.

*GmbH v. American Hoist & Derrick Co.*<sup>35</sup> The Federal Circuit agreed with the policy arguments made in *Zegers* that compensable damage occurs whenever there is infringement of a valid patent. “[T]he fact of infringement establishes the fact of damage because the patentee’s right to exclude has been violated.”<sup>36</sup> The Federal Circuit went on to reinforce that “the statute obviates the need to show the fact of damage when infringement is admitted or proven . . . .”<sup>37</sup> This remains our understanding of reasonable royalties today. In 2014, in *Apple Inc. v. Motorola, Inc.*, the U.S. Court of Appeals for the Federal Circuit reiterated that “[w]hen a patentee shows infringement, a presumption arises that the patentee is entitled to some form of damages. . . . [T]his presumption arises from the statute once infringement is admitted or proven.”<sup>38</sup>

Thus, once a patent is infringed, the fact of harm is assumed, and the patentee only needs to “prove the amount of harm.”<sup>39</sup> In modern patent law, the *amount* of harm is resolved by considering the so-called *Georgia-Pacific* factors.<sup>40</sup> Although there are multiple *Georgia-Pacific* factors, their main purpose is to determine “the amount that would have been set in a hypothetical negotiation between a willing patent owner and a willing potential user as of the date when the infringement began.”<sup>41</sup> In short, patent law now expects that a reasonable royalty will be more than a nominal award *even where the patentee has not commercialized the patented invention*.<sup>42</sup>

This understanding of patent damages is critically important for non-practicing patentees. Such patentees, who generally may not avail themselves of lost profits or lost established royalties, must rely on a reasonable royalty for their measure of damages. Luckily for them, a reasonable royalty today generally means a sizable sum of money.<sup>43</sup> As long as that patented invention—though never practiced by the patentee—has been independently in-

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<sup>35</sup> See 895 F.2d at 1406.

<sup>36</sup> *Id.*

<sup>37</sup> *Id.* at 1407.

<sup>38</sup> 757 F.3d 1286, 1327 (Fed. Cir. 2014) (quoting ROBERT A. MATTHEWS, JR., ANNOTATED PATENT DIGEST § 30:7 (2015)).

<sup>39</sup> See *Lindemann*, 895 F.2d at 1406; see also CHISUM, *supra* note 13, § 20.07.

<sup>40</sup> See *Georgia-Pacific Corp. v. U.S. Plywood Corp.*, 318 F. Supp. 1116, 1120 (S.D.N.Y. 1970), *modified on other grounds*, 446 F.2d 295 (2d Cir. 1971), *cert. denied*, 404 U.S. 870 (1971).

<sup>41</sup> CHISUM, *supra* note 13, § 20.07.

<sup>42</sup> See *King Instruments Corp. v. Perego*, 65 F.3d 941, 949 (Fed. Cir. 1995); Amy L. Landers, *Let the Games Begin: Incentives to Innovation in the New Economy of Intellectual Property Law*, 46 SANTA CLARA L. REV. 307, 324 (2006) (“A patentee qualifies for damages adequate to compensate for infringement without exploiting its patent.”).

<sup>43</sup> See Susan Decker & Dennis Robinson, *Apple Told by Jury to Pay \$532.9 Million in Patent Trial*, BLOOMBERG BUS., Feb. 24, 2015, <http://www.bloomberg.com/news/articles/2015-02-25/apple-told-by-jury-to-pay-532-9-million-in-gaming-patent-trial>, archived at <http://perma.cc/4N1V-QYRFZ>.

vented and utilized by another, then a reasonable royalties award will provide the patentee much of that utilized value.

This creates a perverse result that stifles innovation. For example, consider the case of a true (but not first) inventor who undertakes and succeeds at the hard, risky undertaking of innovation. To her dismay, a patent troll has already laid claim to being the “first” inventor, yet has taken no steps to develop the patent. The true innovator must then pay a tax to the troll, hampering her ability to continue her often socially-valuable innovative activities. Under our current system of patent damages, therefore, it is better to just be an inventor and patentee rather than to be an inventor and innovator. In a significant way, innovation today is for suckers. With incentives set so improperly, who exactly is willing to innovate rather than patenting and then waiting to enforce the patent later?

Despite this anti-innovation stance, this view of reasonable royalties also aligns with the dominant theory of patents. Specifically, many see the patent system as a reward system that aims to address an underproduction problem. That is, without patent law, those that did produce useful information (like inventions) would be unable to recoup their costs as others would simply copy and utilize the information themselves. In short, in a free-market economy, the production of inventions is not thought to be a viable business. Moreover, although we have strong evidence that the production of new ideas like inventions is very important for economic growth, it is likely that without some type of government intervention, society would under-produce this important resource.

To overcome this underproduction, we “artificially” make the business of inventing profitable. In theory we could imagine a number of ways to incentivize invention, whether through grants, prizes or exclusive rights.<sup>44</sup> Yet for many, the patent system presents the best solution to the problem of underproduction, namely utilizing exclusive rights as the reward for inventing.

Under this exclusive rights theory, policy makers decide how big of a reward to grant patentees in order to optimize inventive activity.<sup>45</sup> If the exclusive rights cover a technological space that is heavily utilized during the patent term, then the patentee can extract substantial rents from those users. In contrast, if no one is making or using anything within the exclusionary

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<sup>44</sup> See Amy Kapczynski, *The Cost of Price: Why and How to Get Beyond Intellectual Property Internalism*, 59 UCLA. L. REV. 970, 986 (2012). Recently there has been a resurgence of work on these alternatives and how to classify them. See generally Daniel J. Hemel & Lisa Larrimore Ouellette, *Beyond the Patents-Prizes Debate*, 92 TEX. L. REV. 303 (2013) (discussing the awarding of prizes for patents).

<sup>45</sup> One advantage of the patent system over alternative prize or grant schemes is the idea that by granting exclusive rights that are a function of the information disclosed, the patent reward automatically modulates the reward based on the social importance of the patentee’s contribution.

grant, then that patent is generally worth little. This is all by design and aims to tie the reward to the contribution.

In a sense, these cases focus on the patent grant itself as a reward—a reward calibrated through the right to exclude.<sup>46</sup> If during the term of the patent no one makes, uses, or sells the patented invention, then there is no one to tax via the patent exclusion and the patent reward is zero. Where others do make, use, and sell (even where they do so wholly independently from the patentee), however, the patent allows the patentee to collect tribute from those users. In that reward-based patent worldview, infringement is akin to tax evasion, and infringement alone causes pecuniary harm.

Naturally, this view of patents directly impacts one's view of patent damages. If the patent system is an artificial government intervention that guarantees a reward to patentees, then patent damages should *not* depend on the patentee's activities to commercialize or whether the defendant copied or instead independently came up with the invention. Patentees are rewarded simply for the disclosure of a patentable invention. In all cases, this particular view of patents sees all infringers as those that need to pay the patentee. In other words, all infringers—dependent of whether the patentee practiced the patent—must contribute to the patentee's reward.

The U.S. Court of Appeals for the Federal Circuit, which handles patent appeals, has justified a broad understanding of patent damages based on such a theory. In 1990, Judge Markey emphasized that compensable damage occurs whenever there is infringement of a valid patent as “the fact of infringement establishes the fact of damage because the patentee's right to exclude has been violated.”<sup>47</sup> In other words, the patent grant is specifically intended to exclude others so that the patentee can extract a rent. This right to extract rent should not depend on the activities of the patentee. As repeated later by the Federal Circuit, “[a] patentee qualifies for damages adequate to compensate for infringement without exploiting its patent . . . for the patentee's right to exclude others from making, using or selling the invention.”<sup>48</sup>

These arguments in support of the current view of reasonable royalties may seem straightforward and convincing. Indeed, they enjoy mainstream support and acceptance. What if, however, this accepted understanding is wrong? Part II takes just such a position.<sup>49</sup>

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<sup>46</sup> See, e.g., *Lindemann*, 895 F.2d at 1406.

<sup>47</sup> *Id.*

<sup>48</sup> *King Instruments*, 65 F.3d at 949; see also *Minco Inc. v. Combustion Eng'g Inc.*, 95 F.3d 1109, 1118 (Fed. Cir. 1996); *Rite-Hite Corp. v. Kelley Co.*, 56 F.3d 1538, 1548 (Fed. Cir. 1995).

<sup>49</sup> See *infra* notes 50–161 and accompanying text.

## II. NOMINAL IS REASONABLE FOR UNPRACTICED PATENTS

Prior to the creation of reasonable royalties, the award of patent damages was generally viewed as strict.<sup>50</sup> In 1853, the U.S. Supreme Court noted that patent damages “must be actually proved, and cannot be assumed as a legal inference.”<sup>51</sup> Substantial damage awards were available only to those who could prove the fact of harm and the amount of that harm. This strict view left two viable avenues for patentees—lost profits from product sales or lost royalties from an established royalty program. Patent damages were thus reserved for mature innovators that were already successfully commercializing their inventions. What about all other patentees? As the law stood at that time, they could receive at most only a nominal award. Accordingly, reasonable royalties were created in the courts and later codified into the statute to liberalize patent damages from its then strictures.

In addition, whatever a reasonable royalty might be it is agreed that it is a type of compensatory damages. The U.S. Supreme Court explicitly said as much in its 1964 decision in *Aro Manufacturing Co. v. Convertible Top Replacement Co. Aro*.<sup>52</sup> The Court stated that it is “clear from the language, the legislative history, and the prior law—that the statute allows the award of a reasonable royalty, or of any other recovery, only if such amount constitutes ‘damages’ for the infringement.”<sup>53</sup> Noting the legislative history, the Justices relayed that “the object of the bill is to make the basis of recovery in patent infringement suits general damages, that is, any damages the complainant can prove, not less than a reasonable royalty . . . .”<sup>54</sup> In short, reasonable royalty is a type of damages. Although Congress used the “but in no event less than” language, it was still focused on compensatory damages, particularly “any damages the complainant can prove.”<sup>55</sup>

Despite this agreement, questions remain. How much of a revolution did it represent? Were all patentees now to receive a substantial damage award for any infringement or was the aim more limited? Was the fact of harm to be presumed in all cases of infringement or did patentees still need to prove it separately? As outlined in the preceding Part, the modern interpretation of reasonable royalties clearly considers them to be a major departure, where now the fact of harm is presumed and substantial damages are available in every case of infringement. The modern view does acknowledge that the history of reasonable royalties is complicated by two U.S. Supreme Court cases,

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<sup>50</sup> See generally CHISUM, *supra* note 13, § 20.02.

<sup>51</sup> *Seymour v. McCormick*, 57 U.S. (16 How.) 480, 480 (1853).

<sup>52</sup> See 377 U.S. 476, 505 (1964).

<sup>53</sup> *Id.*

<sup>54</sup> *Id.* at 505–06.

<sup>55</sup> *Id.*; see 35 U.S.C. § 284 (2012).

*Rude v. Westcott* and *Coupe v. Royer*.<sup>56</sup> In the modern understanding these cases, however, only represented a temporary obstacle, as later cases affirmed the broad understanding of reasonable royalties and so it is thought effectively overruling *Rude* and *Coupe*.<sup>57</sup>

This Part, in reviewing the cases and statutory developments that produced reasonable royalties, argues that this modern understanding is wrong. Surely reasonable royalties were intended to liberalize patent damages to include more than just established, mature innovators, but it did not intend to open the door for substantial patent damages for all patentees in every case of infringement. Instead, a careful review of the cases particularly their factual backgrounds shows that the fact of harm was not presumed in every case of infringement. It was presumed only for patentees who were gearing up to commercialize or patentees who had suffered infringement at the hands of copyists. The history simply does not support a presumption of harm for cases where an unpracticed patent is asserted against an independent inventor.

#### A. Patent Damages at Law: 1790–1853

The very first patent damages statute gave little direction to courts.<sup>58</sup> The vague standard was replaced a short three years later with more detail. The Act of 1793 instructed that “the infringer should forfeit and pay to the patentee a sum equal to three times the price for which the patentee has usually sold or licensed to other persons the use of said invention.”<sup>59</sup> This early damages statute required innovation as a prerequisite for any substantial damage award by linking the amount recovered to the price of the existing sales or licenses. No compensable injury to the patentee existed unless the patentee was already selling or licensing the invention. Furthermore, the “usual[] . . . price” for that sale or license was the focus of the inquiry and the actual damages award was triple that usual price.<sup>60</sup> By 1800, Congress again amended the damages statute by removing the reference to the “usual price” and instead awarding “three times the actual damage.”<sup>61</sup> In 1836, Congress removed the automatic trebling of the reward. Congress commanded courts to

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<sup>56</sup> *Rude v. Westcott*, 130 U.S. 152, 165 (1889); *Coupe v. Royer*, 155 U.S. 565, 565–66 (1895); see CHISUM, *supra* note 13, § 20.02 (“This movement toward a reasonable royalty measure as a minimum damage recovery was temporarily checked by *Coupe v. Royer* (1895).”).

<sup>57</sup> CHISUM, *supra* note 13, § 20.02 (“Judge Denison’s seminal opinion in *U.S. Frumentum Co. v. Lauhoff* (1914) gave the reasonable royalty concept a new life, a life which was subsequently christened by the Supreme Court in 1915 and by Congress in 1922.”).

<sup>58</sup> See Patent Act of 1790, ch. 7, 1 Stat. 109–12, § 4 (“[Infringers] shall forfeit and pay . . . such damages as shall be assessed by a jury . . .”); Roger D. Blair & Thomas F. Cotter, *Rethinking Patent Damages*, 10 TEX. INTELL. PROP. L.J. 1, 93 (2001).

<sup>59</sup> Patent Act of 1793, ch. 11, 1 Stat. 318–23, § 5; *Seymour*, 57 U.S. at 488–89.

<sup>60</sup> *Seymour*, 57 U.S. at 488–89.

<sup>61</sup> Act of Apr. 17, 1800, ch. 25, 2 Stat. 37, 38, § 3.

grant only “actual damages” and it left the power to treble that award to the court’s discretion.

In 1853, this statutory history was reviewed by the U.S. Supreme Court in *Seymour v. McCormick*.<sup>62</sup> The Court outlined the rationales behind the shifting focus from the usual selling price to the more general actual damages.<sup>63</sup> It also explained the change from mandatory treble damages to the discretionary model.<sup>64</sup>

The Court in *Seymour* noted that, “as experience began to show that some inventions or discoveries had their chief value in a monopoly of use by the inventor, and not in a sale of licenses, the value of licenses could not be made a universal rule, as a measure of damages.”<sup>65</sup> Moreover, the Court explained the removal of the mandatory trebling of damages, stating that “[e]xperience had shown the very great injustice of a horizontal rule equally affecting all cases without regard to their peculiar merits.”<sup>66</sup> Congress aimed to “obviate this injustice”<sup>67</sup> and amended the statute. The *Seymour* Court lauded this liberalization from focusing exclusively on an established royalty to the more general standard of actual damages. They noted that “[i]t must be apparent to the most superficial observer of the immense variety of patents issued every day, that there cannot, in the nature of things, be any one rule of damages which will equally apply to all cases.”<sup>68</sup> The Court, however, did not allow the liberalization of patent damages without limits. Indeed, the Court made clear that lower courts can award “only such damages as have actually been proved to have been sustained. . . . Actual damages must be actually proven, and cannot be assumed as a legal inference from any facts which amount not to actual proof of the fact.” Accordingly, “[t]he question is not what speculatively he may have lost, but what he did lose.”<sup>69</sup> Ultimately, *Seymour* reversed the lower court’s “enormous and ruinous verdict” for the patentee and instead found that the only actual damage amounted to the “refusal to pay the usual license price.”<sup>70</sup>

### B. 1854–1889: Emergence of Reasonable Royalties

As explained in the previous section, patent damages initially granted substantial damages only when the patentee was actively commercializing the

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<sup>62</sup> See 57 U.S. at 488–89.

<sup>63</sup> See *id.* at 481–83.

<sup>64</sup> See *id.* at 488–91.

<sup>65</sup> *Id.* at 488.

<sup>66</sup> *Id.*

<sup>67</sup> *Id.* at 489.

<sup>68</sup> *Id.*

<sup>69</sup> *Id.* at 490.

<sup>70</sup> *Id.* at 491.

invention. Two modes of such innovative activity were generally recognized. Either the patentee was licensing the invention openly or the invention was being manufactured and sold by the patentee. The patentee had the burden to establish one of these two beneficial ways of getting the invention into the hands of the public and had to provide particular evidence to quantify the harm caused by the infringement. The courts required “substantial proof of causation.”<sup>71</sup> If the patentee could not satisfy that exacting standard, he or she would receive nominal damages. Indeed, nominal damages were awarded with some regularity.<sup>72</sup>

In a number of cases, courts found this damages rule too harsh and sought ways to rectify this “inequity.”<sup>73</sup> In 1865, in a significant U.S. Supreme Court case *Suffolk Co. v. Hayden*, the exacting standard for either lost profits or established royalty could not be proved.<sup>74</sup> Despite this, the Court did not feel comfortable simply awarding nominal damages. The Court noted:

This question of damages, under the rule given in the statute, is always attended with difficulty and embarrassment both to the court and jury. There being no established patent or license fee in the case, in order to get at a fair measure of damages, or even an approximation to it, general evidence must necessarily be resorted to. And what evidence could be more appropriate and pertinent than that of the utility and advantage of the invention over the old modes or devices that had been used for working out similar results? With a knowledge of these benefits to the persons who have used the invention, and the extent of the use by the infringer, a jury will be in possession of material and controlling facts that may enable them, in the exercise of a sound judgment, to ascertain the damages, or, in other words, the loss to the patentee or owner, by the piracy, instead of the purchase of the use of the invention.<sup>75</sup>

The Court emphasized “general evidence” in contrast to the specific evidence of either lost profits or established royalty.<sup>76</sup> In other words, substantial patent damages would no longer be limited to just those patentees that could prove an amount of lost profits or lost royalties. Additionally, the Court

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<sup>71</sup> CHISUM, *supra* note 13, § 20.02.

<sup>72</sup> See *Rude*, 130 U.S. at 167; *Black v. Thorne*, 111 U.S. 122, 122 (1884); *Garretson v. Clark*, 111 U.S. 120, 120 (1884).

<sup>73</sup> See Note, *Recovery in Patent Infringement Suits*, 60 COLUM. L. REV. 840, 847 (1960) (explaining that “[t]he courts at first restricted recovery in these cases to a nominal award, but the inequity of depriving a patent owner of compensation for the misappropriation of his exclusive rights was remedied by the judicial development of an award based on a reasonable royalty”).

<sup>74</sup> See 70 U.S. (3 Wall.) 315, 320 (1865).

<sup>75</sup> *Id.*

<sup>76</sup> See *id.*

gives some idea of what constitutes this new concept of generalized evidence. In *Suffolk*, there was “no established patent or license fee in the case.”<sup>77</sup> Thus, this generalized evidence is meant to reach cases beyond the traditional paradigms of lost profits or lost royalties. Furthermore, the Court put special emphasis on “utility and advantage of the invention over old modes” without mentioning any other factors.<sup>78</sup>

Today, courts rely heavily on these selections from *Suffolk* to show that reasonable royalties should focus only on the value of the technology at issue.<sup>79</sup> These selections are also used to support the notion that no commercialization need take place to receive substantial reasonable royalties. Yet on closer inspection, *Suffolk* cannot be understood to support that broad proposition. Although he had not yet fully commercialized his invention, and therefore was unable to qualify for traditional damages via lost profits or established royalties, the plaintiff Hayden did undertake some steps to commercialize his patent. In the district court, the judge summarized the evidence for patent damages by noting that “[t]here is some evidence . . . of the use, by [third parties] of [Hayden’s] machine . . . by his consent, under particular circumstances.”<sup>80</sup> Interestingly, “compensation for the use of it, as a license” was not “satisfactory to Mr. Hayden” and “is not taken as any price he fixed [as] fair compensation to use his patent.”<sup>81</sup> In other words, though some commercialization occurred, Hayden did not want the amounts paid for those early licenses to constitute evidence of an established royalty (presumably because the licensing royalty was quite low).

In short, *Suffolk* cannot be seen as holding that a patentee is entitled to substantial patent damages without having made any effort to commercialize. In fact, rather than dropping any consideration of commercialization efforts and innovation, *Suffolk* should be understood instead as providing needed emphasis on the realities of commercialization. Early on in the commercialization process, all patentees must convince users to adopt their new, nonobvious technology. Licenses made to those early adopters may not accurately reflect the value of the technology once its value has been proven to users. As a result, although they evidence efforts to commercialize, those early licensing agreements may need to be handled with care lest they be used too easily to prove a low established royalty. This concept was later included in an influential treatise warning against using as an established royalty “[a] fee of small amount temporarily adopted in order to introduce the invention, or to

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<sup>77</sup> *Id.*

<sup>78</sup> *Id.*

<sup>79</sup> See Taylor, *supra* note 12, at 107.

<sup>80</sup> Hayden v. Suffolk Mfg. Co., 11 F. Cas. 900, 907 (C.C.D. Mass. 1862), *aff’d sub nom.* Suffolk Co. v. Hayden, 70 U.S. (3 Wall.) 315 (1865) (emphasis added).

<sup>81</sup> *Id.*

raise money under the pressure of necessity.”<sup>82</sup> Thus, though *Suffolk* was a very important case that liberalized the too-strict standards for patent damages, it did not go so far as to remove some commercialization as a necessary element of patent damages.<sup>83</sup>

Undoubtedly, the Court was liberalizing its view on patent damages. The Court enabled damage awards even where the strictures of established royalties or lost profits could not be satisfied. Yet the important question remains: how far did this liberalization process go? In both cases, the patentee was still undertaking some efforts to commercialize even though the patentee could not satisfy the standards of lost profits or established royalties. Notably, these cases do not support the modern view of reasonable royalties.

### C. *Rude and Coupe: No Presumption of Compensable Harm*

Subsequent cases gave some clues as to the outer limits of the liberalization started by *Suffolk*. In 1889, the U.S. Supreme Court decided *Rude*.<sup>84</sup> The patent in that case was found both valid and infringed.<sup>85</sup> In what would today appear routine, the lower court awarded substantial damages. The defendants appealed the case to the Supreme Court alleging error. They claimed that the patentees had “not proved any damages for the infringement of the claims of

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<sup>82</sup> 4 WILLIAM C. ROBINSON, THE LAW OF PATENTS 329 (1890) (“[N]or, on the other hand, does a large amount paid under compulsion by infringers in settlement for injuries inflicted by their wrongful acts; and evidence of either of these payments under emergency is inadmissible.”).

<sup>83</sup> Eight years later in *Philp v. Nock*, the U.S. Supreme Court echoed these ideas and again supported a damage award even where the traditional test for established royalty could not be satisfied. See *Philp v. Nock*, 84 U.S. (17 Wall.) 460, 462 (1873). The Court stated that the patentee “will be entitled to an amount which will compensate him for the injury to which he has been subjected by the piracy.” *Id.* In arriving at their conclusion, the Court emphasized that the profit made by the defendant and that lost by the plaintiff are “among the elements which the jury may consider.” *Id.* But as with *Suffolk*, the patentee was commercializing his invention. There was evidence in the case that “the royalty which the plaintiff received for the use of his patent was at the rate of \$2 per gross.” *Id.* at 460. The case is also important in drawing a distinction between profits and actual damages. Amount saved or profits made by defendant can be evidence of actual damage but they are not themselves actual damages. In addition, other cases from that era made a strong distinction between the remedy in equity, namely defendant’s profits, and the remedy at law, actual damage to the plaintiff. See *Burdell v. Denig*, 92 U.S. 716, 720 (1875). The Court explained:

No doubt, in the absence of satisfactory evidence of either class in the forum to which it is most appropriate, the other may be resorted to as one of the elements on which the damages or the compensation may be ascertained; but it cannot be admitted, as the prayer which was refused implies, that in an action at law the profits which the other party might have made is the primary or controlling measure of damages.

*Id.*

<sup>84</sup> See 130 U.S. at 152.

<sup>85</sup> *Id.* at 159.

the patentee.”<sup>86</sup> The Supreme Court agreed, noting that this alleged error was “well taken.”<sup>87</sup>

In *Rude*, the defendant had manufactured and sold 2000 drills that infringed the patent’s claims. The plaintiff had “waived all claim for profits arising from manufacturing, use, and sale of the patented machines.”<sup>88</sup> He sought instead only to prove an established royalty.<sup>89</sup> To do so, the patentee put forth three licensing agreements showing evidence of a license paid by the Wayne Agriculture Company. The trial court refused to allow that license to establish any damages and the Supreme Court agreed with that determination. The Court noted that “it would seem that [the license] was made in part under a threat of suit, and in part as the result of an arbitration after litigation of the subject had been commenced, and to avoid future litigation.”<sup>90</sup> The Court described that such “a payment of any sum in settlement of a claim for an alleged infringement cannot be taken as a standard . . .”<sup>91</sup> The Court then affirmatively stated what types of licenses could count towards proving compensable harm:

In order that a royalty may be accepted as a measure of damages against an infringer, who is a stranger to the license establishing it, it must be paid or secured before the infringement complained of; it must be paid by such a number of persons as to indicate a general acquiescence in its reasonableness by those who have occasion to use the invention, and it must be uniform at the places where the licenses are issued.<sup>92</sup>

The licenses proffered by the patentee in *Rude* did not qualify and were rightfully rejected by the court below.<sup>93</sup>

In addition to the licensing evidence, a number of witnesses testified. Witnesses for the patentee produced “estimates . . . [of the value of the patented invention that] were merely conjectural,” ranging from three to six dollars per drill.<sup>94</sup> A witness for the defendant “stated that they did not consider them of any more utility than other seeding drills in use, and that they did not

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<sup>86</sup> *Id.* at 162.

<sup>87</sup> *Id.* at 163.

<sup>88</sup> *Id.*

<sup>89</sup> *Id.* at 164.

<sup>90</sup> *Id.*

<sup>91</sup> *Id.*

<sup>92</sup> *Id.* at 165.

<sup>93</sup> *Id.* (“[T]he sums paid in the instances mentioned, upon which the master relied, cannot be regarded as evidence of the value to the defendants of the invention patented. The court below so treated them, and held that without further evidence, the complainants would be entitled only to nominal damages.”).

<sup>94</sup> *Id.* at 166.

bring any greater price in the market.”<sup>95</sup> The master concluded, “though by what process of reasoning is not perceived” that the correct award should be \$1.50 per drill. The trial court adjusted this award to effectively \$0.60 per drill “without stating the ground of its action.”<sup>96</sup>

The Supreme Court rejected the damages award. It also rejected licensing evidence and the witness testimony as it “furnished no satisfactory basis for any damages, much less data which authorized the specific finding made as to the damages for each drill used.”<sup>97</sup> The Court emphasized that the evidence provided no proof of harm and certainly no quantifiable proof of the amount of that harm. The Court emphasized the “settled rule of law . . . that actual, not speculative, damages must be shown, and by clear and definite proof, to warrant a recovery for the infringement of a patent.”<sup>98</sup> The Court concluded that with “[n]o legal ground being shown for the recovery of specific damages . . . the decree must be [r]eversed, and . . . remanded, with directions to enter a decree for the complainants for nominal damages.”<sup>99</sup>

Two important points can be drawn from the case. First, the modern notion that infringement alone establishes the fact of harm conflicts with *Rude*. In *Rude*, the Court found infringement, yet agreed with the defendants that the plaintiffs had not “proved any damages for the infringement.”<sup>100</sup> For a court following *this* Supreme Court precedent, infringement alone cannot establish the fact of compensable harm.

Second, the Supreme Court’s decision in *Rude* has important implications for patent trolls. Indeed, it deserves much more attention than it currently receives. The case was heard at time when the Court was liberalizing patent damages—yet in *Rude*, the Court drew a sharp line. Although early efforts to commercialize like in *Suffolk* or *Philp v. Nock* could be enough to establish the fact of actual, substantial damages, the licensing activities in *Rude* did not establish any substantial damage. Moreover, although the case was decided well over one hundred years ago, it draws a sophisticated—even modern—distinction about the types of patent licensing agreements.

Patent assertion entities often bristle at being called “non-practicing entities” and point to their numerous licensing transactions as clear evidence that they too are “using” their patent. Yet all that licensing activity is deceptive. In

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<sup>95</sup> *Id.*

<sup>96</sup> *Id.*

<sup>97</sup> *Id.* at 167.

<sup>98</sup> *Id.*

<sup>99</sup> *Id.*

<sup>100</sup> *Id.* at 162.

an important report, the Federal Trade Commission (FTC) distinguished between two distinct types of licensing activity: *ex ante* and *ex post* licensing.<sup>101</sup>

According to the FTC, *ex ante* licensing encompasses the highly beneficial activities by which inventors disseminate their inventions to the people that can utilize them. The FTC explained:

Patent transactions that occur as part of a technology transfer agreement can be considered *ex ante* because they occur *before* the purchaser has obtained the technology through other means. Such *ex ante* patent transactions accompanied by technology transfer are an important means for advancing innovation, creating wealth, and increasing competition among technologies.<sup>102</sup>

In contrast, *ex post* licensing “occur[s] . . . after the firm accused of infringement has invested in creating, developing or commercializing the technology. The firm needs the *ex post* license to avoid liability, even if it invented or obtained the technology independent of the patentee, because patent infringement is a strict liability offense.”<sup>103</sup>

Importantly, it is not enough for a patentee to have licensed the patent rights. The critical question is whether that licensing was primarily focused on transferring the technology (because the licensor had not yet invented it but did want to use it) or just transferring a license not to sue (because the licensor had already independently invented and commercialized the invention). The FTC rightfully points a critical finger at *ex post* licensing. Indeed, as a matter of patent troll definition, as noted in the introduction, this Article argues that a patent troll is someone enforcing a patent against independent inventors despite having engaged in no *ex ante* transaction.

The entire patent troll licensing scheme is predicated on the threat of substantial patent damages if a “troll target”—typically a company developing a patented technology—does not pay to receive an *ex post* license for the patent. Yet in *Rude*, the Supreme Court rejected the *ex post* licensing that is at the heart of most patent troll licensing programs. In other words, the infringement of a patent whose only use had been in an *ex post* licensing scheme provided “[n]o legal ground being shown for the recovery of specific damages” and therefore required “a decree for the complainants for nominal damages.”<sup>104</sup>

Importantly, *Rude* underscores that innovation is a fundamental goal of patent policy. Damages compensating patentees via lost profits or established

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<sup>101</sup> See *supra* note 10 and accompanying text (describing the difference between *ex ante* and *ex post* licensing).

<sup>102</sup> See FTC REPORT, *supra* note 1, at 40.

<sup>103</sup> *Id.* at 8.

<sup>104</sup> 130 U.S. at 167.

royalties are aimed at compensating mature innovators. Damages compensating patentees like in *Suffolk* are aimed at those that are trying to become mature innovators. In contrast, ex post licensing, though a mechanism for generating revenue via patent exclusion, does nothing for innovation. Ex post licensing imposes a tax without any technology transfer. In *Rude*, the Court refused to grant damages for this use of a patent.

Similarly, in 1895 the U.S. Supreme Court decided in *Coupe* that infringement alone does not establish compensable harm.<sup>105</sup> The patentee Royer held a patent for “an improved machine for treating hides.”<sup>106</sup> The patentee produced limited evidence on damages, showing only that the defendant had treated 66,000 hides using the machine. Moreover, one of the plaintiffs had personally testified that, “in his opinion,” use of the machine would save “four or five dollars a hide.”<sup>107</sup> Yet, the defendant countered that “there was no advantage in the use of the plaintiffs’ mechanism, and that he would not take such a machine as a gift.”<sup>108</sup>

The lower court instructed the jury that if they found that the patent had been valid and infringed, the evidence offered by the patentee was sufficient to establish damages. The Supreme Court, however, disagreed: “we cannot approve of this instruction which we think overlooked the established law on the subject.”<sup>109</sup> The Court emphasized the difference between suits at law and equity. At law, damages aim to compensate the patentee for “the pecuniary loss he has suffered from the infringement, without regard to the question whether the defendant has gained or lost by his unlawful acts; the measure of recovery in such cases being, not what the defendant has gained, but what plaintiff has lost.” The Court ultimately held that because “the evidence disclos[ed] the existence of no license fee, no impairment of the plaintiffs’ market—in short, no damages of any kind—we think the court should have instructed the jury that, if they found for the plaintiffs at all, to find nominal damages only.”<sup>110</sup>

Infringement was proven, yet the Court held that there were “no damages of any kind.” Certainly there was not the kind of mature commercialization needed to prove actual damages via an established royalty or lost profits. Furthermore, there was no licensing at all, nor was there any evidence that the “plaintiffs’ market” had been harmed. Accordingly, although the patent was

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<sup>105</sup> See 155 U.S. at 565–66.

<sup>106</sup> *Id.* at 566.

<sup>107</sup> *Id.* at 581.

<sup>108</sup> *Id.*

<sup>109</sup> *Id.* at 582.

<sup>110</sup> *Id.* at 583.

infringed, there were “no damages of any kind” and the lower court was directed to award at most “nominal damages.”<sup>111</sup>

In addition to cases like *Rude* and *Coupe*, an influential patent treatise produced during this period helped reinforce the notion that substantial damages could only be awarded if the plaintiff had made efforts to commercialize.<sup>112</sup> This treatise noted the “two species of damages—nominal and actual.”<sup>113</sup> Actual damages, he noted, are “indemnity for injury inflicted, a compensation for a loss sustained.” To receive beyond nominal damages, therefore, the patentee must provide “clear and definite” proof of both the “existence and extent” of the loss. In other words, “the first point, on which proof should be offered in reference to actual damages is the *use made* of his patent privilege by the plaintiff.”<sup>114</sup> Thus, where a plaintiff has not made use of the patent, he or she may only collect nominal damages.

Indeed, Robinson finds only two uses of a patent that can lead to compensable harm; both are tied to modes of commercialization:

The methods by which the owner of a patent can avail himself of his monopoly may be grouped in two distinct classes. In methods of the first class the practice of the patented invention is thrown open to the public upon condition that the user pay to the owner a definite pecuniary consideration. In methods of the second class the exclusive use of the invention is confined to the owner of the patent or to specific licensees, and the remainder of the public are prohibited from its employment upon any conditions.<sup>115</sup>

Importantly, “a patentee, who neither derives nor intends to derive benefit from his invention, cannot suffer loss by its infringement.”<sup>116</sup>

In sum, *Rude* and *Coupe*, though still precedential opinions of the Court, cannot be reconciled with the modern view that infringement alone establishes compensable harm. As described below, the subsequent history of patent damages does nothing but reinforce the continued validity of these cases as binding precedent.

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<sup>111</sup> *Id.* It does appear that *Coupe* was using the patented machine himself but was not selling the invention to others nor licensing the invention to others, as the Court was confronted with the issue of whether failure to comply with the patent marking statute barred recovery of damages. *See id.*

<sup>112</sup> *See* ROBINSON, *supra* note 82, at 324.

<sup>113</sup> *Id.* at 319.

<sup>114</sup> *Id.* at 324 (emphasis added).

<sup>115</sup> *Id.*

<sup>116</sup> *Id.* at 364. For the modern question of patent assertion, the Court in *Rude* made clear that revenue derived, not from use of the invention, but instead from leveraging the exclusion of the patent, would not be use that leads to compensable patent damages.

*D. 1895–1915: Dowagiac & Reasonable Royalty*

The above cases can be described as the critical pre-history of the reasonable royalties doctrine in part because the courts had yet to use “reasonable” or “reasonable royalties” in their discussion of damages. In 1915, in *Dowagiac Manufacturing Co. v. Minnesota Moline Plow Co.*, the U.S. Supreme Court first described this emerging strand of patent damages as focusing on “a reasonable royalty.” *Dowagiac* relied heavily upon the cases discussed above and a number of additional appellate cases.<sup>117</sup>

In *Dowagiac*, the patent at issue covered a particular improvement in a kind of grain drill. Dowagiac Manufacturing, the plaintiff-patentee manufactured and sold drills that embodied the patented improvements.<sup>118</sup> The lower courts found that Dowagiac’s patent was infringed and affirmed an award of nominal damages.<sup>119</sup>

The Court noted that the defendant’s infringement in this case was “not wanton or wilful” and distinguished the facts of the case from another where the defendants had purposefully copied from the patentee.<sup>120</sup> For evidence of damages, the lower court noted that “although the number of sales made by the defendants was disclosed, the evidence did not present other data essential to an assessment of the damage sustained by the plaintiff by reason of the defendants’ infringement.”<sup>121</sup> The Court agreed, therefore, with the lower court’s determination that the patentee had not proven his lost profits. Although “the number of drills sold by the defendants was shown, there was no proof that the plaintiff thereby lost the sale of a like number of drills or of any definite or even approximate number.”<sup>122</sup> Moreover, as described by the Court, “it did not satisfactorily appear that the plaintiff possessed the means and facilities requisite for supplying the demands of its own customers and of those who purchased the infringing drills.”<sup>123</sup> As is still the case today, to prove lost profits, a patentee must prove a number of difficult issues, and the patentee in *Dowagiac* failed on a number of grounds.<sup>124</sup> Accordingly, the Court found “no adequate basis for an assessment of damages upon the ground of lost sales.”

At the time *Dowagiac* was decided, however, the case law had developed in favor of those patentees who, though practicing the invention in some

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<sup>117</sup> 235 U.S. 641, 641 (1915).

<sup>118</sup> *See id.* at 643.

<sup>119</sup> *Id.* at 651.

<sup>120</sup> *Id.* at 644.

<sup>121</sup> *Id.*

<sup>122</sup> *Id.* at 648.

<sup>123</sup> *Id.*

<sup>124</sup> *See id.*; *Panduit Corp. v. Stahl Bros. Fibre Works, Inc.*, 575 F.2d 1152, 1156 (6th Cir. 1978) (discussing the high bar to prove lost profits in patent cases).

way, had nonetheless fallen short of proving lost profits or an established royalty. In such cases, the Court stated that it was permissible to show the amount of damages by “proving what would have been a reasonable royalty.”<sup>125</sup>

In describing this as “reasonable royalty,” the Court cited *Suffolk* as a case where “a like situation was presented.”<sup>126</sup> Following the lead of *Suffolk*, the Court reversed the grant of nominal damages and remanded the case to consider the issue of a reasonable royalty.

According to the Court, actual damage was “evident” but the proper amount of damages to assess demanded more nuanced inquiry. In undertaking this inquiry, the Court again emphasized “the nature of the invention, its utility and advantages, and *the extent of the use involved*.”<sup>127</sup> In short, like the facts of *Suffolk*, a patentee engaged in some commercialization fell short of proving lost profits or established royalties. The doctrine of reasonable royalties was therefore developed to provide relief (via generalized evidence) for the harm caused by the infringement.

Additionally, the Court noted approvingly that a number of lower court decisions had been developing the concept of reasonable royalties. Importantly, all of these cases relied upon by the Supreme Court are of two varieties: either the patentee had engaged in some commercialization efforts (as in *Dowagiac*) or the defendants explicitly copied from the patentee. Notably absent is any case granting substantial reasonable royalties for infringement by an independent inventor of a wholly unpracticed patent. Furthermore, although those appellate cases addressed the perceived tension between the liberalizing trend in *Suffolk* and the limits established by case likes *Coupe*, they maintained the basic premise that infringement alone cannot establish compensable harm.

As explained in greater detail below in the Appendix, all of the cases cited by the Court in *Dowagiac*, as well as *Dowagiac* itself, involve either a practicing patentee or a defendant that has explicitly copied from the patentee, or both. In addition, rather than overruling *Rude* or *Coupe*, *Dowagiac* does not disturb their holding that infringement alone cannot establish compensable harm.

### E. 1922–1945: Statutory Codification

In 1922, seven years after the U.S. Supreme Court heard *Dowagiac* and first used the term reasonable royalty, Congress amended the patent statute and codified the concept into the statute. The statutory provision stated:

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<sup>125</sup> *Dowagiac*, 235 U.S. at 648.

<sup>126</sup> *Id.*

<sup>127</sup> *Id.* at 642 (emphasis added).

If on the proofs it shall appear that the complainant has suffered damage from the infringement or that the defendant has realized profits therefrom to which the complainant is justly entitled, but that such damages or profits are not susceptible of calculation and determination with reasonable certainty, the court may, on evidence tending to establish the same, in its discretion, receive opinion or expert testimony, which is hereby declared to be competent and admissible, subject to the general rules of evidence applicable to this character of testimony; and upon such evidence and all other evidence in the record the court may adjudge and decree the payment by the defendant to the complainant of a reasonable sum as profits or general damages for the infringement . . . .<sup>128</sup>

Although “reasonable royalty” does not directly appear in the statute, this amendment fits closely with case law that culminated with *Dowagiac*. First, on its face, the statutory provision applies where “it appear[s] that complainant has suffered damage from the infringement . . . but that such damages . . . are not susceptible of calculation . . . with reasonable certainty . . . .”<sup>129</sup> In other words, where the patentee has been commercializing the patented invention in some way but cannot yet establish a royalty or prove lost profits, then this new statutory provision applies. Where it applies, the court “may” turn to the general rule of evidence by which the court can adjudge a “reasonable sum [for the] general damages.”<sup>130</sup> That language falls nicely in line with the assessment of reasonable royalty doctrine described above.

Consistent with the case law, the statutory amendment certainly does not alleviate the need to establish the fact of harm. The statutory provision does not override *Coupe*.<sup>131</sup> Rather, it directs a court to consider a reasonable royalty only “if on the proofs it shall appear that the complainant has suffered damage from the infringement.”<sup>132</sup> Interestingly, some modern commentators have argued that later case law disregarded this seemingly clear mandate. A leading treatise notes:

[T]he [1922] statute seemed to require the complainant to prove the existence of damage to the complainant or profits by the defendant (the actual amount being uncertain) before a reasonable royalty could be recovered. The courts refused to read the statute so literally, reasoning that some damage should be presumed if the patented

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<sup>128</sup> Act of Feb. 21, 1922, ch. 58, § 8, 42 Stat. 392.

<sup>129</sup> *Id.*

<sup>130</sup> *Id.*

<sup>131</sup> *See id.*

<sup>132</sup> *Id.*

invention is a valuable one and the defendant made substantial use of it.<sup>133</sup>

In support of this assertion, the treatise cites three cases: *Austral Sales Corp. v. Jamestown Metal Equipment Co.*, *Standard Mailing Machines Co. v. Postage Meter Co.*, and *American Telephone & Telegraph Co. v. Radio Audion Co. (AT&T)*.<sup>134</sup> A careful reading these cases, however, supports a narrower view of the doctrine and its treatment of the newly minted “reasonable” sum. Rather than indicating some doctrinal shift, the cases merely align with the earlier cases that developed reasonable royalties.

The cases relied upon by this treatise feature either a patentee that is practicing the patented invention or a defendant that copied from the patentee. In 1941 in *Austral*, the U.S. District Court for the Western District of New York found “ample evidence . . . that a large number of sales have been made by the plaintiff under the patent in suit.”<sup>135</sup> In 1929 in *Standard Mailing Machines*, the U.S. District Court for the District of Massachusetts noted that “the plaintiff was in the market with two devices.”<sup>136</sup> Finally, the facts in the U.S. District Court for the District of Delaware’s 1925 decision in *AT&T* are very similar to the complicated facts found in the U.S. Court of Appeals for the Sixth Circuit’s 1916 decision in *United States Frumentum v. Lauhoff*.<sup>137</sup> In *AT&T*, the plaintiff as the exclusive licensee sued the inventor’s company for contributory infringement.<sup>138</sup> As with *Frumentum*, the defendants in *AT&T* could not be said to be independent inventors as the defendant was in fact the original inventor who had then proceeded to sell the patent but who continued to use the patented invention.

Thus, although this treatise is widely cited (and rightfully regarded as an important source for patent doctrine and history), in this area its critically important supposition is just not supported by the cases. The cases still support the notion that a reasonable royalty required some efforts to commercialize. The cases the treatise cites should be understood more narrowly to support the proposition that *where the patentee has undertaken some efforts to commercialize or the defendant has copied* the invention, then the courts presumed the fact of damage due to infringement. Doctrinal developments dur-

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<sup>133</sup> CHISUM, *supra* note 13, § 20.02.

<sup>134</sup> *Id.* For further information, see generally *Austral Sales Corp. v. Jamestown Metal Equip. Co., Inc.*, 41 F. Supp. 508, 510 (W.D.N.Y. 1941); *Standard Mailing Machs. Co. v. Postage Meter Co.*, 31 F.2d 459 (D. Mass. 1929); *Am. Tel. & Tel. Co. v. Radio Audion Co. (AT&T)*, 5 F.2d 535 (D. Del. 1925).

<sup>135</sup> 41 F. Supp. at 510.

<sup>136</sup> 31 F.2d at 461.

<sup>137</sup> See 216 F. 610, 611–12 (6th Cir. 1916); *AT&T*, 5 F.2d at 536; see also *infra* notes 206–214 and accompanying text (discussing the facts and decision in *Frumentum*).

<sup>138</sup> See *AT&T*, 5 F.2d at 536.

ing this period produce no support for presuming damage in every case where infringement is established. Furthermore, the holdings of *Rude* and *Coupe* remain valid law. In fact, the express language of the statute made clear that patentees must provide “proofs . . . that the complaint has suffered damage.”<sup>139</sup>

#### F. 1946–1952: Codification of Reasonable Royalty as Damages

In 1946, the patent statute was once again amended. The new statute stated:

[U]pon a judgment being rendered in any case for an infringement the complainant shall be entitled to recover general damages which shall be due compensation for making, using, or selling the invention, not less than a reasonable royalty therefor . . . .<sup>140</sup>

Here, for the first time reasonable royalty appears in the statute in a form that resembles the modern usage. A few things are notable about the 1946 amendment. First, the award of “general damages” is mandatory; it is something that the court “shall” award.<sup>141</sup> Second, the statute also introduced the language “not less than a reasonable royalty therefor.”<sup>142</sup> Although that language adds a mandatory floor, it also makes clear that this reasonable royalty award is still a type of damage that compensates for infringement. In other words, if there is no actual harm then there are no damages, and even a reasonable royalty cannot be more than nominal damages.

The legislative history for the 1946 amendment supports this understanding. “The object of the bill is to make the basis of recovery in patent-infringement suits general damages, that is, any damages the complainant can prove, not less than a reasonable royalty. . . .”<sup>143</sup> Just as with the 1922 amendment, the 1946 version still required the fact of damage to be proved. In fact, because the statute makes clear that a “reasonable royalty” is used “therefore,” reasonable royalties are a type of actual damages.<sup>144</sup> A reasonable royalty differs from lost profits or established royalty only in that the former two use specific evidence while the latter relies on general evidence. The patentee must still establish the fact of harm by the infringement. The addition of reasonable royalties did not change that requirement but it did (consistent with the case law from which it developed) liberalize the evidence that

<sup>139</sup> Act of Feb. 21, 1922, ch. 58, § 8, 42 Stat. 392.

<sup>140</sup> Act of Aug. 1, 1946, ch. 726, § 1, 60 Stat. 778.

<sup>141</sup> *See id.*

<sup>142</sup> *Id.*

<sup>143</sup> H.R. REP. No. 1587, 79th Cong., 2d Sess., at 1 (1946); *see also* S. REP. No. 1503, 79th Cong., 2d Sess., at 1 (1946) (providing the new language to be added).

<sup>144</sup> Act of Aug. 1, 1946, ch. 726, § 1, 60 Stat. 778.

could be utilized to establish the amount of those damages. In other words, evidence of damages was no longer limited to evidence that could prove lost profits or lost royalties.

In 1952, Congress slightly adjusted the language again in its overall effort to codify patent law. With that change, the patent statute arrived at the familiar form that still exists today:

Upon finding for the claimant the court shall award the claimant damages adequate to compensate for the infringement, but in no event less than a reasonable royalty for the use made of the invention by the infringer . . . .<sup>145</sup>

As noted by the Supreme Court in *Aro*: “In the 1952 codification, Sections 67 and 70 of the 1946 Code were consolidated in the present Section 284. The stated purpose was merely ‘reorganization in language to clarify the statement of the statutes.’”<sup>146</sup>

#### *G. 1952–1972: Fact of Harm Is Not Presumed*

*Georgia-Pacific Corp. v. United States Plywood Corp.*, a 1970 decision from the U.S. District Court for the Southern District of New York, is one of the most cited cases dealing with post-1952 reasonable royalties.<sup>147</sup> It is most well-known for its famous listing of fifteen evidentiary factors “relevant, in general, to the determination of the amount of a reasonable royalty.”<sup>148</sup> Although efforts to commercialize through “royalties received by the patentee” is the first evidentiary factor, the list as a whole does not appear to demand any efforts to commercialize by the patentee. Indeed, absent actual licensing agreements or any other efforts to commercialize, the so-called *Georgia Pacific* factors are rooted in the determination of “the amount that a licensor (such as the patentee) and a licensee (such as the infringer) would have agreed upon (at the time infringement began) . . . .”<sup>149</sup> In other words, without any efforts to commercialize, the patentee is still entitled to no less than the amount of that hypothetical negotiation. That hypothetical negotiation might return a nominal value where the invention has little utility or where low-cost non-infringing alternatives exist, but in general the patentee gets the amount of that negotiation whether or not the patentee was commercializing or not.

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<sup>145</sup> 35 U.S.C. § 284 (2012).

<sup>146</sup> *Aro*, 377 U.S. at 476 (citing H.R. REP. No. 1923, 82d Cong., 2d Sess., at 10, 29 (1952)).

<sup>147</sup> See generally *Georgia-Pacific Corp. v. U.S. Plywood Corp.*, 318 F. Supp. 1116, 1120 (S.D.N.Y. 1970), modified on other grounds, 446 F.2d 295 (2d Cir. 1971), cert. denied, 404 U.S. 870 (1971) (laying out fifteen factors to determine the awarding of reasonable royalties in patent cases).

<sup>148</sup> *Id.*

<sup>149</sup> *Id.*

On closer examination *Georgia-Pacific* does not support such a broad understanding of reasonable royalty. In particular, as with the earlier cases that awarded substantial damages in the form of a reasonable royalty, the patentee in the case, the U.S. Plywood Corp., was in fact commercializing the patented invention through the manufacture and sale of its Weldtex striated plywood.<sup>150</sup> As a manufacturer, U.S. Plywood certainly tried to show that Georgia Pacific's infringement caused damages by way of lost profits. Ultimately, however, U.S. Plywood's case failed in this regard as to the amount of damage because its "contentions, in light of the record herein, [fell] outside the considerable latitude in speculation sometimes necessary in this type of case."<sup>151</sup> The damages issue in the case was referred to a special master and much of the district court opinion deals with that special master's report.

In reviewing the report, the court considered "specific findings and conclusions . . . of controlling importance."<sup>152</sup> First, "[t]he Report found, and that finding is sustained by the court," that U.S. Plywood proved "the fact of harm" or "the fact of harm of injury," i.e., "that loss of sales of Weldtex occurred by reason of GP's infringement."<sup>153</sup> The court in *Georgia-Pacific* explicitly saw the need to establish the fact of harm and it did so based on the commercialization efforts by U.S. Plywood in selling Weldtex plywood.

Today in patent law a reasonable royalty determination is often called simply an application of the *Georgia-Pacific* factors. Yet, even in the one case that has become the focal point for reasonable royalties, the court emphasized that the patentee had proven the fact of harm as the patentee had been clearly practicing the patent by selling the patented plywood. No such explanation would be necessary if in fact the proper interpretation of the patent damages statute now allowed the courts to presume the fact of harm upon a showing of infringement. Correctly interpreted, there is no such presumption and the *Georgia-Pacific* court rightfully never relied on one and instead noted that the patentee (because of its efforts to commercialize) had proven the fact harm.

#### *H. Zegers v. Zegers (1972): Presuming Harm*

As detailed above, up to 1972, the fact of harm was not presumed in patent law. In 1972, however, the U.S. Court of Appeals for the Seventh Circuit changed that in *Zegers v. Zegers, Inc.*<sup>154</sup> In the district court, the patentee prevailed and the court awarded \$34,000 in damages. On appeal, the defendant "argue[d] that [the] plaintiff may never recover a reasonable royalty without

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<sup>150</sup> *Georgia-Pacific Corp. v. U.S. Plywood Corp.*, 243 F. Supp. 500, 502 (S.D.N.Y. 1965) (preceding the litigation that lead to the seminal 1970 *Georgia-Pacific* decision).

<sup>151</sup> *Id.* at 511.

<sup>152</sup> *Id.* at 512.

<sup>153</sup> *Id.* at 512-13.

<sup>154</sup> 458 F.2d 726, 729 (7th Cir. 1972).

proving that he was in fact damaged by the infringement.”<sup>155</sup> The Seventh Circuit disagreed: “we assume *arguendo* that the plaintiff suffered no actual damages in the form of lost sales; we hold that he is nevertheless entitled to recover a reasonable royalty.”<sup>156</sup> In particular, the court held that “deprivation of royalty income which a patentee is entitled to receive from one who practices his invention constitutes a form of [compensable] damages . . . .”<sup>157</sup>

As described in Part I, *Zegers* was cited by an influential treatise and later by the Federal Circuit that picked up on *Zegers* via the that treatise.<sup>158</sup> Accordingly, as the law now stands, patent law presumes a harm—at least a lost licensing opportunity—whenever there is a finding of infringement.

*Zegers* represented a momentous change in patent jurisprudence. Yet this change has not been properly explained. In the first place, the presumption of harm conflicts with the holdings of both *Rude* and *Coupe*, which the Seventh and Federal Circuits must follow. Furthermore, as found in many of the cases above, *Zegers* may be distinguished on its facts from a broader unilateral rule that presumes harm just from infringement alone. As its name suggests, *Zegers v. Zegers Inc.* involves litigation between a family business and one of its relatives who had, at one time, been part of that family business.<sup>159</sup> These close family ties surely distinguish *Zegers* from a case where the plaintiff and defendant are totally unrelated.<sup>160</sup>

Despite its expansive language, *Zegers* should not be relied upon as establishing that infringement alone establishes the fact of harm in every patent case. Instead, it should perhaps best be understood as part of the development suggested by the U.S. Supreme Court in *Seymour*, discussed above.<sup>161</sup> Because of the peculiar factual situation in *Zegers*—dual blocking patents between family members—the case should be understood as relaxing the cases where the fact of harm can be established. The courts had already found that copying and piracy established the fact of harm. *Zegers* extended that trend to

<sup>155</sup> *Id.*

<sup>156</sup> *Id.*

<sup>157</sup> *Id.* at 730.

<sup>158</sup> See *supra* notes 33–42 and accompanying text.

<sup>159</sup> *Zegers*, 458 F.2d at 727 (“[P]atent litigation in the Zegers family has been continuous since 1959.”).

<sup>160</sup> In addition, another peculiar aspect of *Zegers* is worth noting: the case involved blocking patents held by the plaintiff *and* defendant. Although this case involved Edward Zegers asserting his patent against Zegers Inc., in earlier litigation Zegers Inc. successfully sued and obtained an injunction against Edward Zegers. Because of this somewhat unique back-and-forth, the defendant tried a clever argument in support of an award for nominal damages. The defendant argued that nominal damages were appropriate because the plaintiff did not—and could not—practice his patent because doing so would have infringed the defendant’s blocking patent and would have violated a previously secured injunction. The court was unwilling to agree to the nominal damage award because that result would have immunized a blocking patent holder from infringement of the blocked patent.

<sup>161</sup> See *supra* notes 62–70 and accompanying text.

include cases where practicing of the patent was being precluded by the patent position of the defendant.

### III. SUMMARY OF PROPOSED VIEW OF PATENT DAMAGES

At its core, this Article's proposal emphasizes that a patentee that successfully proves infringement must also show actual harm in order to receive more than nominal damages. Currently, patent law presumes the existence of compensable harm with every finding of infringement. Yet many patentees, if required, will not be able to show compensable harm. Where they have undertaken no real efforts to commercialize their patented inventions, patentees cannot demonstrate any actual harm from infringement by an independent inventor. For them, a nominal award is reasonable and is the most that a court could award under this proposed scheme.<sup>162</sup>

The changes to patent damages proposed here are best viewed by describing their relation to our current understanding of patent damages. The current landscape of patent damages is quite easy to state. If a patentee suc-

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<sup>162</sup> Although it facially bears some resemblance to a working requirement, this Article is arguing for something different. Traditional working requirements in patent law focus specifically on manufacturing of the patented invention and they typically made the validity of the patent contingent on manufacturing of the invention. The arguments here differ in two significant respects from such a traditional working requirement. First, this Article does not focus on a requirement for manufacturing or other such physical realization of the invention. Instead the focus is on ex ante technology transfer of the invention. For purposes of this Article, a patentee has practiced the patent whenever they have engaged (or are gearing up to engage) in ex ante transactions to get the invention from the patentee into the hands of those that can utilize the invention. The invention provides utility to those that use the invention. The ultimate question is whether the patentee has helped the invention reach those that will use it. Depending on the invention, for example a process patent, this may or may not include any actual manufacturing by the patentee. Second, as opposed to a traditional working requirement, the proposal put forth here does not impact patent validity but rather just impacts remedies—in particular damages at law. *But see* John F. Duffy, *Reviving the Paper Patent Doctrine*, 98 CORNELL L. REV. 1359, 1359 (2013) (arguing that patent history supports the notion that validity and claim construction hinged on efforts to commercialize). This Article does not argue that patent validity should be contingent on efforts to commercialize. Rather, efforts to commercialize are argued to be a necessary element for substantial patent damages at law, including reasonable royalties. In short, inventing is necessary to receive a patent, but innovating is required to accrue substantial damages for the infringement of that patent. Furthermore, this proposal is also distinct from patent misuse. The proposal here does not tie failure to practice the patent with unilateral unenforceability where there would be no remedies against any infringer. Not only would such an argument be in direct conflict with the statute, it would embody bad policy. *See* 35 U.S.C. § 271(d) (2012). As will be argued below, even an unpracticed patent needs to be protected against outright copyists. All patentees should continue to enjoy muscular protection from copyists. Instead, this Article focuses attention on the remedies available for a particular subset of patentees when asserting patents against a particular subset of defendants. The focus is on the assertion of unpracticed patents against independent inventors. Today such assertions typically result in substantial damage awards via reasonable royalties, but this Article argues instead, that in light of patent history and patent policy, patent law should award at most nominal damages in those cases.

cessfully proves his or her patent has been infringed, a court may choose one of two remedies: lost profits or reasonable royalty.<sup>163</sup> A patentee who is manufacturing and selling the patented invention can claim that the infringement caused a loss of profits.<sup>164</sup> A successful lost profits case requires stringent proof of the amount of lost profits caused by the infringement. Not every patentee can make that showing.<sup>165</sup> For those that fail to prove lost profits, the patent statute provides a safeguard. It guarantees that “in no event” shall a court award “less than a reasonable royalty” as damages.<sup>166</sup> In other words, a reasonable royalty is available to all—that much is clear. Yet it does little to answer the next logical question: what is the mandated reasonable royalty?

Under our current understanding of patent damages, this question is not contested.<sup>167</sup> Today, we base reasonable royalties on a hypothetical negotiation between the patentee and the infringer at the time infringement began. The hypothetical negotiation aims to set the amount that the patentee and infringer would have agreed to for the use of the invention. Today, the amount agreed to in this hypothetical negotiation is seen as the minimum guaranteed to every patentee after a finding of infringement. Accordingly, after a finding of infringement, patent law presumes that the patentee has been harmed and that this hypothetical negotiation is the central mode of approximating that harm. Significantly, these hypothetical negotiations do not consider whether the patentee had been practicing the invention.

Table 1. The Current View of Patent Damages		
Patentee	Practicing the Patent	All Others
	Lost Profits (or Established Royalty)	Hypothetical Negotiation

Table 1 provides a quick summary of the current state of patent damages. A few points should be made. First, the defendant’s status largely does not matter for today’s patent damages.<sup>168</sup> Whether the infringer was an outright copyist or had independently invented the patented invention, he or she may receive either lost profits or reasonable royalties.<sup>169</sup> Second, efforts by the

<sup>163</sup> See Lemley, *supra* note 12, at 655.

<sup>164</sup> For patentees that do not manufacture but are instead engaged in ex ante licensing, they can claim that the infringement caused lost licensing revenue with the amount of damage set by the patentees’ established royalty rate.

<sup>165</sup> See *Panduit Corp. v. Stahl Bros. Fibre Works, Inc.*, 575 F.2d 1152, 1156 (6th Cir. 1978); HERBERT F. SCHWARTZ, *PATENT LAW AND PRINCIPLES* 212–14 (5th ed. 2006).

<sup>166</sup> 35 U.S.C. § 284.

<sup>167</sup> For a recent thorough exploration and criticism of the hypothetical negotiation as the central feature of reasonable royalties, see Taylor, *supra* note 12, at 81–95.

<sup>168</sup> I am putting aside issues relating to willfulness for now. See 35 U.S.C. § 284; see also SCHWARTZ, *supra* note 165, at 231.

<sup>169</sup> See Lemley, *supra* note 12, at 655. The fact that independent inventors are infringers has been an ongoing topic of scholarly research. For more recent discussions, see generally Robert P.

patentee to commercialize the patented invention are not necessary for substantial patent damages via a reasonable royalty. They certainly matter for lost profits or established royalty, but unpracticed and practiced patents are generally treated equally for substantial damages via reasonable royalties.<sup>170</sup> Our current damages landscape is simple, but overlooks important policy and historical issues that, when properly understood, provide for a more varied terrain to patent damages.

Rather than understanding reasonable royalties as always requiring a hypothetical negotiation, reasonable royalties are more accurately understood simply as actual damages that the patentee can prove with generalized evidence. That is, reasonable royalties developed to allow substantial damages where the *fact* of harm was proved and the *amount* of harm could not be fit into the stringent confines of lost profits or established royalties.

This Article argues that actual damages suffered by patentees hinge on the patentee's efforts to commercialize the patent.<sup>171</sup> To establish the existence of harm from infringement by independent inventors, a patentee must necessarily make an effort to commercialize the patent. Commercialization, therefore, must be a necessary element for substantial patent damages, including reasonable royalties. Indeed, this understanding of reasonable royalties, outlined in Table 2 below, is supported by patent history.

<b>Patentee Infringer</b>	<b>Practicing the Patent</b>	<b>Toward Practicing</b>	<b>Not Practicing</b>
Copyist/ Pirate	Lost Profits (or Established Royalty)	Hypothetical Negotiation	Hypothetical Negotiation
Independent Inventor	Lost Profits (or Established Royalty)	Hypothetical Negotiation	Nominal Damages

The proposed scheme expands available damages for patent infringement. Rather than today's binary separation between manufacturers and everyone else, the proper understanding of patent damages divides patentees into three types. First, the most mature patentees are those that are actively practicing their invention through ex ante transfer of the invention. They are either manufacturers selling artifacts that embody the invention (and are thus grant-

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Merges, *A Few Kind Words for Absolute Infringement Liability in Patent Law* (Univ. of Cal., Working Paper No. 2, 2014) (defending patent law's absolute liability rule).

<sup>170</sup> In fact, there is evidence that as to reasonable royalties, a practiced patent is at a disadvantage. See PATENT LITIGATION STUDY, *supra* note 2, at 6 (showing a downward trend in damages awarded for practiced patents, but not for non-practiced ones). One way that a practiced patent is burdened is that the existing licensing agreements can anchor the fact finder's determination of a reasonable royalty. This may well be appropriate but an unpracticed patent is not so encumbered and the damages experts have free reign to postulate a reasonable royalty. See Lemley, *supra* note 12, at 655–56.

<sup>171</sup> See *supra* notes 162–166 and accompanying text.

ing an implied *ex ante* license of use with the sale) or they are directly selling an *ex ante* license for the use of the invention directly. This practicing group is generally able to claim either lost profits or established royalties. As shown in Table 2, patent damages for these patentees are the same whether or not the infringer is a copyist or an independent inventor. Reasonable royalties are theoretically available as a minimum floor for these patentees, but if they truly are engaged in widespread practice of the patent, then they should be able to satisfy the more stringent evidentiary burdens required to prove lost profits or an established royalty.

The second group of patentees includes those that are working toward innovating and are beginning to undertake efforts to commercialize. As argued here, the case law that developed into reasonable royalties was built to afford this middle group of patentees compensation for infringement. Historically, under the strict evidentiary standards of lost profits or established royalties, this group of patentees could not prove the amount of damages and were often left with nominal damages, even though courts generally agreed that infringement did cause pecuniary harm. Reasonable royalties developed to provide some estimation of that pecuniary loss for these patentees by allowing patentees to address actual harm with generalized evidence.

The last group is the trolls: those that have engaged in no efforts to commercialize. Under today's understanding of patent damages, substantial reasonable royalties extend equally to these patentees as well as patentees who are working toward practicing their inventions. This Article argues that this is incorrect. Properly understood, a reasonable royalty aims to compensate for actual damages to the patentee—not imaginary harms to a patentee who has not lifted a finger to commercialize his or her patent. For a patentee making no efforts to commercialize, infringement by independent inventors causes no compensable harm. That patentee cannot prove any legally cognizable harm and though the court “shall” grant “in no event less than a reasonable royalty,” for this scenario, the reasonable royalty is no more than a nominal award.<sup>172</sup>

#### IV. POLICY SUPPORT: NOMINAL IS REASONABLE FOR UNPRACTICED PATENTS

There are significant theoretical problems with the dominant reward-based view of patents.<sup>173</sup> The current view creates a system based on exclu-

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<sup>172</sup> As will be explained below, the law has always treated copyists differently—and for good reason. In a sense, though a patentee has yet to expend any efforts to commercialize, infringement by a copyist has generally been treated as though the patentee had already expended some efforts to commercialize.

<sup>173</sup> See Liivak, *supra* note 10, at 1335 (2013); Oskar Liivak, *Maturing Patent Theory from Industrial Policy to Intellectual Property*, 86 TUL. L. REV. 1163, 1163 (2012).

sion where some are left without access to the invention. As a non-rival good, preventing use of a productive invention appears inefficient. Furthermore, applying a cost benefit analysis, it is impossible to establish that the benefits of rewarding patent trolls outweigh the significant costs of litigating endless patent suits. The dominant reward-based theory is based more on “faith” and mysticism than anything scientific. In sum, although the dominant view supports today’s liberal grant of damages, its theoretical foundations rest on shaky ground.

A narrower understanding of reasonable royalties casts an alternative vision of the patent system that focuses more on commercialization and innovation as the system’s ultimate goal. In this view, rather than focus only on the creation of inventions, the patent system seeks to foster both efficient creation of inventions *and* efficient distribution of those inventions to those who can use them. The aim of the patent system is to provide protection for (and coordinate) both inventive *and* innovative activity.

The active use of productive technological solutions by society is the ultimate goal. A patent is no longer seen as an end in itself, but a means to facilitate the development and dissemination of useful inventions. Indeed, invention itself does precious little.<sup>174</sup> A patent should not be a reward funded by a tax on those that use the invention. Rather, an issued patent should be viewed as providing the patentee with the rights *and obligations* to be the exclusive supplier of the patented invention to all those who can use the invention.

The grant of the patent simply certifies that the inventor created a technological solution that is new, not obvious, and properly disclosed. Patentable inventions should be viewed as technological creations that provide benefits to society. Once a patent is issued, the patent system should now expect that patentee to supply their solution to society. The exclusionary rights granted by the patent need not only exclude others from using the invention. Rather, these rights should simply protect the patentee’s position as the exclusive supplier of the patented technology to society.

When guided by this vision of the patent system, patentees are expected to actively offer their inventions to technological users through product sales or grants of licenses. This is how a patentee should generate revenue. Embracing this innovation-focused view recasts the question “what would the patentee have made but for the infringement?” If the patentee is actively supplying the invention to users, then we can sensibly talk about pecuniary losses to the patentee due to the infringement. Infringement may well be displacing sales that the patentee would have made—and that loss should be compen-

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<sup>174</sup> JOSEPH SCHUMPETER, THE THEORY OF ECONOMIC DEVELOPMENT 88–89 (1951) (“As long as they are not carried into practice, inventions are economically irrelevant.”).

sated by patent damages. Even minimal use by an infringer would likely cause a lost sale and should lead to compensation.

With this obligation-to-innovate world view, however, if the patentee undertakes no commercialization and just sits on the patent—earning no revenue from their position as the exclusive supplier of the patented invention—then “but for the infringement” the patentee’s position would not be any different. They cannot show any pecuniary harm from the infringement. In this view, infringement causes the non-practicing patentee no compensable harm and accordingly nominal damages are reasonable.

Not only does history support such a view of patent damages, but this innovation-focused theory has substantial benefits over the reward-based theory. First, as a theory it has the potential to be verified.<sup>175</sup> Second, the emphasis of this system is on supplying inventive technology to others, not on excluding others *per se*. In a sense, the proper view of the patent system is about inclusion: those who want to use the patented invention should be able to use it—they just need to get the invention from the patent owner.<sup>176</sup> Of course, they will not be able to use it for free, but the fee they pay for access should be directly related to the utility provided by the invention. The purpose of exclusive patent rights is to protect the patentee as society’s exclusive supplier of the invention. The system thus protects patentees while channeling the development of useful inventions into the societal mainstream.<sup>177</sup>

## CONCLUSION

A review of the history of patent damages challenges the modern understanding of how courts award reasonable royalties for infringement. Today cognizable harm is presumed for every case of infringement. That presumption is just not supportable. For a patentee that has engaged in no efforts to commercialize, infringement by an independent inventor causes no cognizable harm and a nominal award is a reasonable royalty. The modern view cannot be reconciled with U.S. Supreme Court cases such as *Rude* and *Coupe*, which held that, although infringed, the patentee had not established the existence of any harm.

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<sup>175</sup> See Liivak, *supra* note 10, at 1365–86.

<sup>176</sup> *Id.* at 1357.

<sup>177</sup> *Id.*

## APPELLATE CASE APPENDIX

The following cases were all cited by the Supreme Court in *Dowagiac Manufacturing Co. v. Minnesota Moline Plow Co.* *Dowagiac* is the first case where the Court explicitly describes the award of reasonable royalties and it is a clear precursor to congressional codification of reasonable royalties concept into the patent statute. A careful review of the facts of those cases reveals that there are two fact patterns where the courts had awarded more than nominal damages. Either the invention had been pirated from the patent holder or the patentee was gearing up to commercialize the invention. Of these cases that figure prominently in the Supreme Court's analysis in *Dowagiac* there is no case that supports significant damages for infringement of an unpracticed patent by an independent inventor. In other words, *Dowagiac* and the cases it relies upon do not support the modern liberal construction of reasonable royalties.

*McCune v. Baltimore & Ohio Railroad Co.*, 154 F. 63 (3rd Cir. 1907)

In 1907, the U.S. Court of Appeals for the Third Circuit heard the case of *McCune v. Baltimore & Ohio Railroad Co.*<sup>178</sup> McCune was the inventor of U.S. patent 341,930 issued on May 18, 1886. The invention was an improved ash-pan for locomotives. The patent expired on May 19, 1903. The trial was held on November 19, 1906. McCune testified about his "effort[s] to make sale of right to that patent." He testified that in 1887 "I went to the Baltimore and Ohio Railroad Company and I offered it to them for sale and they said they could not use it, that it was no use to them."<sup>179</sup> During that negotiation, McCune admitted that no price was ever fixed for the use of the invention, and as B&O refused to license it, he largely gave up further efforts. Even though it appears he became aware that B&O began using an ash pan similar to his invention as early as 1889 or 1890, it was not until 1902 that he seriously began to enforce his patent when "a friend . . . told [him that B&O] was using my invention."<sup>180</sup> He testified that from there on "I made it my business to stop my work and go up and see what they were doing, and I discovered that they were using it on pretty near every engine in the yard."<sup>181</sup>

In the subsequent testimony the trial court sustained a number of B&O's objections. McCune was asked to describe "[i]n the operation of a locomo-

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<sup>178</sup> 154 F. 63, 63 (3rd Cir. 1907).

<sup>179</sup> Transcript of Record at 17, *McCune v. Balt. & Ohio R.R. Co.*, No. 16 (1907) (testimony of James B. McCune).

<sup>180</sup> *Id.* ("[B]ecause I thought when they had turned it down there was no use in following it up any more and I did not pay much attention to it . . .").

<sup>181</sup> *Id.* at 20.

tive, what if any utility or advantage has this device of yours.”<sup>182</sup> The defense counsel for B&O objected to this question and the court sustained the objection, citing *Coupe v. Royer*.<sup>183</sup> McCune was then asked whether he had found his invention in use in any other railroad other than B&O. McCune answered that he had, but before he could further describe those other infringements, the defense counsel objected again. McCune’s lawyer explained:

We expect to prove by this witness and possibly by one or two other witnesses that this patent had been in use not only on the Baltimore & Ohio, but has been in use on the Pennsylvania Lines, has been in use on the New York Central, has been in use on other roads and has been in use on roads on the Pacific slope—that the purpose of showing that this general piracy of this device has been to destroy the market value and thus renew our offer to show what the utility and the advantage of this is.<sup>184</sup>

Again the district court sustained the objection to the testimony. Later in its opinion, the district court held that the plaintiff McCune “had never granted a license, established a royalty, or manufactured and sold the patent device”<sup>185</sup> and directed a verdict for the plaintiff for nominal damages only.

On appeal, McCune argued that it was error to deny the testimony and the appellate court agreed. In reviewing that denial, the appellate court addressed the tension between the U.S. Supreme Court cases *Suffolk v. Hayden* and *Coupe*. In reviewing the cases, the Third Circuit made clear that the objective of evidence on patent damages was to establish “actual damages” and that existing “license fees and royalties are generally, though not always, taken as the measure of damages.”<sup>186</sup> But the court noted that, similar to *Suffolk*, there may be occasions where “general evidence must necessarily be resorted to.”<sup>187</sup>

The court did not see a conflict between *Suffolk* and *Coupe*. Instead, it saw *Coupe* as recognizing the rule from *Suffolk* that “other evidence may be resorted to in the absence of established royalty and license fees.” The court in *McCune* quoted *Coupe* as holding that there was no evidence of license fees or impairment of a market, and “no damages of any kind.”<sup>188</sup> The court in *McCune* regarded that language as implying that evidence of damages could extend beyond evidence of established royalties and lost profits. In oth-

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<sup>182</sup> *Id.* at 31.

<sup>183</sup> *Id.* at 32; see *Coupe v. Royer*, 155 U.S. 565, 565 (1895).

<sup>184</sup> Transcript of Record, *supra* note 179, at 33 (testimony of James B. McCune).

<sup>185</sup> See *McCune*, 154 F. at 63.

<sup>186</sup> *Id.* at 64.

<sup>187</sup> See *id.*

<sup>188</sup> *Id.* at 65.

er words, compensable harm could occur even though a patentee could not prove lost profits or a loss of an established royalty. Based on that understanding, the Third Circuit held that the lower court erred in refusing to hear evidence that might show that the patentee's plans to innovate and create a market had been harmed by the appropriation and use of the invention by others. The court remanded the case with instructions to grant a new trial to hear that excluded evidence.<sup>189</sup>

In short, even though McCune "had never granted a license, established a royalty, or manufactured and sold the patent device,"<sup>190</sup> he established grounds on which to build a theory of damages. If the widespread infringement "prevented the establishment of a market value,"<sup>191</sup> the appellate court held that it was improper to exclude that testimony.

*McCune* falls in line with earlier cases and extends patent law's theory of harm beyond those that are trying to establish a royalty. Actual damage, including the case law that developed into reasonable royalties, was premised on harm to the efforts to commercialize.<sup>192</sup>

*Hunt Bros. Fruit-Packing Co. v. Cassidy*, 64 F. 585 (9th Cir. 1894)

In 1915, the U.S. Supreme Court in *Dowagiac* approvingly cited to the U.S. Court of Appeals for the Ninth Circuit's 1894 decision in *Hunt Brothers Fruit-Packing Co. v. Cassidy*.<sup>193</sup> The patentee in *Cassiday* was trying to commercialize the patented invention. In "some instances," the patentee had set and collected a royalty of \$100 for use of the invention.<sup>194</sup> In addition, he had sold his patented fruit driers for \$250 and estimated that \$100 of that was profit relating to the patented portion of the drier. On appeal, the defendant alleged that the trial court had erred by failing to instruct the jury to award only nominal damages.<sup>195</sup>

The appellate court found no error, holding:

It is difficult to conceive how there could have been more direct proof concerning the amount of a reasonable royalty in a case such

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<sup>189</sup> *Id.*

<sup>190</sup> *Id.* at 64.

<sup>191</sup> *Id.*

<sup>192</sup> Furthermore, if McCune's testimony is given credit, the early access to the patent and the technology does support the idea that B&O copied the technology from McCune. This was particularly galling to McCune as his contact at B&O, the master mechanic for the railroad, was also a close friend. Transcript of Record, *supra* note 179, at 19 (testimony of James B. McCune) (testifying that Mr. Weisgobber, the master mechanic at B&O, and McCune "went to school together and . . . were as good friends as my own brother and myself, but he done me dirt all right").

<sup>193</sup> See *Dowagiac Mfg. Co. v. Minn. Moline Plow Co.*, 235 U.S. 641, 649 (1915); *Hunt Bros. Fruit-Packing Co. v. Cassidy*, 64 F. 585, 587 (9th Cir. 1894).

<sup>194</sup> *Cassiday*, 64 F. at 587.

<sup>195</sup> *Id.* at 585.

as this. The estimate of the patentee . . . is true, an expression of his opinion; but it is an opinion based to some extent upon figures and estimates. . . . In this class of patents there are necessarily no data from which the value of the royalty can be calculated with mathematical certainty. The damages here, like damages in many other classes of cases, are calculable upon such evidence as it is in the nature of the case possible to produce.<sup>196</sup>

Here, the patentee had “endeavored to fix the royalty at \$100” for use of the invention and had “in some instances collected that amount as royalty.”<sup>197</sup> The court noted that “[t]he plaintiff was clearly entitled to damages for infringement,” presumably referencing the commercialization efforts. In the absence of an established royalty or lost sale “the only measure of damages was such sum as, under all the circumstances, would have been a reasonable royalty . . . .”<sup>198</sup>

Again a patentee who was commercializing but nonetheless unable to prove lost profits or established royalties was awarded damages via reasonable royalties.

*Bemis Car Box v. J.G. Brill*, 200 F. 749 (3rd Cir. 1912)

*Bemis Car Box Co. v. J.G. Brill Co.* involved a patentee who was “engaged in the business of manufacturing and selling [railroad] car axle boxes, pedestals, springs, and other parts, not including wheels, which together comprised the running gear for cars drawn by horses upon street railroads.”<sup>199</sup> The patentee established “a broad market” for its products and continued to expand until 1893 “when defendant had become an active competitor in the business with the aid of its infringing device.”<sup>200</sup> From that time on, defendant’s business gradually increased, and the plaintiff’s decreased.<sup>201</sup> As to the defendant, the court emphasized:

The important fact[] [is] that the defendant after becoming familiar as a customer with the qualities of the plaintiff’s invention, imitated it by adopting and, so far as the evidence shows, using as a general practice in its truck and car business a box embodying the novelty of plaintiff’s invention, which differed from it only in trifling details of mechanical form, and which the defendant, when now

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<sup>196</sup> *Id.* at 587.

<sup>197</sup> *Id.*

<sup>198</sup> *Id.*

<sup>199</sup> 200 F. 749, 754 (3rd Cir. 1912).

<sup>200</sup> *Id.*

<sup>201</sup> *Id.*

called upon to defend its conduct, does not seriously attempt to distinguish from the plaintiff's device . . . .<sup>202</sup>

As the plaintiff was actively practicing the invention through sales, the referee in the case calculated actual damages using lost profits. In the alternative, in part owing to questions regarding the fraction of the defendant's sales that would have been made by the plaintiff, the referee also addressed the emerging reasonable royalty cases and reached a similar conclusion about the amount of actual damage caused by the defendant's "reckless" if not "wanton" infringement.<sup>203</sup> The Third Circuit found no error with the work of the referee:

We think there was evidence tending to support these several findings by the referee. Had this case been tried by a jury, the evidence was such that a trial judge would not have been justified in giving a jury binding instructions that it could only find nominal damages for the plaintiff.<sup>204</sup>

The Court concluded that "after careful consideration of them all, we find no substantial ground for reversing the [referee's] report."<sup>205</sup> Again, the case involved a patentee that was trying to sell his invention. In addition, the case involved a defendant that had copied from the patentee. This case certainly does not support extending reasonable royalties beyond a patentee that is commercializing their invention.

*U.S. Frumentum Co. v. Lauhoff*, 216 F. 610 (6th Cir. 1916)

Although all of these cases were cited approvingly by the U.S. Supreme Court in *Dowagiac*, the U.S. Court of Appeals for the Sixth Circuit's 1916 decision in *U.S. Frumentum Co. v. Lauhoff* is regarded as a "seminal" case for developing the reasonable royalty case law.<sup>206</sup> The patented invention involved a process for making films from corn. The district court held for the plaintiff yet granted only nominal damages.<sup>207</sup> On appeal, the Sixth Circuit reversed on the subject of damages.

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<sup>202</sup> *Id.* at 757.

<sup>203</sup> *Id.* at 758.

<sup>204</sup> *Id.* at 764.

<sup>205</sup> *Id.* at 765.

<sup>206</sup> See *Dowagiac*, 235 U.S. at 648–50; *U.S. Frumentum Co. v. Lauhoff*, 216 F. 610, 618 (6th Cir. 1914); CHISUM, *supra* note 13, § 20.02 ("Judge Denison's seminal opinion in *U.S. Frumentum Co. v. Lauhoff* (1914) gave the reasonable royalty concept a new life, a life which was subsequently christened by the Supreme Court in 1915 and by Congress in 1922.")

<sup>207</sup> *Frumentum*, 216 F. at 612.

The court held that, although a patentee does not have an established royalty or any provable lost profits, that alone does not automatically limit the patentee to nominal damages. The court cited back to the language of *Suffolk*:

Where there is no established patent or license fee in the case, or even an approximation to it, general evidence must necessarily be resorted to. . . . And what evidence . . . could be more appropriate and pertinent than that of the utility and advantages of the invention?<sup>208</sup>

The court also considered the supposed tension between *Suffolk* and *Coupe* and found no real conflict. Along the lines supported by the Third Circuit in *McCune*, the Sixth Circuit in *Fruentum* also found no real conflict between the two Supreme Court cases. In considering the award of nominal damages in *Coupe* and the language used to support that award, the *Fruentum* court stated:

[T]he language of this sentence [in *Coupe*] seems to have been carefully chosen so that it should not go beyond the instant case. Its conclusion is predicated not only upon the lack of evidence of an existing license fee or of an impairment of plaintiff's market, but also upon the lack of evidence of "damages of any kind." If the only possible recoverable damages depended on the existence of one or the other of the two specified criteria, there was no object in referring to other evidence of other damages of some other kind.<sup>209</sup>

*Suffolk* should not be seen as a case that enlarges the theories of harm beyond attempted commercialization. Instead, where efforts to commercialize are evident but the strictures of lost profits nor established royalty cannot be satisfied, *Suffolk* should be seen as liberalizing the type and amount of evidence needed to adequately account for that evident harm. By contrast, in a case like *Coupe* where no evidence of harm is presented, the award of nominal damages is not only reasonable but required.

Nevertheless, despite supporting the generalized evidence of a reasonable royalty, *Fruentum* cannot support substantial damages for patentees who have undertaken no steps toward commercialization, for two reasons. First, the patent holder *Fruentum* was himself practicing the process and had the manufacturing capacity to meet the demand that instead went to the defendant.<sup>210</sup> Yet *Fruentum* fell short of proving the other essential elements of

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<sup>208</sup> *Id.* at 618.

<sup>209</sup> *Id.* at 623.

<sup>210</sup> *Id.* at 614 ("It was shown (and we assume sufficiently) that plaintiff had factory facilities for manufacturing the additional amount [of product made by the process] and so could have filled the orders [actually filled by the defendant] . . .").

lost profits, failing to show that but for the infringement, the customers of the defendant would have instead bought from him.<sup>211</sup> *Fruentum* was practicing the patented invention but could not fulfill the demanding standard of lost profits. The *Fruentum* court noted that based on those facts “[i]t follows that, upon the basis of the master’s findings, the District Court was right in directing nominal damages only; and it would ordinarily follow in this condition of the case that the judgment below would be affirmed.”<sup>212</sup> Second, the infringer was the original inventor who had sold the patent to *Fruentum*, and therefore the defendant could not be an innocent independent inventor. The court held:

We are not satisfied to have this case [award only nominal damages]. There is a finding that the patent was valid; that the defendant Lauhoff, who had sold the patent, infringed it extensively and so endeavored to keep what he had sold; and that defendants’ sales were so large that no one can doubt the actual existence of substantial damages. Under such circumstances, to have plaintiff recover nothing, because the difficulty of absolutely definite proof is insuperable, is a result so unfortunate that, if avoidable, it should not be permitted.<sup>213</sup>

Not only was the plaintiff practicing the patented invention himself, but the defendant was not an independent inventor. Under those facts, infringement by the defendant certainly harmed the patentee’s efforts to commercialize and harmed the integrity of a system of patent transfer. According to the court, “no one can doubt the actual existence of substantial damages” even though lost profits and established royalty could not be proven.<sup>214</sup> *Fruentum* certainly counts as one of the early appellate cases to liberalize damages beyond established royalties or lost profits, but it cannot be relied upon to argue that a patentee who has undertaken no efforts to commercialize the patented invention will be awarded substantial damages when infringed by an independent inventor. Furthermore, *Fruentum* reaffirms the appellate court’s view of continued validity of the Court’s *Coupe* judgment that infringement alone cannot establish compensable harm.

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<sup>211</sup> *Id.* (“There was no testimony that defendants’ customers had formerly bought from plaintiff, nor that they were in negotiation with plaintiff or in a territory in which plaintiff was selling, nor of others of those circumstances sometimes held sufficient and sometimes held insufficient to raise the presumption that plaintiff would have made the sales.”).

<sup>212</sup> *Id.*

<sup>213</sup> *Id.* at 614–15.

<sup>214</sup> *Id.* at 615.