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An Assignment's Effect On Hypothetical Negotiation

Thursday, Feb 07, 2008 --- A number of the Georgia-Pacific factors depend on the identities of the “willing licensor” and “willing licensee” in a damages calculation using a hypothetical negotiation to establish a reasonable royalty under 35 U.S.C. § 285.[1]

It is therefore no surprise that changing the licensor or licensee can dramatically change the result of the hypothetical negotiation determined by a fact finder applying Georgia-Pacific.

The substantial effect of the parties’ identities raises the issue of whether a patent owner can manipulate the identity of the willing licensor prior to filing suit to improve the outcome of the hypothetical negotiation.

Imagine that your patent licensing client, Tech Company (“Tech”), calls you one day with a legally innovative idea to enhance its damages recovery.

Tech has been negotiating unsuccessfully with Alpha Corporation to license Alpha a patent that issued one year ago today. Alpha has been selling its accused products since the date the patent issued. Negotiations have failed and Tech is ready to go to court.

But Tech fears its potential recovery is limited because it has previously granted several low-royalty licenses to similar technology, and as a licensing company it may be perceived as “eager” to license Alpha in the hypothetical negotiation.

Tech is also concerned that as a licensing entity, it may have difficulty obtaining a permanent injunction against Alpha, under the Supreme Court’s recent opinion in Ebay v. Mercexchange.[2]

Tech has consulted an expert whose opinion is that it should recover an award of $1 million based on a hypothetical negotiation between Tech and Alpha.

However, Alpha has a large competitor, Zeta Corporation (“Zeta”), with no low royalty licenses in its past due to a business strategy of never licensing its patent rights to competitors.

Zeta Company wants to purchase or license all substantial rights to the patent and file an infringement suit against Alpha.[3]

Zeta has already consulted a damages expert who would testify that based on typical licenses in the field and Zeta’s unwillingness to license competitors, the hypothetical negotiation between Zeta and Alpha would result in a minimum of a $10 million royalty.

The expert's opinion depends heavily on Zeta and Alpha being the parties to the negotiation.[4]

Can Tech and Zeta take advantage of Zeta's better position to increase the value of an infringement action by making Zeta the plaintiff instead of Tech?

This scenario is not far-fetched, having arisen in a recent Southern District of California case, Nichols Institute Diagnostics Inc. v. Scantibodies Clinical Laboratory, Case Number 02-cv-0046 B (JMA).

Nichols obtained rights to United States Patent Number 6,030,790 from a German licensing company, Pharis, after Scantibodies' alleged infringement began, and filed suit against Scantibodies.

Nichols asserted a damages theory based on a hypothetical negotiation between Nichols and Scantibodies taking place on or around the date Nichols obtained its license from Pharis.

After extensive briefing, the district court barred plaintiff Nichols' damages expert from opining to the jury about any negotiation between Nichols and Scantibodies.[5]

The Court's holding was rooted in the well-established rule that the hypothetical negotiation takes place when infringement began, not at any later date, and infringement had begun prior to the Nichols/Pharis license agreement.

At the date of the hypothetical negotiation, Pharis had not yet licensed the patent to Nichols, so Nichols could not be a party to the hypothetical negotiation.

Under this same authority, if Zeta obtains rights to the patent and files suit against Alpha, the court should only allow testimony regarding a hypothetical negotiation between Tech and Alpha.[6]

Discussion

Although the district court in Nichols v. Scantibodies appears to be the only court to have addressed the effect of an assignment on the hypothetical negotiation, the Federal Circuit's current framework for the hypothetical negotiation leaves little room for Tech and Zeta to increase the potential damages award beyond what Tech could recover if it had not licensed the patent to Zeta.

The Federal Circuit consistently has reversed district court verdicts based upon hypothetical negotiations taking place at a time other than the start of the defendant's infringing activity.[7]

Wang Lab. Inc. v. Toshiba Corp. appears indicative of how the Federal Circuit would treat the type of assignment described above. [8]

In that case, the Court refused to waver from the rule requiring a hypothetical negotiation on the date of first infringement.

The district court had moved the hypothetical negotiation from the date of first infringement to the date when the patentee first gave notice of its patent, reasoning that since the patentee's right to collect damages began then, the hypothetical negotiation should take place on that date as well.[9]

The Federal Circuit reversed, holding that while it was "not illogical to hypothesize a negotiation at the time of notice," the district court abused its discretion in failing to apply the precedent that a hypothetical negotiation must take place when infringement began.[10]

The case was remanded for the trial court to determine damages based on a hypothetical negotiation on the date of first infringement.[11]

Given the Court's refusal to tie the hypothetical negotiation to the start of the damages period, even if it might be logical to do so, it seems likely the Court would refuse to alter its rule where a licensee obtains rights in the patent after the start of infringement.

In Applied Medical Resources Corporation v. U.S. Surgical Corporation, the Federal Circuit recently approved an approach involving two separate hypothetical negotiations on different dates, but based its decision on reasoning that likely would not apply to an assignment that changes the parties to the hypothetical negotiation.[12]

There, the parties had been involved in a prior patent infringement case, and the district court in the second action refused to give collateral estoppel effect to the reasonable royalty rate established in that earlier case.[13]

The court reasoned that since the second action involved a different, redesigned accused product ("Versaport II"), damages for that product should not be tied to the hypothetical negotiation involving the earlier product ("Versaport I").[14]

The Federal Circuit agreed, stating that "[b]ecause the determination of reasonable royalty damages is tied to the infringement being redressed, a separate infringement beginning at a different time requires a separate evaluation of reasonable royalty damages."[15]

In the hypothetical discussed above, Tech and Zeta might argue that since a new hypothetical negotiation was necessary in Applied Medical Resources when the accused product changed, a new hypothetical negotiation is also mandated when, through an assignment, the identity of the patentee changes.

But a change in the patentee's identity does not implicate the Federal Circuit's current rule in the same way that a change in the accused product does.

As emphasized in Applied Medical Resources, damages are tied to "the infringement being addressed."[16]

Modification of the accused products results in a new instance of infringement. An assignment, however, does not result in a "new infringement" that would require a second hypothetical negotiation, since the potentially infringing conduct remains the same — only the identity of the party who can recover damages for that infringement has changed.

Conclusion

In sum, although the Federal Circuit has never addressed the effect of an assignment on the parties and date of the hypothetical negotiation, its precedent suggests that a patent holder would not be successful in attempting to manipulate the results of the negotiation by assigning the patent to an entity with greater bargaining power and less willingness to grant a license.

The Federal Circuit repeatedly has steadfastly adhered to the rule that "the key element in setting a reasonable royalty ... is the necessity for return to the date when infringement began."[17]

By licensing its patent to another entity, the patent owner does not change the date upon which infringement began, and therefore is not entitled to a new hypothetical negotiation.

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[1] Georgia-Pacific Corp. v. U.S. Plywood Corp., 318 F. Supp. 1116, 1120 (S.D.N.Y. 1970).

[2] Ebay, Inc. v. MercExchange LLC, 126 S.Ct. 1837, 1841 (2006) (rejecting Federal Circuit rule that a permanent injunction will generally issue once infringement and validity have been determined).

[3] This article does not address the exact transfer of rights between Tech and Zeta other than that the rights are sufficient that Zeta has standing to sue in its own name without joining Tech, and occurs after the alleged infringement by Alpha began.

[4] Whether that negotiation is assumed to take place a year ago when the alleged infringement began, or in the near future when Zeta obtains all

substantial rights to the patent, does not materially affect the expert's opinion because the bulk of the hypothetical royalty is in the form of an up-front payment, and Alpha's first year sales were low.

[5] The Federal Circuit has since invalidated the '790 patent. Nichols Institute Diagnostics Inc. v. Scantibodies Clinical Laboratory Inc., 195 Fed. Appx. 947 (Fed. Cir. 2006) (unpublished).

[6] As a general matter, Tech and Zeta are free to exchange rights to the patent as they see fit. They might even agree that the transfer is retroactive to the date infringement began. However, the basic legal tenet that a party cannot assign something it does not own, Uhlhorn v. Goodman, 84 Cal. 185, 191 (1890), also prevents Tech from assigning Zeta something it did not have rights to: a hypothetical negotiation between Zeta and Alpha.

[7] See, e.g., Integra Lifesciences I Ltd. v. Merck KGaA, 331 F.3d 860, 870 (Fed. Cir. 2003), vacated and remanded on other grounds, 125 S.Ct. 2372 (2005) (remanding for reconsideration of reasonable royalty damages, where district court had disregarded acts that might have constituted infringement when it set the date of the hypothetical negotiation); Unisplay v. American Electronic Sign Co. Inc., 69 F.3d 512, 518 (Fed. Cir. 1995) (reversing a jury verdict that was based on expert testimony regarding a royalty rate from a hypothetical negotiation that occurred after the date of first infringement).

[8] Wang Lab., Inc. v. Toshiba Corp., 993 F.2d 858, 870 (Fed. Cir. 1993).

[9] Id.

[10] Id.

[11] Id. See also Avocent Huntsville Corp. v. Clearcube Tech. Inc., Number CV-03-S-2875-NE, 2006 U.S. Dist. LEXIS 55307 at *76-*85 (N.D. Ala. July 28, 2006) (excluding testimony of expert who placed the hypothetical negotiation on the date the lawsuit was filed, rather than the date of first infringement).

[12] Applied Medical Resources Corp. v. U.S. Surgical Corp., 435 F.3d 1356 (Fed. Cir. 2006).

[13] Id. at 1359.

[14] Id.

[15] Id. at 1362.

[16] Id.

[17] Hanson v. Alpine Valley Ski Area Inc., 718 F.2d 1075, 1079 (Fed. Cir. 1983).