

**AIPLA 2007 ANNUAL MEETING**

**Concurrent Track 2**

**The In-House Counsel Institute**

**Damages**

**by**

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**Speaker Bio:**

Alan Ratliff, CPA/MPA-JD, is a Partner in the international forensic accounting and economic consulting firm, The StoneTurn Group, where he serves as a consultant and expert witness on accounting, business custom and practice, damages, economics, licensing and valuation (business and IP) issues in litigations, arbitrations and transactions, and as a forensic accountant on financial and fraud investigations as well as royalty audits. In addition, Alan has been appointed as a Special Master and arbitrator.

Alan has his undergraduate and graduate degrees in accounting from Baylor (with high honors), and his law degree from SMU (with honors) where he was also a member of the Order of the Coif and a managing editor of the Law Review. Prior to consulting, Alan was a lawyer handling complex commercial disputes and transactions at the law firm of Weil, Gotshal & Manges, a law clerk to the Honorable J. Smith Henley of the United States Court of Appeals for the 8th Circuit (St. Louis), and in public accounting practice. In addition to being a CPA for 20 years, Alan has received Martindale-Hubbell's highest AV-rating. Alan has been selected to appear in several "Who's Who" in American Business and Law listings.

Alan's recent publications appear in law reviews including Texas Tech, Houston, South Texas and SMU (Journal of Air Law & Commerce), and in dozens of periodicals. Alan has served as an adjunct professor or guest lecturer at programs offered by Baylor University, Boston University, The University of Houston, South Texas College of Law, The University of Texas and Virginia Tech, and has presented at CLE's hosted by the Dallas, Houston, Louisiana, New Orleans, and New York City bars, as well as the State Bar of Texas and ABA litigation section, AIPLA, IPO, and for the California and Texas CPA Societies.

Alan was recently recognized for his public service by the City of Houston with "Alan Ratliff Day" on December 3, 2006, serves as a volunteer every two years at the Winter and Summer Olympics, has a collection of over 300 pieces of autographed sports memorabilia, and celebrated his 20<sup>th</sup> wedding anniversary in 2007.

## Recent Federal Circuit Damages Decisions

1. *Monsanto Company v. McFarling*, 488 F.3d 973 (Fed. Cir. 2007)

Affirming jury award of \$40/bag royalty (1 bag = 1 acre) where evidence showed lost technology fee of \$6.50/bag, lost seed sales of \$19-\$22/bag, \$31-\$61/acre yield increase benefit or weed control cost savings, and loss of qualitative benefits (inventory control, quality control, reputation, etc.).

2. *Wechsler v. Macke International Trade, et al.*, 486 F.3d 1286 (Fed. Cir. 2007) (with dissent).

Reversal of lost profits where patentee not selling patented product (pet water dispenser) during period competitor infringed. Issue of whether customers would have waited for patentee in absence of infringer. Question of causation for court or jury?

3. *Mitutoyo Corporation, et al. v. Central Purchasing, LLC*, 2006-1312, -1343 (Fed. Cir. 9/5/2007).

Affirming royalty equal to patentee's profit margin (as a percentage of sales) on its "high end" measuring device applied to the infringer's sales of "low end" measuring device.

## **By the Numbers: IP Litigation & Damages Update**

Since the Supreme Court's 2006 decision in *eBay*, much attention has focused on the trends and quantitative metrics associated with IP litigation. This short article highlights some of the trends and data that may be of interest to practitioners in the field. While some of the studies and observations discussed herein are based on somewhat limited available data, most are statistically significant and reflect meaningful trends over a period of years.

### *Filings & Costs*

Based on a search of the P.A.C.E.R. multi-party case index data for 2006, total IP cases filed in the U.S. by type in 2006 were as follows: patent (2835), trademark (3754) and copyright (4837). This compares to previous year results reported by IPO of about 2700, 3700 and 6000, and typical ranges of 2500-3000, 3500-4000, and 2000-3000, respectively, in the previous five years. Thus, while patent and trademark litigation filings have remained fairly consistent, copyright infringement case filings have soared, doubling from 2004 to 2005, and remaining well above historical levels even through 2006. The most common explanation suggested for the increase in copyright litigation filings are the statutory damage provisions for minor but repeated acts of infringement that can really add up, as well as the increased use and enforcement of the DMCA as the volume of digital and other on-line works continues to expand at a rapid pace.

Locally, the Eastern District of Texas has consistently become the first or second most active patent litigation docket in the country with more than 200 such cases filed there in 2006 (ranking it second behind the C.D. Cal.), about 5% of which made it to jury trial – the most of any district and about twice the national average. Initial filing numbers for 2007 reflect that the Eastern District is the most active patent docket nationally.

While the volume of filings has increased, so has the cost. According to the AIPLA, the cost of large case patent litigation through trial has increased steadily from over \$3 to about \$5 million per party over the last 3 years. Factoring in the various stages of pre-trial disposition of patent litigations, a study prepared for the IPIL advisory council based on 2004 data, estimated that the average cost per side through disposition for all patent litigations is about \$1 million per side.

### *Injunctions*

While it is still early, initial data reflects an increase in the rate of injunctions denied in patent cases post-*eBay*. An initial analysis reported in the fall of 2006 by the ABA in its IPL newsletter reflected injunctions being denied in about half the cases decided immediately after *eBay*, although the denial rate dropped to about one-third by the end of the year. A similar conclusion was reached based on cases through the spring of 2007 as reported during the injunctions panel at IPO's March damages conference. Separately, based on information available through Westlaw and LEXIS, another IPO presentation reflected injunctions were denied in about 16% of patent cases in the year prior to *eBay* and in about 25% of the cases in the period since. Locally, the Eastern District during this same time period granted injunctions in just over half the cases where the issue was presented.

Thus, while the data is limited for the post-*eBay* period (about 20 cases through early 2007), should this trend continue or should this change become permanent, a 50%+ increase in the rate of historical injunction denials must be considered significant, should affect litigation strategy and may affect litigation cost. Concerning the latter, for example, if the likelihood of an injunction is less, a defendant may be willing to delay settlement and fight longer, thereby increasing costs.

### *Damages*

Comparing the 2000-2005 time period to the 1990's, PriceWaterhouseCoopers ("PWC") reported in the September 2006 issue of *les Nouvelles* that the increase in damage awards in patent cases is 59% while the size of trademark damages awards has remained steady. Both the average number (+59%) and size (+3%) of patent damage awards has increased. However, while the absolute numbers increased, in some respects damages other than a reasonable royalty have become more difficult to obtain. PWC reported that the mix of lost profits and royalty damages flip flopped between the decades. In the 2000's, 59% of patent damage awards are based on a reasonable royalty, 38% on lost profits, compared to 24% and 73%, respectively, in the 1990's.

This conclusion seems consistent with trends reported in the popular press concerning the proportional increase in patent infringement litigation filings by non-practicing patentee's (who, generally, are only entitled to a royalty) and in light of a number of Federal Circuit decisions scrutinizing and limiting lost profit claims.

While not all commentators agree that patent damages are increasing at a rapid pace (e.g., Kerr, *les Nouvelles* 2003 arguing most verdicts remain low and that, considering settlements, patent damages have been relatively flat), most reflect results consistent with the PWC study. A special study by the DOJ reported by the ABA in 2007 reflects that in 2002, 140 federal IP cases were resolved by trial. Of those, 83 were won by plaintiffs (60%), damages were awarded in 53, and median awards were just under \$1 million – \$2.3 million in patent cases, \$159,000 in copyright cases, and \$84,000 in trademark cases. Based on Federal Judicial Center data presented at the March IPO damages conference, the median patent damages award in 2005-2006 was just under \$4 million and plaintiffs won 74% of the time.

Locally, of the 9 patent cases tried to a verdict in the Eastern District between late 2005 and late 2006, only two-thirds (67%) were won by plaintiffs and in three of those six, the damage award ranged from \$2 to \$4 million. However, the other three awards were among the nation's six largest ranging from \$74 to \$133 million. However, adjusting both the national and local results for the losing verdicts, the median awards are relatively close, \$1.8 and \$3.7 million, respectively.

#### *Royalty Rates*

Available data from a number of sources reflect that royalty rates both in real world licenses and in litigation are increasing and that royalty rates awarded in litigation are higher than those negotiated in the real world. Based on periodic royalty studies published in *les Nouvelles* and *Licensing Economics Review*, average royalty rates for real world licenses across all industries increased from 5% in the 1980's to 6.2% (median of 4.5%) in the 1990's. Since then, rates have continued to increase with an average rate for 2006 licenses of 6.8% and a median rate of 5%.

Similarly, average royalty rates awarded at trial have remained higher than their real world counter-parts. For example, a study by the Analysis Group that was reported in 1997 reflected a doubling in the average amount of royalty awards after the creation of the Federal Circuit. While an average royalty award rate was not given, about 30% of the awards involved rates ranging from 6-10%, around 25% involved rates of 11-15%, roughly 25% involved rates of 5% or less and, 20% involved rates greater than 15%.

By 2002, a KPMG study reflected that 60% of royalty awards were at rates between 5% and 20%, with the remaining 40% were evenly distributed between groups involving rates of 5% or less, or 20% or more. A 2006 empirical analysis conducted by Professor Mark Lemley reflected awards with an average rate of 13% and a median rate of 10%, fairly consistent with the Analysis Group and KPMG distributions reflecting that most awards were in the 5-15% and 5-20% ranges.

The higher litigation rates may be explained by a variety of factors, including the difference between the settings of a real world negotiation and a hypothetical negotiation. In particular, the hypothetical negotiation assumes validity and infringement, considerations often compromised in the real world. Further, real world licenses often include other considerations such as cross-licenses, covenants not to sue, other IP, technical and developmental assistance which may suppress the actual royalty rate. And, of course, the prospect of a design around hangs over a real world negotiation and, while considered in the hypothetical negotiation, is often no more than a side note addressed after the fact when the infringer has made significant actual use of the patents, infringed for a number of years and never actually designed around.

### *Conclusion*

In sum, (1) IP litigation filings are on the rise, though the case-type mix has changed, (2) litigation costs continue to rise at a rather alarming rate of 20% per year and may increase further depending on the injunction trends, (3) patent injunction denial rates have initially increased in the post-*eBay* era though the observations are limited in number, (4) total and average damage awards are increasing decade-to-date over the 1990's (at least most people think so), (5) average real world royalty rates are increasing and (6) average reasonable royalty rates remain higher than their real world counter-parts.