Pillsbury Winthrop Shaw Pittman LLP

Intellectual Property
November 16, 2007

Client Alert

Federal Circuit Upholds Ongoing Royalties in Lieu of Permanent Injunction on Infringing Products

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On October 18, 2007, the U.S. Court of Appeals for the Federal Circuit issued a decision upholding the power of a district court to impose a post-verdict "ongoing royalty" on future sales of infringing products by an adjudged infringer. *Paice LLC v. Toyota Motor Corp.*, --- F.3d --- (Fed. Cir. Oct. 18, 2007) Case No. 2006-1610, -1631. The district court in this case had denied the plaintiff's request for a permanent injunction and instead ordered Toyota to pay an ongoing royalty of $25 per infringing vehicle for future sales.

The plaintiff, Paice, is the owner of U.S. Patent Nos. 5,343,970 ("the '970 patent"), 6,209,672 ("the '672 patent"), and 6,554,088 ("the '088 patent"), each claiming a drive-train for a hybrid electric vehicle. More specifically, the patents-in-suit claimed a computer controlled torque combination system for managing the torque contributions of the hybrid electric vehicle's electric motor and internal combustion engine. The claimed system maximized fuel economy and simplicity while reducing the cost of the hybrid vehicle system.

Defendants Toyota Motor Corp., Toyota Motor North America, Inc., and Toyota Motor Sales, U.S.A., Inc. (collectively "Toyota"), were engaged in the manufacture and sale of hybrid electric vehicles including the Toyota "Prius I" (1997-2003), Toyota "Prius II" (2003-present), Toyota Highlander, and Lexus RX 400h. Toyota's systems employed a means for combining the torque of the internal combustion engine and the electric motor.

Paice filed suit in the Eastern District of Texas alleging infringement of each of the three patents-in-suit and requesting compensatory damages and a permanent injunction. At the conclusion of a 10-day trial, the jury found that Toyota infringed the '970 patent under the doctrine of equivalents. The jury found no infringement of the '672 and '088 patents. The jury awarded Paice compensatory damages in the form of a reasonable

royalty for past damages at the equivalent of approximately $25 for every vehicle sold with the infringing system.

Following the trial, Paice moved for a permanent injunction to prevent Toyota from continuing any manufacture, use, offer for sale, or sale of the infringing system. Judge Folsom weighed the four factors set forth in *eBay Inc. v. MercExchange, L.L.C.*, 126 S. Ct. 1837 (2006), to determine if a permanent injunction was an appropriate remedy:

1. that [plaintiff] has suffered an irreparable injury;

2. that remedies available at law, such as monetary damages, are inadequate to compensate for that injury;

3. that, considering the balance of hardships between the plaintiff and defendant, a remedy in equity is warranted; and

4. that the public interest would not be disserved by a permanent injunction.

The judge found that (1) Paice had failed to demonstrate irreparable harm; (2) that damages at law were adequate; and (3) that the balance of hardships favored Toyota. The judge, therefore, denied the permanent injunction and instead ordered Toyota to pay an ongoing royalty of $25 for each infringing vehicle sold by Toyota during the remaining life of the patent.

On appeal, Paice challenged the imposition of the ongoing royalty as an adequate remedy in lieu of a permanent injunction. Suprisingly, however, Paice did not appeal the District Court's refusal to grant the injunction, only the imposition of the ongoing royalty.

Ongoing Royalty Versus Compulsory License

The Federal Circuit, likely realizing the import of courts imposing something called a compulsory license on patent holders, first grappled with the characterization of the license, calling it an "ongoing royalty" rather than a "compulsory license." According to the Federal Circuit, a "compulsory license" would allow anyone, even those not party to the lawsuit, to invoke the terms of the license agreement to make, use, or sell infringing products. The Federal Circuit analogized this definition to compulsory licenses found in copyright law.

By contrast, an "ongoing royalty" is properly characterized by a situation in which an adjudged infringer in the litigation is permitted by court order or agreement to make, use, or sell the invention after a finding of infringement. The Federal Circuit was clear in stating that third persons or entities not party to the action could not invoke an order imposing an "ongoing royalty" to make, use, or sell the invention.

Judge Rader, in his concurring opinion, suggested that the label "ongoing royalty" was merely a euphemism for "compulsory license" in this case. Arguing that the patentee should have a meaningful chance to negotiate the terms and rate of the ongoing royalty with the accused infringer before imposition of the royalty by the court, Judge Rader contended that the award in this case was, in fact, a compulsory license. Judge Rader would require district court judges to first remand consideration of an ongoing royalty to the parties for negotiation and only impose such a royalty if negotiations ended unsuccessfully.

Ongoing Royalties Should Not Be Awarded as a Matter of Course

The Federal Circuit clearly stated that district court judges should not award ongoing royalties as a matter of course when permanent injunctions are denied. The opinion of the court reasoned that the imposition of an ongoing royalty is appropriate only when necessary, i.e., not merely when a patentee fails to meet one or more of the four *eBay v. MercExchange* factors. Rather, the court suggested that the parties should have the opportunity to negotiate their own licensing agreement. If negotiations between the parties were unsuccessful, the court might then consider imposing an ongoing royalty.

The subtle distinction the Federal Circuit chose to draw on this issue is especially important to note. Although the *Paice* opinion seemingly grants judges enhanced discretion over the types of remedies awarded to patent owners upon a finding of infringement, the court tempered this power with the expectation that the district courts should consider allowing the parties themselves to determine the terms and rate of any ongoing royalty. In that situation, the district court would only enter the fray and make a ruling imposing an ongoing royalty if the parties could not negotiate reasonable terms and/or a reasonable rate on their own. Only at that point would the court engage in proper fact-finding as to the scope of the ongoing royalty and the rate to be applied.

Judge Rader, in his concurring opinion, expressed a stronger sentiment than the majority opinion on the issue of who should decide the terms of the ongoing royalty. Instead of a mere suggestion that district court judges should remand negotiations on the terms of the ongoing royalty to the parties, Judge Rader would require district court judges to take such action. Judge Rader pointed out that, although the district courts have great discretion to tailor equitable remedies to suit the facts of a particular case, remanding negotiations regarding the terms of the ongoing royalty to the parties should not be discretionary. The judge should only be allowed to impose the ongoing royalty if negotiations have failed.

The Amount of the Ongoing Royalty Is Determined by the Court, Not a Jury

Paice had argued that the award of an ongoing royalty constituted "damages" and therefore was properly triable to a jury under the Seventh Amendment. The Federal Circuit rejected this argument, however, stating that "not all monetary relief is properly characterized as 'damages.'" The court found that the determination of the rate of an ongoing royalty was a question of law left in the hands of the judge. In essence, the requested relief was equitable in nature and a vehicle for providing complete relief to the plaintiff and therefore must be determined by the judge, not a jury.

Open and Unresolved Issues In Light of the *Paice* Decision

It remains to be seen the extent that the decision in *Paice v. Toyota* will spur district courts to impose ongoing royalties following a finding of infringement. Although the Federal Circuit's decision in *Paice*, on its face, may appear as a broad grant of power to the district courts, several facts peculiar to this case potentially limit the ability of a district court to make such an award.

One major factor in the decision in *Paice*, though certainly not dispositive, was the fact that Paice itself was not a manufacturer of the technology at issue. Paice was formed to license the patented hybrid vehicle technology to automobile manufacturers, not to manufacture the technology itself. When considering whether to issue a permanent injunction, courts are more apt to find irreparable harm when plaintiff and defendant are competitors. If competing persons or entities are both manufacturing the patented products and vying for market share and/or name recognition, the imposition of a permanent injunction may be critical to fully adjudicate the rights of the parties.

A second factor leading the court to permit the award of an ongoing royalty in this case was Paice's post-verdict offer to license the patents to Toyota. Further, by its own admission, Paice had been making efforts to license the technology on a widespread basis to other auto manufacturers. These continued offers to license made it clear to the court that a monetary reward would be adequate compensation. Licensing the technology was ultimately Paice's primary goal, making the court's award of an ongoing royalty a logical choice, effectively in furtherance of Paice's desired outcome.

The district court may have been even more reluctant to grant a permanent injunction given the respective positions of the parties. Paice had argued that the issuance of a permanent injunction was necessary to sustain its licensing efforts. However, the jury's award (approximately $25 per vehicle) indicated that perhaps Paice's contribution to the infringing product was minimal at best. The grant of a permanent injunction would have given Paice substantial leverage in licensing negotiations. Because Section 283 of the patent act leaves the award of a permanent injunction to the discretion of the court, the judge was able to mitigate any undeserved or unfair leverage Paice would have obtained via a permanent injunction.

Paice's failure to effectively license the patented technology to others may also have contributed to the imposition of an ongoing royalty. Paice had engaged in licensing discussions with a number of automobile manufacturers with little result. Paice's inability to license the technology, coupled with its failure to adduce evidence of an adverse impact on its ability to license in the future in the absence of a permanent injunction, demonstrated that Paice would not suffer irreparable harm if the injunction was denied.

Conclusion

Paice v. Toyota does not represent a blanket endorsement of the imposition of an ongoing royalty by district court judges in lieu of granting a permanent injunction. Rather, the Federal Circuit appears to have crafted a narrow circumstance in which district court judges may, in their discretion, impose an ongoing royalty in lieu of a permanent injunction. Nevertheless, adjudged infringers who have been sued by a non-practicing patent holder should keep the above factors in mind in proposing a post-verdict remedy, especially where the patents-in-suit cover only a small part of the accused device.

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