INTELLECTUAL PROPERTY

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content. Previously, the Directive on Computer Implemented Inventions (CII)[27], an EU wide legislation to harmonise rules on software patents came to an end due to disagreement over the issue of interoperability.

Therefore, not only is it necessary to differentiate between DRM technologies in different industries but also not to impose interoperability on market players which would only lead to weakening of IP protection that these market players possess. The issue of interoperability of DRMs is the technical face of a fundamental dichotomy between two aspects competition and IPRs: competition is desirable but it cannot be made possible at the expense of intellectual property rights.

Experts' Corner

The Patent Reform Act – Bryan Ray[28]

This past September, the U.S. House of Representatives passed the Patent Reform Act of 2007.[29] The legislation is currently awaiting action by the U.S. Senate.[30] Included in the current state of the legislation are amendments to the statutory provision for the award of damages for patent infringement.

The legislation's sponsors have described these amendments as an "effort to ensure that damages awards accurately reflected the harm caused by infringement."[31] Other supporters of the legislation have echoed these sentiments and declared that the amendments are a means "to help ensure that damages are proportional to the value the [patented] invention added to the [infringing] product."[32] Opponents of the amendments argue that they will unduly limit damages awards and unnecessarily constrain the approaches by which courts can measure patent infringement damages.[33]

Whereas the existing statute governing the recovery of damages for patent infringement is open-ended and applied based on an accumulation of case law, the proposed amendments in the Patent Reform Act provide specific direction to courts with respect to the determination of damages based on a reasonable royalty for the infringer's use of the invention disclosed in the infringed patent.[34] How the proposed rules, if they were to become law, would be implemented by the courts is not clear.

The amendments include a menu of factors for a court to consider when determining damages. For instance, the court is instructed to "conduct an analysis to ensure that a reasonable royalty… is applied only to that economic value properly attributable to the patent's specific contribution

and to mutually be able to use that information which has been exchanged

[27] http://ec.europa.eu/internal_market/indprop/comp/index_en.htm

[28] Bryan Ray is senior consultant at NERA Economic Consulting

[29] H.R. 1908 – Patent Reform Act of 2007 (110th Congress; Introduced: April 18, 2007; Last Action: September 11, 2007). ("H.R. 1908")

[30] S. 1145 – Patent Reform Act of 2007 (110th Congress; Introduced: April 18, 2007; Last Action: July 19, 2007). On January 14, 2008, the Senate Judiciary Committee released a draft report on the Patent Reform Act of 2007 that included discussion on the background and purpose of the legislation, among other topics.

[31] 'Leahy, Hatch, Berman and Smith Introduce Bicameral, Bipartisan Patent Reform Legislation'; April 18, 2007 http://leahy.senate.gov/press/200704/041807a.html

[32] Representative Goodlatte (VA); 'Patent Reform Act' *Congressional Record*, Section 22 (September 7, 2007); p. H10276

[33] Representative Gohmert (TX); 'Patent Reform Act' *Congressional Record*, Section 22 (September 7, 2007); p. H10278; Representative Manzullo (IL); 'Patent Reform Act' *Congressional Record*, Section 53 (September 6, 2007); p. H10233

[34] The current statutory provision for patent infringement damages provides for a patent holder to be awarded damages for infringement that are "adequate to compensate for the infringement, but in no event less than a reasonable royalty." (35 USC 284) The proposed revisions in the Patent Reform Act only address the calculation of a reasonable royalty. They provide no direction on the calculation of lost profit damages.

over the prior art."[35] In spirit, this makes economic sense. According to existing case law, a reasonable royalty is assumed to be the outcome of a hypothetical negotiation, at the time the infringement began, between the infringer (licensee) and the patent owner (licensor). In that negotiation, the infringer is not going to be willing to pay more to use the patented invention than what the use of the invention is worth to it—or, said differently, the incremental value of the patented invention over the infringer's next-best available alternative.[36] Ultimately, a reasonable royalty is based on the ability of the patent owner to extract at least a portion of that value from the infringer in the assumed hypothetical negotiation.

A patent can create incremental value in multiple ways. For example, it may be the case that the patented invention, compared to an alternative, lowers the cost of producing a product, but in no way affects the product's performance or how it is perceived by consumers. The patented invention may provide a feature that is valued by consumers, and thus for which they are willing to pay a premium. That premium may be directly observable in available data. For example, the product may be sold with and without the accused feature, which may provide a natural experiment from which to measure the value of the feature. Or, it may be the case that the premium is amenable to measurement by survey-based analysis. In some instances, the patented invention may be intrinsic to the product and necessary for its saleability at effectively any price.

It is perhaps noteworthy that the legislation refers only to the patent's "prior art" and not to the infringer's "next-best available alternative." Reasonable technical alternatives to the patented invention may not be limited to some defined prior art. Furthermore, other economic alternatives to the use of the patented invention may be available to the infringer. The best of these possible alternatives will constrain the infringer's willingness to pay a royalty for the right to use the patented invention. Accordingly, on its face, the legislation may inappropriately preclude a damages analysis from considering possible viable alternatives to using the patented invention that may limit the invention's incremental value to the infringer.

Importantly, the incremental value of a patented invention, relative to the infringer's next-best available alternative, might not be limited to some portion of the profits earned on only the infringing product. That is, the infringer may earn profits, beyond those directly connected to the infringing product, that are attributable to the patented invention. Possibly in this vein, the legislation stipulates that "damages may be based upon the entire market value of the products or processes" for which the patented invention creates demand.[37]

Finally, in apparent recognition of the extensive case law on the measurement of patent infringement damages, the amendments allow the court to "consider, or direct the jury to consider, the terms of any nonexclusive marketplace licensing of the invention, where appropriate, as well as any other relevant factors under applicable law."[38] How the courts would integrate the proposed damages provisions with the existing case law is uncertain.

Although the damages provisions of the Patent Reform Act contain some ambiguity, they are broadly based on an economic framework for determining a reasonable royalty. They recognize that a patented invention's value derives from its incremental contribution to profits. They also recognize that the incremental value of the

[35] H.R. 1908. The sponsors of the legislation describe this as the measurement of the value of "the truly new 'thing' that the patent reflects." "Leahy, Hatch, Berman and Smith Introduce Bicameral, Bipartisan Patent Reform Legislation"; April 18, 2007; http://leahy.senate.gov/press/200704/041807a.html

[36] The legislation also stipulates that "in the case of a combination invention the elements of which are present individually in the prior art, the patentee may show that the contribution over the prior art may include the value of the additional function resulting from the combination, as well as the enhanced value, if any, of some or all of the prior art elements resulting from the combination." (H.R. 1908)

[37] H.R. 1908

[38] Ibid

patented invention may not be limited to the single component or even product in which the patented invention is embodied. And, finally, they recognize that a patented invention may be only one of multiple features of a product that contribute to the demand for the product. These concepts are by no means new, and some courts and some damages experts already understand and apply them.

New and Notable

A New Tune for the Music Business – Simon Moore[39]

2007 was a year of experimentation for the music industry. Major record labels began to shift away from their use of DRM technologies, throwing their weight behind projects from Apple and Amazon, amongst others, to sell music online, DRM-free.

The most unexpected developments, however, came from outside the majors, with veteran artists opting for more unorthodox retail methods in a bid to revive interest in their work. Radiohead left their previous business partners, EMI, and re-established control over their own IP rights. Subsequently, they self-released their album *In Rainbows* online, with customers allowed to choose how much they would pay for it. Prince launched his newest album, given away for free with copies of the UK newspaper the *Mail on Sunday*. Madonna left her record company Warner Brothers, and struck a deal with concert promoters Live Nation's new recording division.

Radiohead's venture drew the most column inches, with opinion divided over whether it constituted a success or a failure. An early report on the project by analysts comScore found 62% of downloaders chose to pay nothing for the album, with the average price being $6. More than half the revenue from the project was taken from just 12% of purchasers, who paid over $8.[40] Radiohead have not released any official figures.

While much of the media coverage focussed on the 62% who downloaded for free, it is perhaps more interesting that 38% opted to pay something when under no obligation to do so.

With the music industry still struggling to combat piracy, and with attempts to control use through DRM not having had the desired impact, the 'Radiohead model' offers an alternative approach to the problem. Experienced rockers The Charlatans have already announced plans to release their next work in a similar way, while rumours swirl around other big-name acts not currently attached to traditional record labels.

However, there are obvious pitfalls to the approach, which must be recognised by those advocating it as the way forward. Radiohead are a well-established band with a large fanbase, more able to generate the publicity – and hold the goodwill – to be able to afford to experiment. They were also able to bolster revenues with a traditional CD release, and a £40 collector's edition version. Artists without Radiohead's track record may not be able to do without the marketing and exposure that the traditional labels provide.

The Prince and Madonna deals signified a shift in focus for established stars, with live performances rather than recordings becoming the main focus of attention. Records are increasingly being used to drive concert ticket sales, reversing the conventional pattern.

All three arrangements will see the artists becoming the direct recipients of the bulk of revenues, without the record companies taking a cut. Removing the middle-man may help artists who have little use for the services they provide. Artists with large bank balances do not need the initial capital record labels offer, and acts with large fan bases will sell out arenas without the need for expensive marketing campaigns. But not

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[40] http://technology.timesonline.co.uk/tol/news/tech_and_web/the_web/article2817679.ece