The Continuing Evolution of Patent Damages: *What You Don’t Know May Hurt You*

December 4, 2013

Litigation Webinar Series: **INSIGHTS**

Our take on litigation and trial developments across the U.S.

Christopher Marchese
Principal, Fish & Richardson

Justin Barnes
Principal, Fish & Richardson

Fish & Richardson

December 4, 2013
**Overview**

- **Monthly**
  - 3rd Wednesday at 1pm ET
  - Key Developments & Trends
- **Housekeeping**
  - CLE Contact: makarevich@fr.com
  - Questions
  - Materials: fishlitigationblog.com/webinars
- **Next webinar – January 15th**
- #fishwebinar
Roadmap

• Introduction
• Entire Market Value Rule (EMVR), Smallest Salable Patent-Practicing Unit (SSPPU), & Apportionment
• Apportionment Methods
• “End-Runs” Around EMVR and Apportionment
• Comparable Licenses
How Did We Get Here?

• Before NPE cases → lost profits ruled the damages world
  ▪ Reasonable royalty cases were less common
  ▪ Rarely made it to the Federal Circuit
• NPE cases arrived → royalties became more important
• Then *eBay* effectively outlawed injunctions for NPEs
  ▪ Injunctions used to drive settlement
  ▪ Now it became imperative to increase reasonable royalty damages
  ▪ Needed for settlement leverage
• Huge damages awards lead to increased awareness
  ▪ Congressional reform (attempts to legislate EMVR and apportionment)
  ▪ Federal Circuit reaction (*Lucent*, *Uniloc*, *ResQNet*, *i4i*, *Wordtech*, etc.)
Daubert on the Rise

- 2004 NDCA case—court could find only one previous case where court granted Daubert motion on patent damages expert
  - Citing: DSU Medical Corp. v. JMS Co., 296 F. Supp. 2d 1140 (N.D. Cal. 2003)
- However, since then courts have granted Daubert motions with increasing frequency
Daubert on the Rise*

Entire or partial exclusion

- 2007: 3
- 2008: 4
- 2009: 3
- 2010: 3
- 2011: 9
- 2012: 27
- 2013: 34 (through Oct. 2013)

*Based on review of Westlaw Federal IP database and www.patent-damages.com
Entire Market Value Rule
Smallest Salable Patent Practicing Unit & Apportionment
• *Garretson v. Clark*, 111 U.S. 120, 121 (1884):
  - The patentee must “give evidence tending to
    - [APPORTIONMENT] separate or *apportion the defendant's profits* and the patentee's damages *between the patented feature and the unpatented features*, and such evidence must be reliable and tangible, and not conjectural or speculative, *or*
    - [EMVR] he must show by equally reliable and satisfactory evidence that the profits and *damages are to be calculated on the whole machine*, for the reason that *the entire value of the whole machine*, as a marketable article, is *properly and legally attributable to the patented feature."

• *Westinghouse v. Wagner*, 225 U.S. 604, 615 (1912) (same)
Cornell v HP (Judge Rader, NDNY 2009)

- Patent directed to Instruction Reorder Buffer (IRB)
- Cornell could prove IRB was basis for demand (no EMVR)
- SSPPU was CPU
- IRB was only a feature of the CPU

**CPU**  **CPU Brick**  **Cell Board**  **Server**

Base Always = SSPPU?

- Must plaintiff apportion further if the patent is directed to a feature of the SSPPU?
- Or is SSPPU just the starting point?
- Cases have gone both ways...
  - Some cases suggest SSPPU is smallest base
  - Others have held SSPPU is smallest base
  - Others hold further apportionment is required
SSPPU = Smallest Base

• Federal Circuit
  - LaserDynamics, 694 F.3d at 67 (2012) (emphasis added): “Where small elements of multi-component products are accused of infringement,” it is “generally required that royalties be based not on the entire product, but instead on the smallest salable patent-practicing unit.”

• District courts (cont’d next slide)
  - Axcess Int’l, Inc. v. Savi Tech., Inc., No. 3:10-cv-1033-F (NDTX 1/25/13) (Doc. No. 272) (quoting same language from LaserDynamics and Cornell; “Thus, in both cases, the smallest salable patent-practicing unit (the processor in Cornell and the ODD in LaserDynamics) necessarily contained features or functionalities beyond the claimed technology, but was, nevertheless, the appropriate unit for calculating the royalty.”)
SSPPU = Smallest Base

- District courts (cont’d)
  - *Brocade Comm’s Sys., Inc. v. A10 Networks, Inc.*, No. C 10-3428 PSG (NDCA 5/15/13) (Doc. No. 998) (allowing plaintiff to use accused product as base because plaintiff alleged it was SSPPU, although the court expressed “doubts” that plaintiff could prove the product was the SSPPU or could satisfy EMVR)
  - *Internet Machines LLC v. Alienware Corp.*, No. 6:10-cv-23 (EDTX 6/19/13) (Doc. No. 615) (“Because Mr. Bratic used the smallest salable unit as his royalty base, additional apportionment is unwarranted and the narrow exception of the entire market value rule is inapplicable.”) (citing Cornell)
  - *Summit 6 LLC v. Research in Motion Corp.*, No. 3:11-cv-367 (NDTX 6/26/13) (Doc. No. 661) (“[U]sing the entire device as the royalty base is proper under LaserDynamics because the device itself is the ‘smallest patent-practicing unit.’”) (citing LaserDynamics)
SSPPU ≠ Smallest Base; Must Apportion

- **AVM Tech., LLC v. Intel Corp.,** No. 10-610-RGA (DDE 1/4/13) (Doc. No. 230, at 5-6) (emphasis added) (Andrews, J.) (“The use of a *saleable unit that is greater than the patented feature is going to introduce Uniloc error* when the patented feature is a ‘date picker’ whether the saleable unit is a computer loaded with ‘Outlook’ or simply ‘Outlook.’ The Uniloc error will be greater with the computer loaded with ‘Outlook’ than with ‘Outlook’ alone, but the difference in error is one of degree, not of kind.”)
- **Network Protection Sciences, LLC v. Fortinet, Inc.,** No. C 12-01106 WHA (NDCA 9/26/13) (Alsup, J.) (Doc. No. 334, at 12013) (excluding plaintiff’s damages expert despite contention that expert “correctly performed the apportionment analysis ... by first ascertaining” the SSPPU; basing exclusion on plaintiff’s failure to satisfy EMVR)
Where Are We Headed?

- **SSPPU is always the base (unless EMVR applies)?**
  - Creates bright line rule
  - Uses apportionment down to SSPPU
  - Eliminates complex apportionment of SSPPU

- **SSPPU is the starting point (when patent is smaller)?**
  - Focuses on “footprint”
    - *ResQNet*, 594 F.3d at 869 (2010) (“[The trial court must carefully tie proof of damages to the claimed invention’s footprint in the market place.”)
  - Compensates for “economic harm”:
    - *Id.* (“At all times, the damages inquiry must concentrate on compensation for the economic harm caused by infringement of the claimed invention.”)
Apportion For Value Over Prior Art?

- OK, it’s complicated... and may not be required
- So, why would a plaintiff apportion?
  - Avoid Daubert issues and potential reversal on appeal
  - Have damages expert “piggyback” on technical expert, or other sources, for contribution over prior art—further bolster invention story, value of invention
  - Creative apportionment may still yield big $ base
Value Over Prior Art

- Plaintiff—“It’s pioneering!”
  - Use defendant’s own documents, experts, patent prosecution history, weakness of prior art, inventor testimony, third parties to establish importance of invention
  - Costly, complex, potentially confusing
- Defendant—“Prior art is almost identical!”
  - Use same, or similar, sources but from opposite perspective
  - Could harm anticipation case
Law is unsettled on whether SSPPU is starting point for apportionment, or is always the base (unless EMVR applies).

Courts have accepted SSPPU as royalty base where the patented feature was smaller.

Plaintiffs may opt not to further apportion—or may offer alternative theories (SSPPU + apportionment).

Apportionment is the safer bet—and creative apportionment may still achieve a large base.
Apportionment Methods
Apportion profits among various profit centers
- Patents
  - Asserted vs. not
- Trade secrets
- Copyrights
- Trademarks
- Goodwill, brand

Patent’s Value to SSPPU
Patent’s Value to SSPPU

• “Real Estate” approach
  ▪ Divide “area” between patented feature and remainder
  ▪ Potential applications:
    o Integrated circuits—% surface area, % transistors, % gates
    o Software—% lines of code, % modules or files

• Pitfalls:
  ▪ Relative importance
  ▪ Public source features
  ▪ Pinpointing, spread out
  ▪ Interconnections
Patent’s Value to SSPPU

• “Count, Rank, Divide” approach
  ▪ Process
    o Count patents covering accused product
    o Rank by relative value
    o Divide profits by ranked patent values
    o Obtain value of asserted patent(s)
  ▪ See: *Oracle v. Google*, 2012 WL 44485 (NDCA 1/9/12), and 2012 WL 877125 (3/5/12); *LG Display Co. v. AU Optronics Corp.*, 722 F. Supp. 2d 466 (DDE 2010)

• Pitfalls:
  ▪ Complexity
  ▪ Non-patent IP
  ▪ Relative patent value
  ▪ Synergies
Patent’s Value to SSPPU

• “Conjoint Analysis”
  - Isolate value of patented feature
  - Market research—statistical technique (may use surveys)
    - How people value different product features
    - Determine most influential features

• Pitfalls:
  - Design complexities
  - Respondents for complex tech
  - Picking the right features
  - Avoiding simplification with many choices
### Patent’s Value to SSPPU

- **“Use apportionment”**
  - Apportion to account for infringer’s usage
  - Applies to method claims
  - Avoids inflated damages award for non-use
  - May use surveys

- **Pitfalls:**
  - Complexities
  - Reliability
  - Feature patents
Use - Apportionment Applied

  - Accused feature: Outlook “date picker”
  - Method claims asserted
  - Lucent surveyed Outlook users to determine % who used date picker
  - “While damages do not have to be strictly limited [to their usage numbers], the damages award must be ‘correlated, in some respect, to the infringing use by consumers.’” At *8 (quoting *Lucent*, 580 F.3d at 1334)
Defendant’s own documents
  - Internal surveys
  - Marketing documents
  - Engineering documents

May be combined with other evidence

Pitfalls?

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**Patent’s Value to SSPPU**

11. How critical are the following applications to your Linux deployment?

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Many ways to apportion
All have pitfalls and risks
Option: use multiple methods as checks, or do single method in different ways to check
“End-Runs” Around EMVR and Apportionment
“The Basis for” or “Substantial” Demand?

- Majority of cases state **THE BASIS** for demand is the proper test for EMVR
  - *Lucent*, 580 F.3d at 1336 (2009): same (quoting *Rite-Hite*)
  - *LaserDynamics*, 694 F.3d at 63 (2012): same
“The Basis for” or “Substantial” Demand?

• However, **SUBSTANTIAL basis/value** also appears in cases...
  
  ▪ *Lucent*, 580 F.3d at 1337 (2009) (emphasis added): “The first flaw with any application of the entire market value rule in the present case is the lack of evidence demonstrating the patented method of the Day patent as the basis—or even a **substantial basis**—of the consumer demand for Outlook.”
  
  ▪ *Uniloc*, 632 F.3d at 1318 (2011) (emphasis added): “The entire market value rule allows a patentee to assess damages based on the entire market value of the accused product only where the patented feature creates the ‘basis for customer demand’ or ‘**substantially create[s] the value of the component parts**.’” (quoting Rite-Hite)

• See Patent Damages blog—analyzing substantial demand issue
  
Artful Claim Selection & Application

- **System-level claims, or broad apparatus claims**
  - May cover entire multi-featured product
  - Example: claim directed to “computer” comprising:
    - Hard-disk memory
    - CPU
    - I/O
    - Bus coupling memory, CPU, and I/O
    - CPU including `[INVENTIVE FEATURE]`
  - Claim covers the “computer”—is that the patented invention?—thereby avoiding EMVR issues?
Artful Claim Selection & Application

- **U. of Pittsburgh v. Varian**, Case 2:08-cv-01307-AJS (WDPA 2/10/12)
  - Accused components: linear accelerator & RPM
  - Court: crux of EMVR dispute—when is an item part of “the invention”?
    - Pitt: linear accelerator (LA) included in royalty base b/c multiple claims referred to LA and RPM
    - Varian: LA in prior art → not part of invention
    - Court: sided with Pitt; LA “critical component” of infringing apparatus for 2 asserted claims
    - “[B]ecause the Court has concluded the linear accelerators are a part of the patented apparatus and not just a mere accessory, the added value of the linear accelerators may be used in determining the royalty base.”
Artful Claim Selection & Application

- **But see Lucent MP3 Case**, 509 F. Supp. 2d 912 (SDCA 2007), *aff’d other grounds*, 543 F.3d 710 (2008)
  - Lucent: entire computer appropriate royalty base
    - Claims are directed to “computer” (similar to slide above)
    - Computer was central to claimed encoding and decoding processes
  - Court: what matters is novel feature
    - Other elements of claim should not impact base
    - Patent’s value should not change if prior art elements are added to claims
Comparable Licenses

• Tension between comparable licenses and EMVR
  ▪ Patented feature only part of multi-feature device
  ▪ BUT → comparable licenses are based on total revenue of devices similar to the accused device

• Does EMVR apply?
  ▪ Must party asserting comparable license prove “basis for customer demand”?
Comparable Licenses

• Courts have said “NO”
  ▪ Plaintiff asserting comparable license argues it is not relying on EMVR
  ▪ If plaintiff can show licenses are truly comparable, then royalties may be permitted based on total product revenue in license agreements without also proving “the basis for customer demand”

• *See Mondis Tech. Ltd. v. LG Elecs., Inc.*, 2011 WL 2417367 (EDTX 6/14/11)
Comparable Licenses

  - Plaintiff did the same as in *Mondis*—used comparable licenses as support for using entire revenue of accused products as royalty base
    - As in *Mondis*, EMVR not satisfied
  - *Lighting Ballast* court: improper to use entire revenue without proving “basis for consumer demand”
Per Unit Royalty

- Flat royalty rate independent of significance of patented feature and of product cost
  - For example: $1 per overall product where patent covers only a small feature of the product
  - $1 on $10 device; $1 on $100 device; etc.

- Plaintiff’s argument:
  - Not based on revenue from the entire product
  - Avoids *Uniloc* problem: no need to show overall product revenue to jury—just units and rate
Other Ways

- SSPPU is smallest possible base (see above)
- Lump sum royalty (avoids *Uniloc* problem)
- Lost profits – EMVR not required?
  - *Panduit* only requires demand for the **patented product**
    - See *DePuy Spine*, 567 F.3d at 1330 (2009) (“the first *Panduit* factor simply asks whether demand existed for the ‘patented product’”)
  - Lost profits requires evidence of demand for the **patented feature**
    - Calico v. Ameritek, No. 2008-1324, -1341, slip op. at 14-15 (Fed. Cir. 7/18/13) (unpublished opinion) (overturning lost profits award for failure to require “a causal relation between the infringement and its lost profits”; no evidence of demand for the patented safety mechanism where only sales data for the infringing lighter was presented)
Take-Aways: What You Now Know

- Strict EMVR (the basis of demand) is not always available to defendants
  - “Substantially creates the value” (Uniloc, Rite-Hite)
  - Artful claim selection—potentially capture larger royalty base
  - Comparable licenses—history of royalties collected on entire product revenue
  - Per unit royalties—no need to show entire product revenue
  - Lost profits—demand for the patented product (not feature)?
  - SSPPU = smallest possible base?

- New theories likely to surface
Comparable Licenses
**Comparable Licenses**

### Types of Comparables and Uses

- **What can be used as a comparable?**
  - Executed license agreements (outside of litigation)
  - Proposed license agreements (discoverable?)
  - Settlement agreements
  - Sales of patents
  - Patent valuations (e.g., 10K)

- **How can comparables be used?**
  - Starting point for rate
  - Inclusion of convoyed items
  - Royalty base
  - Structure of hypo negotiation
General Principles

• Tie the “comparable” license to the hypothetical negotiation
  ▪ “[T]here must be a basis in fact to associate the royalty rates used in prior licenses to the particular hypothetical negotiation at issue in the case.” Uniloc, 632 F.3d at 1317 (2011); see also Lucent, 580 F.3 at 1325 (2009) (“sufficiently comparable”)

• Tie the “comparable” license to the claimed invention
  ▪ “Any evidence unrelated to the claimed invention does not support compensation for infringement but punishes beyond the reach of the statute.” ResQNet, 594 F.3d at 869 (2010)
Variables for Making the “Tie”

- Actual license must be comparable to the hypothetical license
- Variables re comparability
  - Comparable patents
    - Best case: license to patent-in-suit
    - Worst case: unrelated patents
    - What about general cross-licenses?
  - Comparable licensed technology
  - Comparable licensed products
Variables for Making the “Tie”

- Variables re comparability (cont’d)
  
  - Comparable structure
    - Lump sum vs. running royalty
    - General cross-license
      - Patent-in-suit included?
      - Patent’s value divisible?
    - Licensed territory: WW, US, fraction of US
    - Exclusive vs. non-exclusive
  
  - Non-litigation license vs. settlement agreement
    (see slides below)

  - Relative bargaining power of parties
Comparable Licenses

License vs. Settlement

• Which is the better comparable?
• Non-litigation license agreement
  ▪ Arms-length, non-adversarial negotiation
    o More like hypothetical negotiation
  ▪ However, hypo negotiation assumes:
    o Patent valid
    o Patent infringed
  ▪ Neither assumed in license negotiation
License vs. Settlement

• Which is the better comparable?
• Settlement agreement
  ▪ Adversarial
    o Unlike hypothetical negotiation
  ▪ Influenced by desire to avoid litigation
  ▪ Widespread infringement may depress settlement royalties
  ▪ However, litigation may give closer approximation of:
    o Validity & infringement
    o Depending on proximity to trial
License vs. Settlement

- Key quotes on settlement agreements
  - *ResQNet*: “This court observes as well that the most reliable license in this record arose out of litigation.” 594 F.3d at 872 (2010).
  - *Spreadsheet Automation*: “[A] payment of any sum in settlement of a claim for alleged infringement cannot be taken as a standard to measure the value of the improvements patented, in determining the damages sustained by the owners of the patent in other cases of infringement.” 587 F. Supp. 2d 794, 800 (EDTX 2007) (quoting *Rude v. Westcott*, 130 U.S. 152, 164 (1889))
  - *Rude v. Westcott*: “Many considerations other than the value of the improvements patented may induce the payment in such cases.” 130 U.S. at 164.
  - *Fenner*: “‘Settlement agreements are generally not relevant ‘because in the usual course they do not provide an accurate reflection of what a willing licensor would do in an arm’s length transaction.’” 2010 WL 1727916, at *1 (EDTX 4/28/10)
Lessons - *Lucent v. Gateway*

- “Date picker” patent
- Lucent’s expert
  - Relied on 8 varied license agreements
  - 4 involved PC-related patents
  - 4 involved large portfolio agreements
- Failures
  - Some licenses: specific subject matter of licensed patents not explained
  - Other licenses: directed to vastly different licensing scenario
  - Other licenses: no explanation of the licensed products and the patented technology

*Lucent v. Gateway, 580 F.3d at 1301 (2009)*
**Lessons - Wordtech**

- CD duplicator patent
- Wordtech used its President; no expert
  - Wordtech sought lump sum RR damages
  - Relied on 13 license agreements (11 running royalty; 2 lump sum)
  - Agreements licensed some or all patents-in-suit
- Failures
  - 11 rejected because:
    - Running royalty
    - Far lower royalty rates than jury’s verdict
  - 2 rejected because licenses did not describe:
    - How lump sum was calculated
    - Products licensed
    - Quantity products licensee expected to produce

Lessons - IP Innovation v. Red Hat

- E.D. Texas March 2010—Judge Rader sitting by designation (705 F. Supp. 2d 687)
- Patents: workspace switching
- Accused products: Red Hat’s Linux-based OS
- Judge Rader excluded testimony of IPI’s expert on licenses
  - Expert chose RR rate based on *industry licenses*
  - *Ignored evidence of licenses involving the patents-in-suit because they were 10 years old*
  - “A credible economic approach might have tried to account for the passage of time since ... The patent [licenses] in this case, rather than reject them out of hand.” *Id.* at 691
Lessons - Lighting Ballast Control

- N.D. Texas June 2011—Judge O’Connor
- Accused products: lighting ballast controls
- Two licenses at issue in expert report
  - GE license **excluded**
    - Settlement between LBC and GE
    - Entered into under threat of litigation—highest rate of any license
    - Rights broader than hypo negotiation because it included an additional patent
  - Robertson license **allowed**
    - Arms length transaction
    - Patent-in-suit plus 3 patent applications
    - Non-exclusive

Questions?
Mark your calendar!

Wednesday, January 15th

Foreign Corrupt Practices Act

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Thank You!

Christopher Marchese
Principal, Fish & Richardson
(858) 678-4314
marchese@fr.com
Blog: www.patent-damages.com

Justin Barnes
Principal, Fish & Richardson
(858) 678-4387
barnes@fr.com
Blog: www.patent-damages.com

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