

Litigation Webinar Series

Patent Damages Theories



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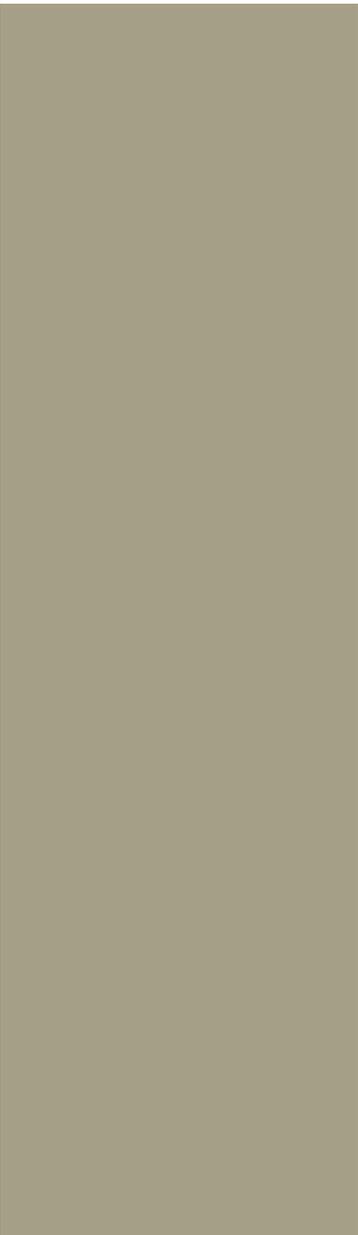
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Overview

- Litigation Series
 - Key Developments & Trends
 - Save the date for our next webinar
 - Minimizing Willful Infringement Post-*Halo*
 - December 15, 2016: 1:00 – 2:00 p.m. ET
 - Register at www.fr.com
- Housekeeping
 - CLE Contact: Jane Lundberg
 - lundberg@fr.com
 - Questions
 - Materials: fishlitigationblog.com/webinars
- #fishwebinar

Agenda

1. Apportionment
2. Extraterritorial issues
3. Non-infringing alternatives
4. Profit splitting



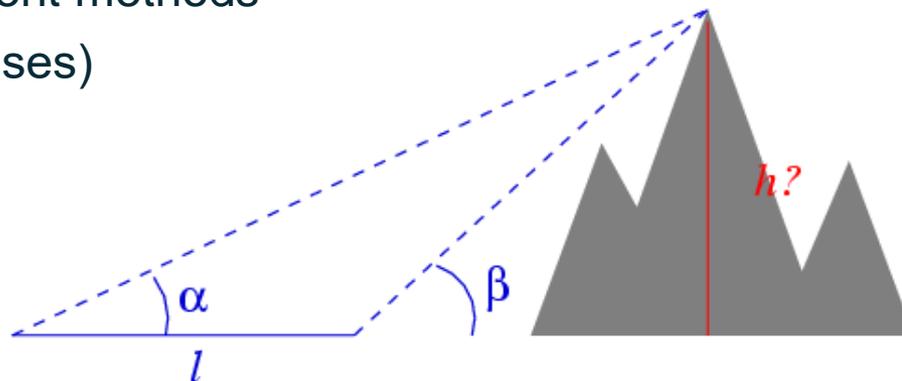
Apportionment

FISH.

Apportionment

Practice pointers for apportionment

- Apportionment is inexact—and that’s OK
 - *VirnetX, Inc. v. Cisco Sys., Inc.*, 767 F.3d 1308, 1328 (Fed. Cir. 2014):
 - “[W]e have **never required absolute precision** in [assigning value to a feature that may not have ever been individually sold]; on the contrary, it is well-understood that this process may involve some degree of **approximation and uncertainty.**” (emphasis added)
- Triangulate:
 - Multiple apportionment methods
 - “Checks” (e.g., licenses)



Apportionment

Practice pointers for apportionment

- Expert witness “piggybacking”
 - *Apple Inc. v. Motorola, Inc.*, 757 F.3d 1286, 1321 (Fed. Cir. 2014)
 - “Experts routinely rely upon other experts hired by the party they represent for expertise outside of their field.”
- Fact witnesses



Apportionment

Success/failure in apportioning

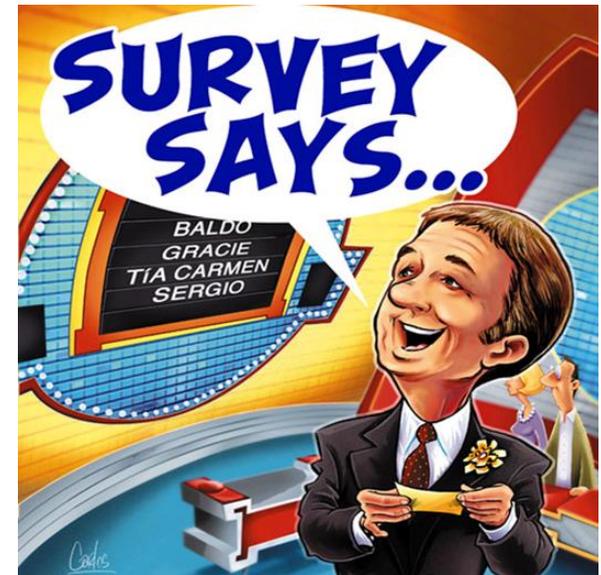
- Analyzed the apportionment opinions
 - Reviewed many cases involving apportionment
 - Updated that research for the past year
- Many cases do not provide visibility into the methodology
- Following slides address cases that did

Apportionment

Success/failure in apportioning

Method #1: Feature counting & isolation

- Mixed bag – worked in < 50% of reviewed cases (includes surveys, defendant's docs)
 - 6 failures
 - 4 provisional failures (do-over allowed)
 - 8 successes
- Common themes
 - “Straight up division” is problematic (without justification)
 - Need relative importance
 - Survey (scaled to importance of feature)
 - Technical expert
 - Defendant's documents
 - Third party market research
 - Combine/triangulate the above sources
 - Apportion out non-patent attributes (e.g., brand, reputation)?



Apportionment

Success/failure in apportioning

Method #2: Related product comparison

- Worked 6 out of 6
 - Including *Apple Inc. v. Motorola, Inc.*, 757 F.3d 1286 (Fed. Cir. 2014)
- Limited availability
 - Find comparable product without patented feature
 - Determine delta to patented product
 - Isolate the patented feature
 - If multiple features in delta, account for the relative value of each such feature and patented feature
 - Again, straight division may be problematic

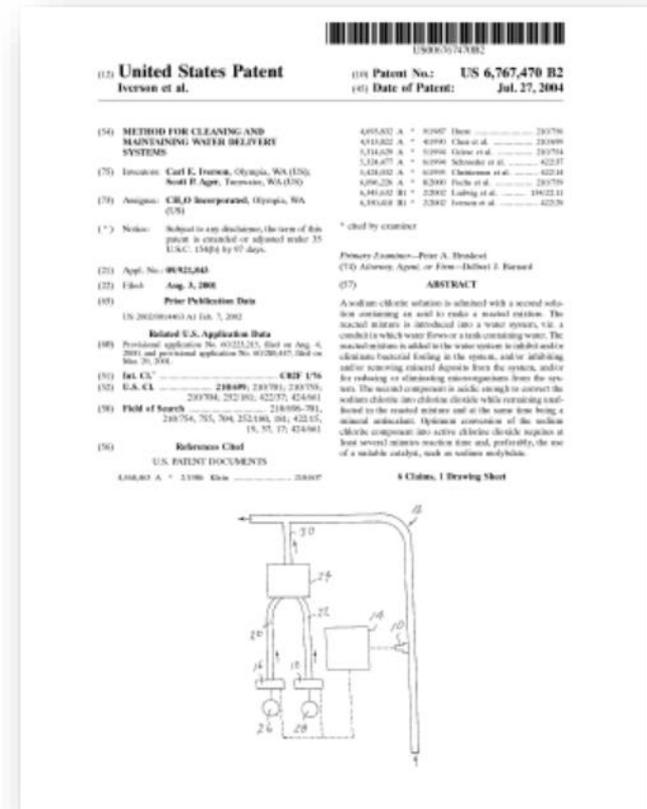


Apportionment

Success/failure in apportioning

Method #4: “Forward citation analysis” approach

- Evaluate patent by looking at number of citing patents
- Worked 2 out of 4
- Highlights
 - Justify how patent families are counted, account for age of patent
 - Support with literature
 - Can do a “check” among technologically similar patents

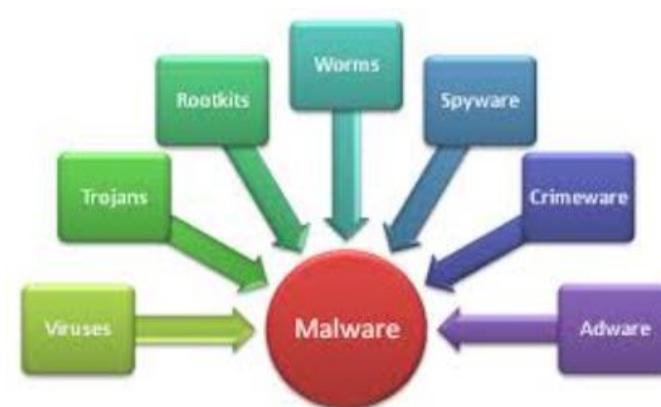


Apportionment

Success/failure in apportioning

Method #5: “Extent of use” approach

- Evaluate portion of success or lack of success attributable to patent
- For example, for malware blocking product, the % of malware blocked by patent
- Worked 3 out of 5
- Highlights
 - Can be used by plaintiff or defense
 - One court noted this worked for plaintiff because the use value of the infringing part was related to its contribution to the total value (i.e., the primary function of the product was also to block malware)



Apportionment

Success/failure in apportioning

Method #6: Top Down Approach – e.g., SEPs

- Determine maximum royalty burden for all SEPs, and then divide among all SEPs accounting for the relative value of the asserted SEPs
- Worked 1 out of 2
- Highlights:
 - Requires “verifiable data points” – such as the number of SEPs – may require third party discovery, estimation
 - Consider patents (not just number of companies)
 - Consider differences in value between patents – 10/84 rule; established SEPs vs. mere claims of essentiality



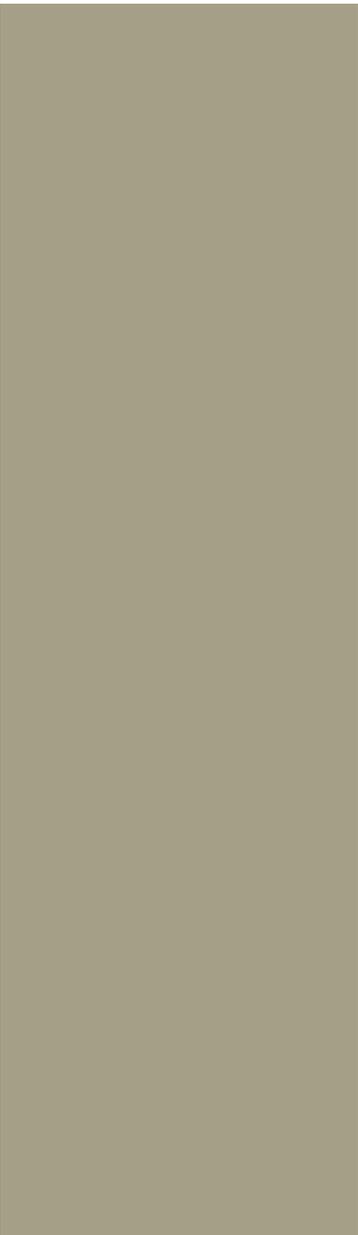
Apportionment

Success/failure in apportioning

Method #7: Blaming the defendant

- Failed 2 out of 2
- Courts: burden of proof on patentee





Extraterritoriality

FISH.

Extraterritoriality

Key Cases

- *Power Integrations, Inc. v. Fairchild Semiconductor Int'l, Inc.*, 711 F.3d 1348 (Fed. Cir. 2013)
- *Halo Electronics, Inc. v. Pulse Electronics, Inc.*, 831 F.3d 1369 (Fed. Cir. 2016)
- *WesternGeco L.L.C. v. ION Geophysical Corp.*, 837 F.3d 1358 (Fed. Cir. 2016)
- *Carnegie Mellon Univ. v. Marvell Techs.*, 807 F.3d 1283 (Fed. Cir. 2015)

Extraterritoriality

Key Cases – U.S. Supreme Court

- *Life Techs. Corp. v. Promega Corp.*
- District Court
 - Jury awarded Promega damages for sales outside U.S. on the theory that the foreign sales constitute infringement under § 271(f)(1)
 - District Court said Promega failed to prove infringement as a matter of law, based largely on its interpretation of § 271(f)(1)
 - Promega appealed
- Federal Circuit
 - Life Techs' actions could constitute infringement under § 271(f)(1) which creates liability for infringement for a person who supplies "all or a substantial portion of the components of a patented invention . . . in such manner as to actively induce the combination of such components outside of the United States in a manner that would infringe the patent if such combination occurred within the United States."
 - Can a single component can be "a substantial portion"?
 - Yes, a single component is "a portion" of all components and stated that *Taq* polymerase is a substantial component, even by itself, in part because the kit is inoperable without it.

Extraterritoriality

Key Cases – U.S. Supreme Court

- *Life Techs. Corp. v. Promega Corp.*
- Supreme Court
 - Whether the Federal Circuit erred in holding that supplying a single, commodity component of a multi-component invention from the United States is an infringing act under 35 U.S.C. §271(f)(1), exposing the manufacturer to liability for all worldwide sales.

Extraterritoriality

Key Cases – *Halo* on remand to Federal Circuit

- Sale
 - “Consistent with all of our precedent, we conclude that, when substantial activities of a sales transaction, including the final formation of a contract for sale encompassing all essential terms as well as the delivery and performance under that sales contract, occur entirely outside the United States, pricing and contracting negotiations in the United States alone do not constitute or transform those extraterritorial activities into a sale within the United States for purposes of § 271(a).”
 - “Although Halo did present evidence that pricing negotiations and certain contracting and marketing activities took place in the United States, which purportedly resulted in the purchase orders and sales overseas, as indicated, such pricing and contracting negotiations alone are insufficient to constitute a ‘sale’ within the United States.”

Extraterritoriality

Key Cases – *Halo* on remand to Federal Circuit

- Offer for Sale
 - “An offer to sell, in order to be an infringement, must be an offer contemplating sale in the United States. Otherwise, the presumption against extraterritoriality would be breached. If a sale outside the United States is not an infringement of a U.S. patent, an offer to sell, even if made in the United States, when the sale would occur outside the United States, similarly would not be an infringement of a U.S. patent.”

Extraterritoriality

Key Cases – *WesternGeco* on remand to Federal Circuit

- Dissent
 - “The key issue left unaddressed in the now-reinstated opinion's analysis is: When a patent holder successfully demonstrates both patent infringement under United States law and foreign lost profits, what degree of connection must exist between the two before the foreign activity may be used to measure the plaintiff's damages?”
 - “Creative lawyers, for example, may seek to insulate their clients from infringement liability by structuring market transactions so as to distance the infringer from the foreign activities, seeking to mirror the present case. . . . When done for liability-avoidance reasons, such a change in form can increase costs without altering the underlying economic substance of the transaction.”

Extraterritoriality

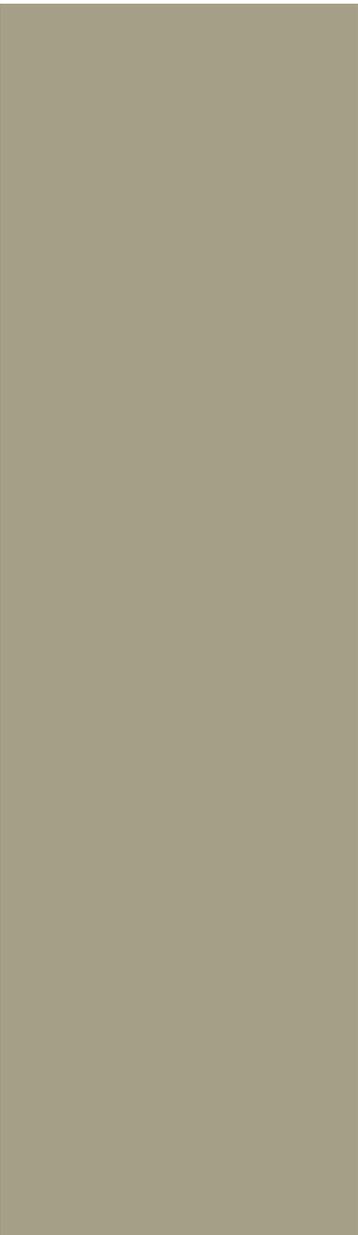
District Court cases

- “All-or-nothing” approach
 - Calculation of damages based on world-wide sales versus portion reaching the U.S.
 - *M2M Solns. LLC v. Enfora, Inc.*, 167 F.Supp.3d 665 (D.Del. 2016)
 - Judge Andrews rejected because:
 - Approach does not overcome presumption against extraterritoriality.
 - Plaintiff’s burden to prove accused products made abroad and shipped abroad actually make it into the U.S.
 - Evidence allowing jury to determine how many products sold abroad made their way into U.S.
 - Third party discovery of customers to prove some enter U.S.
 - Data-backed estimate of how many reach the U.S.

Extraterritoriality

District Court cases

- Discovery of foreign sales
 - *GE Healthcare v. Bio-Rad Labs., Inc.*, No. 1:14-cv-07080, 2015 WL 7582967 (S.D.N.Y. 2015)
 - Defendant argued Federal Circuit precedent precludes discovery of foreign sales of allegedly infringing products.
 - Judge Swain rejected because:
 - Federal Circuit cases did not address scope of discovery
 - Federal Circuit cases do not hold the “extraterritorial conduct entirely irrelevant to the determination of damages arising from infringement committed in the United States.”
 - Discovery of foreign sales information is not precluded by the presumption against extraterritoriality.



Non-Infringing Alternatives

Non-Infringing Alternatives

Trend - Cost to implement NIA is a cap on damages

- Federal Circuit, however, does not agree
 - “[Defendant] is wrong as a matter of law to claim that reasonable royalty damages are capped at the cost of implementing the cheapest available, acceptable non-infringing alternative. . . . To the contrary, an infringer may be liable for damages, including reasonable royalty damages, that exceed the amount the infringer could have paid to avoid infringement.”
 - *Mars, Inc. v. Coin Acceptors, Inc.*, 527 F.3d 1359 (Fed. Cir. 2008)

Non-Infringing Alternatives

Trend - Cost to implement NIA is a cap on damages

- MSJs to limit damages to cost to implement denied
 - *M2M Solns. LLC v. Enfora, Inc.*, 167 F.Supp.3d 665 (D.Del. 2016)
 - Unrebutted expert testimony that commercially acceptable, non-infringing alternative could be implemented for \$60,000, so damages should be limited to \$120,000.
 - Judge Andrews denied because:
 - Federal Circuit rejected such theory in *Mars, Inc. v. Coin Acceptors, Inc.*, 527 F.3d 1359 (Fed. Cir. 2008).
 - Existence of NIA is a factor and “does not conclusively establish an upper limit on a reasonable royalty.”
 - “It remains the province of the jury to credit or discredit the [expert] opinions . . . as to feasibility, commercial acceptability, cost and availability of their proposed, non-infringing alternatives.”

Non-Infringing Alternatives

Convincing the jury – Why haven't you switched?

- NIA sounds a lot like what the plaintiff is saying.
- If NIA is so cheap and better, why haven't you switched?
- If the evidence shows NIA is available and acceptable, why haven't you switched?
- The jury can see the rows of lawyers in the courtroom. If this case is about a \$2000 NIA, why haven't you switched?
- This question has to be answered at trial.

Non-Infringing Alternatives

Convincing the jury – Common sense, practical

- Facts, facts and more facts:
 - What specifically is the NIA?
 - How is it different from the accused product?
 - What are the pros and cons of the NIA?
 - Do the cons render the NIA unacceptable?
 - What would it take to implement?
 - Employee hours
 - Equipment
 - Process for implementation
 - Time table
- Knowledgeable company employee.

Non-Infringing Alternatives

Convincing the jury – Common sense, practical

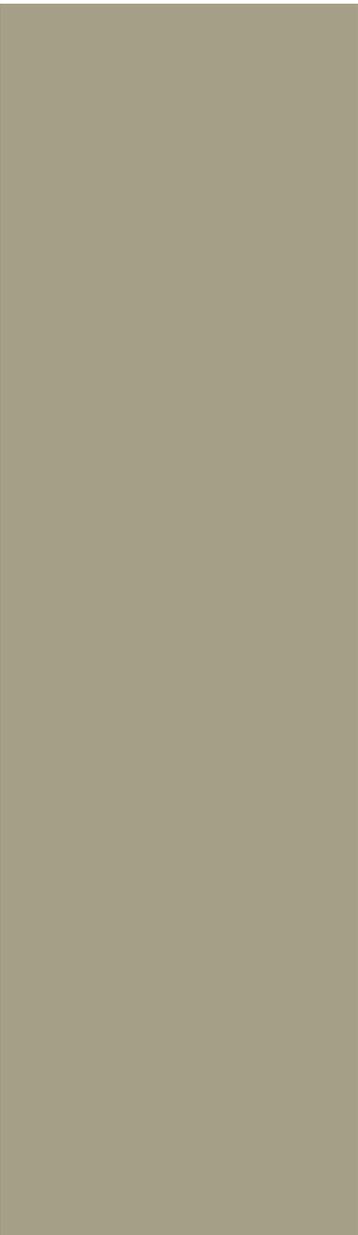
- Experts opinions
- Lay witness opinions (FRE 701)
- Fact witnesses
- Representative cases
 - *Apple Inc. v. Motorola, Inc.*, 757 F.3d 1286, 1321 (Fed. Cir. 2014)
 - *Core Wireless Licensing S.A.R.L. v. Apple Inc.*, No. 15-cv-05008, Order on *Daubert* Motions, (Nov. 18, 2016, N.D. Cal.)
 - *EMC Corp. v. Pure Storage, Inc.*, 154 F.Supp.3d 81 (D.Del. 2016)



Non-Infringing Alternatives

Convincing the jury – Common sense, practical

- Like all damages theories, NIAs have to fit with your overall trial themes.
 - Sometimes they don't.
- Must make time to present NIAs.
 - If you're on the clock and your damages expert is last, leave enough time.



Profit Splitting

Profit Splitting

Example scenarios

- Income/profits from apportioned feature.



**Hamburger = \$0.60
(profits = \$0.20)**

**Cheeseburger = \$1
(profits = \$0.50)**

Surplus profit = \$0.30

Split the profit

- Cost savings/revenue enhancements.

Profit Splitting

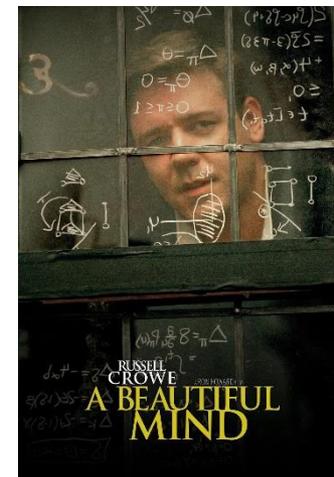
Federal Circuit

- Analytical approach: *TWM Mfg. Co. v Dura Corp.*, 789 F. 2d 895 (Fed. Cir. 1986), *cert. denied*, 479 U.S. 852 (1986)
 - **Projected** profitability—split out profit attributable to the patent.
- *Finjan, Inc. v. Secure Computing Corp.*, 626 F.3d 1197, 1210–11 (Fed. Cir. 2010)
 - “Defendants’ objection to Parr’s ‘one-third/two-third split’ of operating profit margins as arbitrary is also unpersuasive. Parr considered the custom in the industry, history of prior licenses, competitiveness of the parties, and the importance of the patented technology, among other factors, in concluding that the parties would have agreed that Finjan was entitled to 33% of the operating profit margin.”

Profit Splitting

Nash Bargaining Solution

- Originated by John Nash
- Princeton math professor
- Nobel Prize winning economist (1994)
- Movie—“A Beautiful Mind”



Profit Splitting

Nash Bargaining Solution

- Goal is to achieve “Nash Equilibrium” (NE).
- Game consists of multiple players bargaining for a deal.
- Each player has strategy choices.
- NE is achieved when strategies are **mutually reinforcing.**
- NE will typically generate a 50/50 split.

Profit Splitting

Nash Bargaining Solution

Patent cases

- Plaintiff and defendant are bargaining for a deal.
- Identify each party's expected profits without a deal (no inf.).
- Consider surplus achieved by the deal (defendant's profits from infringement).
- Split surplus to achieve NE
 - True equilibrium results in a 50/50 split—"best" possible outcome for both parties.
 - Thus, plaintiffs typically argued for a 50/50 split.
 - NBS allows for consideration of relative bargaining power, which may modify the split.

Profit Splitting

Nash Bargaining—rejected by NDCA (2011)

Oracle v. Google, No. C 10-03561 WHA (N.D. Cal. July 22, 2011) (Alsup, J.):

- NBS violates *Uniloc*: “would invite a miscarriage of justice by clothing a fifty-percent assumption in an impenetrable facade of mathematics.”
- NBS was not acceptable:
 - “**has never been approved by a judge** to calculate reasonable royalties in litigation, at least in the face of an objection. This is despite the fact that for decades it has been lurking in the field of economics,”
 - theory “that a **patent plaintiff would love** ... because it awards fully half of the surplus to the patent owner, which in most cases will amount to **half of the infringer’s profit**, which will be many times the amount of real-world royalty rates.”

Profit Splitting

Nash Bargaining—rejected by CAFC as applied

VirnetX, Inc. v. Cisco Sys., Inc., 767 F.3d 1308, 1337 (Fed. Cir. 2014):

- “The Nash theorem arrives at a result that follows from a certain set of premises. ***It itself asserts nothing about what situations in the real world fit those premises.*** Anyone seeking to invoke the theorem as applicable to a particular situation ***must establish that fit***, because the 50/50 profit-split result is proven by the theorem only on those premises.” (Emphasis added)
- “[W]e agree with the courts that have rejected invocations of the Nash theorem without sufficiently establishing that the premises of the theorem actually apply to the facts of the case at hand.”
- VirnetX’s expert started at a 50/50 split without applying the premises, and then considered relative bargaining power to arrive at 45/55.

Profit Splitting

What now?

- Apply a model that fits the circumstances.
- One option: Rubenstein-Muthoo bargaining model:
 - Ariel Rubenstein – Hebrew Univ. of Jerusalem
 - Abhinay Muthoo – Univ. of Essex



Profit Splitting

Rubenstein-Muthoo bargaining model

- Economic negotiation model:
 - Party A makes an offer.
 - Party B accepts the offer or makes a counteroffer.
 - And so on.
- Difference:
 - Rubenstein allows time to pass between offers.
 - Muthoo solves the model as time between offers approaches zero.

Profit Splitting

Rubenstein-Muthoo bargaining model

- Principles, assumptions:
 - No 50/50 starting point.
 - No assumption of equal negotiating strengths.
 - Inclusion of party-specific and time-specific facts and information.
 - Relative cost of capital or discount rate for each party to the negotiation—a proxy for relative strength in negotiation.
- Last bullet—the party that can borrow at lower interest rates enjoys greater bargaining power.

Profit Splitting

Rubenstein-Muthoo bargaining model

- Party-specific:
 - Tie cost of capital/discount rate to specific parties at the bargaining table
 - Industry standard publications with data for particular industries, comparable companies (e.g., Ibbotson, Duff and Phelps, Bloomberg)
 - Seek evidence from the parties re actual borrowing rates, debt
 - Bank loans, cost of debt, balance sheets, income statements
 - Determine parties' weighted average cost of capital (WACC)
- Time-specific:
 - Use data from around the date of the hypothetical negotiation

Profit Splitting

Rubenstein-Muthoo bargaining model

- Allowed:
 - *Content Guard Holdings, Inc. v. Amazon.com*, 2:13-cv-01112-JRG (E.D. Tex. Aug. 6, 2015) (Doc. No. 825) (“articulate[d] each premise of the Rubenstein model and cite[d] to specific evidence”; used “Defendant-specific evidence as inputs to some of the premises”)
- Excluded:
 - *Omega Patents, LLC v. CalAmp Corp.*, No. 6:13-CV-1950 (M.D. Fla. Dec. 23, 2015) (Doc. No. 117) (plaintiff was a single-person non-practicing entity without any financial records; insufficient evidence of WACC tailored to plaintiff’s particular situation; reliance exclusively on the bargaining model without consideration of other evidence such as commercial relationship, relative contributions, competition, and financial condition)

Profit Splitting

Rubenstein-Muthoo bargaining model

Peer-reviewed literature:

- Muthoo, “Bargaining Theory and Royalty Contract Negotiations,” *Review of Economic Research on Copyright Issues* (2006) (applying Muthoo bargaining model to IP negotiations including reasonable royalty)
- McDuff, “Splitting the Atom: Economic Methodologies for Profit Sharing in Reasonable Royalty Analysis,” *les Nouvelles* (June 2016)

Profit Splitting

Final Thoughts

- May combine a profit split with other approaches
- Economic modeling may can be used to triangulate, or check

Questions?

Thank you!



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