

Claimed damages under close scrutiny

The Federal Circuit is examining plaintiffs' demands in patent cases with a renewed vigor, rendering many traditional calculations inappropriate



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Patents

Recent Federal Circuit case law has changed the game regarding reasonable royalty damages in patent cases, placing a renewed focus on the nature and type of evidence required to tie the damages to the patented invention, or in most cases the lack thereof. Generalized theories and abstract constructs have been unambiguously rejected in favor of the rigorous application of case-specific facts. As a result, it is critical that practitioners utilize targeted efforts to develop detailed damages evidence designed to avoid these pitfalls and consider litigation tactics to exploit the more stringent damages proofs now being required.

THE EVOLVING PATENT DAMAGES LANDSCAPE

Patentees and accused infring-

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ers alike have long based reasonable royalty damages calculations on the somewhat wishy-washy application of well-established factors set forth in *Georgia-Pacific v. U.S. Plywood*, 318 F.Supp 1116 (S.D.N.Y. 1970), designed to make a hindsight approximation of a "hypothetical negotiation" between the patentee and accused infringer for a license to the patent-in-suit.

License agreements will also be central to any damages case, and in order to counter the anticipated attacks by accused infringers, it is critical to be prepared to provide as much data as possible backing up your prior license evidence.

Since September 2009, several important damages decisions have been issued by the Federal Circuit U.S. Court of Appeals, with both mega-awards and relatively pedestrian awards receiving scrutiny. While leaving the existing legal framework intact, the Federal Circuit has applied breathtaking rigor to its application in ways that will impact every patent infringement case going forward.

In *Lucent Techs v. Gateway*, 580 F.3d 1301 (Fed. Cir. 2009), the court limited the role of the entire market value rule for minor components of accused products and scrutinized prior license evidence. The jury had found that the date picker function in Microsoft's calendars infringed Lucent's patent and awarded Lucent a lump sum royalty award of

\$358 million, which amounted to approximately 8 percent of Microsoft's revenue for the sale of Outlook.

The Federal Circuit vacated the damages award and remanded the case because this damages calculation was not supported by substantial evidence. Specifically, the evidence failed to show that licenses offered by Lucent were similar enough to support the award, as they arose from divergent economic circumstances and covered different technology. Moreover, any application of the entire market value rule was in error, where the infringing date-picker feature constituted a tiny fraction of a much larger commercial product. The court left the door open to the entire market value rule in *dicta*, however, suggesting that the value of the entire product could be used as a base for a royalty calculation as long as the magnitude of the rate is within an acceptable range as determined by the evidence.

In *ResQnet.com v. Lansa*, 594 F.3d 860 (Fed. Cir. 2010), the court vacated a \$500,000 damages award based on a 12.5 percent reasonable royalty because the award was based on speculative and unreliable evidence from ResQnet's damages expert. Like the problematic licenses relied upon in *Lucent*, ResQnet's flawed damages evidence included rebundling licenses with no discernible link to the claimed invention, which its expert used to drive the royalty rate to "unjustified double digit levels." These stood in stark contrast to the much lower rates of the existing license to the patents-in-suit. In vacating the award, the Federal Circuit emphasized that licenses must be linked to the claimed invention to be relevant.

In *Uniloc v. Microsoft*, 632 F.3d 1292 (Fed. Cir. 2011), the court rejected the 25 percent rule and further limited the entire market value rule. The jury had

awarded \$388 million in damages for infringement by the product activation feature in Microsoft's Word and Windows products, despite the fact that the patent-in-suit was directed to a software registration system — a feature that had nothing to do with the accused products' primary functionality. The Federal Circuit affirmed the grant of a new trial on damages based on improper reliance by Uniloc's expert on the 25 percent and entire market value rules in establishing a reasonable royalty. First, the court categorically rejected the abstract 25 percent "rule of thumb" as a flawed tool that violates both *Daubert* and the Federal Rules of Evidence, while emphasizing that the patentee must sufficiently tie the expert testimony to the facts of the case in order to prove reasonable royalties.

Second, the court clarified that the entire market value rule can only be used where the patentee proves that the patent-related feature is the basis for customer demand, regardless of how low of a royalty rate it asserts, thereby foreclosing the pragmatic approach hinted at in *Lucent*.

The case of *IP Innovation v. Red Hat*, 705 F.Supp.2d 687 (E.D.Tex. 2010), demonstrates that expert testimony that fails to comply with these rulings risks complete exclusion. This successful *Daubert* challenge to plaintiff's damages expert, which came in a case where Federal Circuit Judge Randall Rader sat by designation, illustrates the profound risks of using unrelated licenses and industry data that fails to comply with these newly articulated requirements. There, the expert's reliance on the entire market value rule, his emphasis on general industry studies — rather than existing licenses to the patents-in-suit — and his failure to account for "the economic realities of [the] claimed component as part of a larger system" were fatal and resulted in complete exclusion. Rather than relying on such abstract and unsupported theories, Rader opined that the best measure of a reasonable royalty and the more proper starting point would have been prior licenses to the patents-in-suit.

LESSONS GOING FORWARD

While the Federal Circuit's renewed focus on damages has not resulted in a rewrite of the law, it signals that the

court will apply the established patent law regarding damages with profound, breathtaking rigor. The collective lesson to be learned is clear — damages evidence supporting both the royalty base and rate must be closely tied to the facts of the case. Reliance on general theories, industry studies or averages, rules of thumb, and an imprecise, opinion-based discussion of the pertinent *Georgia-Pacific* factors divorced from the facts of the dispute is no longer good enough.

Now more than ever, experts must focus on a reasoned analysis rooted in the circumstances of the case, rather than the desired outcome, as courts will see through an attempt to get to the same number by different means.

The Federal Circuit is looking at damages issues with a more sophisticated eye, and is moving toward an apportionment model where the royalty base must be based on the incremental value that the patented technology adds to the accused product. Moreover, there must be a basis in fact — based on sound economic principles and specifically tied to the evidence of record — to associate the royalty rates used in prior licenses to the particular hypothetical negotiations at issue. As such, prior licenses are only relevant if they closely relate to the actual patents, parties and products at issue. The required proof to support (or attack) both a royalty base and rate under this more rigorous model must be developed during discovery and well-presented at trial. As a result, proving damages will require extensive technical and economic analysis, and it will be costly.

DEFENSE LITIGATION TACTICS

The onerous proofs now being required by the Federal Circuit to link damages evidence and calculations to the claimed invention, parties and accused products provide fertile ground for attacks on plaintiff's damages case. In light of these developments, *Daubert* motions to exclude testimony by plaintiff's damages expert for failure to comply with the patent laws as articulated in these recent rulings should be considered in every single patent case. For example, where an expert relies on prior licenses, but fails to properly link them to the patented invention, or overreaches by improperly applying the

entire market value rule, his testimony may be excluded.

Similarly, there will be myriad opportunities to challenge prior license evidence — whether relied upon by plaintiff's expert or standing alone. The focus should be on identifying failures to adequately show the requisite link, both technical and economic, between the prior licenses and the specific hypothetical negotiation at issue. In the absence of a particularized factual showing that the technical subject matter of prior licenses is comparable to the claimed technology, plaintiff may be left only with prior licenses to the patent-in-suit, which are often litigation-driven, to support its royalty calculation.

Consider aggressively seeking discovery on the negotiations surrounding those licenses, which is likely to show that the agreed-upon rate was the result of a desire to avoid litigation rather than an accurate reflection of the invention's value, to further undermine support for plaintiff's damages case.

EFFECTIVELY DEVELOPING EVIDENCE

The Federal Circuit's recent pronouncements on damages have made it harder and more costly to achieve large damages awards in patent cases, and it is now paramount to proactively employ strategies to develop supporting evidence that complies with these new requirements. Given the near certainty of routine *Daubert* motions by defendants capitalizing on the recent case law, plaintiffs should consider these tactics to avoid getting their damages expert excluded from the outset.

When hiring a damages expert, consider candidates with the experience, background and acumen necessary to handle the far more sophisticated economic and technical analysis now being required. Get your damages expert involved and focused early, not only on economic issues, but also technical ones. In order to effectively link the inventive features of the patent-in-suit to the accused products, and prior license evidence to the claimed technology, pay attention to the interplay between your damages expert and technical expert and push them to collaborate to prove the requisite links.

Finally, work with your experts to develop evidence of the importance of the patented feature or component to the ac-

cused product, particularly where your damages rely on entire market value.

License agreements will also be central to any damages case, and in order to counter the anticipated attacks by accused infringers suggested above, it is critical to be prepared to provide as much data as possible backing up your prior license evidence. Limit your reliance to license agreements where you can develop facts that show a logical connection to the claimed invention

and economic similarities between the previous licenses and hypothetical negotiation in your case. Provide the court with sufficient details to allow an apples-to-apples comparison between the proffered licenses and your requested royalties for infringing sales. Be specific regarding how lump sum or running royalty license payments were calculated. Develop evidence, for example, regarding how the parties to each license calculated each lump sum

payment, which products each license was intended to cover, and how many of these products each licensee was expected to produce. When negotiating licenses that may impact future litigation, proactively consider these issues and be vigilant not to establish cheap precedents for your technology. In addition, consider providing details on assumptions used to establish lump sum royalties, in order to bolster any future anticipated damages case.