

LIMITATIONS ON DAMAGES FOR NPEs:
ENTIRE MARKET VALUE UNDER *CORNELL
UNIV., LUCENT, UNILOCO AND
LASERDYNAMICS*

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Damages For Patent Infringement

Recoverable Damages

35 U.S.C. § 284

Upon finding for the claimant the court shall award the claimant damages adequate to compensate for the infringement, but in no event less than a reasonable royalty for the use made of the invention by the infringer together with interest and costs as fixed by the court.”

Consider Royalty Computation Example

Hypothetical case

- Plaintiff is a non-practicing entity (NPE)
- Patent is directed to a short movie feature for digital cameras
- Defendants sell digital cameras
- Each camera has 40-60 features
- Each camera sells for \$150-\$250
- The chips for the short movie function cost \$5 per camera
- Total sales have been 10 million units for \$2 billion in revenue

Royalty Computation

- Royalty equals base x rate

Q1. Which is the appropriate base?

- A. \$2 billion
- B. 10 million units
- C. \$50 million
- D. None of the above

Q2. What is the appropriate rate?

- A. \$5 per camera
- B. 1% of revenue
- C. 25% of the profit
- D. None of the above

What is a “reasonable royalty”?

- **Minimum** level of damages to which a prevailing patentee is entitled by statute. 35 U.S.C. § 284.
- It applies where the patentee cannot prove lost profits, e.g., because the patentee does not compete with the accused infringer.
- Forms of “reasonable royalty”
 - Established royalty
 - Lump sum
 - Running royalty based on sales: base x rate

How is a “reasonable royalty” determined?

- Hypothetical negotiation between the patentee and the infringer at a time before infringement began.
- 15-factor test that recreates the economic circumstances between a willing licensor and willing licensee, including:
 - Prior licensing of the patent and comparable technologies
 - The commercial relationship between licensor and licensee, such as whether they are competitors
 - The established profitability of products made under the patent
 - The advantages of the patented products over prior products
 - The portion of profits creditable to the invention as opposed to non-patented elements such as improvements added by infringer or marketing

Georgia-Pacific v. United States Plywood Corp., 318 F. Supp. 1116, 1120 (S.D.N.Y. 1970), modified, 446 F.2d 295 (2d Cir. 1971)

Reassertion of the entire market value rule

- Clearly restated in *Rite-Hite Corp. v. Kelley Co., Inc.*, 56 F.3d 1538, 1549 (Fed. Cir. 1995) (en banc)

Early cases invoking the entire market value rule required that for a patentee owning an “improvement patent” to recover damages calculated on sales of a larger machine incorporating that improvement, the patentee was required to show that the entire value of the whole machine, as a marketable article, was “properly and legally attributable” to the patented featured.

...

We have held that the entire market value rule permits recovery of damages based on the value of a patentee’s entire apparatus containing several features when the patent-related feature is the “basis for customer demand.”

Cornell Univ. v. Hewlett-Packard Co. ,
609 F.Supp., 2d 279 (N.D.N.Y. 2009)
(Rader, J.)

- Patent directed to out-of-order execution feature in HP's processors, which in turn were merely one aspect of HP's servers and workstations.
- Plaintiff sought damages on the entire market value of (a) the servers or (b) the "CPU bricks."
- Based on (b), the jury awarded \$184 million.
- Judge Rader applied the "entire market value rule" and granted JMOL.
- Judge Rader found that the logical base was the "smallest salable infringing unit with close relation to the claimed invention-namely the processor itself."
- Judge Rader granted remittitur of \$53 million.

Cornell Univ. v. Hewlett-Packard Co. (N.D.N.Y.) (cont'd)

- Cornell failed to adduce competent evidence of a link between the use of the patented feature in HP's processors and consumer demand for its complete servers and workstations.
 - “At best . . . purchasers opt for Hewlett-Packard products because of their superior performance.”
 - But the patented out-of-order execution feature was only one of numerous features that enhanced performance.
- The court, therefore, precluded Cornell from relying on the entire market value of HP's servers and workstations as the royalty base.

Cornell Univ. v. Hewlett Packard Co., 609 F.Supp. 2d 287-289 (N.D.N.Y. 2009)

Cornell Univ. v. Hewlett-Packard Co. (N.D.N.Y.) (cont'd)

- The court emphasized the need for “**sound economic and factual predicates**” underlying the reasonable royalty analysis.
- Cornell did not introduce any economic evidence satisfying *Daubert*.
 - No market studies
 - No market-wide demand curves

Cornell Univ. v. Hewlett Packard Co., 609 F.Supp. 2d 288-89
(N.D.N.Y. 2009)

Lucent Techs., Inc. v. Gateway, Inc., 580 F.3d 1301 (Fed. Cir. 2009)

- Patent directed to date-picker tool.
- Accused product was Microsoft Outlook. Royalty base consisted of \$8B in sales.
- Court reversed jury award of \$358M lump sum royalty for failure to comply with the entire market value rule: “Lucent did not carry its evidentiary burden of proving that anyone purchased Outlook because of the patented method.”

Indeed Lucent’s damages expert conceded that there was no “evidence that anybody anywhere at any time ever bought Outlook, be it an equipment manufacturer or and individual consumer, . . . because it had a date picker.”

Lucent Techs., Inc. v. Gateway, Inc., 580 F.3d 1301, 1337 (Fed. Cir. 2009)

Uniloc USA, Inc. v. Microsoft Corp., 32 F.3d 1292 (Fed. Cir. 2011)

- Patent directed to “product activation” feature for software.
- Uniloc’s expert testified that \$565M royalty was reasonable because it was only 2.9% of Microsoft’s \$19B in sales of Office and Windows.
- Federal Circuit affirmed new trial on damages because use of \$19B royalty base, even as a “check,” violated entire market value rule.
- Court found it “undisputed” that customers did not buy Office or Windows because of “product activation.”

Uniloc USA, Inc. v. Microsoft, 632 F.3d 1292, 1319, 1321 (Fed. Cir. 2011)

The related death of the 25% rule

- 25% rule suggests that the licensee would pay a royalty rate equivalent to 25% of its expected profits for the product that incorporates the IP at issue
- *Uniloc USA, Inc. v. Microsoft Corp.*, 632 F.3d 1292, 1315 (Fed. Cir. 2011)

This court now holds as a matter of Federal Circuit law that the 25 percent rule of thumb is a fundamentally flawed tool for determining a baseline royalty rate in a hypothetical negotiation. Evidence relying on the 25 percent rule of thumb is thus inadmissible under *Daubert* and the Federal Rules of Evidence, because it fails to tie a reasonable royalty base to the facts of the case at issue.

***LaserDynamics, Inc. v. Quanta
Computer, Inc., 2012 WL 3758093
(Fed. Cir. 2012)***

- Patent directed to method that enables optical disc drive to automatically identify the type of optical disc inserted, CD or DVD.
- *LaserDynamics* damages expert opined to a running royalty of 2% of the total sales of laptop computers.
- *LaserDynamics* expert's 2% royalty was based on his opinion that 6% would be a reasonable royalty on the optical disc drives alone.
- In first trial, jury awarded \$52 million in damages. The court granted JMOL and offered a remittitur to \$6.2 million.

LaserDynamics, Inc. v. Quanta Computer, Inc. (Fed. Cir. 2012) (cont.)

- In second trial, *LaserDynamics* damages expert opined the damages should be \$10.5 million. Jury awarded lump sum amount of \$8.5 million.
- On appeal, Federal Circuit upheld grant of new trial on damages from first trial on the ground that plaintiff had not submitted evidence to satisfy the entire market value rule.
- In granting new trial on damages for error in the hypothetical negotiation date, the Federal Circuit also opined that plaintiff's royalty of 6% on the optical disc drives was "arbitrary and speculative" and could not be presented in the retrial.

Issue #1: Can a “low” royalty rate justify an otherwise improper base?

■ Initial view: Sometimes.

“There is nothing inherently wrong with using the market value of the entire product, especially when there is no established market value for the infringing component or feature, so long as the multiplier accounts for the proportion of the base represented by the infringing component or feature.”

Lucent Techs., Inc. v. Gateway, Inc., 580 F.3d 1301, 1337 (Fed. Cir. 2009)

■ Current view: No.

- “The Supreme Court and this court’s precedents do not allow consideration of the entire market value of accused products for minor improvements simply by asserting a low enough royalty rate.”

Uniloc USA, Inc. v. Microsoft, 632 F.3d 1292, 1320 (Fed. Cir. 2011)

- “Importantly, the requirement to prove that the patented feature drives demand for the entire product may not be avoided by the use of a very small royalty rate.”

LaserDynamics, Inc. v. Quanta Computer, Inc., 2012 WL 3758093, *12 (Fed. Cir. 2012)

Why does the royalty base matter?

- Disclosure of accused infringer's revenues can be highly prejudicial:
 - “The disclosure that a company has made \$19 billion in revenue from an infringing product cannot help but skew the damages horizon for the jury, regardless of the contribution of the patented component to this revenue.”

Uniloc USA, Inc. v. Microsoft, 632 F.3d 1292, 1320 (Fed. Cir. 2011)

- “Admission of such overall revenues, which have no demonstrated correlation to the value of the patented feature alone, only serve to make a patentee's proffered damages amount appear modest by comparison, and to artificially inflate the jury's damages calculation beyond that which is 'adequate to compensate for the infringement.'”

LaserDynamics, Inc. v. Quanta Computer, Inc., 2012 WL 3758093, *12 (Fed. Cir. 2012)

Prejudice from admitting an improper royalty base

- *Uniloc* court noted “\$19 billion cat was never put back into the bag”:

Q. And you understand your lump-sum max theory is \$7 million?

A. Yes.

Q. And that would be an effective royalty of approximately .000035%?

A. If one were inappropriately putting the entire market value of the products, that’s what it would result in.

Q. And at the end of the day, the infringer, Microsoft, who violated the patent law, they get to keep 99.9999% of the box and the inventor, whose patent they in-fringed, he gets the privilege of keeping .00003%?

A. When expressed as the entire market value of the products, that’s correct.

Uniloc USA, Inc. v. Microsoft, 632 F.3d 1292, 1320-21 (Fed. Cir. 2011)

Issue #2: What Evidence Of Demand Is Required?

- Selected customer statements are insufficient to show market demand.
 - “[S]elected user’ statements in isolation and without a relationship to the actual claimed technology do not show an accurate economic measurement of total market demand for the switching feature, let alone its contribution to demand for the entire [operating system] asserted as the royalty base.”

IP Innovation L.L.C. v. Red Hat, Inc., 705 F.Supp.2d 687, 690 (E.D. Tex. 2010) (Rader, J.)

- Customer complaints or praise, however, can be combined with other evidence to support a finding of market demand.

Tec Air, Inc. v. Denso Mfg. Michigan Inc., 192 F.3d 1353, 1362 (Fed. Cir. 1999)

What Evidence Of Demand Is Required (cont'd)?

- Surveys, market studies, regression analyses or other competent economic evidence are necessary to establish consumer demand.

Inventio AG v. Otis Elevator Co., C.A. 06-5377, Slip Op., 5 (S.D.N.Y. June 23, 2011)

- “Mr. Murtha never conducted any market studies or consumer surveys to ascertain whether demand for a laptop computer is driven by the patented technology.”

LaserDynamics, Inc. v. Quanta Computer, Inc., 2012 WL 3758093, *13 (Fed. Cir. 2012)

- “Cornell could have offered marketplace-wide evidence of demand sensitivities,” but “did not offer a single demand curve or attempt in any way to link consumer demand for servers and workstations to the claimed invention.”

Cornell Univ. v. Hewlett Packard Co., 609 F.Supp. 2d at 288.

Testimony of defendant's executives is insufficient

- Testimony by company executives that features of the invention are important cannot substitute for evidence of **consumer** demand . . .

Rolls-Royce PLC v. United Techs. Corp., 2011 WL 1740143 (E.D. Ca. 2011)

Cornell Univ v. Hewlett Packard Co., 609 F. Supp. 2d 279 (N.D.N.Y. 2009) (*Cornell II*)

Uniloc USA, Inc. v. Microsoft, 632 F.3d 1292, 1311, 1319 (Fed. Cir. 2011)

- . . . but can be combined with other evidence to help demonstrate demand.

Marine Polymer Technologies, Inc. v. Hemcon, Inc., 672 F.3d 1350, 1360 (Fed. Cir. 2012)

Issue #3: Must the patented feature be *the* basis of customer demand?

- Patentee must show that the patented feature was *the* basis of customer demand for the products included in the royalty base.

Lucent Techs., Inc. v. Gateway, Inc., 580 F.3d 1301, 1336 (Fed. Cir. 2009)

- “It is not enough to present evidence that the patented feature was desirable, or that it played some role — even a substantial role — in the customer’s decision to purchase a system containing the infringing product.”

Inventio AG v. Otis Elevator Co., C.A. 06-5377, Slip Op., 5 (S.D.N.Y. June 23, 2011)

Patented feature must be *the* basis of customer demand

- “It is not enough to merely show that the disc discrimination method is viewed as valuable, important, or even essential to the use of the laptop computer.”
- “Nor is it enough to show that a laptop computer without an ODD practicing the disc discrimination method would be commercially unviable.”

LaserDynamics, Inc. v. Quanta Computer, Inc., 2012 WL 3758093, *12 (Fed. Cir. 2012)

Patented feature must be *the* basis of customer demand

- “Were this sufficient, a plethora of features of a laptop computer could be deemed to drive demand for the entire product. To name a few, a high resolution screen, responsive keyboard, fast wireless network receiver, and extended-life battery are all in a sense important or essential features to a laptop computer; take away one of these features and consumers are unlikely to select such a laptop computer in the marketplace.”

LaserDynamics, Inc. v. Quanta Computer, Inc., 2012 WL 3758093, *12 (Fed. Cir. 2012)

- "Wheels are critical to an automobile, but no one would apportion all of the demand for a car to just the wheels.”

Oracle Am., Inc. v. Google Inc., 798 F. Supp. 2d 1111, 1115-16 (N.D. Cal. 2011)

Unpatented features cannot play any substantial role in demand

- If features other than the patented component contribute to demand for the products included in the royalty base, then the patented invention was not “**the**” basis for consumer demand.

Inventio AG v. Otis Elevator Co., C.A. 06-5377, Slip Op., 5 (S.D.N.Y. June 23, 2011)
Mformation Technologies, Inc. v. Research in Motion Ltd., 2012 WL 1142537 (N.D. Cal. Mar. 29, 2012)

- Such unpatented features may include:
 - Other components in the product/system not covered by the patent
 - The vendor’s history, reliability, price or execution
 - Marketing

Inventio AG v. Otis Elevator Co., C.A. 06-5377, Slip Op., 5 (S.D.N.Y. June 23, 2011)

Alternative test: patent “substantially” creates value

- The Court in *Uniloc* suggested a more relaxed test for proving demand:
 - A patentee may base damages on the entire market value of the accused product where the patented feature “substantially create[s] the value of the component parts.”

Uniloc USA, Inc. v. Microsoft, 632 F.3d 1292, 1318 (Fed. Cir. 2011)

- One district court denied a *Daubert* motion under this standard, holding that there was evidence that the patented video-on-demand feature “substantially contributed to the value of the [Verizon FiOS] system.”

ActiveVideo Networks Inc. v. Verizon Communications Inc., C.A. 10-248 (E.D. Va. July 5, 2011)

Issue #5: Does Defendant's failure to provide separate valuation excuse use of entire product?

- Fact that defendant has not separately valued the patented feature or component does not excuse compliance with the entire market value rule.
 - Court rejected patentee's argument that accused feature had "no separate valuation, no aftermarket, and thus no way to value the accused feature separately."

IP Innovation L.L.C. v. Red Hat, Inc., 705 F. Supp. 2d 687, 690 (E.D. Tex. 2010) (Rader, J.)

- Despite fact that "QCI is in the business of assembling and selling complete laptop computers, not independent ODDs, and that QCI does not track the prices, revenues, or profits associated with individual components," Court "reject[ed] the contention that practical and economic necessity compelled LaserDynamics to base its royalty on the price of an entire laptop computer."

LaserDynamics, Inc. v. Quanta Computer, Inc., 2012 WL 3758093, *13 (Fed. Cir. 2012)

Role of patentee's past licensing history

- If patent was historically licensed based on total product sales, that may “economically justify” the use of the entire market value of the accused products in the royalty base, even in absence of proof of demand.

Mondis Technology, Ltd. v. LG Elecs., Inc., 2011 WL 2417367, *1-3 (E.D. Tex. 2011)

- On the other hand, if the patentee licensed the patent for a lump sum or on some other basis not premised on product sales, that tends to demonstrate that the patentee would not have agreed to a running royalty on sales in the hypothetical negotiation.

Current alternatives for royalty

- If a multi-component product cannot be used as the royalty base, it is appropriate for the patentee to rely on the “smallest salable patent-practicing unit.”

LaserDynamics, Inc. v. Quanta Computer, Inc., 2012 WL 3758093, *11 (Fed. Cir. 2012)

Cornell Univ. v. Hewlett–Packard Co., 609 F. Supp. 2d 279, 283, 287–88 (N.D.N.Y.2009)

- Alternatively, the patentee can apportion between the patented feature and the unpatented features.

LaserDynamics, Inc. v. Quanta Computer, Inc., 2012 WL 3758093, *13 (Fed. Cir. 2012)

Mondis Technology, Ltd. v. LG Elecs., Inc., 2011 WL 2417367, *3 (E.D. Tex. 2011)

- A lump sum may also be appropriate in certain circumstances.

LaserDynamics, Inc. v. Quanta Computer, Inc., 2012 WL 3758093, *14 (Fed. Cir. 2012)