

**The 2010 Midwest Intellectual Property Institute**

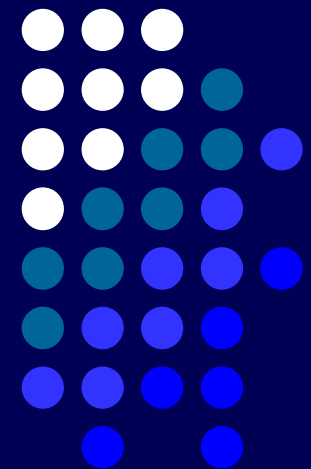
# **Big Verdicts Under Scrutiny: Taking a Hard Look at the Damages Case**

**Jake M. Holdreith**

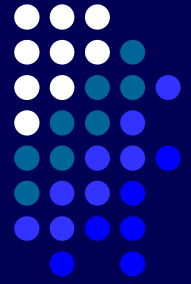
Robins, Kaplan, Miller & Ciresi L.L.P.

**Michael J. Wagner**

LitiNomics, Inc.



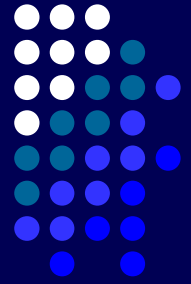
# The Federal Circuit Has Put The Bar On Notice That It Is Paying Attention To Damages



“Most jury damages awards reviewed on appeal have been held to be supported by substantial evidence. *See* Skenyon et al., *supra*, at § 3:20 (summarizing sixty-two damages cases). Nonetheless, on post-trial JMOL motions, district court judges must scrutinize the evidence carefully to ensure that the “substantial evidence” standard is satisfied, while keeping in mind that a reasonable royalty analysis “necessarily involves an element of approximation and uncertainty.” *Unisplay*, 69 F.3d at 517.”

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

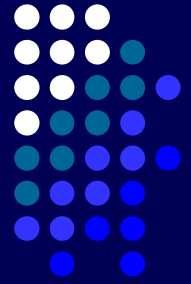
# Judge Rader



“[Patent damages] is an area of great challenge in our law. . . . The secret is that that it depends on the evidence. You cannot make that determination based on a rule of law. It’s an area that requires great evidentiary work by the attorneys, and judges have to be involved at an early stage to sort out the issues so that we don’t spend an awful lot of time in litigated effort on something that is of little value.”

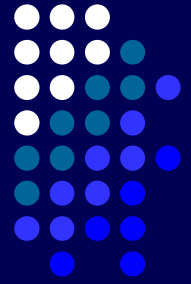
- Interview of Judge Rader in July/August 2010 issue of *IP Litigator*

# Key Concepts

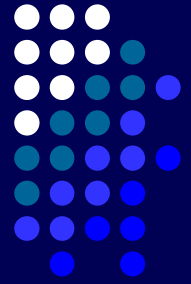


- The Federal Circuit is scrutinizing evidentiary issues more than legal rules.
  - Reliability or correctness of the expert methodology to isolate the value of the claimed invention.
  - Sufficiency of the evidence relied on by the expert and presented to the jury.

# Key Concepts



- These factors are getting particular scrutiny:
  - evidence of the value the market places on the claimed technology
  - evidence that any licenses offered in evidence are relevant and comparable
  - choosing the correct unit for calculating the royalty base and/or adjusting the rate correctly to reflect the portion of the value of the unit chosen that is contributed by the claimed technology

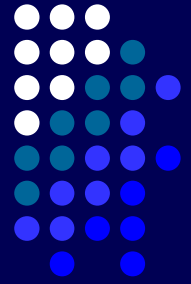


# Recent Decisions

- ***ResQNet.com***: \$506,305 verdict reversed on appeal for insufficient evidence
- ***Lucent***: \$358,000,000 verdict reversed on appeal for insufficient evidence
- ***IP Innovation LLC***: Plaintiff's damage expert excluded at trial (Judge Rader)
- ***Cornell Univ. v. HP***: \$184,000,000 verdict reduced to \$53,000,000 (Judge Rader)

# Recent Federal Circuit Cases

LICENSES MUST BE COMPARABLE



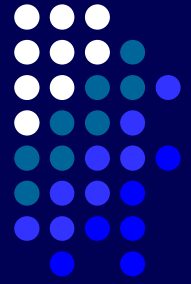
- ***ResQNet.com, Inc. v. Lansa, Inc.***

594 F.3d 860 (Feb. 2010) (Circuit Judges Newman, Lourie, and Rader; Per Curiam opinion with Judge Newman concurring in part, dissenting in part)

- Remanded a verdict of \$506,305 in damages based on a 12.5% royalty rate.
- Rate was based on licenses. Federal Circuit held that five of the licenses (with higher rates) “had no relation to the claimed invention.”

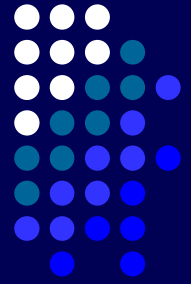
# Recent Federal Circuit Cases

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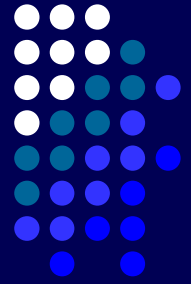


- ***ResQNet.com, cont'd***
  - Accused product was terminal emulation software.
  - Five of the licenses provided finished products and services for rebranding and rebundling, rather than a bare license to use the claimed technology.
  - Two of the licenses were litigation bare licenses of the claimed technology.

# Pop Quiz



- **Guess which licenses had higher royalty rates?**
  - The finished product and services “rebundling” licenses?  
or
  - The litigation licenses to the bare technology?

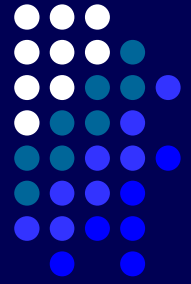


- *ResQNet.com, cont'd*

“Yet Dr. David used licenses with no relationship to the claimed invention to drive the royalty rate up to unjustified double-digit levels. Dr. David based his damages on seven ResQNet licenses, five of which had no relation to the claimed invention. These five re-branding or re-bundling licenses (hereinafter, the “re-bundling licenses”) furnished finished software products and source code, as well as services such as training, maintenance, marketing, and upgrades, to other software companies in exchange for ongoing revenue-based royalties.”

# Recent Federal Circuit Cases

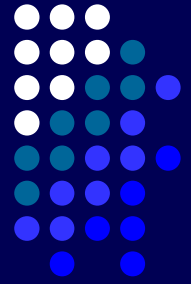
## LICENSES MUST BE COMPARABLE



- ***ResQNet.com, cont'd***
  - Court observed “that the most reliable licenses in this record arose out of litigation” and had much lower rates.
  - On remand, the district court was instructed that it “should not rely on unrelated licenses to increase the reasonable royalty rate above rates more clearly linked to the economic demand for the claimed technology.”

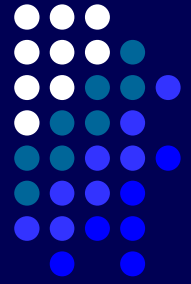
# Recent Federal Circuit Cases

## LICENSES MUST BE COMPARABLE



- ***ResQNet.com, cont'd***
  - Majority: there was no evidence that the product in the rebundling licenses practiced the asserted claims.
  - Judge Newman, dissenting: Economic expert's testimony that the bundling licenses are directed at "code for terminal emulation technology . . . based on the patents in suit" was sufficient to tie the licenses to the patented technology.

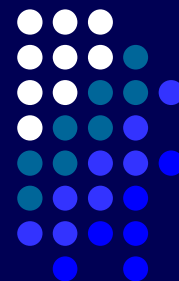
# Take Aways



- The Federal Circuit is looking for evidence that any past licenses offered in evidence are properly linked to the claimed technology.
- Litigation licenses of the patent(s)-in-suit may be the most comparable.
- It is not only 8-figure verdicts that are getting scrutiny.

# Recent Federal Circuit Cases

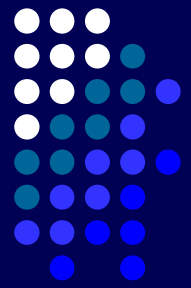
## EVIDENCE OF THE VALUE OF THE TECHNOLOGY



- ***Lucent Technologies, Inc. v. Gateway, Inc.***

580 F.3d 1301 (Sept. 2009) (Before Circuit Judges Michel, Newman, and Lourie)

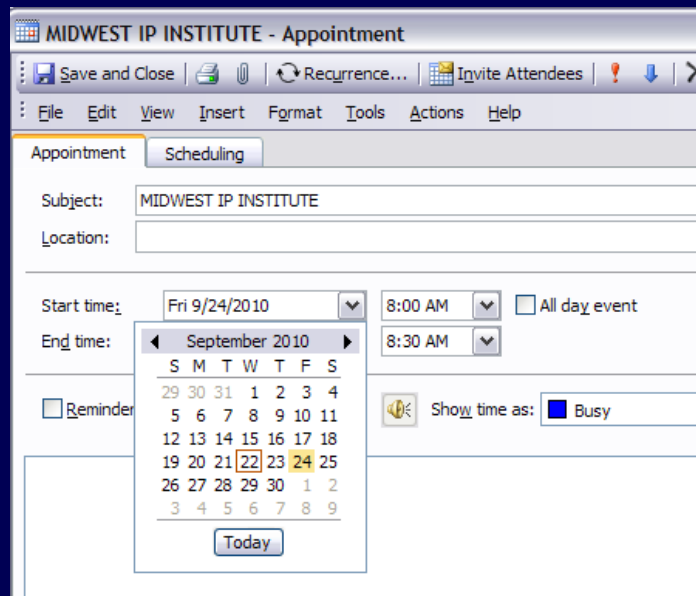
- \$358 million damages award (8% of the sales price of Microsoft Outlook) against defendant-intervener Microsoft was vacated.



## Lucent v. Gateway (cont'd)

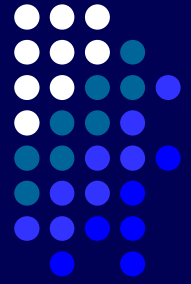
### EVIDENCE OF THE VALUE OF THE TECHNOLOGY

- The Federal Circuit characterized the claimed technology as use of a software tool for inputting information into a field in Microsoft Outlook, Money and Mobile, including a tool for picking a date from a calendar displayed on the user's screen.



## *Lucent v. Gateway (cont'd)*

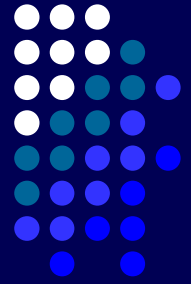
### EVIDENCE OF THE VALUE OF THE TECHNOLOGY



- Federal Circuit found that “Lucent submitted no evidence upon which a jury could reasonably conclude that Microsoft and Lucent would have estimated, at the time of [a hypothetical] negotiation, that the patented date-picker feature would have been so frequently used or valued as to command” the \$358 million award.
- The Court suggested that Lucent’s expert explicitly invited the jury to speculate as to the amount of use the parties should have expected.

## Lucent v. Gateway (cont'd)

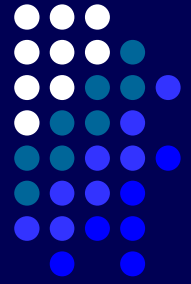
### THE ROYALTY BASE



- The Federal Circuit faulted Lucent's expert for not explaining "whether the patented technology is essential to the licensed product being sold, or whether the patented invention is only a small component or feature of the licensed product (as is the case here)."
- Applicability of entire market value rule requires proof that "the patent-related feature is the basis for consumer demand."
  - **But note:** always proper to use whole base if rate is right.

## *Lucent v. Gateway (cont'd)*

### THE ROYALTY BASE

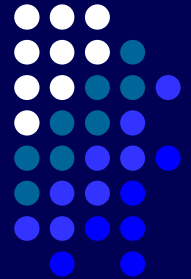


“There is nothing inherently wrong with using the market value of the entire product, especially when there is no established market value for the infringing component or feature, so long as the multiplier accounts for the proportion of the base represented by the infringing component or feature.”

## *Lucent v. Gateway (cont'd)*

### LICENSES MUST BE COMPARABLE

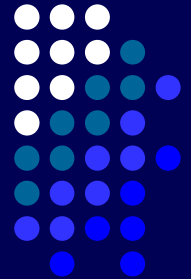
- Court: it was insufficient for four licenses in evidence to be compared on the basis that they were “PC-related;”
- a greater and particularized showing of the similarity of the licensed technology to the claimed technology would be required.



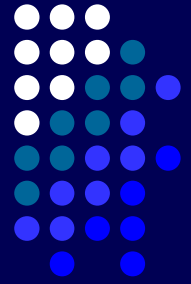
## *Lucent v. Gateway (cont'd)*

### LICENSES MUST BE COMPARABLE

- Court: running royalty licenses could be relied on award a lump sum, but only if there were a specific basis in the evidence as to how the running royalties could evidence the amount of a lump sum.

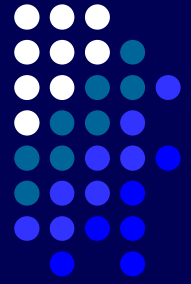


# Take Aways



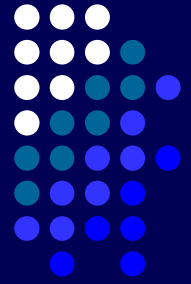
- Federal Circuit is looking for evidence of the extent that the accused component/feature is used (or expected to be used) as a measure of its value.
- Federal Circuit is looking for evidence that the accused unit and the royalty rate are properly correlated (e.g. by EMVR or by adjustment of the rate.)

# Take Aways



- Federal Circuit is looking for evidence that any licenses in evidence are comparable.
  - Technically: is the licensed technology comparable to the claimed technology?
  - Financially: are the payment terms comparable to the hypothetical license?

# Recent District Court Cases with Judge Rader Sitting by Designation

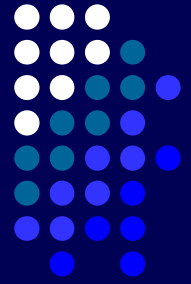


- ***IP Innovation L.L.C. v. Red Hat, Inc.***

No. 2:07-CV-447 (RRR), 2010 WL 986620 (E.D. Tex. Mar. 2010)

- Plaintiff's expert is excluded for improperly inflating the royalty base and rate and by "failing to account for the economic realities of this claimed component as part of a larger system." Expert also "arbitrarily picked a royalty rate that is much higher than the existing royalty rates for licenses to the patents-in-suit."
- "[S]ome plausible economic connection between the invented feature and the accused operating systems" must be shown "before using the market value of the entire product as the royalty base."

# Recent District Court Cases with Judge Rader Sitting by Designation

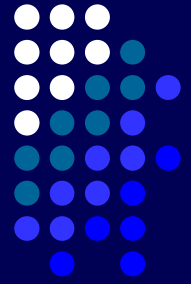


- ***Cornell University v. Hewlett-Packard Co.***

609 F. Supp. 2d 279 (N.D.N.Y. Mar. 2009)

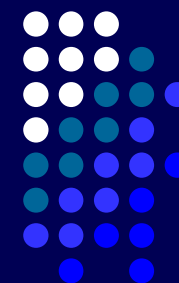
- Reduced jury's \$184 million award to \$53 million reflecting a royalty on CPU only as opposed to servers as there was no presentation of "any evidence linking demand for the claimed invention to the CPU bricks."
- "Infringing products must be the basis for customer demand for the entire machine including the parts beyond the claimed invention."
- Court emphasized that the royalty base and rate are distinct components of the damages analysis.

But see . . .



*i4i Ltd. Partnership v. Microsoft Corp.*

# Recent Federal Circuit Cases

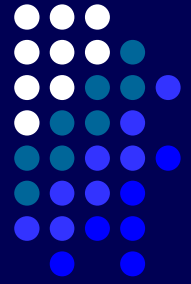


- ***i4i Ltd. Partnership v. Microsoft Corp.***

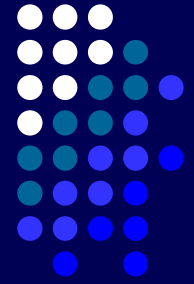
598 F.3d 831 (Mar. 2010) (Circuit Judges Schall, Prost, and Moore)

- In upholding the \$200 million award (\$98 royalty rate x 2.1 million Word products), the Federal Circuit found evidence supporting that the XML editor played an important role in encouraging users to purchase new Word software.
- Endorsed use of the *Georgia-Pacific* factors to arrive at a reasonable royalty rate.

## *i4i v. Microsoft (cont'd)*



- Accused royalty base was 2.1 million units of Word actually used in an infringing manner (based on survey evidence.)
- Patentee proposed a baseline royalty rate of \$96 per unit, based on Microsoft's profit margin of 76.6% multiplied by the price of benchmark stand alone XML editor (\$499) multiplied by 25%.
- Patentee proposed that a hypothetical negotiation based on the Georgia-Pacific factors would result in a final royalty rate of \$98 per unit.



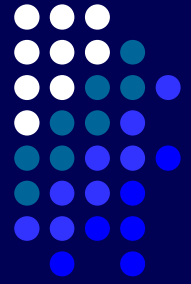
## *i4i v. Microsoft (cont'd)*

- Facts to support damages amount were drawn from:
  - (1) internal Microsoft documents;**
  - (2) publicly available information about other custom XML editing software; and**
  - (3) a survey designed to estimate the amount of infringing use.**

Federal Circuit found that “these facts had a sufficient nexus to the relevant market, the parties, and the alleged infringement.”

## *i4i v. Microsoft (cont'd)*

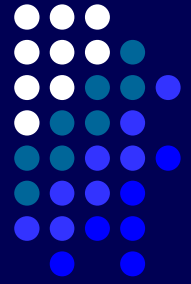
### EVIDENCE OF THE VALUE OF THE TECHNOLOGY



- Facts to support damages amount were drawn from:  
**(1) internal Microsoft documents:**  
“i4i presented statements by i4i employees that custom XML was not a ‘slight addition [but i]t’s more like 90 percent of the value’ was ‘where the future is, seriously,’ and ‘the glue that holds the Office ecosystem together.’”

## *i4i v. Microsoft (cont'd)*

### EVIDENCE OF THE VALUE OF THE TECHNOLOGY



- Facts to support damages amount were drawn from:

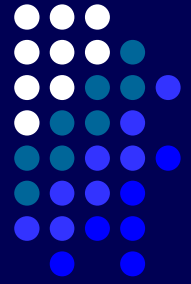
(1) internal Microsoft documents;

**(2) publicly available information about other custom XML editing software:**

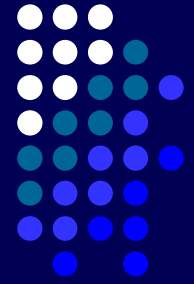
A benchmark stand-alone XML editor sold for \$499.

## *i4i v. Microsoft (cont'd)*

### EVIDENCE OF THE VALUE OF THE TECHNOLOGY



- **Survey estimated infringing use by businesses.**
  - Survey was sent to 988 large and small businesses randomly selected from 13 million companies.
  - Survey included 40 substantive questions.
  - 46 responses were received and 19 companies reported using Word in an infringing manner.
  - Survey expert determined that 1.9% (19/988) of all copies of Word sold to businesses between 2003 and 2008 were used in an infringing manner. This percentage was then multiplied by the number of Word copies sold to businesses.

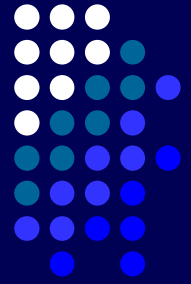


## *i4i v. Microsoft (cont'd)*

- **Reasonableness of the Methodology:**

“We have consistently upheld experts’ use of a hypothetical negotiation and Georgia-Pacific factors for estimating a reasonable royalty. [citations omitted] Wagner’s testimony about the acceptance of the hypothetical negotiation model among damage experts and economists, combined with his methodical explication of how he applied the model to the relevant facts, satisfied Rule 702 and Daubert.”

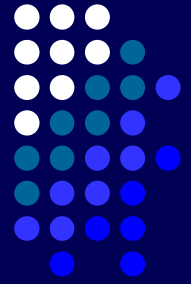
## *i4i v. Microsoft (cont'd)*



- **Reasonableness of the Damages Award**

- Federal Circuit did not address whether there was sufficient evidentiary basis for the damages award because Microsoft chose not to file a pre-verdict JMOL on damages.
- Microsoft waived its ability to have the Federal Circuit assess the reasonableness of the damages award, but the Federal Circuit did note that if Microsoft had filed a JMOL, “the outcome might have been different.”

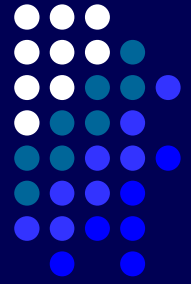
## *i4i v. Microsoft (cont'd)*



- **Reasonableness of the Damages Award**

- Federal Circuit suggested it would have looked to Word's retail price (sometimes as low as \$97) and the licensing fees Microsoft paid for other patents (as low as \$1 Million to \$5 Million) to assess whether the award was "grossly excessive or monstrous."

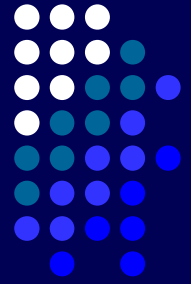
# Another Recent District Court Case



- ***ReedHycalog v. Diamond Innovations***

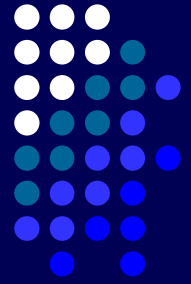
No. 6:08-CV-325 (LED), 2010 WL 3021550 (E.D. Tex. Aug. 2010)

- Litigation licenses are admissible; to avoid potential prejudice to defendant from the implication of validity and infringement by a third party willing to pay money to settle a lawsuit, the licenses will not be identified as resulting from litigation.



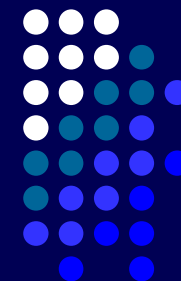
**What are some of the strategies that litigants are taking to address the greater scrutiny being applied by courts?**

# Licenses



- How do you prove the comparability?
- Which expert does the comparison?  
Technical expert?
- If it is similar technology, does it equate to similar value?
- Do you need a licensing expert?

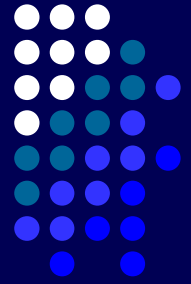
# Licenses – Should The Accused Infringer Move *In Limine*?



“The evidence of record in the present dispute illustrates the importance the entire market value may have in reasonable royalty cases. The license agreements admitted into evidence (without objection from Microsoft, we note) highlight how sophisticated parties routinely enter into license agreements that base the value of the patented inventions as a percentage of the commercial products’ sales price.”

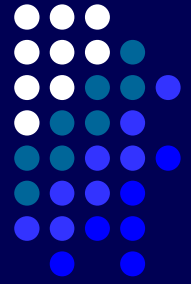
- *Lucent Tech., Inc. v. Gateway, Inc.*, 580 F.3d 1301 (Fed. Cir. 2009) (emphasis added)

# Use Of A Benchmark



- How do you prove the comparability?
- Which expert does the comparison?  
Technical expert?

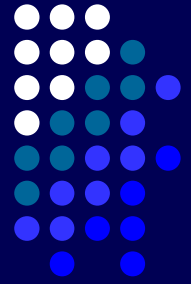
# Use Of A Benchmark



“Regarding the benchmark, Wagner explained that he chose XMetaL because it was the product Microsoft bought and used before developing its own custom XML editor, it was the cheapest of the custom XML editors available on the market at the time, and it was one of three principal competitors Microsoft identified in the custom XML market. Microsoft contended that a better estimate of the custom XML editor’s value was \$50, the difference in price between versions of Word with and without the editor. Microsoft also argued that because XMetaL has many additional features besides custom XML editing, the \$499 retail price overestimated the value of the custom XML editor.”

- *i4i Ltd. Partnership v. Microsoft Corp.*, 598 F.3d 831 (Fed. Cir. 2010)

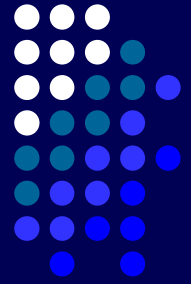
# Allocating Value



“The parties presented little evidence relating to Factor 13. Nonetheless, the only reasonable conclusion is that most of the realizable profit must be credited to non-patented elements, such as “the manufacturing process, business risks, or significant features or improvements added by [Microsoft].” As explained by Microsoft’s expert Mr. Kennedy, Outlook consists of millions of lines of code, only a tiny fraction of which encodes the date-picker feature. Although the weighing of Factor 13 cannot be reduced to a mere counting of lines of code, the glaring imbalance between infringing and non-infringing features must impact the analysis of how much profit can properly be attributed to the use of the date-picker compared to non-patented elements and other features of Outlook. Here, numerous features other than the date-picker appear to account for the overwhelming majority of the consumer demand and therefore significant profit.”

- *Lucent Tech., Inc. v. Gateway, Inc.*, 580 F.3d 1301 (Fed. Cir. 2009) (emphasis added)

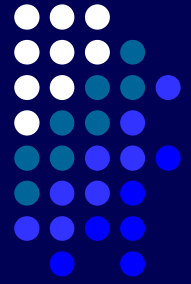
# Allocating Value



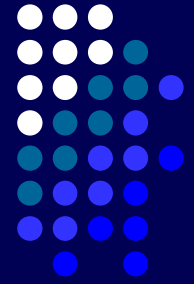
“Consideration of evidence of usage after infringement started can, under appropriate circumstances, be helpful to the jury and the court in assessing whether a royalty is reasonable. Usage (or similar) data may provide information that the parties would frequently have estimated during the negotiation. See *Sinclair Ref.*, 289 U.S. at 697 (“The use that has been made of the patented device is a legitimate aid to the appraisal of the value of the patent at the time of the breach.”). Such data might, depending on the case, come from sales projections based on past sales, consumer surveys, focus group testing, and other sources. Even though parties to a license negotiation will usually not have precise data about future usage, they often have rough estimates as to the expected frequency of use. This quantitative information, assuming it meets admissibility requirements, ought to be given its proper weight, as determined by the circumstances of each case.”

- *Lucent Tech., Inc. v. Gateway, Inc.*, 580 F.3d 1301 (Fed. Cir. 2009) (emphasis added)

# Additional Experts



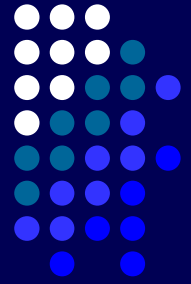
- **Market expert** to help determine what consumer is getting from a product?
- **Survey expert** to conduct consumer polling/surveys to evaluate consumer preferences or extent of infringing use?



# Other Damages Models

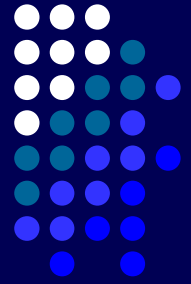
- *Georgia-Pacific* analysis still necessary, but do you consider other damages models?
  - Analytical model?
  - Valuation model?
  - An analysis that borrows from proving price erosion under a lost profits theory? Would this require retaining an economist as an expert?

# *Daubert* Motions



- “and judges have to involved at an early stage to sort out the issues so that we don’t spend an awful lot of time in litigated effort on something that is of little value.”
  - *Cornell v. HP*
  - *IP Innovation v. Red Hat*

# Potential Further Developments



- ***Finjan v. Secure Computing***

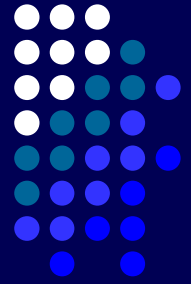
oral argument took place in June 2010

- Software modules sold and priced individually
- Patentee accused a method in some modules

- ***Cornell v. Hewlett-Packard***

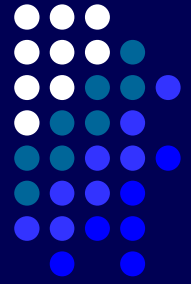
oral argument took place in April 2010

## Judge Rader (cont'd)



**“So, it is the marketplace that drives this, and economists need to do a better job of factoring out the value of the claimed invention. It has to be economic evidence, and it has to be limited to the scope of the claimed invention, but it should show the full value of that invention in the marketplace.”**

- Interview of Judge Rader in July/August 2010 issue of *IP Litigator*



# Q & A