

CHINA BUSINESS REVIEW

THE MAGAZINE OF THE US-CHINA BUSINESS COUNCIL

The Risks of Patent Infringement Damages for Global Businesses

Businesses with a global reach will always face the threat of patent infringement lawsuits in the United States, but companies can manage the risk of high damages.

By Teague I. Donahey

Patent infringement cases in the United States are typically tried to a jury, and damages awards for such cases can reach tens if not hundreds of millions of dollars, particularly in cases involving technology companies. The recent California jury verdict awarding Apple, Inc. more than \$1 billion in damages for patent infringement by Samsung smartphones represents perhaps one of the more noteworthy examples to date, but it is hardly an isolated case. The almost \$11 million verdict for patent infringement that an Ohio jury handed down against Xinyi Glass, a China-based automobile glass manufacturer, in 2009 was perhaps less extraordinary but, no doubt to Xinyi Glass, no more encouraging.

Since much of the world's technology manufacturing today takes place outside of the United States, in China and other similar locales, one might expect that technology manufacturers in Asia would face little threat from patent lawsuits in the United States. Indeed, the US Supreme Court has emphasized that the US patent laws are territorially bounded and should not be applied to foreign activities extraterritorially. However, the US patent statute and associated case law provide enough caveats to this general rule that a clever plaintiff's attorney in the United States has the legal ammunition to allege patent infringement against almost any foreign manufacturer whose goods enter US soil through the stream of commerce.

So there is always some risk of being subjected to patent infringement lawsuits in the United States, even for companies operating overseas. But what is the risk of significant monetary damages awards in today's legal climate? Although risk assessment in any particular instance is of course fact-specific, we can make several useful general observations.

Increased scrutiny of patent damages awards

The US Court of Appeals for the Federal Circuit, the court responsible for hearing appeals of patent cases in the first instance, has increasingly scrutinized patent damages awards to ensure that they are based on sound evidence and economically-valid reasoning, and has regularly rejected damages awards that it deems excessive. Although the Federal Circuit's recent damages decisions have incrementally "chipped away" at damages awards in patent cases, the overall trend has been to limit plaintiff's damages theories and the kinds of evidence that will be sufficient.

In *Lucent Technologies v. Gateway*, for example, the Federal Circuit held that a jury cannot award damages based on revenues for an entire product, such as a smartphone, unless the patented feature forms the basis for consumer demand for the entire product. And in *Uniloc v. Microsoft*, the Federal Circuit rejected as arbitrary and unacceptable another damages shortcut—the so-called “25 percent rule”—under which a plaintiff’s damages expert witness would attempt to allocate 25 percent of a defendant’s profits to the plaintiff as a starting point for calculating damages.

Another series of cases has grappled with the issue of what kinds of licenses and settlement agreements may be used as evidence at trial of what would be a “reasonable royalty,” which is one way juries can calculate damages for patent infringement. In *ResQNet.com v. Lansa*, *Wordtech Systems v. Integrated Network Solutions*, and *LaserDynamics v. Quanta Computer*, the Federal Circuit repeatedly exercised vigilance in examining the use of the parties’ licenses and settlement agreements for this purpose, and overturned damages awards where such agreements were used inappropriately.

Patent damages for foreign activities

While these prior decisions dealt with a number of miscellaneous damages issues, in the more recent case of *Power Integrations v. Fairchild Semiconductor*, the Federal Circuit turned to the difficult legal questions posed by a defendant’s foreign activities in the context of territorially-based US patent rights—namely, what kinds of foreign sales, marketing, and distribution activities have a sufficient “nexus” to the United States to sweep them within the scope of US patent law (and lawsuits)? And what quantity and quality of evidence will a US patent holder be required to present to a jury before it is entitled to monetary damages based on such foreign activities?

In this case, the plaintiff, Power Integrations, a US-based electronics components supplier, had sued defendant Fairchild Semiconductor for infringing patents covering certain circuitry found in cell phone chargers. Fairchild has significant manufacturing and business operations outside the United States, including in China. The jury awarded Power Integrations a reasonable royalty and lost profits totaling roughly \$33 million, which appeared to have been based on Fairchild’s worldwide sales of infringing products. Fairchild appealed, arguing that the damages award based on foreign sales was improper and excessive.

On appeal, Power Integrations argued that it was entitled to the jury’s full damages award because it was foreseeable that Fairchild’s US infringement would cause Power Integrations to lose sales in foreign markets. The Federal Circuit rejected Power Integration’s argument, noting that “the entirely extraterritorial production, use, or sale of an invention . . . is an independent, intervening act that, under almost all circumstances, cuts off the chain of causation initiated by an act of domestic infringement.”

Power Integrations also argued that, even if it was not entitled to damages based on worldwide sales, 18 percent of Fairchild’s foreign sales were ultimately imported into the United States by third parties and therefore that at least 18 percent of the total damages award had a sufficient “nexus” to the United States. The 18 percent ratio had been derived from the testimony of Power Integrations’ damages expert. The expert used questionable data from the Internet suggesting that 18 percent of Fairchild’s main customer Samsung’s worldwide cell phone shipments were imported into the United States, and that this ratio could be used as a reasonable proxy for US importations of the accused Fairchild chips. The Federal Circuit would not play along, however, holding that the data underlying the expert’s opinion was

unreliable and methodology was speculative because it assumed that all Samsung phones would be imported with chargers using Fairchild's accused circuitry.

In the end, the Federal Circuit sent the case back to the trial court for a new trial on damages. Language in the Federal Circuit's opinion indicates that it anticipates that a properly-run trial would result in a damages award in the range of \$700,000—a far cry from the initial \$33 million jury award.

Another arrow in the quiver of a patent infringement defendant

As the *Power Integrations* case and other recent US court decisions show, though PRC businesses face patent infringement risks in the United States, there is another side of the coin: US courts are increasingly focusing on patent damages awards to ensure they are not excessive and that they comply with the territorial limitations of US patent laws. As a result, US patent holders seeking to enforce patents against non-US manufacturers in the technology sector face challenges.

Indeed, it is not enough for a patent holder to show that a product or a product component infringes from a technical standpoint. In *Power Integrations*, the Federal Circuit made it clear that a plaintiff needs to establish with specific, reliable, and non-speculative evidence that the accused products have been imported into the United States or otherwise have a sufficient US “nexus.” This can be difficult. An electronics manufacturer may source a given component from multiple suppliers, for example. And tracking the movement of an electronic component down a worldwide distribution chain is no small feat, frequently requiring time-consuming, burdensome, and often unsuccessful third-party discovery efforts.

Sound legal counsel can help companies manufacturing in China minimize the risk of being subjected to a patent infringement lawsuit in the United States. But once such a lawsuit is filed, companies will face the risks associated with monetary damages. Effective legal strategies following in the footsteps of *Power Integrations* and other similar decisions—tied together with aggressive advocacy—will help ensure that any patent infringement damages claims in US courts are constrained within proper territorial bounds and do not become excessive. In this sense, the defense of the monetary damages case can be just as important as proving non-infringement of a patent from a technical standpoint, and should not be neglected.

ABOUT THE AUTHOR

Teague I. Donahey is a partner in Sidley Austin LLP's San Francisco office, where he focuses on the representation of technology companies in litigation and trials in US courts and the US International Trade Commission. The opinions expressed are those of the author and do not necessarily reflect the views of the firm or its clients. This article is for general information purposes and is not intended to be and should not be taken as legal advice.