Lessons From The Changing Patent Damages Landscape

Law360, New York (November 29, 2012, 11:38 AM ET) -- Congress created the United States Court of Appeals for the Federal Circuit in 1982 to bring greater uniformity to certain areas of federal jurisdiction including, importantly, the patent law. In 2009, then-Chief Judge Paul Michel observed in an oral argument that, notwithstanding the 30-year lapse, the Federal Circuit’s decisions “are apparently lacking in clarity and unhelpful to reasonable royalty calculations” and that “[i]t’s kind of amazing, that since patent cases are heavily about damages, that at this late date, ... there still seems to be massive unclarity about how reasonable royalty damages are to be calculated.”[1]

As the chief’s comments reflect, the damages jurisprudence has often been treated as the neglected stepchild in patent law, with most patent damages analysis — including the analysis of incredibly technologically sophisticated products and services — still governed by the methodology first set forth in a district court case from 1970 about a plywood dispute.[2] But the status quo has begun to change.

Perhaps in response to controversially large damages awards or to the increase in patent litigation brought by nonpracticing entities in the last decade, in a series of thoughtful opinions the Federal Circuit has begun to reshape the legal topography of the patent damages law so that damages awards are more faithful both to economic reality and to the statutory basis for a damages award. This article extracts several lessons from the changing landscape.

The Traditional Damages Landscape

Patent damages analysis typically follows a timeworn and well-trodden path. By statute, a patent damages award must be “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.”[3] To litigate damages, counsel for each side retains experienced experts with an economic or accounting background to explain the extent to which, assuming the patents are valid, infringed and enforceable, the infringement has damaged the plaintiff.

Each side invokes an accepted legal framework: the multifactor Georgia-Pacific test for a reasonable royalty, or the multifactor Panduit test for lost profits, if they are available and sought.[4] And for decades, the damages law essentially remained in a kind of a stasis.

Although one can find outlier cases in which other methodologies were used or damages testimony was excluded based on a Daubert or other challenge, typically the jury resolves the full scope of the compensatory damages dispute. Given the deferential standard of review, jury awards are rarely disturbed.[5] The net result has been that median patent damages awards drifted upwards over time, with all except one of the top 10 initially adjudicated damages verdicts occurring after 2006.

The Emerging Fault Lines

That is changing. When assessed as a group, over the right temporal arc, the recent damages case law reveals cracks in the existing landscape. Justice Anthony Kennedy’s concurring opinion in
eBay hinted at them, although it was not a damages case.[6] There, in the context of highly bundled products — that is, products that reflect numerous technologies or inventions, such as source code or electronic devices — found to have infringed patents addressed to only a small portion of the accused product or method, he and three other justices observed that it may not be appropriate for the remedy (there, the equitable remedy of injunction) to be coterminous with the entire product.[7]

The Lucent case took up that apparent invitation, striking down a $360 million damages award in part because the accused feature was only one of “hundreds, if not thousands or more” features that were not accused, and that these nonaccused features provided much of the demand and profit that were inappropriately captured in the compensatory damages figure.[8]

Lucent also imposed new rigor on the Georgia-Pacific “comparable licenses” factor, disallowing the use of certain licenses and reminding that comparability cannot be breezily assumed; the patentee must prove it.[9] In i4i, the panel broadly suggested that the so-called 25-percent rule, which had been applied and accepted for decades, was nearing its expiration date.[10] In Uniloc, a Federal Circuit panel announced the rule’s end, holding it to be inapplicable as a matter of law.[11]

Most recently, in LaserDynamics, a panel concluded that as a general rule, the royalty base for highly bundled products must be based on the “smallest salable patent-practicing unit.”[12] Echoing Lucent’s insistence that assertedly comparable licenses actually be meaningfully comparable before they qualify as Georgia-Pacific comparable licenses, LaserDynamics also sharply questioned whether litigation-driven settlements could ever be “comparable” for Georgia-Pacific purposes;[13] and intimated that the “book of wisdom” may not capture events that occur after the hypothetical negotiation.[14] Viewed as a group, these cases reveal a changing landscape.

**Exploiting the Fault Lines**

The shifts in the damages jurisprudence’s tectonic plates provide opportunities for strategically aggressive litigants. Here are several lessons to exploit the current inflection point: a more receptive audience (at the Federal Circuit and, now, in district courts) for arguments rejected in particular cases or historically not made.

**Use Daubert to Challenge Expert Damages Testimony**

Analysis in our judicial system proceeds from precedent, but in the patent damages context the power of precedent has too readily become the tyranny of inertia. Too often, counsel present and defend against patent damages analysis essentially by rote — through experts who explain the marshaled facts through a Georgia-Pacific lens, without thinking through in a rigorous and disciplined way whether the theories and methodologies that underlie the expert’s analysis and conclusions have any real-world grounding or would survive the judicial straining that Daubert and its progeny require. Daubert challenges, if not common, are not unusual for technical expert testimony, but are much less common in the damages context. Recently, courts at both the trial and appellate courts have signaled an increased receptiveness to them.
In the district courts, Judge Richard Posner’s opinions in the Apple/Motorola dispute provides perhaps the sharpest example of challenging through a Daubert attack an expert expounding the received wisdom. Each well-funded party presented its damages analysis through seasoned damages experts, each of whom employed familiar legal templates for their analysis.

Doubtless they had used such methodologies in prior cases, without challenge. But Judge Posner, sitting as a district judge, concluded that the methodologies and conclusions of each side’s damages expert didn’t survive Daubert’s strictures — with the notable result of ultimately dismissing the lawsuit with prejudice. In the context of a patent trial, that appears to be a first. And it wouldn’t have occurred, absent creative Daubert motions that cut against the historical tide.

The Federal Circuit has likewise reflected renewed receptivity to Daubert challenges to expert damages testimony. In the i4i case, the Federal Circuit presaged its disapproval of the so-called 25-percent rule. When in the next year the Uniloc case presented the right procedural posture, the Federal Circuit — in a lengthy opinion that excoriated the 25-percent rule on analytical, historical and pragmatic grounds — found the “rule” inapplicable as a matter of law, notwithstanding its application and acceptance in a variety of cases and jurisdictions for nearly two decades.

**Challenge the Received Wisdom**

In addition to renewed receptivity to evidentiary attacks, there are examples of judicial receptivity to first-order doctrinal attacks in the patent damages context. Justice Kennedy’s concurring opinion in eBay/MercExchange may be the first recent opinion to have suggested increased judicial receptivity to them. The circuit’s recent LaserDynamics opinion also provides object lessons in challenging the received wisdom. The first concerns using litigation settlements as Georgia-Pacific comparable licenses.

Before LaserDynamics, some district courts had seized on a statement in ResQNet.com Inc. v. Lansa Inc., that “the most reliable license in this record arose out of litigation,” to allow plaintiffs to use litigation settlements, which often include royalty rates and other monetary terms that exceed those found in arm's-length commercial licenses, to drive up damages awards.

In LaserDynamics, the panel concluded that a settlement agreement could not satisfy Georgia-Pacific’s comparability requirement where: the settlement agreement had been secured right before a trial in which the accused infringer would have been subject to sanctions if it proceeded to trial; the settlement agreement was for an amount substantially higher than the next highest amount paid for an arm's-length license to the asserted patent; the patentee had executed 29 licenses for the asserted patents, for much lower amounts; and the settlement agreement had been entered into three years after the hypothetical negotiation date.

Importantly, the opinion describes ResQNet as permitting reliance on prior settlement agreements only in “limited circumstances,” and — citing Supreme Court and Federal Circuit authority — opined that “[t]he propriety of using prior settlement agreements to prove the
amount of a reasonable royalty is questionable.”[22] Will the use of settlement agreements as Georgia-Pacific comparable licenses meet the 25-percent rule’s fate: disallowed as a matter of law when the right case squarely presents the issue? Regardless, it is clear today that parties must carefully consider whether they are appropriate — and indeed admissible — in any case going forward.

The second object lesson concerns bundled products and the entire market value rule. As a general rule, the royalty base for highly bundled products must be based on the smallest salable patent-practicing unit.[23] This flows from the principle that where small elements of multicomponent products are accused of infringement, calculating a royalty on the entire product may present a risk that the patentee will be improperly compensated for noninfringing components of that product.[24]

There’s a narrow exception to this general rule: the entire market value rule, which allows for the recovery of damages based on the value of an entire apparatus containing several features.[25] But according to LaserDynamics the exception applies only if the patentee proves that the patented feature drives demand (not just preference) for the entire multicomponent product.[26] That limitation on the rule’s applicability appears to present a dilemma for a plaintiff seeking to get before the jury the total revenues of the accused product, to make the claimed royalty rate seem reasonable.

However, in Lucent, the circuit concluded that the base used in a running royalty calculation can always be the value of the entire commercial embodiment, as long as the magnitude of the rate is within an acceptable range, as determined by the evidence.[27]

Despite that conclusion, three years later the accused infringer’s counsel in LaserDynamics again pressed the issue about the propriety of the introduction of such evidence, and achieved the opposite result: The court recognized that such disclosure skews the jury’s assessment of the royalty rate, and held that “[a]dmission 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.’”[28]

Such cases reflect increased judicial receptivity to arguments designed to tether damages analysis (and, consequentially, damages awards) to the statute, which is designed to result in awards that reflect economic reality, not the result of winning the lottery.[29]

**Weigh in With Amicus Briefs in Panel Opinion Cases**

Cases that are en banc or before the U.S. Supreme Court often receive, and appropriately so, important amicus participation. But many important developments in the damages law are coming from panel opinions. Lucent, Uniloc and LaserDynamics, each of which made important contributions to the changing patent law, were all panel opinions, but only Lucent benefited from the arguments made by well-represented amici.

The transactions costs of amicus participation in a panel opinion case are higher than for en banc
cases; it can be time- and resource-consuming to track appeals. But for firms with robust practices, or for companies whose business requires or generates large numbers of patent litigations, this strategic investment can yield an attractive return: a helpful change in the law that cuts across the docket.

**Attend to the Procedure That Underlies the Substantive Arguments**

The contrast between the treatment that a received wisdom (the 25-percent rule) received in i4i and its treatment in Uniloc points up a basic but sometimes-overlooked point: The standard of appellate review affects the degree to which (and indeed even whether) courts can reconsider accepted doctrine.

In particular, the Uniloc court was able to shoot the arrow that terminated the 25-percent rule only because the defendant had provided the bow: The defendant had filed, in the appellate court’s view, the right motions in the district court. The point seems obvious, but it gets overlooked: Evidentiary objections, or failures to carry the burden of proof, are not self-correcting. Litigants need to make the right procedural motions to preserve their substantive arguments.

Often overlooked, the patent damages law is receiving renewed judicial attention. Both at its doctrinal core and in how its principles are implemented, that law is in a state of flux. The changes afford patent litigants on both sides of a caption to find new ways to define what constitutes a win in a patent case — and what constitutes a loss — even before the jury is empaneled.

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[5] E.g., Biotec Biologische Naturverpackungen GmbH v. Biocorp. Inc., 249 F.3d 1341, 1355 (Fed. Cir. 2001) (jury’s compensatory damages award should be sustained unless grossly excessive or monstrous, clearly not supported by the evidence, or based only on speculation or guesswork).


[7] Id. at 396-397 (Kennedy, J., concurring).

[8] Lucent Techs., 580 F.3d at 1332.

[9] Id. at 1325-1332 (discussing a series of licenses).

[10] i4i Ltd. Partnership v. Microsoft Corp., 598 F.3d 831, 856-857 (Fed. Cir. 2009) ($200 million damages award based on the 25-percent rule), aff’d, 131 S.Ct. 2238 (2011) (“Had [the accused infringer] filed a pre-verdict JMOL, it is true that the outcome might have been different.”).


[13] Id. at 43-44.

[14] Id. at 44.


[17] i4i, 598 F.3d at 856-857.

[18] Uniloc, 632 F.3d at 1315.


[21] Laser Dynamics, Slip Opn. at 44.

[22] Id. at 43.

[23] Id. at 24.

[24] Id. at 22-23.

[25] Laser Dynamics, Slip Opn. at 23.

[26] Id. at 23-24. A district court has concluded that the entire market value rule applies, even when the patented feature does not drive demand for the accused product as a whole, where basing the reasonable royalty on the entire accused product is the industry standard and is consonant with the comparable licenses in evidence. Mondis Technology Ltd. v. LG Electronics Inc., et al., No. 2:07-CV-565-TJW-CE (E.D. Tex. June 14, 2011) at 4-7.

[27] Lucent Techs., 580 F.3d at 1338-1339.

[28] Laser Dynamics, Slip Opn. at 25.

[29] Lucent Techs., 580 F.3d at 1324 (only purpose of compensatory damages is to make the patentee whole).

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