

# What Systems Engineers Need to Know About the Latest Developments Affecting Patent Licensing

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# What Are Patent Damages?

- Two main forms of relief in patent lawsuits.
- Order preventing further conduct: an “injunction.”
- An award of money as compensation: “damages.”
- Injunctions are increasingly difficult to get.
- Damages are increasingly important.

# Damages Matter to Licensing

- Patent licensing does not occur in a vacuum.
- Do the proposed licensing terms provide maximum value to your company?
- Or would filing or defending a patent lawsuit be more profitable?
- It is a mistake to ignore the possibility of litigation regarding the patent.

# Damages Matter to Licensing

- It is a mistake to only focus on the possibility of an injunction being issued or costs of litigation.
- An important factor to also consider is potential monetary damages.
- But even many lawyers do not clearly understand patent damages analysis.

# Overview

- Patent damages awards are supposed to make the patent-holder “whole.”
- Two methods: lost profits vs. reasonable royalty.
- The easier reasonable royalty method is heavily impacted by the entire market rule.
- But remember: Judges and juries can make major mistakes regarding damages.

## How Damages Are Awarded In Patent Cases – Making The Patentholder Whole

- Damages in patent cases are not based on the profit made by the infringer, but on the damage suffered by the patentee
- Upon a finding of infringement, US Patent law permits the jury to award 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.” 35 U.S.C. § 284 (1994).

# Lost Profits vs. Reasonable Royalty

- Lost Profits
  - How was the plaintiff injured by the infringement?
  - Measured by the plaintiff's loss of profits caused by lost sales or price reductions caused by infringement
  - Requires that the plaintiff and defendant be competitors
    - Although not necessarily direct competitors
  - Originally limited to a two-player market
    - Now lost profits can be awarded on the basis of market share
  - Much harder to prove than reasonable royalty

# Reasonable Royalty and Lost Profits

- Reasonable Royalty
  - Baseline remedy for patent infringement
    - Backup remedy if lost profits claim fails
  - Does not require plaintiff to show injury or use the patent in its business
  - A “reasonable royalty” is the rate the parties would have agreed to on the date the defendant started infringing
    - The jury determines this rate by imagining that the parties engaged in a “hypothetical” negotiation and takes into account all of the economic factors the parties would have actually considered
  - Some courts say that a “reasonable royalty” cannot exceed the defendant’s expected profits – others do not care.

# The Hypothetical Negotiation

- The hypothetical negotiation is the theoretical basis for the reasonable royalty analysis
  - Set out in the case Georgia-Pacific Corp. v. United States Plywood Corp., 318 F.Supp. 1116 (S.D.N.Y. 1970)
- The purpose of imagining this non-existent meeting is to determine what “price” the parties would have agreed to on the date the defendant started infringing.

# The Hypothetical Negotiation

- This analysis presumes factors which do not occur in the real world
  - Assumption of Infringement and Validity
  - Perfect exchange of information
  - You can't walk away
  - What if the patentee does not want to license?
  - Looking back in time distorts value

# The Entire Market Value Rule

- The entire market value rule is another aspect of the reasonable royalty analysis that allows a plaintiff to recover damages based on the value of an entire apparatus containing several features
  - Components are separate but a functional unit; or
  - Patent is the reason customers buy the product
- Entire product is the royalty base

# The Entire Market Value Rule

- Tec Air, Inc. v. Denso Manufacturing, 192 F3d 1353 (Fed. Cir. 1999)
  - Motors were required to be sold with patented radiator and condenser assemblies
  - The combination of these components, both patented and unpatented, were required for the unit to function
  - Accordingly the combination of the components was the royalty base
  - Jury Verdict \$25.2M using a 6.5% royalty upheld

# The Entire Market Value Rule

- Juicy Whip, Inc. v. Orange Bang, Inc., 382 F.3d 1367 (Fed.Cir.2004)
- Patent was for a juice dispenser that mixed water & syrup
- Under the entire market value rule Juicy Whip sought lost profits for their lost sales of unpatented syrup
- The trial court held no lost profits for syrup because dispenser and syrup did not share a “functional relationship”.
  - The two items were sold together "only as a matter of convenience or business advantage,”
- The Federal Circuit disagreed, holding that the dispenser and the syrup were like “parts of a single assembly or a complete machine” and the two items do "function together to achieve one result.”

# The Entire Market Value Rule

- Rite-Hite Corp. v. Kelley Co., 56 F.3d 1538(Fed. Cir. 1995)
- One vehicle restraint product used to secure a truck to a loading dock was patented, the other was not.
- The defendant's product competed primarily with the plaintiff's product which did not use the patented technology.
- Rite-Hite wanted damages for patent and unpatented products.
- Fed. Cir. held: If reasonably foreseeable that sales of unpatented products were affected by infringement then Plaintiff can recover lost profits.
- However, with regard to Restraint Products vs. Dock Levelers: To be recoverable, "the unpatented components function together with the patented component in some manner so as to produce a desired end product or result."

# The Entire Market Value Rule

- Imonex Services v. W. H. Munzprufer Dietmar Trenner GMBH, 408 F.3d 1374 (Fed.Cir.2005)
- The patent in this case covered coin selectors used in coin-operated laundries
- 1<sup>st</sup> Verdict = \$10.4M; 2<sup>nd</sup> Verdict = \$1.4M
- The plaintiff sought a reasonable royalty award based on the sales of the coin selectors and the laundry machines based on the entire market value rule
- There was no evidence that the basis for consumer demand for the laundry machines was based on the patented coin selectors

# The Entire Market Value Rule

- DePuy Spine, Inc. v. Medtronic Sofamor Danek, Inc., 567 F.3d 1314 (Fed.Cir.2009)
- '678 Patent on surgical screws
- DePuy alleged that Medtronic caused it to lose sales of its patented product and its unpatented product
  - Jury awarded \$77.2M out of \$226.3M for unpatented
- Depuy was not able to show that Medtronic's infringement caused it to lose sales of those products.
- The infringing Medtronics products did not compete with these non-patented products which, DePuy admitted, it was only able to sell to customers when it had gotten its "foot in the door" with the patented products.

# The Entire Market Value Rule

- Bose Corp v. JBL, Inc., 274 F.3d 1354 (Fed. Cir. 2001)
- '721 Patent for Loudspeaker
- \$5.7M – Bench Trial
- “Porting” improved Bass sound and eliminated Port noise
- All of the components of the loudspeaker worked together
- Significant reason customers bought product was for quality of Bass
  - JBL even admitted that is why customers bought its infringing product
- Accordingly, Entire Market Value Rule correctly applied

## Apportionment/Allocation Rule

- What if the patented feature or patented component is not the basis for customer demand?
- What if the customer doesn't really care about the feature or doesn't know it's there?
- What if only a limited number of customers care about the feature?
- Damages should be apportioned based on the value of the patented feature

Judges and Juries Make Mistakes –  
example: Laserdynamics v. Quanta

## LaserDynamics Wins \$52m Damages in Quanta Patent Suit

Friday, July 10 06:43 am

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Japan-based LaserDynamics has won \$52m in damages from Taiwan's Quanta Computer after winning a patent infringement suit filed in the US District Court of Texas regarding a patent covering computer technology to recognize a CD or DVD.

The jury ruled that Quanta contributed to or induced infringement of LaserDynamics' patent. Quanta said it will appeal against the ruling.

## Judges and Juries Make Mistakes – example: Laserdynamics v. Quanta

### QUESTION NO. 4:

What sum of money, if any, if paid now in cash, would fairly and reasonably compensate LaserDynamics as a reasonable royalty for infringement that you have found?

Answer in dollars and cents, if any, for a reasonable royalty:

Answer:

~~\$52,000,000~~ R 7/6/09

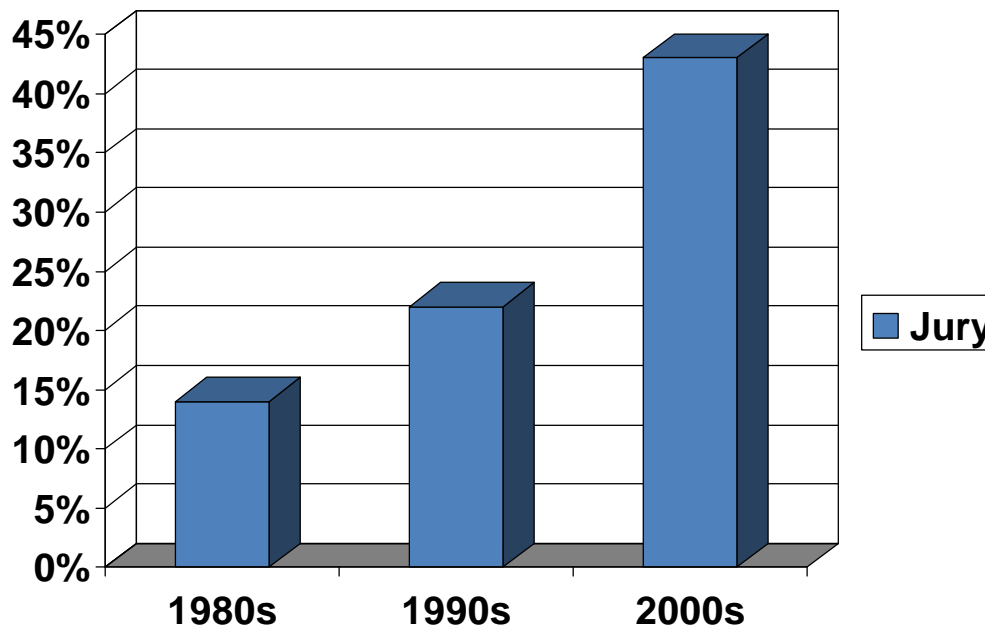
\$52,000,000

## Juries are Not Calculating Damages Correctly

- Many juries and judges do not apply the allocation rule correctly
- Juries give all components the same weight, and royalties for all of the components are based on the value of the entire product.
- Defendants must make the difficult decision to push for apportionment, or suggest a very low royalty on the whole of the product
- It has been hard for judges to control this or to correct this since juries very rarely explain how they actually reach a damages award.

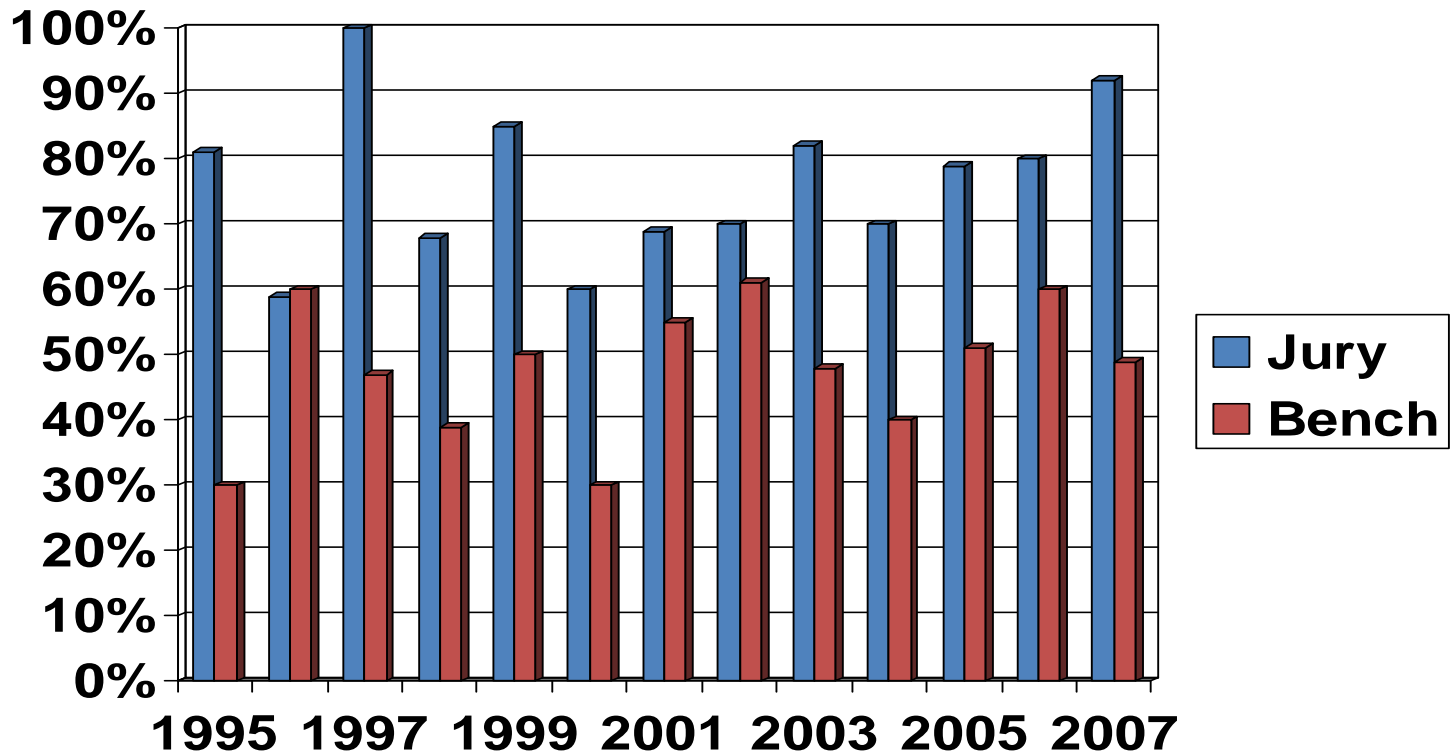
# Juries are Not Calculating Damages Correctly

- Evidence the safeguards are not working:
  - Plaintiffs' use of juries instead of bench trials is up 300% in the last 20 years.



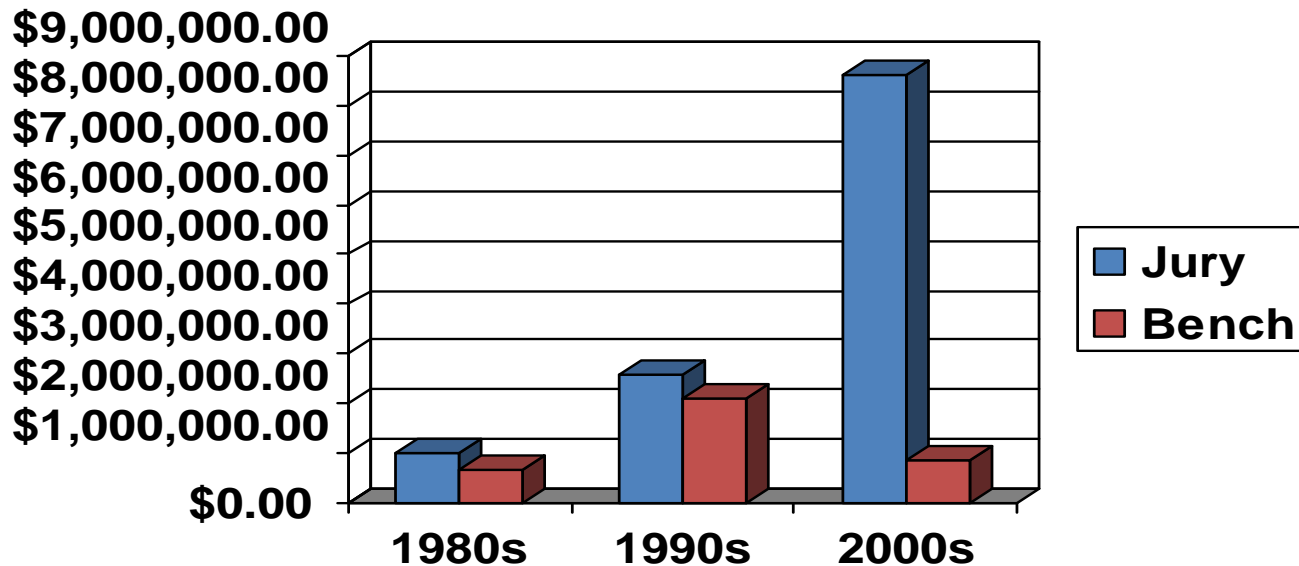
# Juries are Not Calculating Damages Correctly

- Evidence the safeguards are not working (cont.):
  - Trial success rates for plaintiffs are about 2X better for juries instead of bench



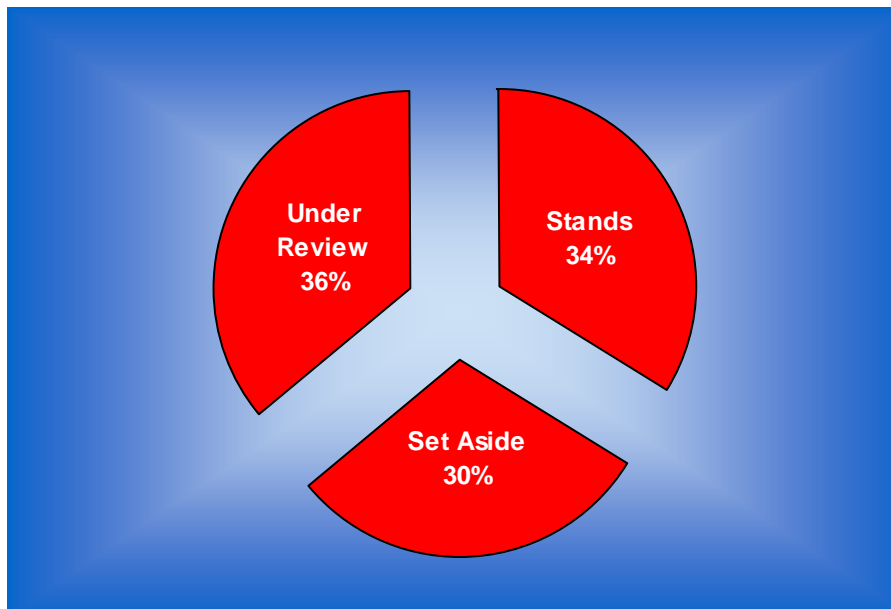
# Juries are Not Calculating Damages Correctly

- Evidence the safeguards are not working (cont.):
  - In last 9 years Jury awards are 800% larger than bench awards
  - The dollar value of bench awards are actually decreasing



# Juries are Not Calculating Damages Correctly

- Evidence the safeguards are not working (cont.):
  - Judges have had to set aside a large percentage of the biggest verdicts, which shows jury is not understanding instructions.
  - Chart shows what happened to jury damages in the 50 largest verdicts of the last 4 years: Only 34% have survived review.



## Juries are Not Calculating Damages Correctly

- Lucent v. Microsoft, 543 F.3d 710 (Fed. Cir. 2008)
- Patented was for audio coding in Windows Media Player
- Jury awarded \$1.5B using entire price of computer as base
- Court threw out verdict for 2 reasons:
  - 1) Misapplication of “Established Royalty”
    - a) Licenses were not comparable
      - One license was just for code itself, not use
      - Another license was from 2 years after lawsuit filed, right before trial
      - Another license was for US\$1,500
      - Another license was for hardware, not software
    - 2) No evidence that customers bought entire computer for the patented audio coding

## Juries are Not Calculating Damages Correctly

- Lucent v. Microsoft appeal:
  - Lucent did not have standing to enforce the '080 Patent
  - Lucent failed to show the '457 Patent was ever used

# What the US Congress is Doing

- 2009 Patent Reform Act sought to fix some problems
  - Forcing the court to limit the patent holder's recovery to the real economic worth of an invention to a company who might want to license that invention to use in another product or to a consumer who might purchase a product because of that very invention.
  - Codifies the Entire Market Value Rule.
  - Codifies Allocation.
  - Codifies requirement that the court determine whether there is already a "market price" for licensing the patent – in the form of pre-existing licenses for similar patent rights.
- THE BILL DID NOT PASS

## Some Final Thoughts

- Again, patent licensing does not occur in a vacuum.
- Should not ignore potential patent litigation.
- Should not focus only on potential injunction.
- Smart to consider how much money would be at stake if there was patent litigation.

## Some More Final Thoughts

- Just a brief introduction to a very complicated area.
- Also, be aware that the law in this area is in flux.
- For example, Congress and/or new judges on the Federal Circuit are likely to adjust the law in ways that are not easily predicted.
- Hope you have a better feel for how patent damages can impact your licensing negotiations.
- Any questions?

Thank you for this opportunity.

Please contact Wang, Hartmann, Gibbs & Cauley, PLC  
if you have any questions.

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