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KEY IDEAS:

EMVR = UNOBTAINIUM?
FEDERAL CIRCUIT SETS UNREACHABLE BAR

Like modern-day alchemy, the entire market value rule (EMVR) appears to be a viable damages theory. However, it seems to be more lead than gold. A recent precedential opinion in *LaserDynamics, Inc. v. Quanta Computer, Inc.*[1] ratcheted use of the ephemeral EMVR down a few notches.

The Federal Circuit Court of Appeals relied on and continued a recent case-law trend by strictly constraining the EMVR's use. The court's refusal to consider the case *en banc* signaled that benefits of the EMVR, long a favorite of patentees seeking to maximize reasonable royalty awards, may be illusory except in those rare cases involving a truly "breakthrough" patent.

EMVR Basics

By statute, reasonable royalty damages are the minimum amount of infringement damages "adequate to compensate for infringement," with such damages awarded "for the use made of the invention by the infringer."[2] Reasonable royalty damages are often calculated by multiplying a royalty rate (%) times a base of infringing sales (royalty base).

Where only small elements of multi-component products are accused of infringement, a royalty base consisting of the sales price of the entire product carries a "considerable risk" that the patentee will be compensated for non-infringing product components.[3] "Thus, it is generally required that royalties be based not on the entire product, but instead on the 'smallest salable patent-practicing unit.'"[4]

The EMVR is a "narrow exception to the general rule."[5] Damages are recoverable under the EMVR *only* "if the patented apparatus was of such paramount importance that it substantially created the value of the component parts."[6] To establish that the EMVR applies, "the patentee must prove that the patent-related feature is the *basis for customer demand*" of the entire product.[7]

"In effect, the [EMVR] acts as a check to ensure that the royalty damages being sought under 35 U.S.C. § 284 are in fact 'reasonable' in light of the technology at issue," and thus the rule "arose and evolved to limit the permissible scope of patentees' damages theories."[8] To ensure that the rule is not misapplied, the trial court must carefully tie proof of damages to the claimed invention's marketplace footprint,[9] and that the damages theory is based on "sound economic and factual predicates."[10]

1 *LaserDynamics, Inc. v. Quanta Computer, Inc.*, 694 F.3d 51 (Fed, Cir. 2012).
2 35 U.S.C. § 284; *LaserDynamics, Inc.*, 694 F.3d at 66.
3 *LaserDynamics, Inc.*, 694 F.3d at 67.
4 *Id.* at 67 (citing *Cornell Univ. v. Hewlett-Packard Co.*, 609 F. Supp. 2d 279, 283, 287-88 (N.D.N.Y. 2009) (Rader, C.J., sitting by designation)).
5 *Id.* at 67.
6 *Rite-Hite Corp. v. Kelley Co.*, 56 F.3d 1538, 1549 (Fed. Cir. 1995) (citations omitted).
7 *Lucent Techs., Inc. v. Gateway, Inc.*, 580 F.3d 1301, 1336 (Fed. Cir. 2009) (citations omitted) (emphasis added); *see, e.g., Rite-Hite Corp.*, 56 F.3d at 1549.
8 *LaserDynamics, Inc.*, 694 F.3d at 67.
9 *Id.* at 67 (citing *ResQNet.com, Inc. v. Lansa, Inc.*, 594 F.3d 860, 869 (Fed. Cir. 2010)).
10 *Id.* at 67 (citing *Riles v. Shell Exploration & Prod. Co.*, 298 F.3d 1302, 1311 (Fed. Cir. 2002)).

Prepared by:

PETER STRAND
Washington, D.C.
(202) 783-8400
pstrand@shb.com

Peter is a partner in the Firm's Intellectual Property & Technology Litigation Practice. He holds an LLM in intellectual property law from the University of Houston School of Law.

Background of *LaserDynamics*

Parties and Patented Technology

LaserDynamics sued Quanta Computer, Inc. (QCI) and others in the Eastern District of Texas, alleging infringement of a method patent that enabled a computer optical disc drive (ODD) to identify the type of disc inserted into the ODD.[11] The patented method automatically identified the type of disc and spared the user from having to manually identify the type of disc before the ODD could begin to read data.[12]

LaserDynamics is exclusively in the business of licensing the ODD patents of its founder and sole employee to manufacturers of disc drives and consumer electronics.[13] QCI, the remaining defendant on appeal, assembles laptop computers with installed ODDs for various customers, including name-brand computer companies such as Dell, Hewlett-Packard, Apple, and Gateway.[14] LaserDynamics alleged that QCI's sales of computers with ODDs actively induced end users of the computers to infringe the patent.[15]

Trial I

At the first trial, LaserDynamics' expert, Emmett Murtha (Murtha), presented the case on damages.[16] Murtha testified that the parties would have agreed to a running royalty of 6% for stand-alone ODDs and 2% of the total sales of laptop computers by QCI had they engaged in a hypothetical negotiation in August 2006.[17]

To justify his use of the complete laptop computer as the royalty base, Murtha relied on opinions of other LaserDynamics' experts that the patented feature provided an important and valuable function, and the presence of that feature was a prerequisite for any laptop computer to succeed in the marketplace.[18] QCI did not challenge Murtha's use of the EMVR of the entire laptop computer during the first trial.[19]

At the conclusion of the first trial, the jury found that the patent was not invalid and that QCI infringed it, awarding LaserDynamics $52 million in actual damages, apparently based on Murtha's opinion as to the appropriate reasonable royalty.[20]

Post-Trial Opinion

After the verdict, QCI filed a motion under Federal Rule of Procedure 59(a) seeking remittitur or a new trial. QCI argued for the first time that Murtha's testimony should have been excluded due to his unreliable methodology in applying the EMVR.[21] The district court agreed, granting QCI's motion and giving LaserDynamics the option of remittitur to $6.2 million or a new trial on damages.[22] LaserDynamics opted for a new damages trial.[23]

11 *Id.* at 56 (e.g., compact disc (CD) versus a video disc (DVD)).

12 *Id.* at 57.

13 *Id.*

14 *Id.* at 58

15 *Id.* at 59; 35 U.S.C. § 271(b).

16 *LaserDynamics, Inc.*, 694 F.3d at 60.

17 *Id.*; *LaserDynamics, Inc. v. Quanta Computer, Inc.*, No. 2:06-CV-348-TJW, 2010 WL 2331311, at *2 (E.D. Tex. June 9, 2010). Note that the date of the hypothetical negotiation also proved to be a problem for LaserDynamics. *LaserDynamics, Inc.*, 694 F.3d at 75-76.

18 *LaserDynamics, Inc.*, 694 F.3d at 60.

19 *Id.* at 61. Applying regional circuit law, the Federal Circuit later concluded that QCI had not waived the objection and that the district court properly exercised its discretion in considering whether the EMVR was properly applied based on QCI's post-trial motion. *Id.* at 70-71.

20 *LaserDynamics, Inc. v. Quanta Computer, Inc.*, No. 2:06-CV-348-TJW, 2010 WL 2331311, at *1, *2 (E.D. Tex. June 9, 2010).

21 *LaserDynamics, Inc.*, 694 F.3d at 63.

22 *Id.* at 63-64; *LaserDynamics, Inc.*, 2010 WL 2331311, at *4.

23 *LaserDynamics, Inc.*, 694 F.3d at 64.

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Trial II on Damages

Before the second trial, QCI moved to exclude Murtha's 2% royalty opinion based on his misapplication of the EMVR.[24] QCI's objections to the application of the EMVR were sustained, and Murtha's 2% royalty opinion based on the entire value of a laptop computer was excluded.[25] Given the court's rulings, Murtha testified at the second trial that damages should be $10.5 million based on a running royalty of 6% of the average price of a standalone ODD.[26] At the second trial, the jury awarded a lump sum royalty of $8.5 million. LaserDynamics appealed the district court's order granting a new trial and/or remittitur, and QCI cross-appealed on other grounds.[27]

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Appeal

On appeal, the Federal Circuit Court of Appeals held, *inter alia,* that the district court properly granted a new trial on damages based on Murtha's misapplication of the EMVR during the first trial.[28]

EMVR Constrained

The Federal Circuit observed that, in a product made of dozens of distinct components, assessing the value of each patented and non-patented component as a part of the overall product "can be an exceedingly difficult and error-prone task."[29]

The court also cautioned that error from an improperly admitted EMVR theory may manifest in the disclosure of revenues earned by the accused infringer on a complete product rather than on the patented component only.[30] The court noted that disclosure of overall product revenues skews the jury's perception by making the patentee's damages appear modest in comparison to the entire product revenues. This perception artificially inflates the amount of damages apparently required to provide "adequate" compensation to the patentee.[31]

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Insufficient Proof

Applying EMVR rules to the facts, the court concluded:

- Murtha advanced an EMVR theory during the first trial despite calling it "product value apportionment," which did not alter what it was.[32]
- LaserDynamics failed to prove that the patented feature was the basis for customer demand for laptop computers as required by the EMVR.[33]
    - It was *not enough* to show that the patented feature is viewed as "valuable, important, or even essential" to the use of a laptop computer.[34]
    - It was *not enough* to show that a laptop computer without the patented feature would be "commercially unviable," because proof that customers want a product with the patented features "is not tantamount to proof that only one of those features alone drives the market . . ."[35]

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24 *Id.* at 64; *LaserDynamics, Inc. v. Quanta Computer, Inc.,* No. 2:06-CV-348-TJW, 2011 WL 7563818, at *1 (E.D. Tex. Jan. 7, 2011).
25 *LaserDynamics, Inc.,* 694 F.3d at 64.
26 *Id.* at 65.
27 *Id.*
28 *Id.* at 66.
29 *Id.* at 66.
30 *Id.* at 68.
31 *Id.* at 68 (citing *Uniloc USA, Inc. v. Microsoft Corp.,* 632 F.3d 1292, 1320 (Fed. Cir. 2011)).
32 *Id.* at 68.
33 *Id.*
34 *Id.*
35 *Id.*

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- Consumer preference for a product with the patented functionality says nothing about whether the presence of that functionality "is what motivates consumers to buy a [product] in the first place."[36] The EMVR requires this higher degree of proof.[37]
- Even though consumers may expect the patented feature to be present in a product, "[t]here is no evidence that this feature alone motivates consumers to purchase [the product], such that the value of the entire product can be attributable to the patented" feature.[38] At best, LaserDynamics proved that all computers sold in the retail market include ODDs and that customers would be hesitant to purchase a computer without an ODD.[39]

- Murtha never conducted any market studies or consumer surveys to gauge whether customer demand for laptop computers is driven by the patented technology.[40]
- Murtha "plucked" his 2% royalty per laptop computer "out of thin air" with no credible economic analysis to support it.[41]

No "Hardship" Exception

The court rejected LaserDynamics' contention that practical and economic necessity compelled a royalty calculation based on the price of an entire laptop computer,[42] concluding, "we see no reason to establish a necessity-based exception to the [EMVR] for LaserDynamics in this case."[43]

Conclusion

The court's opinion in *LaserDynamics* is the latest that limits the EMVR's application. The trend is clear—the EMVR is *not* a viable path to large royalty damages. Patentees must be pragmatic and first seek to recover damages, then seek to maximize those damages, rather than the inverse. Before seeking reasonable royalty damages based on the total product's EMVR, ask yourself (and your client) these four questions:

1. Does the patent relate to one feature or component of a larger product? If the answer is "yes," you need to think long and hard about whether an EMVR theory is worth pursuing.
2. What is the smallest unit in which the patent-practicing unit is sold? If that unit is easily identified, you may want to focus on damages based on sales of that unit and let the EMVR theory go.
3. If you simply must pursue an EMVR theory, ask an expert (1) whether consumer surveys or market research can be developed that will prove the basis for customer demand for the product, (2) what that research will likely show, and (3) what this type of research will cost. Consider the response you get in light of the *LaserDynamics* opinion. Then, be prepared to abandon the EMVR theory once you see the cost and get a feel for the almost inevitable result of the research.
4. Can you turn lead into gold?

36 *Id.*
37 *Id.*
38 *Id.* at 69.
39 *Id.*
40 *Id.* at 68.
41 *Id.* at 69.
42 *Id.*
43 *Id.* at 70.