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KEY IDEAS:

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Shook, Hardy & Bacon offers expert, efficient and innovative representation to our clients. We know that the successful resolution of intellectual property issues requires a comprehensive strategy developed in partnership with our clients.

WATERSHED DAMAGES DECISION? CAFC WEIGHS IN ON ISSUES, PROOF REQUIREMENTS

In what may be seen as a watershed moment in appreciating the critical value of damages calculations, the Federal Circuit Court of Appeals' (CAFC's) September 19, 2009, decision in *Lucent Technologies, Inc. v. Microsoft Corp.* steps beyond the issues in the case. Chief Judge Paul Michel, writing for the panel, grapples with front-page issues relating to proof of reasonable royalty damages in patent infringement cases and makes clear the court's views on key patent damages issues currently at the heart of the patent-reform debate.[1] Perhaps even more importantly, the court's opinion demonstrates the difficult challenges facing patent owners and alleged infringers when presenting damages evidence. Because of this, *Lucent* ought to be a part of your IP IQ.

1. How the *Lucent* Issues Teed Up

Lucent sued Microsoft and others, alleging indirect patent infringement of its "Day patent." This patent claims a method for entering information into fields on a computer screen without using a keyboard (a "date picker" function).[2] At trial, a jury found that the patent was valid and that Microsoft indirectly infringed.

Trial evidence established that Microsoft sold approximately 110 million units of software products capable of practicing Lucent's Day patent. The total dollar value of those sales was approximately $8 billion. At trial, Lucent sought a running royalty based on 8 percent of sales revenue for the infringing software products, and it asked the jury to award $561.9 million based on Microsoft's related sales. Microsoft countered that a lump-sum payment of $6.5 million was sufficient for licensing the protected technology.[3] The jury decided on a lump-sum award, not a running royalty, and awarded $357,693,056.18 to Lucent for Microsoft's infringement.[4]

After the district court denied Microsoft's post-trial motions, Microsoft appealed.[5] The CAFC initially reviewed and affirmed the lower court's decisions on validity and infringe-

1 The slip opinion is 64 pages long, 33 of which are devoted to damages issues. The September 23, 2009, argument in *I4i L.P. v. Microsoft Corp.*, Fed. Cir. No. 2009-1504, available at oralarguments.cafc.uscourts.gov, suggests another such opinion may be forthcoming.
2 *Lucent Techs., Inc.*, 2009 WL 2902044, at *1.
3 *Id.* at *16. *See Lucent Techs.*, 580 F. Supp. 2d at 1042 & n. 7.
4 *Id.* at *2
5 *Id.* at *1, *18.

ENHANCING YOUR IP IQ
Vol.1, No.7 OCTOBER 2009

ment.[6] Reviewing the damage award, the CAFC analyzed whether, at the time of the hypothetical negotiation, Microsoft would have agreed to a lump-sum, paid-in-full royalty of about $358 million.[7] The CAFC initially rejected Microsoft's challenges to the damages award.[8] Because it found that the damages calculation lacked sufficient evidentiary support, however, the CAFC vacated and remanded that portion of the case for further proceedings.[9] By so ruling, the court addressed important procedural and substantive issues relating to reasonable royalty damages.

The CAFC began the opinion's damages section by reviewing the law related to reasonable royalty damages. By statute, patent infringement damages 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."[10] A patentee can prove its loss by showing actual damages in the form of its lost profits or a reasonable royalty for the infringer's use of the patented technology.[11] Lost profits were not at issue in *Lucent*, so the court focused on reasonable royalty damages.[12] Based on the evidence, the CAFC adopted a hypothetical negotiation approach to analyzing damages and reviewed those damages in light of key *Georgia-Pacific* factors.[13]

2. Proof Pitfalls Exposed

"A complicated case this was, and the damages evidence of record was neither very powerful, nor presented very well by either party."

Lucent was tried by two well-known IP litigation firms. Still, the CAFC found that Microsoft had waived key objections to the introduction of damages evidence by failing to object at trial.[14] The court ultimately observed that, "A complicated case this was, and the damages evidence of record was neither very powerful, nor presented very well by either party."[15] Rather than a reflection on very able counsel, the CAFC's observations demonstrate practical challenges to proving damages in three key areas: proving comparable licenses, proving patent value and proving use.

a. Proving Comparable Licenses

The CAFC first analyzed damages proof relating to the second *Georgia-Pacific* factor—comparable licenses entered into by the accused infringer.[16] The court observed that this factor subsumes the issue of whether the parties would have agreed to a lump-sum payment or a running royalty.[17]

6 *Id.* at *17.
7 *Id.* at *18
8 *Id.* at *17.
9 Id. at *1, *17, *29 ("We agree, nevertheless, with Microsoft's argument that substantial evidence does not support the jury's verdict of a lump-sum royalty payment of $357,693,056.18.").
10 35 U.S.C. § 284; *Lucent Techs., Inc.*, 2009 WL 2902044, at *17.
11 *Lucent Techs., Inc.*, 2009 WL 2902044, at *17; *SmithKline Diagnostics, Inc. v. Helena Labs. Corp.*, 926 F.2d 1161, 1164 (Fed. Cir. 1991).
12 *Lucent Techs., Inc.*, 2009 WL 2902044, at *17.
13 *Id.* at *18. *Georgia-Pacific Corp. v. U.S. Plywood Corp.,* 318 F. Supp. 1116, 1120 (S.D.N.Y. 1970).
14 *Lucent Techs., Inc.*, 2009 WL 2902044, at *18.
15 *Id.* at *29.
16 *Id.* at *18.
17 *Id.*

Shook, Hardy & Bacon L.L.P.

ENHANCING YOUR IP IQ

Vol.1, No.7 OCTOBER 2009

The court highlighted three specific problems with the comparable license evidence introduced at trial.[18] First, there was no evidence establishing the parties' expectations about how often consumers would use the patented method.[19]

Second, there was little evidence of how a license agreement structured as a running royalty is probative of a lump-sum payment.[20] In fact, in trying to explain how to determine a lump sum payment, Lucent's expert used the verboten word "speculate."[21]

Third, if they were ascertainable at all, the factual circumstances underlying the comparable patents were "far different" from those at issue in *Lucent*.[22] The court looked closely at the comparable license agreements Lucent introduced into evidence, concluding that none of them were particularly helpful. In this regard, the court observed,

> The law does not require an expert to convey all his knowledge to the jury about each license agreement in evidence, but a lump-sum damages award cannot stand solely on evidence which amounts to little more than a recitation of royalty numbers, one of which is arguably in the ballpark of the jury's award, particularly when it is doubtful that the technology of those license agreements is in any way similar to the technology being litigated here.[23]

"[W]e see little evidentiary basis under *Georgia-Pacific* Factor 2 for awarding roughly three to four times the average amount in the lump-sum agreements in evidence,"

Ultimately, the court said, " . . . [W]e see little evidentiary basis under *Georgia-Pacific* Factor 2 for awarding roughly three to four times the average amount in the lump-sum agreements in evidence," and concluded "For the reasons stated, Factor 2 weighs strongly against the jury's award."[24]

18 *Id.* at *20.
19 *Id.* ("Lucent submitted no evidence upon which a jury could reasonably conclude that Microsoft and Lucent would have estimated, at the time of the negotiation, that the patented date-picker feature would have been so frequently used or valued as to command a lump-sum payment that amounts to approximately 8% of the sale price of Outlook.").
20 *Id.* at *20, *23 ("For a jury to use a running-royalty agreement as a basis to award lump-sum damages, however, some basis for comparison must exist in the evidence presented to the jury. In the present case, the jury had almost no testimony with which to recalculate in a meaningful way the value of any of the running royalty agreements to arrive at the lump-sum damages award.").
21 *Id.* at *22. ("In short, Smith's testimony could be interpreted as suggesting to the jury that it was proper to 'speculate' as to the proper lump-sum damages amount even though he may have intended the word 'speculate' to mean 'estimate.'").
22 *Id.* at *20, *21 (" . . . Lucent relies on eight varied license agreements which purportedly support the jury's lump-sum damages award. When we examine these license agreements, along with the relevant testimony, we are left with two strong conclusions. First, some of the license agreements are radically different from the hypothetical agreement under consideration for the Day patent. Second, with the other agreements, we are simply unable to ascertain from the evidence presented the subject matter of the agreements, and we therefore cannot understand how the jury could have adequately evaluated the probative value of those agreements.").
23 *Id.* at *22.
24 Id. at *25.

"The evidence can support only a finding that the infringing feature contained in Microsoft Outlook is but a tiny feature of one part of a much larger software program."

b. Proving Patent Value

The court next turned to *Georgia-Pacific* factors 10 and 13 relating to how the parties would have valued the patented feature during the hypothetical negotiation.[25] At the conclusion of its inquiry, the CAFC observed, "The evidence can support only a finding that the infringing feature contained in Microsoft Outlook is but a tiny feature of one part of a much larger software program."[26] Based on this observation, the court concluded that *Georgia-Pacific* factors 10 and 13 provided little support of the lump-sum damages award.[27]

The court's discussion of the entire market value rule (EMVR) relates closely to the discussion of value. In response to Microsoft's EMVR argument, the court held that, "to the extent the jury relied on an entire market value calculation to arrive at the lump-sum damages amount, that award is not supported by substantial evidence and is against the clear weight of the evidence."[28] The court found two errors in the EMVR's application.[29]

First, there was no evidence that the patented method was the basis—or even a substantial element of the basis—for consumer demand for the infringing Microsoft product.[30] The court concluded that Lucent had failed to meet its burden of proof.[31]

Second, Lucent's expert chose the wrong royalty base and "tried to reach the damages number he would have obtained had he used the price of the entire computer as a royalty base. Being precluded from using the computer as the royalty base, he used the price of the software, but inflated the royalty rate accordingly."[32] The court then said emphatically, "This cannot be an acceptable way to conduct an analysis of what the parties would have agreed to in the hypothetical licensing context."[33]

Interestingly, the court then said, "There is nothing inherently wrong with using the market value of the entire product, especially when there is no established market

25 *Id.* at *25 ("Factor 10 is '[t]he nature of the patented invention; the character of the commercial embodiment of it as owned and produced by the licensor; and the benefits to those who have used the invention.' Georgia-Pacific, 318 F.Supp. at 1120. Factor 13 is '[t]he portion of the realizable profit that should be credited to the invention as distinguished from non-patented elements, the manufacturing process, business risks, or significant features or improvements added by the infringer.' Id. These two factors, at least as applied to the facts of this case, both aim to elucidate how the parties would have valued the patented feature during the hypothetical negotiation.").

26 *Id.* at *25 ("In short, Outlook is an enormously complex software program comprising hundreds, if not thousands or even more, features. We find it inconceivable to conclude, based on the present record, that the use of one small feature, the date-picker, constitutes a substantial portion of the value of Outlook.").

27 *Id.* at *26.

28 *Id.* at *17.

29 *Id.* at *30.

30 *Id.* at *31.

31 *Id.* at *31 ("And when we consider the importance of the many features not covered by the Day patent compared to the one infringing feature in Outlook, we can only arrive at the unmistakable conclusion that the invention described in claim 19 of the Day patent is not the reason consumers purchase Outlook. Thus, Lucent did not satisfy its burden of proving the applicability of the entire market value rule.").

32 *Id.* at *32.

33 *Id.*

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*."[34] (emphasis added) But this holding contrasts with a recent district court opinion by CAFC Judge Randall Rader, sitting as the trial judge by designation in *Cornell University v. Hewlett-Packard Co.*,[35] There, Judge Rader rejected an attempt to conflate the royalty rate and the royalty base, calling the assertion "legally incorrect," and holding that, "As the Federal Circuit explained in *Rite Hite*, whether or not a plaintiff is entitled to include the entire market value of a system incorporating infringing and non-infringing components in the royalty base is separate from the analysis of the effect of convoyed or collateral sales on the royalty rate."[36]

c. Proving Use

"But neither precedent nor economic logic requires us to ignore information about how often a patented invention has been used by infringers. Nor could they since frequency of expected use and predicted value are related."[1]

The CAFC also criticized the application of the facts to *Georgia-Pacific* factor 11 relating to the infringer's use of the patented invention.[37] Addressing an objection to the use of evidence relating to patent use after the date of the hypothetical negotiation, the court wrote, "But neither precedent nor economic logic requires us to ignore information about how often a patented invention has been used by infringers. Nor could they since frequency of expected use and predicted value are related."[38]

The court then reviewed and endorsed the use of the "Book of Wisdom."[39] The court cautioned that the "damages award ought to be correlated, in some respect, to the extent the infringing method is used by consumers. This is so because this is what the parties to the hypothetical negotiation would have considered."[40]

4. Lessons Learned

The *Lucent* opinion provides valuable guidance on trial proof of reasonable royalty damages. Ten key takeaways:

1. Don't take damages proof for granted;
2. Understand your burden and prepare a detailed order of proof;
3. Marshal your evidence early to achieve your proof objectives;
4. Work with your experts to avoid proof gaps and linguistic mistakes;

34 *Id.* at *33.
35 2009 WL 1082485 (March 30, 2009, N.D.N.Y.). A discussion of this opinion is set forth in "*Some Things Never Change: Apportionment and the 'Entire Market Value Rule,*'" IpQ (Shook, Hardy & Bacon, LLP, Washington, D.C.), Vo1. 1, No. 3, June 2009.
36 *Id.* at *289.
37 *Lucent Techs., Inc.*, 2009 WL 2902044, at *26.
38 *Id.*
39 *Id.* at *26–27. *See "Cracking Open the Book of Wisdom: Where the Past Can Become the Present,"* IpQ (Shook, Hardy & Bacon, LLP, Washington, D.C.), Vol. 1, No. 5, August 2009.
40 *Id.* at *28.

Shook, Hardy & Bacon L.L.P.

ENHANCING YOUR IP IQ

Vol.1, No.7 OCTOBER 2009

5. Select truly comparable license agreements and explain points of similarity in detail;

6. Show actual use by relying on the "Book of Wisdom" and correlate damage to that use;

7. Apportion the value of the patented feature to the entire product;

8. Don't overreach by playing games with the rate and the royalty base;

9. Correlate the calculation of a running royalty and a lump sum royalty or get a clear jury instruction and verdict form to avoid any confusion; and

10. Object early and often to prejudicial evidence to preserve your rights on appeal.

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