



**REASONABLE ROYALTIES IN PATENT
LITIGATION:**

METHODS, EVIDENCE, AND EXPERTS

Michael A. Einhorn, Ph.D.*

1. INTRODUCTION

Courts commonly hear expert testimony in order to determine suitable financial remedies resulting from infringement of plaintiff rights.¹ The minimal and most common financial remedy in patent litigation is the *reasonable royalty*, which is the “amount that a person, desiring to manufacture [use, or sell] a patented article, as a

* At mae@mediatechcopy.com, <http://www.mediatechcopy.com> The author is an economic consultant and expert witness in the areas of intellectual property, media, entertainment, and product design. He is a former professor at Rutgers University as well as the author of *Media, Technology, and Copyright: Integrating Law and Economics* (2004) and over seventy related professional articles in intellectual property, economic analysis, and damage valuation. He has advised parties and supported litigation in matters involving patent damages and related valuations in semiconductors, medical technologies, search engines, e-commerce, wireless systems, and proprietary and open source software. A complete professional biography can be found in the appendix.

¹Upon finding for the claimant, the court shall 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, together with interest and costs as fixed by the court. 35 U.S.C. 284 (2000).

business proposition, would be willing to pay as a royalty and yet be able to make [use, or sell] the patented article in the market at a reasonable profit.”² In other instances, allowable remedy for patent infringement may include actual damages³ (if greater than reasonable royalty) (35 U.S.C. 285), punitive enhancements (35 U.S.C. 284), attorneys’ fees (35 U.S.C. 285), and defendant profits for infringement of design patents (35 U.S.C. 289).

This article reviews important Federal Circuit litigation and related considerations for inventors, lawyers, and experts in connection with the determination of reasonable royalty

1. **Best License Evidence:** Contracts negotiated in previous license transactions for the patent-in-suit are the best credible evidence for providing a reasonable royalty for that patent. :

²Trans World Mfg. Corp. v. Al Nyman & Sons Inc., 750 F. 2d 1552, 1568 (Fed. Circ. 1984). Consequently, “the objective of a reasonable royalty calculation is to determine the amount necessary to adequately compensate for an infringement.” *See also* Maxwell v. J. Baker, Inc. 86 F. 2d 1098, 1109 (Fed. Cir. 1996).

³Actual damages adequate to compensate for the infringement are “the difference between [the patent owner’s] pecuniary condition after the infringement, and what his condition would have been if the infringement had not occurred.” *Aro Mfg. Co. v. Convertible Top Replacement Co.*, 377 U.S. 476, 507, 84 S.Ct. 1526, 12 L.Ed.2d 457, 141 USPQ 681, 694 (1964).

2. **Next License Alternatives:** Reasonable royalties may be estimated from other benchmark licenses out of suit, but these benchmark situations and technologies must be related somehow to the patent-in-suit. The conflicting particulars of imperfect benchmarks can be presented to the jury for an appropriate weighting of facts. :
3. **Admissibility of Settlement Agreements:** Courts may admit into evidence previous settlement agreements that may be sufficiently related to the patent-in-suit. But there is no general admissibility for settlement agreements unless so sufficiently related.
4. **Discovery of Settlement Negotiations:** Attorneys may discover previous settlement negotiations that may be related to agreements themselves that might prove worthy of later admission as the case evolves.
5. **Book of Wisdom:** There is an apparent divergence in court opinion regarding the use of data and other information learned from future events that are not evident after the time of the putative royalty negotiation.
6. **Analytic Method:** Courts are not confined to the standards and methods of the *Georgia Pacific* case. In this regard, the analytic method calculated an extraordinary rate of return gleaned from later market events to reflect a reasonable royalty that could have purportedly evolved in a prior negotiation.

7. **Entire Market Value Rule (EMVR):** The Federal Circuit has seriously constrained the use of the rule that allowed more expansive royalty bases that include the sales of a larger product that may include the patent—in-suit as one component or feature.

There are four practical considerations of these decisions as they concern innovation or implementation of new technology.

1. The easing of restrictions on discovery and admissibility of settlement negotiations and agreements may actually reduce the willingness for parties to negotiate if the resulting facts might be later discoverable or admissible.

2. The “book of wisdom” that allows courts to ascribe to patent negotiators a clairvoyant awareness of future events and data can lead to outcomes that are incommensurate with actual behavior and common sense.⁴

3. The analytic method depends on a number of cost constructions and data assumptions that do not reflect a realistic view of financial theory. If implemented, the patentee could wind up disgorging all of the profits that a licensee would presumably have earned from use of the patent. The outcome of the analytic method leaves no

⁴331 F.3d 860 (2003).

profit for the licensee and is not found in court standards that require a willingness on the part of both parties to engage in a mutually beneficial negotiation. .

4. The EMVR is now disallowed in some instances where it demonstrably had been the basis of previous contracts that were actually signed by the patentee in suit. With overly restrictive use of the EMVR, lower courts may be left with the dubious task of determining on how to administer a “court decree” based on legal precedent rather than actual market factors...

2. BEST LICENSE EVIDENCE

*Based on the 1970 District Court case of Georgia Pacific Corp. v. United States Plywood Corp., royalty experts have often applied fifteen factors to determine reasonable royalty that is suitably recovered as remedy in a patent infringement.*⁵

Royalties are now generally expressed as a percentage of a royalty base, generally equal to the actual sales of the patented unit itself, or related to the sales of some larger product in which the patented technology unit is a functioning component or feature (possibly with some additional apportionment; infra note xx). The use of

9. 318 F. Supp. 1116, 1120 (S.D.N.Y. 1970), modified sub om, 446 F. 2d 295, 295 (2d Cir. 1971). (2d Cir. 1971), cert denied, 404 U.S. 870 (1971).

the *Georgia Pacific* standards is not obligatory.⁶ A factfinder may consider any or all of these factors when attempting to establish a reasonable royalty; other factors may also be considered.

There generally are no peer-reviewed technical rules for weighting the influence of any particular *Georgia Pacific* standard, and it would be improper for an expert to suggest otherwise.⁷ Moreover, the Federal Circuit recently disallowed the application of expert methods for reasonable royalty that had some previous imprimatur due to insufficient correspondence with the facts or context of the actual case before the court. These decisions critically include *Uniloc USA, Inc. v. Microsoft Corp.* (disallowance

⁶TWM v. Dura, *infra* note 47

⁷While it is not obligatory to submit an expert report to measure damages, a factfinder cannot speculate from numbers unsupported by law and divorced from guidance.⁷ *Unicom Monitoring, LLC v. Cencom, Inc.*, 2013 U.S. Dist. LEXIS 56351 (D.N.J. April 19, 2013) (Cooper, U.S.D.J.) (Indeed, “the failure to present competent evidence regarding how the factfinder should provide evidence for and perform the reasonable royalty calculation is fatal to [a patentee’s] claim for reasonable royalty damages ... Rather, the court needs either clear guidance from an expert about how to apply complex calculations or simple factual proofs about what this patentee has previously accepted in factually analogous licensing situations.”) See also *Crystal Semiconductor*, 246 F.3d 1336; *Shockley v. Arcan, Inc.*, 248 F.3d 1349, 58 USPQ2d 1692 (Fed.Cir.2001) (An expert report to measure remedy then requires sound economic and factual predicates.). .

of the 25 percent rule)⁸. and *VirnetX, Inc. v. Cisco Systems, Inc.* (disallowance of the Nash bargaining solution)⁹

That said, *established royalty rates* paid by any party for the actual patent-in-suit are the best legal measure of reasonable royalties for use of the patent. That is, “when a patentee has consistently licensed others to engage in conduct comparable to the defendant’s at a uniform royalty, that royalty is taken as established “ and damages equal to that established royalty may be awarded.¹⁰ In the absence of an established royalty rate for the patent-in-suit, licenses involving imperfect alternative technologies and situations would be the apparent best option, as discussed below.¹¹

⁸632 F. 3d 1292 (Fed. Cir. 2011). The plaintiff’s use of a 25 percent rule of thumb rule was ruled invalid because it failed to tie a reasonable royalty base to the facts of the case at issue

⁹Infra note 22.

¹⁰*Monsanto Co. v. McFarling*, 488 F. 3d 973, 979 (Fed. Cir. 2007). *See also* *Tektronix, Inc. v. United States*, 213 Ct. Cl. 257, 552 F.2d 343, 347, 193 USPQ 385, 390 (1977), cert. denied, 439 U.S. 1048, 99 S. Ct. 724, 58 L. Ed. 2d 707 (1978); *Unisplay, S.A. v. American Elec. Sign Co.*, 69 F.3d 512, 519, 36 USPQ2d 1540, 1545 (Fed.Cir.1995) (The patentee’s prior license agreements “should carry considerable weight in calculating a reasonable royalty rate.”); *Studiengesellschaft Kohle, m.b.H. v. Dart Indus., Inc.*, 862 F.2d 1564, 1568, 9 USPQ2d 1273, 1278 (Fed.Cir.1988) (“[T]he patentee’s usual licensing approach should be considered in assessing a reasonable royalty.”).

¹¹*ResQNet*, 594 F. 3d at 872 (licenses must be ‘commensurate with what the defendant has appropriated.) *See also* *Lucent*, 580 F. 3d at 1325. (“licenses relied on by the patentee in proving damages [must be] sufficiently comparable to the hypothetical license at issue in suit.”)

When established royalties are not available but admissible benchmarks, the expert has useful evidence for a more general application of *Georgia Pacific* Factor 15 -- the construction of a hypothetical arms-length negotiation between a willing buyer and a willing seller¹² Here, the vantage of willing buyers and sellers should be distinguished from the nominal plaintiff and defendant in suit, as particulars for the latter could involve individual subjective or idiosyncratic weightings that no independent willing agent would consider¹³

As part of any agreeable solution, the hypothetical outcome must take into account each party's expectation of a reasonable profit, and not admit any other resolution.¹⁴ Thus a minimum and maximum royalty rate could be defined for each contestant. That said, the set of admissible outcome between these endpoints is a continuum of conceivable results (a core). Without an established royalty, the expert

¹²"[A] willing-buyer/willing-seller concept, in which a suppositious meeting between the patent owner and the prospective [user] of the infringing [method] is held to negotiate a license agreement." *Tektronix*, 552 F.2d at 349, 193 USPQ at 391.

¹³Id. ("[W]hether ... [the] defendant ... [was] never willing to pay a reasonable royalty is irrelevant... The willing-buyer/willing-seller concept is ... employed by the court as a means of arriving at reasonable compensation and its validity does not depend on the actual willingness of the parties to the lawsuit to engage in such negotiations ... [T]here is, of course, no actual willingness on either side.")

¹⁴*Square Liner 360, Inc. v. Chisum*, 691 F.2d 362, 377, 216 USPQ 666, 677 (8th Cir. 1982). *See also* *Leesona*, 599 F.2d at 970-71, 202 USPQ at 436. Among other restraints, a reasonable

generally would not be able to select further from the list of possible outcomes one particular position that would be uniquely ascertainable through peer-reviewed methodology

Although not generally required, an expert might do well to discuss the relevance of each of the remaining Georgia Pacific standards in her/his report. This review is an insurance option reasonably undertaken to avoid an opponent's suggestion of an analytic gap (Joiner). Based on professional judgment, the expert may suggest some reasonable ordinal ranking of influence.

That said, there is no technique to quantify the precise valuation of any factor, or to weight the significance of several factors that may offset one another and so numerically combine them into a unique resultant. Experts are allowed, if not compelled, to present such limited facts without necessarily opining on the parameterization of the underlying factors that cannot be defended. As will be discussed below, a jury or judge may have the assignment of weighing the presented factual and interpretive evidence to reach a suitable outcome.

royalty may not exceed the cost savings arising from the difference between its proposed non-

3. NEXT LICENSE ALTERNATIVES

The Federal Circuit case of ResQNet v. Lansa defined further standards for benchmark licenses that can be invoked in a reasonable royalty calculation when best evidence is not available.

In *ResQNet v. Lansa*,¹⁵ plaintiff ResQNet based a calculation upon a set of seven licenses in the industry-at-large, and so advanced a mid-range 12.5% as a reasonable outcome. The defendant presented no response to ResQNet's report. Reversing the District Court's award of damages, the Federal Circuit held that six of the seven licenses had no relationship to the claimed patent-in-suit, while the last contained a lower royalty rate that the expert had opined.¹⁶

Critically, the Federal Circuit held that proper consideration of potential benchmark licenses cannot amount to a simple "recitation of royalty numbers, one of which is arguably in the ballpark, particularly when it is doubtful that the technology of

infringing alternative installation and the patented method.

¹⁵594 F. 3d 860 (Fed. Cir. 2010).

¹⁶At 870-71 Judge Newman dissented, contending that the six licenses were ResQNet's own "bundling" licenses that implicated the technology in question. She found that the expert report thoroughly discussed the *Georgia Pacific* standards and acknowledged the critical distinctions in the contract. Per her view, the evidence was rightfully heard by the trier of fact. (At 876-82).

those license agreements is in any way similar to the technology being litigated.” [emphasis mine] “When relying on licenses to prove a reasonable royalty, alleging a loose or vague comparability between different technologies or licenses does not suffice.” However, a perfect correspondence from a benchmark license to the patent in suit is not necessary; “any reasonable royalty analysis necessarily involves an element of approximation and uncertainty.”¹⁷

The Federal Court came to rule further on inexact benchmark licenses in several cases.

*Finjan, Inc. v. Secure Computing Corp.*¹⁸

*ActiveVideo Networks, Inc. v. Verizon Communications, Inc.*¹⁹

¹⁷ Lucent, 580 F. 3d, at 1325 (*See also* Unisplay, 69 F. 3d at 517).

¹⁸626 F. 3d 1197, 1211 (Fed. Cir. 2010). Plaintiff had presented to the District Court a benchmark license that had the same technology as the patent-in-suit. However, Finjan did not compete directly with the benchmark licensee as it did with the defendant Secure, and the candidate benchmark involved a lump sum rather than a running royalty. At 1212. Because the technologies were the same, the federal circuit nonetheless affirmed the benchmark and the subsequent damages award because the *identified differences were deemed sufficient to permit the jury to properly discount the license.* [emphasis mine].

¹⁹Nos. 2011–1538, 2011–1567, 2012–1129, 2012–1201. (Fed. Cir. Aug. 24, 2012). Plaintiff expert presented two benchmarks that post-dated the time of the hypothetical negotiation, did not involve the patents-in-suit, and did not cover the technologies in the case. At 1333. A third benchmark covered both the patent-in-suit and a related software service not in the litigation before the court. *Id.* The Federal Circuit yet concluded that the “degree of comparability” between the benchmark and the license-in-suit was “a factual issue best

*VirnetX, Inc. v. Cisco Systems, Inc.*²⁰

The upshot of these cases is made clear in the cited footnotes. i...e, the jury may hear the expert testimony and decide for itself how to weight the importance of complicating factors.²¹ The expert is confined by the Daubert trilogy to present relevant facts and only methods that can sustain peer-review.²²—

addressed by cross-examination and not by exclusion.” *Id.* With similar differences between the license-in-suit and the benchmark licenses; “*the jury was entitled to hear the expert testimony and decide for it what to accept or reject.*” [emphasis mine] *Id.*, *See also* i4i Ltd. P’ship v. Microsoft Corp., 598 F. 3d 831, 856 (Fed. Cir. 2010), *aff’d* 131 S. Ct. 2238 (2011).

²⁰767 F.3d 1308 (2014). Plaintiff expert presented six prospective benchmark licenses. Two of the licenses predated the patents-in-suit; both implicated a technology related to (but not identical with) the patent in question, and one of the two contained an additional software license. Three additional ones did implicate the patent in question, but were established three years after the date of the hypothetical negotiation in 2009. Finally, one benchmark license was a composite license for sixty-eight patents, including the one patent-in-suit. In view of *ResQNet* at 869 and *Finjan* at 1211, “we conclude that the district court here did not abuse its discretion in permitting [the expert] to rely on the six challenged licenses ... Four of the patents did relate to the patent-in suit, while the others were drawn to related technology ... Moreover, all of the other differences that [defendant] Apple complains of were presented to the jury, *allowing the jury to fully evaluate the relevance of the licenses*” [emphasis mine]

²¹*See also* *Paper Converting Mach. Co. v. Magna-Graphics Corp.* 745 F. 2d 11, 22 (Fed. Cir. 1984) (“Determining the weight and credibility of the evidence ... is the special province of the trier of fact.”)

²² *Daubert v. Merrell Dow Pharmaceuticals*, 509 U.S. 579, 589 (1993); *General Electric Co. v. Joiner* (522 U.S. 136 (1997)); *Kumho Tire Co. v. Carmichael*, 526 U.S. 137 (1999).

4. **ADMISSIBILITY OF SETTLEMENT AGREEMENTS:**

The Court relaxed prior restrictions on admissibility of settlement agreements in ResQNet v. Lansa, and then tightened them in LaserDynamics, Inc. v. Quanta Computer, Inc.

The Federal Circuit further considered in *ResQNet* the admissibility of *previous settlement agreements* involving the patent-in-suit. The court here modified its own prior judicial restrictions on settlement agreements to allow the defendant Lansa to favorably introduce into evidence a prior settlement agreement that involved the patentee ResQNet and a third party licensee; “the most reliable license in this record arose out of [other] litigation.”²³ The court remanded the case to the District Court for consideration of the license agreement that had been excluded previously.²⁴ However, the opinion here recognized “[o]n other occasions, this court has acknowledged that [the threat of] litigation itself can skew the [settlement] results of the hypothetical

²³At 872. *See also* *Laserdynamics*, 694 F. 3d at 78. “[I]n *ResQNet* ... a long settlement agreement stood apart from all other licenses in the record as being uniquely relevant and reliable.”

²⁴828 F. Supp. 2d 688, 694 (S.D.N.Y. 2011). The District Court later came to choose two suitable benchmarks – involving and not involving settlement.

negotiation ... [L]icense fees negotiated in the face of a threat of . . . litigation . . . may be strongly influenced by a desire to avoid full litigation.”²⁵

These concerns played a fuller role in Judge Newman’s dissenting opinion. (At 880). Controversies in other courts also became relevant to a further discussion.²⁶

The issue of settlement admissibility resurfaced in *LaserDynamics, Inc. v. Quanta Computer, Inc.*²⁷ Here, the Court struck down a District Court decision that admitted at Laserdynamics’ behest a very favorable settlement agreement that it had previously entered with a third party.²⁸ The panel held that *ResQNet* does not stand for the general proposition that all settlement license agreements are admissible.²⁹ While

²⁵At 872; *see also* Fenner Invs, Ltd. v. Hewlett-Packard Co., No. 6:08-CV-273, 2010 WL 1727916, at *3 (E.D. Tex. Apr. 28, 2010) (listing possible reasons parties enter into settlements, including “cost of additional litigation,” “relative financial positions of the parties,” the “risk of a sizeable verdict against a defendant,” and the risk of “a finding of invalidity or unenforceability against a plaintiff”).

²⁶T.N. Narechania & J. T. Kirklin, *infra* note 35, at 18-25.

²⁷694 F.3d 51 (2012)

²⁸At 66, 67. The disputed agreement involved a very profitable deal for Laserdynamics. The referenced deal was made shortly before a trial in which the licensee would have been at a severe legal and procedural disadvantage. The awarded license fee thus was six times higher than the next highest royalty ever paid for the patent-in-suit.

²⁹“[T]his propriety of using prior settlement agreements to prove the amount of a reasonable royalty is questionable.” At 77. citing *Rude v. Westcott*, 130 U.S. 152, 164 (1889). Contrary to popular interpretation, the Supreme Court did not hold in *Rude* that settlement licenses

ResQNet sought to admit the most reliable benchmark, the disputed license from Laserdynamics represented “by a wide margin” the *least reliable* contract. At 77-78. Thus, “the record stands in stark contrast to *ResQNet*, where a lone settlement agreement stood apart from all other licensees in the record as being uniquely relevant and reliable.” *Id.*

However, the Court in *Laserdynamics* rejected admissibility based on Rule 408, which “specifically prohibits the admission of settlement offers and negotiations offered to prove the amount of damages owed on a claim.” (At 77) The underlying case from the lower court actually involved Rule 403; courts may exclude only evidence that is more prejudicial than probative... Thus the Federal Circuit’s hard pronouncement regarding Rule 408 appears to be dictum that later courts may need to sort out. The Court’s support here for the very restrictive Rule 408 also differs from the more permissive *ResQNet*, as well as the loosening of restriction on admissibility in Rule 703 (expert may disclose otherwise inadmissible facts or data if probative value outweighs

arising out of litigation could never be considered in calculating a reasonable royalty. Rather, the *Rude* Court rejected entirely the concept of a reasonable royalty. At 167. In fact, the Supreme Court did not approve a “reasonably royalty” as a basis for patent- infringement damages until 1915. See *Dowagiac Mfg. Co. v. Minnesota Moline Plow Co.*, 235 U.S. 641, 648 (1915). Congress codified the *Dowagiac* decision in 1922. See, e.g., Christopher B. Seaman, *Reconsidering the Georgia-Pacific Standard for Reasonable Royalty Patent Damages*, 2010 B.Y.U. L. Rev. 1661, 1671 (2010).

their prejudicial effect.)and in Rule 705 (expert may be required to disclose those facts or data on cross-examination.)

5. **DISCOVERABILITY OF SETTLEMENT NEGOTIATIONS**

Between ResQNet and Laserdynamics, the Federal Circuit handed down In re MSTG, Inc., an opinion that loosened restriction on party discovery of settlement negotiations (re notes, communication, and data) that presumably predated any settlement agreements that followed.

The dispute before the Federal Circuit began in District Court when the magistrate had compelled production of the related negotiation documents that MSTG's expert was to rely upon when composing his report (at 1342).³⁰ MSTG had already provided the settlement agreement without argument.

The Federal Circuit declined MSTG's request to vacate the magistrate's order; "settlement negotiations related to reasonable royalties and damage calculations are not protected by a settlement negotiation privilege." At 1348. But here the Court's resolution was confined narrowly; the judges passed "for another day" to recognize a

³⁰The magistrate judge found that the negotiation documents "might contain information showing that the grounds [the expert] relied on to reach his conclusions are erroneous." At 1340 The Federal Circuit concurred: "MSTG cannot at one and the same time have its expert rely on information about the settlement negotiations and deny discovery as to those same negotiations" as a matter of fairness. "

new general negotiation privilege.³¹ Rather, the Court stated that the standards of Federal Rule of Civil Procedure 26(b)(1) already presented a useful discovery policy that could be generally enforced; i.e., discovery of material is allowable if the discovery can be “reasonably calculated [but not necessarily certain] to lead to the discovery of admissible evidence.” At 1346-48.

The Federal Circuit’s opinion in MSTG here noticeably contrasts with an opposing earlier opinion found in the Sixth Circuit, “any communications made in furtherance of settlement are privileged”; “in order for settlement talks to be effective, parties must feel uninhibited in their communications.”³² The Sixth Circuit found that there are many factors in such negotiations that may come into play that are unrelated to the value or validity of a patent that nonetheless affect the parties’ negotiations or decisions to settle. This has led to considerable controversy in the lower courts; e.g.,

³¹As is now governed by FED. R. EVID. 501. Evidentiary privileges are recognized by principles of common law factors that are now specified in *Jaffee v. Redmond* 518 U.S. 1 (1996)

³²*Goodyear Tire & Rubber Company v. Chiles Power Supply, Inc.*, 332 F.3d 976, 983 (2003)

the Eastern District of Texas agrees with the Sixth Circuit, while the Northern District of California agrees with the Federal Circuit.³³

The apparent upshot of the MSTG case regarding discoverability of settlement negotiations (so discerned in order to enable later production of possibly admissible evidence) complements the findings in *ResQNet* and *LaserDynamics* regarding admissibility of those settlements. John Kenneth Feltre and Samuel Brenner of Ropes & Gray LLP summarize the present situation with a deeper analysis of the resulting District Court cases³⁴

Discovery of Settlement Agreements: Settlement license agreements involving comparable patents and technology are *discoverable*.

Discovery of Settlement Negotiations: Settlement license negotiations are *probably discoverable*, especially when the resulting agreement that involves the same patent or similar technology.

Admissibility of Settlement Agreements: Settlement agreements are *admissible* to prove reasonable royalty damages if there is a close “fit” between the

³³A full discussion of the judicial split on the issue appears in Tejas N. Narechania and Jackson Taylor Kirklin, “An Unsettling Development: The Use of Settlement Related Evidence for Damages Determinations in Patent Litigation, 2012 Journal of Law, Technology and Policy 1, 8-11 (2012)

³⁴John Kenneth Felter and Samuel Brenner, Settlement Evidence and Patent Damages, file:///C:/Users/Michael/AppData/Local/Temp/ABA%20-%20TrialEvidence_ArticleReprint_FelterandBrenner-2.pdf, at 8-11

patents-in-suit and the technology that is the subject of the agreements, and if the agreements reliably reflect royalty terms that the parties would have agreed upon pre-infringement.

Admissibility of Settlement Negotiations: *It is not clear* whether or when settlement license negotiations are *admissible* to prove a reasonable royalty.

To conclude the above discussions of settlement and admissibility, recent Federal Court decisions have set forth terms that District Courts now presumably attempt to administer when considering both restrictions on either. As the Sixth Circuit appears to have feared, more open discovery and admissibility may yet present difficulties for inventors and attorneys attempting to negotiate initial contracts and later disputes. With the latest decisions, communications and agreements will be less protected, outcomes will be more uncertain, and any judicial policy that may otherwise promote settlement may actually be hindered by its expectations of an uncertain future.³⁵ It is not clear such uncertainty facilitates decision-making in technology markets that are so open-ended.

³⁵Kuhl, Parker, Rescue Me! The Attack on Settlement Negotiations after ResQNet v. Lansa (April 18, 2011). Berkeley Technology Law Journal, Forthcoming. Available at SSRN: <https://ssrn.com/abstract=1814005> or <http://dx.doi.org/10.2139/ssrn.1814005>

6. BOOK OF WISDOM

The Federal Circuit seems to have reached conflicting opinions regarding the propriety of using data and events revealed after the time of the prospective negotiation.

From the Federal Circuit's *Hanson* decision in 1983,³⁶ "the key element in setting a reasonable royalty ... is the necessity for return to the date when the infringement began."³⁷ The Court firmed up *Hanson* in *Interactive Pictures Corp. v. Infinite Pictures, Inc.*³⁸ Defendant Infinite Pictures (IPI) had prepared business plans with projections that it had constructed before infringement began. IPC's expert held that these plans would have affected IPI's frame of mind -- optimistically -- at the time of the putative negotiation and thus set the stage for an advantageous outcome for IPC. As IPI later missed the sales projections and appealed their application, the Federal Circuit ruled that these projections -- right or wrong -- credibly represented the defendant's frame of mind at the time of negotiation. The Federal Circuit then affirmed

³⁶*Hanson v. Alpine Valley Ski Area, Inc.*, 718 F.2d 1075, 1078-9, 219 USPQ 679, 682 (Fed.Cir.1983).*See also* *Wang Labs, Inc. v. Toshiba Corp.* 993 F. 2d 858, 879 (Fed. Cir. 1993).

³⁷*Id.* quoting *Panduit Corp. v. Stahlin Bros. Fibre Works, Inc.*, 575 F.2d 1152, 1158, 197 USPQ 726, 731 (6th Cir.1978).

³⁸ 274 F. 3d 1371. (Fed. Cir. 2002)

the jury's damage award. The decision corresponds to a later Federal Circuit ruling in *Riles v Shell Exploration*.³⁹

The Federal Circuit seemed in 1983 to choose an opposite course in *Fromson v. Western Litho. Plate & Supply Co.*⁴⁰ Here, the court allowed the expert to rely upon crucial facts that became evident only after the infringement ensued. Based on a 1934 Supreme Court precedent of *Sinclair Refining Co. v. Jenkins Petroleum Process Co.* (289 U.S. 689), the negotiating parties were perceived to have a “book of wisdom” that would allow them to see into the future and so plan and negotiate accordingly. The “book of wisdom” that would have allowed them during the hypothetical negotiation to see into the future. That is, “ the [book of wisdom] ... permits and often requires a court to look to events and facts that occurred thereafter and that could not have been known to or predicted by the hypothesized negotiators.” *Id.*

An analyst could consider the different outcomes above when reading the court's later decision in *Integra Lifesciences I, Ltd., v. Merck KGaA*.⁴¹ The court here acknowledged that a hypothetical negotiation based on events in 1994 or 1995 could have been quite different due to the contemporaneous development of the underlying

³⁹ “a reasonable royalty determination for purposes of making damages evaluation must relate to the time infringement occurred, and not be an after-the-fact assessment.

⁴⁰ *Fromson v. Western Litho. Plate & Supply Co.*, 853 F.2d 1568. (Fed. Cir. 1983) *See also* *SmithKline Diagnostics, Inc. v. Helena Laboratories, Inc.*, 926 F. 2d 1161 (Fed. Cir. 1991).

pharmaceutical industry. Bringing in facts and events from the later year could have implicated the possible award of new government approvals and related stacking inventions that would have improved the profitability of a first patent negotiated in 1994. Depending on whether the “book of wisdom” is operative, such events in 1995 might not have been conceivable to any party’s frame of mind during the prior negotiation.

Alternatively, the infringed patent could have failed entirely in the market after 1994 due to regulatory disallowance or emergence of superior competing technologies not covered by the patent. Based on a “book of wisdom”, the Court could then have ascribed to the 1994 negotiation a very meager royalty amount well incommensurate with the actual outlook (presumably cheerier) of both parties at the time. But if the book of wisdom were actually operable prior to the actual events that followed, the patentee would not have researched and developed its invention in the first place. The counterfactual analysis then leads to an absurd outcome.

⁴¹331 F.3d 860 (Fed. Cir. 2003).

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7. ANALYTIC METHOD

*In the absence of any historic license data to support a hypothetical negotiation per Georgia Pacific, a special master in TWM v. Dura conceived an alternative procedure called the analytic approach.*⁴²

The master first determined the profit margin of the licensor as the ratio: (sales revenues- cost of goods sold) /sales revenue. Cost of goods sold here would include only the costs of goods and services related to the actual production and distribution of the infringing good. Using a presumably “fair” formula, the master then deducted from the remaining profit margin an imputed percentage of general operating expenses; total expenses were assigned to the patent-in-suit based on its relative share of sales revenues.⁴³ Finally, the master used industry data to determine and deducted an imputed cost that the defendant would presumably have paid to access capital for its

⁴² TWM Manufacturing Co. v. Dura Corp., 729 F. 2d 895 (Fed. Cir. 1986), cert. denied, 479 U.S. 852 (1986).

⁴³There is no reason to believe that this fully loaded apportionment of general expenses has anything to do with the incremental costs that would presumably underpin any economist’s determination of profit.

project.⁴⁴ The master then deemed the remainder as an extraordinary rate of return on production that would provide a royalty amount that plaintiff could presumably recover as a measure of a reasonable royalty

The Federal Circuit on appeal found that the fifteen *Georgia Pacific* factors were not the only suitable basis for an expert opinion. *Id.* Furthermore, the panel declined to exercise *de novo* review of the empirical findings of the special master, a trier of fact. That said, no attorney should infer any Federal Court judgment on the propriety of the analytic approach to provide a meaningful negotiation outcome. Nor have the results of this application ever been compared with actual royalties negotiated in other instances.

In fact, the analytic approach is based on data realized after the putative negotiation interval and so has every difficulty of a “book of wisdom”. Like *Fromson*, the analytic method apparently admits the influence of many later events realized by pure serendipity of a future market, and entirely beyond the reasonable parameters of any negotiation. Depending on the breakdown of numbers, it is here quite possible that extraordinary rate of return will be negative, suggesting that the patentee not receive

⁴⁴ This imputed cost of capital is based on a determination of prior costs of researching and developing the invention itself. This determination may be possible when the invention is a stand-alone device. However, a breakout of costs is more problematic when the invention devolved from a lab or collective research group that develops several inventions simultaneously

any royalty for its development of a new product. . The outcome here leaves no incentive for the licensee. Harkening back to *Sinclair* seems then to involve another conjuring that has no proven relation to the actual facts of a negotiation – a difficulty previously identified in *Uniloc* and *VirnetX*.⁴⁵

8.ENTIRE MARKET VALUE RULE

Patent royalty awards are sometimes based on a multiple of a percent royalty rate times a royalty base that consists of sales of stand-alone patent-practicing units. However, when the patented feature or component is part of a larger product, plaintiffs sometimes aim to include in the royalty base the sales revenue of the entire product in which the patented technology represents one feature or unit. This second option is known as the *entire market value rule*, which was first set down in the Supreme Court case of *Garretson v. Clark*⁴⁶ and later extended to other applications involving conveyed and derivative goods⁴⁷

⁴⁵Supra notes 8-9 and surrounding text.

⁴⁶*Garretson v. Clark*, 111 U.S. 120, 121 (1884) (stating that the patentee “must show, by equally reliable and satisfactory evidence, that the profits and damages are to be calculated on the whole machine, for the reason that the entire value of the whole machine, as a marketable article, is properly and legally attributable to the patented feature”) *Marconi Wireless Tel. of Am. v. United States*, 99 Ct. Cl. 1, 46, 53 U.S.P.Q. 246,

Judge Rader of the Federal Circuit limited in 2009 the application of the EMVR in reasonable royalty cases when sitting by designation in the District Court case of *Cornell v. Hewlett Packard*.⁴⁸ Unless plaintiff can prove that the infringing component is the *basis for customer demand* for the entire machine, reasonable royalties for an infringed product should be valued as a percent of a royalty base that incorporates the “smallest salable patent-practicing unit.”⁴⁹ The judge affixed two further conditions as part of the requirements.⁵⁰ The court later omitted the latter

249 (Ct. Cl. 1942), *aff'd in part and vacated in part*, 320 U.S. 1 (1943); *Tektronix, Inc. v. United States*, 552 F.2d 343, 352 (Ct. Cl. 1977)

⁴⁷*Paper Converting Machine Co. v. Magna-Graphics Corp.*, 745 F.2d 11, 22-23 (Fed. Cir. 1984); *King Instrument Corp. v. Otari Corp.*, 767 F.2d 853, 865-66 (Fed. Cir. 1985). Sitting *en banc*, the Federal Circuit in *Rite-Hite Corp. v. Kelley Co.*, 56 F.3d 1538 (Fed. Cir.), *cert. denied*, 516 U.S. 867 (1995), “The expression “convoyed sales” should preferably be limited to sales made simultaneously with a basic item; the spare parts here [sold after the original infringing product was sold] should best be called ‘derivative sales.’” *Carborundum Co. v. Molten Metal Equipment Innovations, Inc.*, 72 F.3d 872, 881 n.8 (Fed. Cir. 1995); *American Seating Co. v. USSC Group, Inc.*, 514 F.3d 1262, 1268 (Fed. Cir. 2008).

⁴⁸609 F. Supp. 2d 279, 286-87 (N.D.N.Y. 2009). citing *Fonar Corp. v. General Elec. Co.*, 107 F.3d 1543, 1552 (Fed. Cir. 1997); *State Indus., Inc. v. Mor-Flo Indus., Inc.*, 883 F.2d 1573, 1580 (Fed. Cir. 1989);

⁴⁹Unlike the EMVR that allows the entire sales revenues of the composite unit to be included in the royalty base, the expert must now apportion the sales total of the SSPPU to the patent that represents a share of the total valuation of the SSPPU. This too can be a technically involved valuation that may involve financial or economic theory.

two conditions when it simplified this finding in *Lucent Technologies, Inc. v. Gateway, Inc.*⁵¹

Nonetheless, *Lucent* stated an offsetting qualification: “There is nothing inherently wrong with using the market value of the entire product, especially when there is no established market 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.*” [emphasis mine]⁵² Thus the apparently inapposite conclusion to *Cornell*: “Even when the patented invention is a small component of a much larger commercial product, awarding a reasonable royalty based on either sale price or number of units sold can be economically justified.”⁵³

⁵⁰1) the individual infringing and non-infringing components must be sold together so that they constitute a functional unit or are parts of a complete machine or single assembly of parts, *Paper Converting Mach. Co.*, 745 F.2d at 23; and (2) the individual infringing and non-infringing components must be analogous to a single functioning unit, *Kalman v. Berlyn Corp.*, 914 F.2d 1473, 1485, 16 USPQ2d 1093, 1102 (Fed. Cir. 1992).

⁵¹580 F.3d 1301; 2009 U.S. App. LEXIS 20325; 92 U.S.P.Q. 2D (BNA) 1555.

⁵²*Id.*, at 1339.

⁵³ *Id.*

The Federal Circuit became more restrictive in *Uniloc USA v. Microsoft Corp.*⁵⁴

“The Supreme Court and this court’s precedents do not allow consideration of the entire market value of accused products for minor patent improvements *simply by asserting a low enough royalty rate.*” [emphasis mine]⁵⁵ What is necessary here is *apportionment between the* respective values of infringing and non-infringing components.⁵⁶ In *LaserDynamics*,⁵⁷ the plaintiff sued Quanta Computer, Inc., (QCI) for infringement of its patented optical disc drive technology (ODD) that appeared in QCI’s laptop computers. Judge Reyna reaffirmed from *Uniloc* that “[T]he Supreme Court and this court’s precedents do not allow consideration of the entire market value of accused products for minor patent improvements simply by asserting a low enough royalty rate.”⁵⁸

⁵⁴632 F. 3d 1292, at 1319-20 (Fed. Cir. 2011).

⁵⁵*Id.*

⁵⁶*Id.*

⁵⁷*Op. cit.*

⁵⁸*Id.*, at Section III.A.1. Citing *Uniloc*, at 1319-20. (“The critical feature inheres not in technical characteristics but in the underpinnings of consumer demand; what matters is the “presence of the functionality that *motivates consumers to buy a laptop computer in the first place.* It is this *latter and higher degree of proof that must exist* to support an entire

Uniloc and *LaserDynamics* then imposed a very high evidentiary requirement on the plaintiff to demonstrate a higher degree of proof that may require the use of consumer surveys or econometric analysis. Subsequently, District Courts have attempted to identify some common law standards consistent with higher court restrictions in those decisions.⁵⁹ Yet the EMVR may yet have more expanded life given the outcome -- and implicit economic reasoning -- of *Mondis Technology v. LG Electronics*.⁶⁰

Although Mondis' patent-in-suit was not a primary basis for consumer demand for wider retail product, the magistrate rejected the defendant's Daubert motion to disqualify the plaintiff expert Steven Magee, even though Dr. Magee used a sales base of wider monitors and televisions. In fixing a royalty base, Dr. Magee had presented in his technical analysis thirteen comparable licenses of the patents-in-suit. Each of these licenses had a fixed royalty on the entire base of the retail product that contained a

market value rule theory.” [emphasis mine])

⁵⁹ART +COM v. Google, (155 F. Supp. 3d 489 (D. Del. 2016); Power Integrations. v. Fairchild Semiconductor, 09-cv-05235 2016 WL 444699 (N.D. Cal. 2016); Nortek Air Solutions v. Energy Labs, 14-cv-02919 (N.D. Cal. 2016); GoDaddy.com v. RPost Communications, 14-cv-00126, 2016 WL 2643003 (D. Ariz. 2016) .

⁶⁰2:07-CV-565-TJW-CE (E. D. Tex., 2011), 2011 U.S. Dist. LEXIS 78482.

patent-practicing unit. The *Mondis* court cited *Lucent* and ruled that the use of the EMVR in this matter was economically justified;⁶¹ “the Federal Circuit has repeatedly emphasized the importance of such licenses in the reasonable royalty analysis.”⁶² The “basis for consumer demand” of *Uniloc and LaserDynamics* thus could not be “absolute”.⁶³

8. CONCLUSIONS

There are four critical points to carry away from this discussion as it affects expert analysis, as affected by the Federal Circuit.

1. Reports with misapplied methods and analytic gaps are more likely to be limited or disqualified entirely.

⁶¹Lucent, op. cit. at 1339, and surrounding text

⁶²Id., citing *ResQNet.com, Inc. v. Lansa, Inc.*, 594 F.3d. 860, 869-73 (Fed. Cir. 2010). See also Lucent, supra note 54, at 1329 (a patentee cannot sustain its burden of proof with “evidence which amounts to little more than a recitation of royalty numbers); *Wordtech Systems, Inc., v. Integrated Network Solutions*, 609 F. 3d at 1318-22 (patentee’s royalty analysis was a “pattern of guesswork” that provided no bases for comparison); *Finjan, Inc. v. Secure Computing Corporation*, 626 F. 3d at 1211-12 (Fed Cir. Nov. 4, 2010) (use of past licenses “must account for differences in the technologies and economic circumstances of the contracting parties”)

³⁷ Id., at * 15.

⁶³ Id.

2. The Federal Circuit has opened the door for more discovery and admissibility of settlement agreements. An expert can serve a more important role in this process.
3. There are important insights that an expert can provide in reviewing the parameters, context, and outcomes of court decisions regarding remediation.
4. Court decisions are at times at odds with economic theory and practical judgment.
5. There An expert can serve a more critical role as a respondent to a lacking report that fails to meet Federal Circuit strictures.

ABOUT THE AUTHOR

Michael A. Einhorn (mae@mediatechcopy.com, <http://www.mediatechcopy.com>) is an economic consultant and expert witness active in the areas of intellectual property, media, [entertainment](#), damage valuation, licensing, antitrust, personal injury, and commercial losses. He received a Ph. D. in economics from Yale University. He is the author of the book *Media, Technology, and Copyright: Integrating Law and Economics* ([Edward Elgar Publishers](#)), a Senior Research Fellow at the [Columbia Institute for Tele-Information](#), and a former professor of economics and law at Rutgers University. He has published over seventy professional and academic articles and lectured in Great Britain, France, Holland, Germany, Italy, China, and Japan.

In the [technology](#) sector, Dr. Einhorn worked at Bell Laboratories and the U.S. Department of Justice (Antitrust Division) and consulted to General Electric, AT&T, Argonne Labs, Telcordia, Pacific Gas and Electric, and the Federal Energy Regulatory Commission. He has advised parties and supported litigation in matters involving [patent damages](#) and related valuations in semiconductors, medical technologies, search engines, e-commerce, wireless systems, and proprietary and open source [software](#).

Litigation support involving media economics and [copyright damages](#) has involved [music](#), movies, television, advertising, branding, apparel, architecture, fine arts, video games, and photography. Matters have involved Universal Music, BMG, Sony Music Holdings, Disney Music, NBCUniversal, Paramount Pictures, DreamWorks, Burnett Productions, Rascal Flatts, P. Diddy, Nelly Furtado, Usher, 50 Cent, Madonna, U2, and Led Zeppelin.

Matters involving trademarks and publicity rights have included Samsung, Hasbro, Weather Channel, the Kardashians/BOLDFACE Licensing, Oprah Winfrey/Harpo Productions, Madonna/Material Girl, CompUSA, Steve Madden Shoes, Kohl's Department Stores, *The New York Observer*, and Avon Cosmetics. Matters in publicity right damages have involved Zoey Deschanel, Arnold Schwarzenegger, Rosa Parks, Diane Keaton, Michelle Pfeiffer, Yogi Berra, Melina Kanakaredes, Woody Allen, and Sandra Bullock.

Dr. Einhorn can be reached at 973-618-1212.

This biography is also available at <http://www.jurispro.com/MichaelEinhorn>

