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THE SEDONA CONFERENCE

Commentary on Patent Damages and Remedies

A Project of The Sedona Conference
Working Group on Patent Damages
and Remedies (WG9)

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THE SEDONA CONFERENCE COMMENTARY ON PATENT DAMAGES AND REMEDIES

*A Project of The Sedona Conference Working Group on
Patent Damages and Remedies (WG9)*

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Preface

Welcome to the Public Comment Version of The Sedona Conference Commentary on Patent Damages and Remedies, a project of The Sedona Conference Working Group on Patent Damages and Remedies (WG9). This is one of a series of working group commentaries published by The Sedona Conference, a 501(c)(3) research and educational organization that exists to allow leading jurists, lawyers, experts, academics, and others, at the cutting edge of issues in the areas of antitrust law, complex litigation, and intellectual property rights, to come together—in conferences and mini-think tanks called Working Groups—and engage in true dialogue, not debate, in an effort to move the law forward in a reasoned and just way.

The mission of WG9, formed in November 2010, is “to create guidelines that will help to clarify and guide the evolution of patent damages and remedies considerations to encourage patent damages and remedies law to remain current with the evolving nature of patents and patent ownership.” The Working Group consists of over sixty active members representing all stakeholders in patent litigation. To develop this Commentary, the Working Group held numerous conference calls over the past several years, and the draft was the focus of dialogue at The Sedona Conference’s 14th Annual Conference on Patent Litigation in Del Mar, CA in October 2013.

The Commentary represents the collective efforts of many individual contributors. On behalf of The Sedona Conference, I thank everyone involved for their time and attention during the drafting and editing process, and in particular: Donald R. Banowitz, Michael L. Brody, Jan M. Conlin, John M. Desmarais, Andrea Weiss Jeffries, Rachel Krevans, James W. Morando, Tamir Packin, and Edward G. Poplawski. The Working Group was also privileged to have the benefit of candid comments by several active district court judges with extensive patent litigation trial experience, including the Honorable James F. Holderman, the Honorable Susan Illston, and the Honorable Barbara M.G. Lynn, who all served as the Judicial Review Panel for this Commentary, as well as the Honorable Cathy Ann Bencivengo, the Honorable James L. Robart, and the Honorable Ronald M. Whyte, who also reviewed and commented on the draft. The statements in this Commentary are solely those of the non-judicial members of the Working Group; they do not represent any judicial endorsement of the recommended practices.

Working Group Series output is first published in draft form and widely distributed for review, critique and comment, including in-depth analysis at Sedona-sponsored conferences. Following this period of peer review, the draft publication is reviewed and revised by the Working Group taking into consideration what is learned during the public comment period. Please send comments to us at info@sedonaconference.org, or fax them to us at 602-258-2499. The Sedona Conference hopes and anticipates that the output of its Working Groups will evolve into authoritative statements of law, both as it is and as it should be.

Craig W. Weinlein
Executive Director
The Sedona Conference
June 2014

Foreword

As nine-figure and even ten-figure patent damages jury verdicts become more common, patent damages law has become increasingly important. Even though the forty-year-old *Georgia-Pacific* framework for calculating reasonable royalties remains good law, patent damages law remains one of the most complex, unpredictable, and rapidly evolving areas of the law. Indeed, in many cases the parties' expectations with respect to patent damages often differ by orders of magnitude. This, of course, makes resolving cases short of trial much more difficult. Moreover, even a jury verdict may not add sufficient clarity or certainty to allow the parties to resolve remaining disputes. While a large number of jury verdicts remain undisturbed, many jury verdicts regarding patent damages are being overturned by the Court of Appeals for the Federal Circuit or even by district courts in posttrial rulings.

In this paper, Working Group 9 provides principles and best practices in an effort to add clarity and predictability to the area of patent remedies. Participants and observers of the Working Group included a diverse group of attorneys, including inside counsel for patent holders (including non-practicing entities), inside counsel for practicing entities who often find themselves as defendants in patent litigation, and outside counsel representing both patentees and accused infringers. The Working Group also included expert witnesses who are regularly tasked with writing expert reports assessing patent damages. Members of the federal judiciary also participated as observers to the Working Group.

This paper provides a consensus set of principles and best practices that the Working Group believes will move the law forward in a reasoned and just way. The Working Group began its undertaking by focusing on the statutory mandate that damages should be "adequate to compensate for infringement, but in no event less than a reasonable royalty for the use made of the invention by the infringer." With that perspective in mind, the Working Group revisited the *Georgia-Pacific* framework for calculating damages, ultimately recommending a departure from the *Georgia-Pacific* framework of establishing a hypothetical negotiation at the time infringement began in favor of a "retrospective" approach to the hypothetical negotiation. Under the retrospective approach, the hypothetical negotiation takes place at the time of trial and allows for consideration of all relevant facts and circumstances occurring up to the time of trial. The Working Group also provides guidelines and best practices regarding several *Georgia-Pacific* factors, and deals with critical issues including: apportionment; the entire market value rule; whether settlement agreements should be considered in the hypothetical negotiation framework; and the appropriate post-verdict legal and equitable remedies available to patent holders. The Working Group also provides best practices for substantive and procedural damages issues regularly arising before, during, and after trial.

This paper does not attempt to address all the issues that arise in the context of remedies for patent infringement; rather, it puts forth guidelines and best practices that can be applied consistently across cases. With respect to patent damages, the paper focuses on reasonable royalty damages because the Working Group felt that it could make a significant contribution in that area of the law. The paper does not address lost profits damages. The paper also does not address the effects of obligations to license patents on fair, reasonable, and non-discriminatory (FRAND) terms, nor does it deal with enhanced damages, such as those potentially available after a finding of willful patent infringement.

John M. Desmarais
Editor-in-Chief, Chair, Working Group 9 Steering Committee

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2. The party or original patentee (where the original patentee is not a party) or its counsel previously had made a statement about the patent to a court, the Patent and Trademark Office, or another administrative body that cannot reasonably be reconciled with the initiation or the maintenance of a claim or defense;56
3. There is evidence (a) which establishes as a matter of law that a claim or defense is objectively baseless, and (b) which, after the initiation of a lawsuit, is actually called to the party’s attention through discovery, or, prior to the initiation of a lawsuit, was obtained, or through the exercise of reasonable diligence could have been obtained, from the public record or from witnesses under the control of the party; or.....56
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I. Background

Brief History of Patent Remedies

The Constitution grants Congress the power “to promote the Progress of Science and the Useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries.” Congress has exercised that power by granting courts the authority to award compensatory damages for infringement and injunctions prohibiting future infringement.

Patent infringement damages have their current statutory basis in Section 284 of the Patent Act, which states that, upon a finding of infringement, “the court shall award the claimant 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”¹ In practice, damages awards today typically are based on two general forms of damages: lost profits of the patentee; or a reasonable royalty based on either an established royalty or the framework of a hypothetical negotiation.

Early Supreme Court case law divided along two lines: the first interpreted the then existing patent damages statutes² to require either actual harm to the patentee or an established royalty for the patented technology in order to award damages. For example, the Court in one early case held the patentee was entitled to only nominal damages upon a finding of infringement, because the patentee did not prove any established royalty and “[t]here was no question . . . of damages arising from lost sales, or injurious competition, for no machines had been manufactured and put on the market by the patentee.”³ The Court further offered a definition of what constitutes an established reasonable royalty, noting that “it must be paid or secured *before* the infringement complained of; it must be paid by such a number of persons as to indicate a general acquiescence in its reasonableness by those who have occasion to use the invention; and it must be uniform at the places where the licenses are issued.”⁴

The next year, the Court followed this same approach in *Coupe v. Royer*, pointing to the lower court’s error in permitting a jury to award infringement damages without evidence of a true licensing fee or impairment of the patentee’s market in any way. As such, since there were “no damages of any kind . . . the lower court should have instructed the jury . . . to find nominal damages only.”⁵

The second line of case law focused instead on the actual value of the invention to determine an appropriate measure of damages, without regard to any established royalty rate or actual harm to the patentee. For example, the Court affirmed a damages award following a jury instruction permitting examination of “the utility and advantage[s] of the invention over the old modes or devices that had been used for working out similar results,” despite a lack of evidence of either harm to the patentee or an established royalty rate.⁶ The Court affirmed this view in 1871, characterizing the damages question as requiring a determination of what advantages the defendant derived from using the patented invention over simply using other processes that were legally available for public use, which would have allowed him to obtain “an equally beneficial result.”⁷

¹ 35 U.S.C. § 284.

² Section 14 of the Patent Act of 1836 provided, in part: “[I]t shall be in the power of the court to render judgment for any sum above the amount found by such verdict as the actual damages sustained by the plaintiff, not exceeding three times the amount thereof, according to the circumstances of the case, with costs”

In 1870, Congress amended the statute to provide that for suits in equity, “the claimant [complainant] shall be entitled to recover, in addition to the profits to be accounted for by the defendant, the damages the complainant has sustained thereby, and the court shall assess the same or cause the same to be assessed under its direction, and the court shall have the same powers to increase the same in its discretion that are given by this act to increase the damages found by verdicts in actions upon the case”

³ *Rude v. Westcott*, 130 U.S. 152, 167 (1889).

⁴ *Id.* at 165 (emphasis added).

⁵ *Coupe v. Royer*, 155 U.S. 565, 583 (1895).

⁶ *Suffolk Co. v. Hayden*, 70 U.S. 315, 320 (1865).

⁷ *Mowrey v. Whitney*, 81 U.S. 620, 651 (1871).

Similarly, an 1853 case noted that an inventor of an improvement to a mill should not be permitted to claim damages arising from lost profits on the entire mill; rather, damages should be measured based solely on the use of the inventor's improvement to the mill.⁸ The decision in *Westinghouse Elec. & Mfg. Co. v. Wagner Elec. & Mfg. Co.* elaborated on this principle, stating that where a patentee's invention "only created a part of the profits, he is only entitled to recover that part of the net gains."⁹ Further, the patentee in such a case must produce evidence of apportionment of the profits between the patented features and the remaining features to distinguish between the patentee's damages and the defendant's rightful profits.¹⁰ However, the *Westinghouse* Court also stated that "when it is impossible to make a mathematical or approximate apportionment[,] . . . [o]n established principles of equity, and on the plainest principles of justice, the guilty trustee cannot take advantage of his own wrong[.]" and the patentee is entitled to all of the infringer's profits.¹¹

Many viewed *Westinghouse* as enabling patentees to recover excessive damages for infringement in too many cases. Just three years later, in *Dowagiac Mfg. v. Minn. Moline Plow*, the Court retreated from the expansive *Westinghouse* decision, holding that "[i]n the absence of [an established] royalty, and in the absence of proof of lost sales or injury by competition," the patentee bore the burden of proving a reasonable royalty.¹² The Court then remanded the case, giving the patentee the opportunity to show the invention's actual value by "proving what would have been a reasonable royalty, considering the nature of the invention, its utility and advantages, and the extent of the use involved."¹³

As noted above, the current approach to damages derives from Section 284 of the Patent Act, and most typically requires a determination of the patentee's lost profits or what constitutes a reasonable royalty. While an established royalty may form the basis for a reasonable royalty under the current law, it is rare for such an established royalty to exist because the particular invention or technology at issue may not have been licensed out to other entities in the same factual context. As such, courts have come to use the hypothetical negotiation framework and rely on the numerous factors enumerated in *Georgia-Pacific Corp. v. U.S. Plywood Corp.* to determine what constitutes a reasonable royalty in any given case. The factors include:

1. royalties received by the patentee for licensing the patent-in-suit, proving or tending to prove an established royalty;
2. rates paid by the licensee for the use of comparable patents;
3. nature and scope of the license, as exclusive or non-exclusive, or as restricted or non-restricted in terms of territory or with respect to whom the manufactured product may be sold;
4. licensor's established policy and marketing program to maintain his patent monopoly by not licensing or by granting licenses under special conditions designed to preserve that monopoly;
5. commercial relationship between the licensor and licensee, such as whether they are competitors or whether they are inventor and promoter;

⁸ See *Seymour v. McCormick*, 57 U.S. 480, 489 (1853). This view is a precursor to today's entire market value rule, which applies to both lost profits damages and reasonable royalty damages. This rule applies when the invention is one element of a product sold, and states that a patentee is only entitled to damages based on the invention itself (not the entire product), unless the patented element is the basis—or a substantial basis—for demand of the entire product. See *infra* Chapter II, Principle II-2.

⁹ *Westinghouse Elec. & Mfg. Co. v. Wagner Elec. & Mfg. Co.*, 225 U.S. 604, 615 (1912).

¹⁰ See *id.* Again, this is consistent with the entire market value rule and current principles of apportionment in cases awarding damages based on lost profits. See *infra* Chapter II, Principle II-2.

¹¹ *Id.* at 620.

¹² *Dowagiac Mfg. Co. v. Minn. Moline Plow Co.*, 235 U.S. 641, 649 (1915). However, the Court did not expressly overrule the statements made in *Westinghouse*, which remained good law until the Patent Act amendments in 1946, which eliminated the patentee's right to disgorgement of all of the defendant's profits under *Westinghouse*. See Erick S. Lee, *Historical Perspectives on Reasonable Royalty Patent Damages and Current Congressional Efforts for Reform*, 13 UCLA J.L. & TECH. 1, 8 (2009) (noting the 1946 amendments' abrogation of the use of an infringer's profits as a basis for measuring damages).

¹³ *Dowagiac*, 235 U.S. at 648.

6. effect of selling the patented invention in promoting sales of other products of the licensee, and existing value of the invention to the licensor as a generator of sales of his non-patented items;
7. duration of the patent and the term of the license;
8. established profitability of the product made under the patent, its commercial success, and its current popularity;
9. utility and advantages of the patent property over the old modes or devices, if any, that had been used for working out similar results;
10. nature of the patented invention, character of the commercial embodiment of it as owned and produced by the licensor, and benefits to users of the invention;
11. extent to which the infringer has made use of the invention, and any evidence probative of the value of that use;
12. portion of the profit or selling price that may be customary in the industry to allow for the use of the invention or similar inventions;
13. 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;
14. opinion testimony of qualified experts;
15. amount that a prudent licensor and a prudent licensee would have agreed upon at the time the infringement began, if both had been reasonably and voluntarily trying to reach an agreement.¹⁴

While the hypothetical negotiation and the *Georgia-Pacific* factors remain a well-accepted framework for calculating reasonable royalty damages today, the *Georgia-Pacific* factors leave significant room for interpretation. Because of that, in recent years the Federal Circuit has issued many decisions evaluating appropriate methods and considerations when calculating infringement damages based on a reasonable royalty. Cases addressing these issues have become common in recent years and courts are finding a need to ensure that such awards are based on accepted methodologies and sufficient evidence.

Current State of the Law Regarding the Determination of a Royalty¹⁵

Recent Federal Circuit Cases on Use of the Reasonable Royalty to Calculate Damages

The Federal Circuit stated in *Lucent*, in 2009, that several approaches may be used to calculate a reasonable royalty, including: (1) the analytical method, which calculates damages based on the infringer's anticipated profit from sales of the infringing product; and (2) the "more common" hypothetical negotiation approach contemplated in *Georgia-Pacific*.¹⁶

In *Lucent*, lump sum damages of roughly \$358 million were awarded to Lucent for Microsoft's indirect infringement.¹⁷ The Federal Circuit vacated the damages award on the ground that it was not supported by substantial evidence.

¹⁴ *Georgia-Pacific Corp. v. U.S. Plywood Corp.*, 318 F. Supp. 1116, 1120 (S.D.N.Y. 1970).

¹⁵ This paper does not address the impact of Fair, Reasonable, and Non-Discriminatory (FRAND) obligations on the royalty analysis or recent adaptations of the *Georgia-Pacific* factors to account for those obligations.

¹⁶ *Lucent Techs., Inc. v. Gateway, Inc.*, 580 F.3d 1301, 1324 (Fed. Cir. 2009).

¹⁷ *See id.* at 1325.

At trial, both parties advocated for the hypothetical negotiation approach. Accordingly, the Federal Circuit reviewed the damages award by applying the *Georgia-Pacific* framework. At trial, Lucent asked for damages based on a running royalty, while Microsoft argued that any damages were represented by a lump sum royalty payment of \$6.5 million. Because the jury verdict awarded a lump sum, paid-in-full royalty of about \$358 million, on appeal the Federal Circuit evaluated whether substantial evidence supported the jury's implicit finding that at the time of the hypothetical negotiation, Microsoft would have agreed to a lump sum, paid-in-full royalty of about \$358 million.¹⁸

In addressing *Georgia-Pacific* factor 2—“[t]he rates paid by the licensee for the use of other patents comparable to the patent in suit”—the Federal Circuit held that the licenses presented by Lucent at trial were for other groups of patents, and were created from contexts far different from a license negotiation tailored to the patent-in-suit.¹⁹ The Federal Circuit, applying *Georgia-Pacific* factors 10 and 13, found that the infringing feature contained in Microsoft Outlook is but a tiny feature of one part of a much larger software program, and that it was inconceivable to conclude, based on the record below, that the use of that small feature constituted a substantial portion of the value of Microsoft Outlook. Accordingly, the Federal Circuit held that *Georgia-Pacific* factors 10 and 13 provided little support for the jury's lump sum damages award.²⁰

In analyzing *Georgia-Pacific* factor 11—“[t]he extent to which the infringer has made use of the invention; and any evidence probative of the value of that use”—the Federal Circuit relied on the “book of wisdom”²¹ to reject Microsoft's argument that information about consumers' use of the infringing feature was irrelevant because it postdated the time of the hypothetical negotiation. In allowing such post-hypothetical negotiation evidence, the Federal Circuit explained that “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.”²² The Federal Circuit held that *Georgia-Pacific* factor 11 did not support the jury verdict because “the evidence of record is conspicuously devoid of any data about how often consumers use the patented date-picker invention.”²³

The *Lucent* court noted that while the determination of the reasonable royalty “must relate to the time infringement occurred, and not be an after-the-fact assessment,”²⁴ evidence of subsequent events “can, under appropriate circumstances, be helpful to the jury and the court in assessing whether a royalty is reasonable.”²⁵ In rejecting Microsoft's argument that Lucent should not be permitted to rely on evidence concerning consumer use of the patented feature due to its generation post-negotiation, the Federal Circuit stated that such information may aid the hypothetical negotiation calculation, since it provides information that parties would have had to estimate if done at the time of negotiation.²⁶

In evaluating the decision below, the Federal Circuit also held that, to the extent the jury relied on an entire market value rule calculation to arrive at the lump sum damages amount, that award was not supported by substantial evidence and was against the clear weight of the evidence, for two reasons:

¹⁸ *Id.*

¹⁹ *Id.* (citing *Georgia*, 318 F. Supp. at 1120).

²⁰ See *Lucent*, 580 F.3d at 1332–33.

²¹ While the hypothetical negotiation constructively takes place at or before the time the infringement began, the methodology is flexible and it may accommodate a court's inquiry into “events and facts that occurred [after the hypothetical negotiation] that could not have been known to or predicted by the hypothesized negotiators.” *Fromson v. Western Litho-Plate & Supply Co.*, 853 F.2d 1568, 1575 (Fed. Cir. 1988). This is known as “the book of wisdom,” or evidence arising after the infringement began. See *Sinclair Refining Co. v. Jenkins Petroleum Process Co.*, 289 U.S. 689, 698 (1933) (Cardozo, J.) (“[I]f years have gone by before the evidence is offered[, e]xperience is then available to correct uncertain prophecy. Here is a book of wisdom that courts may not neglect.”).

²² *Lucent*, 580 F.3d at 1333.

²³ *Id.* at 1334.

²⁴ *Unisplay, SA v. Am. Elec. Sign Co.*, 69 F.3d 512, 518 (Fed. Cir. 1995).

²⁵ *Lucent*, 580 F.3d at 1333–34.

²⁶ See *id.* at 1334. However, the Federal Circuit ultimately determined that Lucent could not rely on the book of wisdom approach, as the “record [was] conspicuously devoid of any data about how often consumers use[d] the patented . . . invention.” *Id.*

First, Lucent had failed to show that the patented invention provided “the basis—or even a substantial basis—of the consumer demand for Outlook,” a necessary condition for application of the entire market value rule. Rather, the evidence demonstrated that the infringing date-picker tool was “but a very small component of a much larger software program” and that the vast majority of Outlook’s features did not infringe. “Indeed Lucent’s damages expert conceded that there was no ‘evidence that anybody anywhere at any time ever bought Outlook . . . because it had a date picker.’”²⁷

Second, Lucent’s damages expert used the wrong approach in explaining how the entire market value rule should be applied. Initially, the expert sought to apply a royalty rate of 1% to a royalty base consisting of the price of the entire computer loaded with the infringing software. After the district court excluded this testimony, the expert changed the royalty base to the price of the software alone but increased the royalty rate to 8% in order to obtain the same damages number. As “there was no evidence that Microsoft had ever agreed to pay an 8% royalty on an analogous patent,” the Federal Circuit held that the expert’s approach “d[id] not comport with the purpose of damages law or the entire market value rule.”²⁸

In 2010, the Federal Circuit took a similar view in *ResQNet.com v. Lansa, Inc.*, vacating a damages award because it “relied on speculative and unreliable evidence divorced from proof of economic harm linked to the claimed invention.”²⁹ The patentee’s damages expert based his royalty opinion on the *Georgia-Pacific* framework, assessing a “starting point” for the hypothetical negotiation based on the first *Georgia-Pacific* factor—royalties received by the patentee from existing licenses. But the first *Georgia-Pacific* factor focuses on “licensing of the patents-in-suit, proving or tending to prove an established royalty.”³⁰ In his explanation to the jury, the patentee’s damages expert referred to license agreements bearing no relation to the invention at issue; these licenses furnished source code and services, and had no “discernible link to the claimed technology”; yet the expert relied solely on these agreements to find support for an “unjustified” royalty rate in the double-digits.³¹ As such, the district court erred in adopting the expert’s proposed royalty rate and failing to make an effort to link the licenses to the patented technology.³² In *dicta*, the Federal Circuit “observe[d] as well that the most reliable license in this record arose out of litigation.”³³ On remand, the Federal Circuit further instructed the district court that it “may also consider the panoply ‘of events and facts that occurred thereafter and could not have been known to or predicted by the hypothesized negotiators.’”³⁴

In *Wordtech Sys., Inc. v. Integrated Networks Solutions, Inc.*, the Federal Circuit found error in the jury’s reliance on non-comparable license agreements in awarding a lump sum reasonable royalty to the patentee.³⁵ The Federal Circuit held that the patentee’s evidence of thirteen prior licenses was insufficient to support the jury’s award, as only 2 of those 13 were lump sum agreements. The award was an approximate average of those two lump sum licenses, but the Federal Circuit held that even those licenses were insufficient because “they provide[d] no basis for comparison with [the] infringing sales.”³⁶ Specifically, “[n]either license describe[d] how the parties calculated each lump sum, the licensees’ intended products, or how many products each licensee expected to produce.”³⁷

Three years ago, the Federal Circuit disavowed the use of the “25 percent rule of thumb” as a “fundamentally flawed tool for determining a baseline royalty rate in a hypothetical negotiation . . . because it fails to tie a

²⁷ *Id.* at 1337–38.

²⁸ *Id.* at 1338.

²⁹ *ResQNet.com, Inc. v. Lansa, Inc.*, 594 F.3d 860, 868 (Fed. Cir. 2010).

³⁰ *Georgia-Pacific*, 318 F. Supp. at 1120.

³¹ *ResQNet.com*, 594 F.3d at 870.

³² *See id.* at 873.

³³ *Id.* at 872.

³⁴ *Id.* (quoting *Fromson*, 853 F.2d at 1575).

³⁵ *See Wordtech Sys., Inc. v. Integrated Networks Solutions, Inc.*, 609 F.3d 1308 (Fed. Cir. 2010).

³⁶ *Id.* at 1320.

³⁷ *Id.*

reasonable royalty base to the facts of the case at issue.”³⁸ There, the patentee’s damages expert presented no evidence that a 25%/75% split was standard practice in beginning Uniloc’s license negotiations, nor did Uniloc attempt to show that the patented invention’s contribution to the accused products justified a 25% royalty. Further, the Federal Circuit rejected the expert’s use of Microsoft’s total revenue as a “check” on the reasonableness of the proposed royalty rate, noting that precedent does not support use of the entire market value rule in the case of minor patent improvements even if the asserted royalty rate is low enough.³⁹

In *LaserDynamics, Inc. v. Quanta Computer, Inc.*, the Federal Circuit revisited the entire market value rule and the admissibility of settlement agreements.⁴⁰ The Federal Circuit made clear that to satisfy the entire market value rule, the patented feature must be the motivating factor for the purchase of the product, not merely a “required” or “important” feature. The Federal Circuit also discussed the use of settlement agreements as evidence to establish the amount of a reasonable royalty, stating that the “propriety of using prior settlement agreements to prove the amount of a reasonable royalty is questionable.”⁴¹ The Federal Circuit reasoned that settlement agreements are of questionable propriety due to the difference between the circumstances of litigation as compared to the legal fiction of a hypothetical negotiation resulting in an agreement between willing licensees and licensors. In *LaserDynamics*, a particular settlement agreement LaserDynamics sought to introduce was excluded. The license amount in the settlement agreement was many times more than the amount other licensees negotiated outside of litigation, likely because the defendant was facing trial and sanctions. The licenses granted outside of litigation were “far more reliable indicators of what willing parties would agree to in a hypothetical negotiation.”⁴² It was therefore improper for LaserDynamics’ expert to selectively rely on the license amount from the settlement, while ignoring the licenses voluntarily negotiated outside of litigation; the royalty rate arrived at by LaserDynamics’ expert was “untethered from the patented technology at issue and the many licenses thereto, and, as such, was arbitrary and speculative.”⁴³

As indicated above, case law has interpreted Section 284 to permit damages based on either a reasonable royalty or lost profits. The Federal Circuit’s explicit recognition in *Lucent* that the statute permits multiple and varying approaches for the determination of a reasonable royalty, and that the approach of *Georgia-Pacific* is only one permissible approach,⁴⁴ paves the way for the consideration of new alternative approaches, which is one of the primary focuses of this Commentary.

Recent District Court Cases on Use of the Reasonable Royalty to Calculate Damages

In light of recent Federal Circuit case law, including those cases discussed above, district courts are taking a variety of approaches with respect to: (1) the entire market value rule; (2) alternatives to the hypothetical negotiation between patentee and defendant; (3) the issue of whether licenses are sufficiently “comparable”; and (4) the admissibility of settlement agreements.

With regard to the entire market value rule, district courts have taken different approaches in their application of the rule. For example, the Southern District of New York excluded an expert’s testimony on the entire market value rule because, in its view, the expert had applied the wrong standard.⁴⁵ Rather than opine that the patented feature was “the” basis for customer demand, he had opined that it was “a substantial basis for demand.”⁴⁶ In contrast, the Eastern District of Texas allowed testimony on the entire market value, despite the

³⁸ *Uniloc USA, Inc. v. Microsoft Corp.*, 632 F.3d 1292, 1315 (Fed. Cir. 2011).

³⁹ *See id.* at 1320.

⁴⁰ *See LaserDynamics, Inc. v. Quanta Computer, Inc.*, 694 F.3d 51 (Fed. Cir. 2012).

⁴¹ *Id.* at 77.

⁴² *Id.* at 78.

⁴³ *Id.* at 81.

⁴⁴ *See also WhitServe, LLC v. Computer Packages, Inc.*, 694 F.3d 10 (Fed. Cir. 2012) (“We do not require that witnesses use any or all of the *Georgia-Pacific* factors when testifying about damages in patent cases.”).

⁴⁵ *See Inventio AG v. Otis Elevator Co.*, No. 06 Civ. 5377, 2011 WL 3359705, at *6 (S.D.N.Y. June 23, 2011).

⁴⁶ *Id.*

fact that it was undisputed that the patented feature did not provide the basis for customer demand, because between 13 and 16 comparable licenses also provided for a royalty based on the entire value of the licensed products.⁴⁷

There is uncertainty and variation in application of the “hypothetical negotiation” as the paradigm for determining the appropriate reasonable royalty. The Southern District of California denied a defendant’s motion to exclude a patentee’s damages expert from testifying about “real-world” negotiations.⁴⁸ Under the expert’s theory, the parties would enter the negotiation with their “respective walk away approaches” and ultimately “meet in the middle.”⁴⁹ The defendant argued that the expert’s approach was not appropriately grounded in the facts of the case, disputing the patentee’s expert use of several methodologies in support of the expert’s conclusions.⁵⁰ The court, however, rejected the defendant’s argument, noting that “[l]itigants routinely adopt several approaches for calculating a reasonable royalty” and concluding the business realities negotiation theory employed by the patentee’s expert was based on reliable principles and methods.⁵¹

A number of district courts have also been receptive to the idea of using evidence generated subsequent to the timing of the hypothetical negotiation. For example, the court in *LecTec Corp. v. Chattem, Inc.*, declined to exclude the testimony of a damages expert regarding events subsequent to the date of the hypothetical negotiation, holding that criticism of the book of wisdom approach is “better directed to weight rather than admissibility.”⁵² Similarly, the District of Delaware has rejected a defendant’s argument that the patentee’s expert gave “subsequent events too much weight in his royalty calculation” in denying the defendant’s motion to exclude expert testimony.⁵³

District courts have also taken divergent approaches when deciding whether licenses are sufficiently “comparable.” Some courts have looked with disfavor on the use of “industry” licenses where the licenses encompass far more than the technology at issue in the case.⁵⁴ Courts have also taken expert witnesses to task where the experts failed to take into account existing licenses to the claimed technology that would have been “appropriate as touchstones for determining the appropriate royalty rate.”⁵⁵ Courts seem to be increasingly scrutinizing expert testimony about why the licensed technology is comparable to the technology claimed in the patent-in-suit, and whether the circumstances of prior licenses are comparable to the circumstances between the parties.⁵⁶

Other courts have taken a more relaxed approach to “comparability.” For example, in a case involving a patented stent, the Eastern District of Texas decided that licenses were sufficiently comparable when they related to a drug delivered by the stent, or to a method of drug delivery that was similar to the method employed by the patented product.⁵⁷ Similarly, the District of Delaware upheld a jury determination that a patentee receive over \$9 million for the infringement of three of its patents even though Microsoft had paid just \$8 million to license the patentee’s entire portfolio.⁵⁸ The court reasoned that the discrepancy was, in part,

⁴⁷ See *Mondis Tech. v. LG Electronics, Inc.*, 2:07-CV-565, 2011 WL 2417367, at *2–6 (E.D. Tex. June 14, 2011).

⁴⁸ *Lucent Techs., Inc. v. Microsoft Corp.*, No. 07-cv-2000, 2011 WL 7664416, at *16 (S.D. Cal. June 16, 2011).

⁴⁹ *Id.*

⁵⁰ See *id.*

⁵¹ *Id.*

⁵² *LecTec Corp. v. Chattem, Inc.*, No. 5:08-CV-130, slip op. at 4 (E.D. Tex. Feb. 1, 2011).

⁵³ *St. Clair Intellectual Prop. Consultants, Inc. v. Canon, Inc.*, No. 03-241, 2004 U.S. Dist. LEXIS 19475, at *9 (D. Del. Sept. 28, 2004).

⁵⁴ *IP Innovation LLC v. Red Hat, Inc.*, 705 F. Supp. 2d 687, 691 (E.D. Tex. 2010).

⁵⁵ See, e.g., *id.*

⁵⁶ See, e.g., *Wordtech Sys.*, 609 F.3d at 1320; *Fenner Investments, Ltd. v. Hewlett-Packard Co.*, No. 6:08-cv-273, 2010 U.S. Dist. LEXIS 101384, at *5 (E.D. Tex. Apr. 16, 2010); *Ricob Co., Ltd. v. Quanta Computer, Inc.*, 06-cv-462-bbc, 2010 U.S. Dist. LEXIS 27301 at *26–27 (W.D. Wis. Mar. 23, 2010).

⁵⁷ See *Saffran v. Johnson & Johnson*, No. 2:07-CV-451 (TJW), 2011 U.S. Dist. LEXIS 34858, at *31–32 (E.D. Tex. Mar. 31, 2011).

⁵⁸ See *Finjan Software, Ltd. v. Secure Computing Corp.*, C.A. No. 06-369 (GMS), 2009 U.S. Dist. LEXIS 72825, at *41 (D. Del. Aug. 18, 2009), *rev’d on other grounds*, 626 F.3d 1197 (Fed. Cir. 2010).

the result of “the substantial intangible benefits that stem from being endorsed by Microsoft.”⁵⁹ The “true value” of the Microsoft license could therefore reasonably have exceeded \$8 million.⁶⁰

The Federal Circuit has recognized the difficulty of identifying “comparable” licenses, realizing that upon close inspection, few, if any, “real world licenses introduced at trial [arise] from circumstances *identical* to those presumed to prevail in the hypothetical royalty negotiation.”⁶¹ Laboring, perhaps, under *Uniloc’s* emphatic reiteration of *Lucent’s* exacting standard, the Eastern District of Virginia recently lamented that “[a]ll five licenses [it considered in a case] contained various restrictive limitations as well as the rights to use the patents. Each license also reflected the result of different perceived litigation strength[s] and weaknesses based on litigation developments,” including verdicts, a hung jury and the early-state settlements.⁶² The court concluded:

[Because] each of the five licenses reflects unique considerations which defy quantification . . . [we] cannot envision a reasonable, reliable way to use those five licenses to arrive at an ongoing royalty

[Furthermore,] the [c]ourt harbors serious doubt as to whether it has any authority to incorporate the various intangible provisions included in the prior licenses.⁶³

Just as district courts have taken different approaches to determine whether licenses are comparable, or whether the entire market value is appropriately in play, they have also taken divergent approaches regarding the admissibility of litigation-induced settlement licenses. Some courts have denied the admission of settlement agreements because of their view that the potential for prejudice and jury confusion substantially outweighs the licenses’ probative value.⁶⁴ There also is the risk that permitting use of litigation settlement agreements will result in a more complicated trial in which a lot of time and energy will be devoted to evidence relating to the circumstances that caused the litigation settlement agreement. Other courts, however, have admitted settlement agreements on a case-by-case basis when they: (1) are the only sufficiently comparable license(s) to the patent-in-suit; or (2) closely resemble comparable, non-litigation-induced licenses.⁶⁵

The Practical Realities of the Evolving Royalty Law

Bifurcation of the Trial

Because of the increase in the complexity of damages theories, the need for flexibility given the varied district court approaches to damages issues, and the length of time required to try the damages portion of a patent case, a significant consideration going forward is whether damages should be tried together with liability issues, or bifurcated and tried at a later date.

⁵⁹ *Id.* at *39.

⁶⁰ *Id.*

⁶¹ *Lucent*, 580 F.3d at 1329 (emphasis added).

⁶² *ePlus, Inc. v. Lawson Software, Inc.*, No. 3:09-cv-620, 2011 U.S. Dist. LEXIS 54957, at *46 (E.D. Va. May 23, 2011).

⁶³ *Id.* at *46, 47 n.9.

⁶⁴ See, e.g., *Fenner Invs. Ltd. v. Hewlett Packard Co.*, 2010 U.S. Dist. LEXIS 41514, at *10 (E.D. Tex. Apr. 28, 2010); *Cornell Univ. v. Hewlett-Packard Co.*, 2008 U.S. Dist. LEXIS 39343, at *13–14 (N.D.N.Y. May 8, 2008).

⁶⁵ See *ReedHycalog UK, Ltd. v. Diamond Innovations, Inc.*, 727 F. Supp. 2d 543, 546 (E.D. Tex. 2010); see also *ResQNet.com*, 594 F.3d at 872.

Under the Federal Rules, bifurcation is proper for “convenience, to avoid prejudice, or to expedite and economize.”⁶⁶ District courts have broad discretion in determining whether to bifurcate.⁶⁷ The party seeking bifurcation bears the burden of demonstrating that it is proper given the facts of the case.⁶⁸

Advantages to bifurcation—in particular in multi-defendant or multi-patent/multi-accused product cases—include potential cost savings and efficiencies. In certain cases, it makes little sense to incur the costs associated with fact and expert damages discovery, which can be quite substantial, unless and until a determination is made on the extent to which any defendant is liable.

However, bifurcation may result in duplicative efforts where evidence on liability issues overlaps with the proof required to support damages theories. Further, should damages be determined by a different jury, bifurcation may put either, or both, patentee and defendant at a strategic disadvantage. A patentee loses the benefit of the jury having full knowledge of all of the proof of the defendant’s wrongdoing when it is determining the royalty to be awarded.⁶⁹ Similarly, an accused infringer may be at a disadvantage where the damages jury has no knowledge of its non-infringement and/or invalidity arguments.

Before filing suit, a plaintiff-patentee should be cognizant of any local rules or practices regarding bifurcation. Certain districts have local rules regarding bifurcation and individual judges may have “a preference [on bifurcation] based on past experience” from which “they rarely deviate.”⁷⁰ For example, for several years one judge in the District of Delaware adhered to a standard patent scheduling order under which damages and willfulness were bifurcated from liability “unless good cause is shown.”⁷¹ The judge’s rationale was that “discovery disputes related to document production on damages and the *Daubert* motion practice related to damages experts are a drain on scarce judicial resources.”⁷² In each instance in which no liability is found, the time spent mediating discovery disputes or making damages *Daubert* determinations is utterly wasted. This judge also believed that parties are likely to settle after liability has been found to avoid an unpredictable damages award.⁷³ Settlement discussions after a liability determination are believed to “give the parties—those with the most expertise in the market—the first opportunity to translate the [court]’s final legal decision on liability into practical commercial consequences.”⁷⁴

By contrast, in the Northern District of Georgia, bifurcation is unlikely. The district’s local rules state that “[t]here shall be a rebuttable presumption against the bifurcation of damages from liability issues in patent cases for purposes of either discovery or trial.”⁷⁵ Similarly, individual judges from the District of Utah, Northern District of Texas, Southern District of Florida, Northern District of Illinois, and the Northern

⁶⁶ FED. R. CIV. P. 42(b).

⁶⁷ See, e.g., *Robert Bosch, LLC v. Pylon Mfg. Corp.*, 719 F.3d 1305, 1319–20 (Fed. Cir. 2013) (making clear that “district courts, in their discretion, may bifurcate willfulness and damages issues from liability issues in any given case” and that “[d]istrict court judges, of course, are best positioned to make [the determination to bifurcate issues] on a case-by-case basis”); *Shum v. Intel Corp.*, 499 F.3d 1272, 1276 (Fed. Cir. 2007); *York v. AT&T*, 95 F.3d 948, 957 (10th Cir. 1996); *Idzotic v. Pa. Railroad Co.*, 456 F.2d 1228, 1230 (3d Cir. 1972).

⁶⁸ See, e.g., *Brown v. Toscano*, 630 F. Supp. 2d 1342, 1345 (S.D. Fla. 2008); *Windsor Indus., Inc. v. Pro-Team, Inc.*, 87 F. Supp. 2d 1129, 1131 (D. Colo. 2000).

⁶⁹ 35 U.S.C. § 284.

⁷⁰ *Bifurcation Ruling Highlights Divergent Approaches to Patent Case Management*, THE DOCKET REPORT (Aug. 31, 2009, 10:41 AM), <http://docketreport.blogspot.com/2009/08/bifurcation-ruling-highlights-divergent.html>.

⁷¹ See Hon. Sue Robinson, *Standard Patent Scheduling Order*, para. 2(a) (revised 12/4/09), available at <https://web.archive.org/web/20100527104709/http://www.ded.uscourts.gov/SLR/Forms/SchedOrder-Patent.pdf> (“The issues of willfulness and damages shall be bifurcated for purposes of discovery and trial, unless good cause is shown otherwise.”). Judge Robinson’s recently revised standard patent scheduling order no longer bifurcates willfulness and damages issues from liability issues. See Hon. Sue Robinson, *Standard Patent Scheduling Order* (revised 3/24/14), available at <http://www.ded.uscourts.gov/sites/default/files/Chambers/SLR/Forms/Sched-Order-Patent-03-24-14.pdf>.

⁷² *Robert Bosch, LLC v. Pylon Mfg. Corp.*, Civ. No. 08-542-SLR, 2009 WL 2742750, at *1 (D. Del. Aug. 26, 2009); *Dutch Branch of Streamserve Dev., AB v. Exstream Software LLC*, Civ. No. 08-343-SLR, 2009 U.S. Dist. LEXIS 76006, at *2 (D. Del. Aug. 26, 2009).

⁷³ See *Robert Bosch*, 2009 WL 2742750, at *1.

⁷⁴ *Id.*; *Dutch Branch*, 2009 U.S. Dist. LEXIS 76006, at *3.

⁷⁵ Patent L.R. 5 (N.D. Ga.), available at <http://www.gand.uscourts.gov/pdf/NDGARulesPatent.pdf>.

District of Indiana have also stated a presumption against bifurcation.⁷⁶ In the view of these judges, bifurcation results in duplicative discovery, witnesses and evidence, and simply delays final resolution.⁷⁷ They believe that the requisite level of complexity that warrants bifurcation simply does not exist when there is only one patent-in-suit, where the technology is straightforward and easy to understand, or where the court will only have to grapple with issues common to many (or all) patent cases, including claim construction, an assessment of the prior art, or the resolution of inventorship disputes.⁷⁸

Litigants should be aware that bifurcation may have a significant effect on the admissibility of evidence. For example, the District of Maryland has bifurcated a trial where a defendant wanted to raise an “advice of counsel” defense to avoid a willfulness finding and treble damages, but did not want to waive attorney-client privilege with respect to liability issues.⁷⁹ Similarly, the District of Delaware has acknowledged that evidence of a previous verdict in favor of the plaintiff-patentee—and evidence of prior licensing agreements—was relevant to patentee’s damages theories⁸⁰ but nevertheless excluded the evidence. Given that liability and damages were being tried together, the court concluded that the evidence posed a substantial danger of unfair prejudice to defendant.⁸¹

Bifurcation may also allow for the admission of damages evidence that is better tailored to the extent to which a defendant is liable. If the extent of liability has not yet been determined, parties may present damages evidence that far exceeds—or grossly underestimates—the true scope of the injury to the patentee. At least one district court has suggested that bifurcation would allow the parties to present the jury with more accurate damage estimates, noting “several instances in which damages evidence will be admissible only if certain factual predicates are established.”⁸² By establishing facts related to liability and the scope of the injury through a bifurcated trial, damages experts would be limited in their estimates and would present a more accurate picture to the jury.

Should a litigant desire to bifurcate damages from liability, in a district where bifurcation is not the norm, a motion to bifurcate should be brought early in the case. If parties have already completed extensive discovery related to damages, any benefits of reaching the liability issues faster will already be limited. Similarly, if parties have constructed their litigation strategy around the assumption of a single trial, it is not productive to require them to redevelop their plans after the preliminary stages of litigation. Thus, bifurcation may be less appealing to the court once discovery is underway.

Posttrial Rulings on Reasonable Royalty Calculations

Posttrial challenges to reasonable royalty calculations can be difficult. For example, the Western District of Wisconsin has upheld a patentee’s expert’s argument that worldwide royalty rates should be adjusted upwards for application in the United States because patent enforcement is much more common in this country.⁸³ The trial judge did not question that analysis because the jury awarded less than the full measure of damages the

⁷⁶ See *Lutron Elecs. Co., Inc. v. Creston Elecs., Inc.*, No. 2:09-cv-707 DB, 2010 U.S. Dist. LEXIS 49623 (D. Utah May 19, 2010); *Nielsen v. Alcon, Inc.*, Civ. A. No. 3:08-CV-02239-B, 2010 U.S. Dist. LEXIS 26804 (N.D. Tex. Mar. 22, 2010); *Baratta v. Homeland Housewares, LLC*, No. 05-cv-60187 (S.D. Fla. Oct. 27, 2008); *DSM Desotech Inc. v. 3D Sys. Corp.*, 2008 U.S. Dist. LEXIS 87473 (N.D. Ill. Oct. 28, 2008); *BASF Catalysts LLC v. Aristo, Inc.*, No. 2:07-cv-222, 2009 U.S. Dist. LEXIS 16263 (N.D. Ind. Mar. 2, 2009).

⁷⁷ See *Baratta*, 05-cv-60187, slip op. at 9; *Nielsen*, 2010 U.S. Dist. LEXIS 26804, at *5.

⁷⁸ See *id.*

⁷⁹ *Mike’s Train House, Inc. v. Broadway Ltd. Imports, LLC*, Civ. No. JKB-09-2657, 2011 U.S. Dist. LEXIS 27550 (D. Md. Mar. 17, 2011).

⁸⁰ See *St. Clair Intellectual Prop. Consultants, Inc. v. Fuji Photo Film Co., Ltd.*, 674 F. Supp. 2d 555, 559 (D. Del. 2009).

⁸¹ See *id.*

⁸² *United States Gypsum Co. v. Lafarge N. Am. Inc.*, 670 F. Supp. 2d 737, 747 (N.D. Ill. 2009).

⁸³ See *Ricoh*, 2010 U.S. Dist. LEXIS 27301, at *28–29.

expert recommended.⁸⁴ Because the jury adopted a lower figure, the judge determined that even if the patentee had failed to support its view, he would not say that there was “no rational connection between the award and the evidence.”⁸⁵

Similarly, the District of Minnesota, despite being “initially troubled” by a jury’s damages verdict it declared “certainly generous,” has upheld a damages determination because it had “sufficient basis in the evidence at trial” and did not “reflect a miscarriage of justice.”⁸⁶ Faced with evidence that the damages may exceed the cost of a non-infringing alternative, the court reasoned that “a reasonable jury . . . could have disregarded this proposed non-infringing alternative.”⁸⁷

And, the Northern District of Ohio has upheld a jury’s damages award that was outside the range established by the parties’ experts.⁸⁸ In that case, both parties’ experts agreed that 4% was a reasonable royalty for a hypothetical licensing agreement between two willing parties.⁸⁹ The plaintiff’s expert, however, emphasized that the plaintiff licensor was “not anxious to grant a license,” and the jury decided on damages exceeding a 4% reasonable royalty.⁹⁰ The court upheld the award, concluding that “when supported by the evidence, a jury may rightfully award damages . . . in excess of any amount advocated by either party.”⁹¹

Posttrial Relief and the Issue of On-Going Royalties

Injunctions

As noted above, the Constitution grants Congress the power “to promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries.”⁹²

Congress has exercised that power, and the Patent Act expressly provides for the granting of a permanent injunction to a successful patentee: “The several courts having jurisdiction of cases under this title may grant injunctions in accordance with the principles of equity to prevent the violation of any right secured by patent, on such terms as the court deems reasonable.”⁹³

In *eBay Inc. v. MercExchange, LLC*, the United States Supreme Court took up the issue of the standard that should govern when injunctions are issued in patent cases.⁹⁴ The Court rejected the Federal Circuit’s “general rule that courts will issue permanent injunctions against patent infringement absent exceptional circumstances,” and held that the patentee must satisfy the same four-factor test applied in other injunction contexts by showing: (1) irreparable injury; (2) that the remedies available at law are inadequate to compensate for that injury; (3) that the balance of hardships between the plaintiff and defendant favors an injunction; and (4) the public interest would not be disserved by issuance of an injunction.⁹⁵

⁸⁴ See *id.*

⁸⁵ *Id.*

⁸⁶ *SpectraLytics, Inc. v. Cordis Corp.*, 650 F. Supp. 2d 900, 907–08 (D. Minn. 2009), *aff’d in part, remanded on other grounds*, 2011 U.S. App. LEXIS 11981 (Fed. Cir. June 13, 2011).

⁸⁷ *Id.*

⁸⁸ See *Bendix Commercial Vehicle, Sys., LLC v. Haldex Brake Prod. Corp.*, No. 1:09 CV 176, 2011 U.S. Dist. LEXIS 138, at *6–7 (N.D. Ohio Jan. 3, 2011).

⁸⁹ See *id.* at *4.

⁹⁰ *Id.* at *6–7.

⁹¹ *Id.* at *5; *Cf., e.g., Lucent*, 580 F.3d at 1332 (refusing to uphold jury’s damages in part because the jury did not choose “a damages award somewhere between maximum and minimum lump-sum amounts advocated by the opposing parties.”); *Fuji Photo Film Co. v. Jazx Photo Corp.*, 394 F.3d 1368, 1378 (Fed. Cir. 2005) (“[T]he jury is not bound to accept a rate proffered by one party’s expert but rather may choose an intermediate royalty rate.”).

⁹² U.S. CONST. art. 1, § 8.

⁹³ 35 U.S.C. § 283.

⁹⁴ See *eBay Inc. v. MercExchange, LLC*, 547 U.S. 388 (2006).

⁹⁵ *Id.* at 391, 393–94.

The majority opinion, however, did not provide any guidance with respect to the weight, if any, that should be given to the previously accepted concept that patents are a property right, which generally should be protected by the right to exclude. This led to two concurring opinions, addressed in Chapter V, which, directly or indirectly, address that question.^{96 97}

Of course, in some instances injunctions remain appropriate. For example, in *Robert Bosch, LLC v. Pylon Manufacturing Corp.*,⁹⁸ the Federal Circuit held that it was an abuse of discretion for the court to decline to award injunctive relief where: (1) the parties were direct competitors; (2) there was a loss of market share and potential customers; and (3) due to financial problems, the infringer might not be able to satisfy a monetary judgment.⁹⁹ The International Trade Commission also continues to grant injunctions, as it does not have the power to award damages and is not bound by the *eBay* factors.

Alternatives to Injunctions

Prior to the Supreme Court's ruling in *eBay*, courts routinely granted injunctions to successful patentees; therefore, there rarely existed a need to determine what remedy was appropriate for post-judgment infringement. Post-*eBay*, determinations regarding ongoing infringement absent an injunction have become important.

Where an injunction is not granted, courts can simply do nothing and await any future suit for further infringement. This approach, however, undoubtedly presents efficiency concerns for the parties and the courts. As such, the issue has arisen whether courts can determine forward damages for ongoing infringement in the same suit. The Federal Circuit has held that “[u]nder some circumstances, awarding an ongoing royalty for patent infringement in lieu of an injunction may be appropriate.”¹⁰⁰ For example, in *ActiveVideo Networks, Inc. v. Verizon Communications, Inc.*, the Federal Circuit concluded that the district court erred in finding money damages inadequate to compensate for the infringement, as the patent holder had engaged in extensive licensing and licensing efforts, had solicited the defendant for a license over a long period of time preceding and during litigation, and there was no direct competition between plaintiff and defendant.¹⁰¹ The Federal Circuit concluded that plaintiff was entitled to an ongoing royalty: “ActiveVideo’s loss of revenue due to Verizon’s infringement can be adequately remedied by an ongoing royalty from Verizon for each of its subscribers. This is what ActiveVideo has sought from Verizon since 2004, and based on the infringement determinations ActiveVideo is certainly entitled to it.”¹⁰²

The Federal Circuit has also held that “[t]here is a fundamental difference, however, between a reasonable royalty for pre-verdict infringement and damages for post-verdict infringement.”¹⁰³ As a result of the Federal Circuit’s limited guidance, various mechanisms for dealing with ongoing royalties in lieu of a permanent injunction have been utilized by district courts, with no common approach having yet been adopted.¹⁰⁴ For instance, may parties ask the jury to determine a fully paid up lump sum to account for future infringement, or must the issue of ongoing infringement absent an injunction be dealt with via an ongoing running royalty? If the jury is permitted to award a lump sum, how should such a lump sum properly be determined?

⁹⁶ See *infra*, Chapter V.A.

⁹⁷ *Id.* at 394–95 (Roberts, J., concurring); *id.* at 395–97 (Kennedy, J., concurring); see also *Apple, Inc. v. Motorola, Inc.*, 869 F. Supp. 2d 901 (N.D. Ill. June 22, 2012), *rev’d*, 2014 WL 1646435 (Fed. Cir. April 25, 2014).

⁹⁸ *Robert Bosch, LLC v. Pylon Mfg. Corp.*, 659 F.3d 1142 (Fed. Cir. 2011).

⁹⁹ See *id.* at 1152–55.

¹⁰⁰ *Paice LLC v. Toyota Motor Corp.*, 504 F.3d 1293, 1314 (Fed. Cir. 2007).

¹⁰¹ See *ActiveVideo Networks, Inc. v. Verizon Comm’n, Inc.*, 694 F.3d 1312, 1339–40 (Fed. Cir. 2012).

¹⁰² *Id.* at 1340.

¹⁰³ *Amado v. Microsoft Corp.*, 517 F.3d 1353, 1361 (Fed. Cir. 2008).

¹⁰⁴ See, e.g., *Sovereign Software LLC v. J.C. Penney Corp., Inc.*, 899 F. Supp. 2d 574, 589–90 (E.D. Tex. 2012) (applying a 2.5x enhancement to the jury’s implied royalty rate for ongoing royalties).

*Attorneys' Fees and Fee Shifting*¹⁰⁵

The guidelines provided in Chapter V are intended to give greater clarity as to which litigation practices warrant shifting fees and costs pursuant to 35 U.S.C. § 285.¹⁰⁶ When there is clarity around the practices that are unacceptable, these practices appear less attractive to litigants, and consequently, the victims of such practices will be more readily made whole when claims and defenses are nonetheless improperly pursued.

The perceived need for enhanced clarity in this domain arises from the economics of patent litigation. The inherent complexity of a patent case necessarily makes its prosecution or defense a costly undertaking. As a result, there is an ever-present opportunity for both plaintiffs and defendants to arbitrage the cost of litigation into a settlement that is inconsistent with the merits of the claim or defense. Thus, for example, the AIPLA's biennial survey of litigation costs reports that the 2011 median cost through appeal of a patent lawsuit involving \$1–\$25 million was \$2.5 million. For a patent lawsuit involving more than \$25 million, the 2011 median cost through appeal was \$5.5 million.¹⁰⁷

Absent a meaningful fee shifting remedy, a litigant faced with an adversary's meritless claims or defenses has three options, all of them bad:

1. capitulate, and pay a negotiated ransom to avoid the cost of abusive litigation;
2. fight through an adversary's abusive conduct, and pay the price of abusive litigation directly in unnecessary attorneys' fees; or
3. retaliate in kind, thereby escalating the level of pointless costs by imposing them in both directions.

The only way to shortcut this spiral of futility is to remove the financial incentives that make abusive pursuit of meritless litigation a rational option. That necessarily means shifting the cost of abusively imposed litigation expense to the instigator.

The mechanism for fee shifting is explicit in the statute's recognition that "[t]he court in exceptional cases may award attorney fees to the prevailing party."¹⁰⁸ Such fee shifting, however, is rarely employed. In April 2014, the U.S. Supreme Court lowered the "exceptional" case standard for prevailing parties to collect attorneys' fees from the Federal Circuit's former "objectively and subjectively baseless" standard to one that covers litigation practices that "stand[] out from others with respect to the substantive strength of a party's litigating position (considering both the governing law and facts of the case) or the unreasonable manner in which the case was litigated."¹⁰⁹

Proposed legislation has been recently introduced to address these issues, such as the House bill entitled "Saving High-Tech Innovators from Egregious Legal Disputes Act," or "SHIELD," which proposed a fee-shifting provision that would apply to any party "alleging the infringement of [a] patent" in the software or computer hardware field.¹¹⁰ Most recently, for example, the House Judiciary Committee approved H.R. 3309, the "Innovation Act" introduced by Chairman Bob Goodlatte (R-Va.), that includes an attorney fee-shifting provision for patent cases, which would award reasonable fees and expenses to a prevailing party "unless the court finds that the position and conduct of the nonprevailing party or parties were reasonably justified in law

¹⁰⁵ This paper does not address willful patent infringement or the potential enhanced damages and attorneys' fees recoverable after such a finding.

¹⁰⁶ See *infra*, Chapter V.C.

¹⁰⁷ See AM. INTELLECTUAL PROP. LAW ASS'N, REPORT OF THE ECONOMIC SURVEY 2011 (2011).

¹⁰⁸ 35 U.S.C. § 285.

¹⁰⁹ See *Octane Fitness, LLC v. Icon Health & Fitness, Inc.*, 134 S.Ct. 1749, 1756 (2014).

¹¹⁰ Saving High-Tech Innovators from Egregious Legal Disputes Act of 2012, H.R. 6245, 112th Cong. (2012) ("Notwithstanding section 285, in an action disputing the validity or alleging the infringement of a computer hardware or software patent, upon making a determination that the party alleging the infringement of the patent did not have a reasonable likelihood of succeeding, the court may award the recovery of full costs to the prevailing party, including reasonable attorney's fees, other than the United States.").

and fact or that special circumstances (such as severe economic hardship to a named inventor) make an award unjust.”¹¹¹

The Working Group believes that providing more concrete guidance as to what behavior is not reasonably justified—thereby attaching greater potential monetary risk to its pursuit—will make such behavior less tactically beneficial and, as a result, less common. At a minimum, it is hoped that such guidance will give a meaningful remedy to the victims of such conduct.

¹¹¹ Innovation Act, H.R. 3309, 113th Cong. (2013); *see also* Patent Abuse Reduction Act of 2013, S. 1013, 113th Cong. (2013).

II. Principles for the Royalty Paradigm

Principle II-1: *The reasonable royalty in patent infringement matters should fairly compensate the patent holder for the actual use made by the infringer of the patented invention and should be determined by considering what fully informed and reasonable persons in the position of the patent owner (or owners throughout the period of infringement) and the infringer would agree to at the time of trial as a fair price for the use of the patented invention, from the time of first infringement through the time of trial, taking into account all relevant facts and circumstances occurring before or during that period.*

Comment

The Working Group discussed three approaches to the overall reasonable royalty paradigm:

1. The status quo—a hypothetical negotiation at the time of first infringement using only facts available at that time, except for certain future facts that may be taken into account under the “book of wisdom” principle;¹¹²
2. A strict “Prospective Only” model—a hypothetical negotiation at the time of first infringement, using only facts known at that time, and eliminating altogether the book of wisdom exception; and
3. A new “Retrospective” Model—taking into account not only facts available at the time of first infringement but all facts available through the time of trial, eliminating any need for the book of wisdom exception.

The Working Group has determined that the third approach is the most consistent with both the statutory damages provision and sound economic principles. Key reasons for this decision are as follows:

- Due to the amorphous nature of the book of wisdom principle, the status quo approach is seriously flawed. As practitioners appreciate, there are few references to the book of wisdom in the case law, and of those, none provide clear guidance as to the nature and extent to which future facts and circumstances may be taken into account when assessing the appropriate reasonable royalty. The parties and their experts, therefore, cannot reasonably predict what facts they will be permitted to rely upon at trial, and the district court has little help when making its decision. As a result, parties on both sides attempt to “cherry-pick” from the future facts favorable to their case, and omit mention of any future developments that are unfavorable. There is no legal or economic principle that justifies this result. Moreover, the (largely) prospective nature of the status quo approach tends to be applied exclusively to the assessment of the appropriate royalty rate, and not at all to the assessment of the appropriate base to which the royalty rate is to be applied. That is, once the royalty rate of the hypothetical negotiation is determined, it is applied to the actual numbers of units sold from the time of first infringement through trial. These actual units clearly encompass facts not known to the parties at the time of the negotiation, and in many cases, facts not even predictable. Thus, there is a mix-and-match aspect to the status quo approach that is arguably inconsistent.
- The strict prospective model was analyzed extensively. The advantage of this model is that it provides predictability and is consistent with the status quo principle of determining the reasonable royalty at the time of first infringement. That is, if the hypothetical negotiation is placed at the time of first infringement, facts not then available to the parties should not be

¹¹² For a description of the “book of wisdom” principle, *see supra* note 21.

considered. Allowing consideration of such facts to enter into the negotiation (via the book of wisdom or otherwise) is a clear departure from, and perhaps an erosion of, the principle. While appealing, the Working Group recognized that a rigid prospective model may be at odds with the overriding mandate of the damages statute: to adequately compensate the patent owner for the use made of the invention by the infringer. For example, after the date of first infringement, a key fact may change so as to cause the infringement to be much more detrimental to the patent owner or so as to cause the patent rights to be far more valuable than appeared to be the case earlier. In such instances, the prospective only model would not yield damages adequate to compensate the patent owner for the infringement. Conversely, if after the date of first infringement, a key fact changed such that the patent rights were less valuable to the owner and the infringer, ignoring that fact results in overcompensation to the patent owner and an unfair penalty to the infringer. It was this potential for unfair results that was the catalyst for the creation of the book of wisdom exception to the prospective model in the first instance.

- The Working Group believes that the Retrospective Model is the most economically sound approach that both accomplishes the goals of the patent damages statute and also is consistent with the economic principles governing patent valuation. Taking all facts known through the time of trial into account eliminates the potential for unfairness in the prospective model without introducing the cherry-picking and uncertainty that the book of wisdom imported into that model. Moving the hypothetical negotiation later in time, however, to a time at or near the time of trial has potential infirmities as well. Specifically, it could lead to a higher (and potentially unfair) royalty due to what are commonly known as “lock in” effects.¹¹³ As discussed below, the Working Group endorsement of the Retrospective Model incorporates a methodology to avoid this potential problem. With that methodology in place, the Retrospective Model can achieve the full purposes of the statute—adequate compensation to the patent owner—without unfairness to either party.

The Working Group’s Retrospective Model states:

The royalty shall be determined by considering what (a) fully informed and (b) reasonable persons (c) in the position of the patent owner or owners throughout the period of infringement and the infringer would agree to at the time of trial as a fair price for the license, taking into account (d) all relevant facts and circumstances occurring before or during that period.

Detailed application of the hypothetical negotiation is discussed in succeeding sections of this report, but the general principles are set out here:

- a. “Fully informed” means a licensor and licensee who both know all relevant facts available to them, not just the facts actually known to the individuals at the plaintiff and defendant entities at the relevant times.
- b. “Reasonable persons” means hypothetical negotiators in the place of the actual plaintiff and defendant, applying an objective, not a subjective, determination. The hypothetical negotiators must be assumed to behave like reasonable business people would under the circumstances.

¹¹³ The “lock in” effects are drawing significant attention in the context of fair, reasonable, and non-discriminatory (FRAND) licensing because “one of the primary purposes of the [F]RAND commitment is to avoid patent hold-up, which occurs when the holder of a standard-essential patent demands excess royalties after standard implementers are already locked into using the standard.” *In re Innovatio IP Ventures, LLC Patent Litig.*, No. 1:11-CV-9308, 2013 WL 5593609, at *8–*9 (N.D. Ill. Oct. 3, 2013); see *Microsoft Corp. v. Motorola, Inc.*, No. C10-1823JLR, 2013 WL 2111217, at *10 (W.D. Wash., Apr. 25, 2013); see also, *infra*, Chapter II, Principle II-7 and accompanying commentary.

- c. “[What] the patent owner or owners throughout the period of infringement and the infringer would agree to” means that the hypothetical reasonable person will bargain in light of the actual circumstances of the patent owner(s) and the defendant(s), and the actual context of the market for the invention and products or processes using the invention at the relevant times.
- d. “All relevant facts and circumstances” include the factors listed in *Georgia-Pacific* (to the extent relevant) and any other factors relevant to the particular case being litigated, for example:
- (i) the relative bargaining power of the patent owner and the accused infringer throughout the period of infringement, including their positions in the market for the accused processes and/or products;
 - (ii) the importance of the accused product or process to the business of the defendant(s);
 - (iii) the actual financial position of the patent owner(s) and the accused infringer(s) throughout the period of infringement;
 - (iv) the terms of comparable licenses, if any;
 - (v) industry practices in license structures and amounts, for example, whether it is industry practice to pay lump sum royalties, or to pay a set amount per unit rather than a rate-times-a-base price;
 - (vi) if the appropriate license structure is a rate-times-a-base, what is the appropriate base? That is, how much of the value of the accused product or process is attributable to the claimed invention?;
 - (vii) past practice of patent owner(s) and defendant(s) in license structure and amounts;
 - (viii) what licenses has the patent owner already given on this technology and will this hypothetical license impair any of them? Are there most favored nations clauses in existing licenses that must be respected? Has the patent owner already given an exclusive license in the field in which the defendant is practicing the invention?;
 - (ix) royalty stacking, if any;
 - (x) non-infringing alternative design, or “design around,” possibilities, including their cost, technical and commercial feasibility, and time to develop;
 - (xi) how the royalty under the hypothetical license would fit into an appropriate cost and profit structure for the defendant(s).

If any of the relevant factors changed materially during the period from the time of first infringement to the time of trial, two different royalty rates might apply—one to the period before the material change, and one to the period after—rather than one rate for the entire period.

Principle II-2: The entire market value of the accused product should only be used as the royalty base for the reasonable royalty determination when the patented aspect(s) of the product is (are) shown to form the basis or substantially all of the basis for consumer demand. The evidence to be considered may include evidence of consumer demand any time prior to trial.

Comment

The entire market value rule (EMVR) allows patent infringement damages to be based on the full market value of the product or process sold in certain circumstances. It originated as a doctrine applicable only to a lost profits analysis but in recent years also has been applied to the reasonable royalty analysis.

The principle articulated above allows for application of the EMVR in the reasonable royalty context, just as it applies in the lost profits context,¹¹⁴ but at the same time avoids the concerns that have been lodged against using the EMVR in the reasonable royalty context, such as those expressed by the FTC, which has commented:

Courts should eliminate the entire market value rule and the question of whether the patented feature was the “basis for customer demand” from the determination of the appropriate base in a reasonable royalty damages calculation. It is irrelevant and it risks injecting significant confusion that threatens to produce inaccurate awards.¹¹⁵

Because many infringement cases involve accused products or processes having features unrelated to the patent-in-suit or which are successful in part for reasons unrelated to the patented feature or method, there is consensus among the Working Group that in the reasonable royalty context, a royalty may be applied to the entire market value of an accused product only in circumstances where the patented feature or method is the basis or substantially all of the basis for demand of the product.¹¹⁶ In cases involving accused products with many (in some cases, as many as hundreds or thousands) of components and inventions, it is unlikely that any one patented feature or method will provide the basis or substantially all of the basis for the demand for the product.

In determining whether a royalty may be applied to the entire market value of an accused product, courts, experts, and parties must exercise diligence to ensure that the appropriate question is asked: Is the patented feature the sole basis or substantially all of the basis for customer demand? For example, it is not sufficient merely to establish, whether through expert or documentary evidence, that “but for” that feature or method a consumer would not purchase the product. In most circumstances involving complex products, there are several “but for” features and/or methods without which there would be no consumer demand. If there is more than one “but for” feature or method, then a royalty should not be applied to the entire market value of an accused product.

In making this determination, courts, experts, and parties also must guard against the tendency to assume away the basic functionality of an accused product or process. Consider the following example: the asserted patent claims a new method of security for routers. The accused infringer’s internal documentation states that consumers would not buy the accused routers if they were not secure. The patent holder conducts a survey asking whether security is important in the decision to purchase a router, and whether security was the

¹¹⁴ See, e.g., *Rite-Hite Corp. v. Kelley Co.*, 56 F.3d 1538, 1549 (Fed. Cir. 1995) (*en banc*) (“When a patentee seeks damages on unpatented components sold with a patented apparatus, courts have applied a formulation known as the ‘entire market value rule’ to determine whether such components should be included in the damage computation, whether for reasonable royalty purposes, . . . or for lost profits purposes . . .”).

¹¹⁵ FED. TRADE COMM’N, THE EVOLVING IP MARKETPLACE: ALIGNING PATENT NOTICE AND REMEDIES WITH COMPETITION, at 25, 211 (2011), available at <http://www.ftc.gov/os/2011/03/110307patentreport.pdf> [hereinafter *FTC Report*].

¹¹⁶ Although not discussed in the text, the entire market value rule also allows for damages based on the entire market value of an accused product where: (i) the infringing and non-infringing components are sold together so that they constitute a functional unit or are parts of a complete machine or single assembly of parts; or (ii) the infringing and non-infringing components are analogous to a single functioning unit. See *Rite-Hite*, 56 F.3d at 1549–50 (Fed. Cir. 1995) (*en banc*); *Cornell Univ. v. Hewlett-Packard Co.*, 609 F. Supp. 2d 279, 286–87 (N.D.N.Y. 2009) (Rader, J., sitting by designation).

basis for the purchase. The respondents universally responded that security is their top priority in deciding which router to purchase, and that they purchased the accused routers because they were secure. For EMVR purposes, the internal documentation and the survey are focused incorrectly—they remove from consideration whether the device in question has all of the various features that provide for basic router functionality in the first place. The proper threshold EMVR question is whether security is the feature—among all product features including the routing features—that drives consumer demand. Security may be very important, but presumably, a consumer would not buy a secure router that did not properly forward data from one network to another.

Moreover, it is important to distinguish the claimed invention from a general characterization of the feature to which the invention pertains. Taking the above example, it is important to determine whether the particular security method claimed in the asserted patent was the basis for consumer demand, as opposed to other non-infringing security methods. That is, did consumers purchase the accused router because of the particular security method employed to secure the router's data transmissions? This might be the case, or consumers may have purchased the accused router simply because it was secure, irrespective of the particular security method. Furthermore, the asserted security method may be a subset of numerous other technologies encompassed in accused router's security technology, which may suggest that no one patent is responsible for the demand for the security feature.

Notwithstanding the foregoing, it may be appropriate under certain circumstances to use the entire market value of the accused product even in the absence of satisfying the EMVR test articulated as Principle II-2. For example, there may be an established practice whereby the entire market value of a product is used as the royalty base in bona fide license agreements licensing the patented technology for use in products analogous to the accused products. In such a case, it may be appropriate to use the entire market value of the accused products as the royalty base and the concomitant royalty rate provided for in the bona fide comparable licenses, rather than to apportion the entire market value of the accused products and adjust the industry license rate(s) or risk rendering the bona fide licenses non-comparable.¹¹⁷ Such an approach would be supported by *Georgia-Pacific* factor 1 (the royalties received by the patent owner for the licensing of the patent-in-suit, proving or tending to prove an established royalty).

Ultimately, it is the responsibility of the court to address whether the EMVR is satisfied prior to trial. If the patent holder cannot establish that the patented invention is the sole basis or substantially all of the basis for consumer demand (or whose only evidence of this is of the type of improper evidence discussed above), then the royalty base must be properly apportioned, and the patentee should not be permitted to rely upon the EMVR or present a royalty based upon the entire market value of the accused products or services.

Principle II-3: Where the entire market value rule does not apply, it is necessary to apportion the revenue associated with the infringing product between its patented and unpatented features. In so doing, it may be appropriate to consider the smallest saleable unit containing the feature or embodying the patented method for use as the apportioned royalty base. The evidence to be considered in assessing apportionment may relate to any time period prior to trial.

Comment

This principle recognizes that where the EMVR does not apply due to a finding that the patented feature does not form the requisite basis for customer demand, it is important when determining the base, to allocate the portion of the value of the product that is the result of the patented feature. A reasonable royalty should be based on the incremental value the patented invention adds to the overall product or service; i.e., “[t]he portion of the realizable profit that should be credited to the invention as distinguished from non-patented

¹¹⁷ See, e.g., *Mondis*, 2011 WL 2417367 at *2–*3 (denying motion to strike use of EMVR notwithstanding failure to meet the EMVR test because comparable licenses used the entire market value as the royalty base).

elements, the manufacturing process, business risks, or significant features or improvements added by the infringer.”¹¹⁸ Other product features, as well as other factors (e.g., product marketing, the goodwill associated with the entity making or selling the product or service, the sales team, the sales model, and the availability and type of additional products, services or support available from the entity) may contribute to the revenue of a particular product or service.

Ideally, apportionment isolates the patented feature from other features and factors that contribute to the patented product or service’s value. There are a number of potential starting points for determining the appropriate royalty base. In some circumstances, the best starting point will be the smallest saleable unit containing or utilizing the patented invention.¹¹⁹ In other circumstances, the most appropriate starting point will be the incremental difference in value between a product containing or utilizing the patented invention and a similar product that does not include or utilize the patented invention. In yet other circumstances, the right starting point will be the amount paid for the component that includes or utilizes the patented invention.

Irrespective of which starting point is used, the objective of the court, experts, and parties involved is to apportion the royalty base as closely as possible to reflect the incremental value attributable to the patented invention. Stated differently, the starting point may not be the end point of the analysis. Taking the smallest saleable unit as an example, it may be necessary to further apportion below the smallest saleable unit starting point.¹²⁰

Additionally, the fact that patent claims may be expressed in different formats, and of different scope, does not allow the patent owner to avoid apportionment.¹²¹ A patent, for example, may be claimed as a combination of a known apparatus or method in combination with additional elements or steps that constitute the improvement, or it may be claimed in a format where the improvement is explicitly recited (known as a “Jepson” claim). As the FTC put it:

Another artificial construct for identifying the base that courts should reject is always to equate it with the device recited in the infringed claim. In many cases, there will be an easy correspondence between the inventive feature, the device recited in the infringed claim, and the appropriate base. In other cases, the correspondence will not be so clear. For example, a software invention for rendering video images can be recited in a claim covering video software, or in a claim covering a standard personal computer running the video software . . . “[T]he real focus ought to be on the economic realities and not the vagaries of claim drafting,” particularly because “the way claims are drafted [is] . . . so manipulable.”¹²²

In determining how to properly apportion the royalty base, the focus should be on the point of novelty of the patented invention and not on how that invention is claimed.

¹¹⁸ *Garretson v. Clark*, 111 U.S. 120, 121 (1884) (noting that the patentee “must in every case give evidence tending to separate or apportion the defendant’s profits and the patentee’s damages between the patented feature and the unpatented features”); *Georgia-Pacific*, 318 F. Supp. at 1120.

¹¹⁹ See, e.g., *Cornell Univ.*, 609 F. Supp. 2d at 288.

¹²⁰ See, e.g., *Rembrandt Social Media, LP v. Facebook, Inc.*, 1:13-CV-158, 2013 WL 6327852, *5–6 (E.D. Va. Dec. 3, 2013); *Dynetix Design Solutions, Inc. v. Synopsis, Inc.*, C 11-05973 PSG, 2013 WL 4538210, at *3–4 (N.D. Cal. Aug. 22, 2013); *AVM Techs., LLC v. Intel Corp.*, CIV.A. 10-610-RGA, 2013 WL 126233, at *3 (D. Del. Jan. 4, 2013). Cf. *Internet Machines LLC v. Alienvare Corp.*, 6:10-CV-23, 2013 WL 4056282, at *13 (E.D. Tex. June 19, 2013) (“Because [the damages expert] used the smallest salable unit as his royalty base, additional apportionment is unwarranted . . .”).

¹²¹ *Egry Register Co. v. Standard Register Co.*, 23 F.2d 438, 440 (6th Cir. 1928) (“[The patent owner] cannot, by the language which his claims happen to take, transform his invention of an improvement in an existing structure into one of a complete structure, as if it were wholly new, so as to entitle him to profits upon these parts of it which are not in any fair sense his invention.”).

¹²² *FTC Report*, *supra* note 115, at 211.

Principle II-4: Where the accused product incorporates multiple technologies, once the proper royalty base has been determined, the reasonable royalty rate should reflect the relative contribution of the patented invention as compared to the other technologies incorporated into the royalty base. All technologies incorporated into the royalty base prior to trial should be considered. This approach should help to alleviate the problem often referred to as royalty stacking.

Comment

A product, especially a complex product, can, and often does, embody multiple different patents. Many electronic devices, including computers and tablets, as well as most software, and even certain pharmaceutical products, involve hundreds or even thousands of patents. For example, it is estimated that the 3G CDMA wireless standard involves nearly 1000 different patents and thus, 3G wireless handsets often involve large numbers of patents. The presence of royalty stacking, i.e., when multiple patents read on a single product, exacerbates the complexities of calculating a reasonable royalty. Ignoring the effects of royalty stacking may lead to an overestimation of actual patent damages and to overcompensation of the patent holder.¹²³ The Federal Circuit noted in *Integra Lifesciences I, Ltd. v. Merck KGaA*, that “[t]he cumulative effect of such stacking royalties can be substantial” and should play a role in determining patent damages.¹²⁴ Accordingly, with respect to a product in which multiple patents are potentially at issue, the reasonable royalty calculus should account for such royalty stacking.

A simple example helps illustrate the issue of royalty stacking. In a product covered by 25 different patents, assuming each were of equal value, if each patentee were awarded a 5% royalty, more than the entire revenue of the product is taken just to compensate for intellectual property rights.

From an end-results perspective, a royalty stacking-based calculation should arrive at the same conclusion as any other reasonable royalty calculation; namely, a stacking methodology seeks to reasonably attribute the contribution of the patent(s)-in-suit to the overall value of the product at issue. In short, patents covering a small component or feature of a larger invention should command a lower royalty rate than patents covering the whole product.

Recognizing the importance of stacking is particularly meaningful when assessing comparable licenses. In situations where royalty stacking is in play, analysis of comparable product licenses must recognize the contribution of the patent-at-issue to the overall contribution of value to the product-at-issue. Stated differently, in evaluating licenses, it is important not to confuse the notion of comparable licenses with respect to a given type of *product* with comparable licenses regarding a given *technology*. Thus, licenses that “stack” onto one product should be relevant and admissible even if not directly comparable.

Accounting for royalty stacking in assessing the reasonable royalty is easier said than done, however, given the amount and type of evidence that would be required at trial to elucidate the non-asserted patents that may read on the accused product(s). In a multi-featured product, courts have endorsed various ways of determining the value of the patented features, such as through the use of surveys, conjoint analysis, hedonic regression, or other analytical methods that suit the circumstances. Such evidence relating to non-asserted patents will complicate the trial but is necessary to arrive at a reasonable royalty. The party arguing that stacking is a concern should come forward with other licenses or royalty demands on the product-in-suit. Allegations of stacking without such evidence would require proving other patents read on the product at issue where no license was sought, and is too speculative. Such proof would result in a patent trial within a patent trial and would quickly become unmanageable.

¹²³ It should also be noted that while many commentators consider royalty stacking to be a significant concern, there are also several studies suggesting that royalty stacking may not be such a serious problem, or at least that its effect is not borne out in empirical studies. For instance, a 2008 article reviewed empirical literature from four separate industries—semiconductor, software, biomedical, and mobile phone—and concluded that royalty stacking was neither common nor costly enough to warrant policy changes at the litigation stage. Rather, the studies suggested that any potential harm was better handled through *ex ante* licensing strategies. See Damien Geradin et al., *The Complements Problem Within Standard Setting: The Evidence on Royalty Stacking*, 14 B.U. J. Sci. & Tech. L. 144, 145 (2008).

¹²⁴ *Integra Lifesciences I, Ltd. v. Merck KGaA*, 331 F.3d 860, 871–72 (Fed. Cir. 2003), *rev'd on other grounds*.

Principle II-5: A reasonable royalty must reflect the extent to which, throughout the period of infringement, the patented invention has represented an improvement over available alternatives at the time of infringement, including the prior art. A royalty which over- or under-values the inventive contribution of the patent claim is not reasonable.

Comment

The reasonable royalty should compensate the patent owner for the claimed invention's incremental improvement over the prior art or the next best commercially acceptable non-infringing alternative, if such alternative exists. This notion is consistent with economic theory in that the value of an asset is limited to the economic benefit that can be obtained from using the asset vis-à-vis that which can be obtained by using the next best available alternative. It is the incremental economic benefit over that which can be earned using the next best alternative that determines the economic value of the patented invention, and thus the royalty the owner can obtain in the market for the use of that patented invention.

The principle that damages due a patent owner should be commensurate with the incremental economic contribution afforded by the claimed invention(s) was recognized in *Grain Processing Corp. v. American Maize Products*, in which the Federal Circuit held that “only by comparing the patented invention to its next-best available alternative(s)—regardless of whether the alternative(s) were actually produced and sold during the infringement—can the court discern the market value of the patent owner's exclusive right, and therefore his expected profit or reward, had the infringer's activities not prevented him from taking full economic advantage of this right.”¹²⁵

A conceptual problem may arise when the claimed invention is comprised of a combination of prior art elements. However, in such instances, it is the incremental functionality enabled by the unique combination of prior art elements that comprises the novelty, which is then compared to the prior art for purposes of determining a reasonable royalty.

Even where the claimed invention is but one of multiple components or features within a larger apparatus and is shown to be the basis, or substantially all of the basis, of consumer demand for the entire apparatus as per the entire market value rule, the incremental value of what is contributed by the invention must be assessed. In such instances, the reasonable royalty appropriately should reflect the economic value associated with the entire market value of the apparatus, measured by the benefit of the apparatus containing the invention over the next best alternative to the apparatus.

¹²⁵ *Grain Processing Corp. v. American Maize Products Co.*, 185 F.3d 1341, 1351 (Fed. Cir. 1999).

Principle II-6: Three principles apply to the consideration of a non-infringing alternative design, or “design around,” in determining a reasonable royalty, as noted below:

Principle II-6(a): Evidence of a non-infringing design around that is technically and commercially feasible and available during the damages period is relevant to the reasonable royalty determination. A design around need not actually have been implemented in order to be considered, but must be raised during fact discovery to prevent expense, delay, and prejudice.

Principle II-6(b): In order to be considered a design around in the first instance, the proposed alternative design must be shown by a preponderance of the evidence not to infringe the asserted claims of the patent(s)-in-suit, and to be an acceptable substitute.

Principle II-6(c): On a proper showing, the total economic cost of the infringer’s next best available alternative may serve to cap the damages award.

Comment

Courts have long considered the availability of non-infringing alternatives to be well within the scope of information relevant to the determination of a reasonable royalty.¹²⁶ Indeed, it is often analyzed as a *Georgia-Pacific* factor.¹²⁷ Thus, under existing law, it is clear that a legitimate non-infringing design around alternative may be considered in the reasonable royalty analysis.

It is often the case, however, that conclusory assertions of available design arounds are made after the close of fact discovery through a damages expert during the expert discovery period. Such late and general assertions lead to *Daubert* motions, motions *in limine*, and/or evidentiary objections at trial that require the court to make an important evidentiary determination late in the proceedings, and with little information. Further, if the court permits the introduction of evidence of the late-identified design around, the patent holder may be at a distinct disadvantage. The patent holder may not be in a position to mount a persuasive challenge as to the technical or commercial merits of the asserted design around due to the lack of fact discovery, yet the argument that the asserted design around should limit the damages award may have appeal to the fact-finder. Not only is there uncertainty for both litigants and the court regarding the required timing and extent of the disclosure of any potential design around, the evidentiary standards regarding the admissibility of any asserted design around are also unclear.

In the context of lost profits, the initial burden is on the patent holder to show, *inter alia*, the absence of acceptable non-infringing alternatives. Once the absence of acceptable non-infringing alternatives is proven, the burden of proof shifts to the accused infringer, who must then prove that an acceptable non-infringing

¹²⁶ See, e.g., *Panduit Corp. v. Stablin Bros. Fibre Works, Inc.*, 575 F.2d 1152, 1159 (6th Cir. 1978); *Hughes Tool Co. v. G.W. Murphy Industries, Inc.*, 491 F.2d 923, 931 (5th Cir. 1973); *Smithkline Diagnostics, Inc. v. Helena Labs. Corp.*, No. B-83-10-CA, 1989 WL 418791, at *6 (E.D. Tex. June 30, 1989), *aff’d* 926 F.2d 1161 (Fed. Cir. 1991); see also *Radio Steel & Mfg. Co. v. MTD Prods., Inc.*, 788 F.2d 1554, 1557 (Fed. Cir. 1986); *Columbia Wire Co. v. Kokomo Steel & Wire Co.*, 194 F.108, 110 (7th Cir. 1911).

¹²⁷ *Georgia-Pacific*, 318 F. Supp. at 1120 (listing “the utility and advantages of the patent property over the old modes or devices, if any, that had been used for working out similar results,” as the ninth of fifteen evidentiary factors for determining a reasonable royalty); see also *i4i Ltd. P’ship v. Microsoft Corp.*, 598 F.3d 831 (Fed. Cir. 2010) (affirming admissibility of expert’s reliance on *Georgia-Pacific* factors in his reasonable royalty determination, including the lack of “acceptable non-infringing alternatives . . . at the time of the hypothetical negotiation”); *LaserDynamics, Inc. v. Quanta Computer, Inc.*, No. 2:06-cv-348, 2011 WL 197869, at *2 (E.D. Tex. Jan. 20, 2011); *Abbott Labs. v. Sandoz, Inc.*, 743 F. Supp. 2d 762, 773 (N.D. Ill. 2010).

alternative exists.¹²⁸ While the law as to who bears the initial and ultimate burden in the reasonable royalty context is not settled,¹²⁹ there is no reason for it to differ. That is, the patent holder should initially evaluate any non-infringing alternatives proffered by the accused infringer during discovery, and show why they are infringing and/or not acceptable substitutes. The burden should then shift to the accused infringer to prove that the proffered alternative is, in fact, non-infringing and acceptable so as to mitigate the potential damages award.

Common sense and economics both argue that, in general, it would be irrational for an accused infringer to pay more for a license to a patent than the total economic cost it would incur to implement its next best available alternative to the patented technology, inclusive of all of the costs associated with the implementation of that next best alternative (such costs would necessarily include any costs due to any inferiorities of the alternative as compared to the patented technology). In the real world, negotiators for patent licenses consider the alternatives to patent licenses, including achieving the goal of the patented technology in a manner that does not require a license.¹³⁰ So, too, goes the argument, should the hypothetical negotiators.¹³¹

This economic theory has become established in the consideration of a lost profits award. In *Grain Processing Corp. v. American Maize Products Co.*, the Federal Circuit held that the existence of a non-infringing alternative must be considered in reconstructing the “but for” world, and thus may cap or render unavailable a lost profits damages award.¹³² Although the Federal Circuit seemed poised to apply *Grain Processing* in the reasonable royalty context,¹³³ it declined the opportunity to do so in *Mars, Inc. v. Coin Acceptors, Inc.* In *Mars*, the accused infringer argued that “an infringer should not be required to pay more in reasonable royalties than it would have paid to avoid infringement in the first place by switching to an available non-infringing alternative.”¹³⁴

¹²⁸ See, e.g., *Zygo Corp. v. Wyko Corp.*, 79 F.3d 1563, 1571 (Fed. Cir. 1996) (noting that the plaintiff bears the burden on lost profit damages calculations, including the non-existence of a non-infringing alternative); *Smithkline Diagnostics, Inc. v. Helena Labs. Corp.*, 926 F.2d 1161, 1165 (Fed. Cir. 1991); *TWM Mfg. Co. v. Dura Corp.*, 789 F.2d 895, 901 (Fed. Cir. 1986); see also *Grain Processing*, 185 F.3d at 1354 (finding that a non-infringing alternative need not be on the market during the infringement period to factor into a lost profits analysis, but nonetheless, “[w]hen an alleged alternative is not on the market during the accounting period, a trial court may reasonably infer that it was not available as a non-infringing substitute at that time,” which means then that the burden then falls on the infringer to prove availability, and the fact-finder “must proceed with caution” in assessing that proof).

¹²⁹ See, e.g., *ResQNet.com*, 594 F.3d at 872 (“The district court seems to have been heavily influenced by Lansa’s decision to offer no expert testimony to counter Dr. David’s opinion. But it was ResQNet’s burden, not Lansa’s, to persuade the court with legally sufficient evidence regarding an appropriate reasonable royalty. As a matter of simple procedure, Lansa had no obligation to rebut until ResQNet met its burden with reliable and sufficient evidence. This court should not sustain a royalty award based on inapposite licenses simply because Lansa did not proffer an expert to rebut Dr. David.” (citing *Lucent*, 580 F.3d at 1329 (“Lucent had the burden to prove that the licenses were sufficiently comparable to support the lump sum damages award.”))); THE NAT’L JURY INSTRUCTION PROJECT, MODEL PATENT JURY INSTRUCTIONS 64–66 (2009), available at <http://www.nationaljuryinstructions.org/documents/NationalPatentJuryInstructions.pdf> (providing clear burden of proof on plaintiff for establishing lost profits damages, but listing a number of considerations for the jury in determining reasonable royalty damages, where the plaintiff did not establish lost profit damages for any or all of the accused products).

¹³⁰ See, e.g., C.W. Shifley, Commentary, *Alternatives to Patent Licenses: Real-World Considerations of Potential Licensees Are—and Should Be—a Part of the Courts’ Determinations of Reasonable Royalty Patent Damages*, 34 IDEA: J.L. & TECH. 1, 3 (1993). Mr. Shifley quotes George E. Frost, former patent counsel for General Motors, describing the real world process of negotiating a license royalty as necessitating a determination of the “increment of value”: “[W]e need to be sure that we don’t get into royalties that are more than what the alternative costs, because there’s no sense at all to pay more to use the patent including the royalty, . . . than it would cost to use the alternative.” *Id.*

¹³¹ See, e.g., *id.* at 2 (quoting commentator George E. Frost as saying “[t]he dollar disadvantage of going to the most practical non-infringing alternative in lieu of the patent product . . . places a ceiling on what any rational negotiator would . . . pay”).

¹³² See *Grain Processing*, 185 F.3d at 1350–51 (“[A] fair and accurate reconstruction of the ‘but for’ market also must take into account, where relevant, alternative actions the infringer foreseeably would have undertaken had he not infringed. Without the infringing product, a rational would-be infringer is likely to offer an acceptable non-infringing alternative, if available, to compete with the patent owner rather than leave the market altogether. The competitor in the ‘but for’ marketplace is hardly likely to surrender its complete market share when faced with a patent, if it can compete in some other lawful manner.”).

¹³³ See *Riles v. Shell Exploration & Prod. Co.*, 298 F.3d 1302, 1312 (Fed. Cir. 2002) (“The economic relationship between the patented method and non-infringing alternative methods, of necessity would limit the hypothetical negotiation.” (citing *Grain Processing*, 185 F.3d at 1347 (the difference in production costs between infringing and non-infringing products “effectively capped the reasonable royalty award”)); *Zygo*, 79 F.3d at 1571–72 (Fed. Cir. 1996) (vacating and remanding the district court’s damages determination where both lost profits and reasonable royalty failed to take into account non-infringing alternatives that would have given the alleged infringer a “stronger position to negotiate for a lower royalty rate”); see also *Micro Chemical, Inc. v. Lextron, Inc.*, 317 F.3d 1387, 1393 (Fed. Cir. 2003) (reserving judgment on “whether the holding of *Grain Processing* has applicability in the reasonable royalty context”).

¹³⁴ *Mars, Inc. v. Coin Acceptors, Inc.*, 527 F.3d 1359, 1373 (Fed. Cir. 2008).

The Federal Circuit rejected this argument, both because “there was no available and acceptable non-infringing alternative to which Coinco could have switched at the time of the hypothetical negotiation,” and because “it is wrong as a matter of law to claim that reasonable royalty damages are capped at the cost of implementing the cheapest available, acceptable, non-infringing alternative.”¹³⁵ Instead, the Federal Circuit stated, “[t]o the contrary, an infringer may be liable for damages, including reasonable royalty damages that exceed the amount that the infringer could have paid to avoid infringement.”¹³⁶ Although the *Mars* court rejected the notion that reasonable royalty damages are *always* capped by the cost of implementing a non-infringing alternative, it left open the possibility that reasonable royalty damages may be capped by such a cost in the appropriate circumstances.

In keeping with *Mars* and in an effort to move the law forward, the Working Group favors limiting the reasonable royalty award, in certain specific circumstances and upon a proper showing, to the aggregate cost associated with implementing a technically and commercially feasible non-infringing alternative in place of the accused instrumentality. Such a limitation is supported by economic theory,¹³⁷ and is consistent with the retrospective paradigm of the hypothetical negotiation articulated above.

The total economic cost to implement an available non-infringing alternative would include, for example, R&D expense, product development expense, any incremental manufacturing costs, and any foregone profits due to time-to-market considerations as well as changes in prices and market share.

However, to avoid undercompensating the patent holder, the court should require the litigants to follow certain best practices outlined below before allowing the accused infringer to present an argument that an asserted non-infringing design around alternative should cap the reasonable royalty award.

BEST PRACTICES

1. *The fact-finder should make the ultimate determination as to whether a proffered design around alternative is both non-infringing and acceptable by evaluating the evidence with the understanding that it is the accused infringer who bears the ultimate burden of establishing an acceptable design around by a preponderance of the evidence.*
2. *The proponent of a royalty cap based on the existence of a non-infringing design around alternative must provide competent, admissible evidence (subject to cross-examination) regarding:*
 - a. *All costs associated with implementation of the design around over the implementation of the accused instrumentality, measured at the time the accused instrumentality was in the planning stages, in other words, the additional amount it would have cost the accused infringer to have implemented the non-infringing design rather than the accused instrumentality, e.g., design and development costs (including any additional personnel costs), cost of*

¹³⁵ *Id.* Interestingly, the Federal Circuit did not cite or mention *Grain Processing* in the opinion.

¹³⁶ *Id.*; see also *Boeing Co. v. United States*, 86 Fed. Cl. 303, 319 n.14 (2009) (“The Federal Circuit recently rejected the argument that ‘reasonabl[e] royalty damages are capped at the cost of implementing the cheapest available, acceptable, non-infringing alternative.’”).

¹³⁷ See, e.g., Joan L. Eads, Commentary, *Does Grain Processing Apply in a Reasonable Royalty Damage Analysis?*, 10 No. 26 ANDREWS INTELL. PROP. REP. 13 (2004); ECONOMIC APPROACHES TO INTELLECTUAL PROPERTY 52–57 (Gregory K. Leonard & Lauren J. Stiroh eds., 2005); Nathaniel C. Love, Comment, *Nominal Reasonable Royalties for Patent Infringement*, 75 U. CHI. L. REV. 1749, 1757–66 (2008); Liane M. Peterson, *Grain Processing and Crystal Semiconductor: Use of Economic Methods in Damage Calculations Will Accurately Compensate For Patent Infringement*, 13 FED. CIRCUIT B.J. 41 (2003); John W. Schlicher, *Measuring Patent Damages by the Market Value of Inventions—The Grain Processing, Rite-Hite, and Aro Rules*, 82 J. PAT. & TRADEMARK OFF. SOC’Y 503 (2000); Christopher B. Seaman, *Reconsidering the Georgia-Pacific Standard for Reasonable Royalty Patent Damages*, 2010 BYU L. REV. 1661, 1711–26; John S. Torkelson, *Calculating Reasonable Royalty Damages for Infringement of Early-Stage Technology Patents*, 4 SEDONA CONF. J. 47, 56–57 (2003); see also *FTC Report*, *supra* note 115, at 160–76 (noting that where courts “reject, either implicitly or explicitly, a limitation based on the maximum amount a willing licensee would pay,” they “risk overcompensating patentees in litigation as compared to the market and creat[e] problems such as higher prices, increased patent speculation, and decreased innovation”).

materials, and costs associated with any required redesign of other components to accommodate the non-infringing design (including any licensing fees for implementing a third party's patented technology in the non-infringing design).

- b. All costs associated with the marketing and selling of the design around over the marketing and selling of the accused instrumentality, e.g., sales force training that would be required for the design around that was not required for the accused instrumentality.*
- c. The technical and commercial equivalence of the design around to consumers such that consumer demand for the design around would have been equivalent to the consumer demand for the accused instrumentality.*

Principle II-7: Where the technology claimed in the asserted patent is necessary to practice because (1) it is essential to a de facto standard or a standard adopted by a recognized standard setting organization (i.e., standard-essential); (2) a technically feasible non-infringing design around alternative is restricted or prohibited by government regulations or requirements; and/or (3) the technically feasible design around is cost-prohibitive, then the reasonable royalty should exclude any premium the patent may command solely resulting from the adoption of the standard or the governmental/commercial prohibitions on design modification. All standards adopted prior to trial may be considered.

Comment

As recognized by the court in *Microsoft Corp. v. Motorola, Inc.*, “when [a] standard becomes widely used, the holders of Standard Essential Patents (SEPs) obtain substantial leverage to demand more than the value of their specific patented technology. This is so even if there were equally good alternatives to that technology available when the original standard was adopted. After the standard is widely implemented, switching to those alternatives is either no longer viable or would be very costly.”¹³⁸ Many commentators have described patent holdup—i.e., the ability of SEP owners to demand more than the value of their patented technology, and to attempt to capture the value of the standard itself—as a serious factor in increased licensing rates or royalty calculations, which can result in overcompensation of patent holders.¹³⁹

Potential holdup or lock-in effects arise primarily in two scenarios. In the first, a patented component has become necessary to practice a technical standard. The technical standard may be one that was promulgated by a standard setting organization or it may simply be a standard that has arisen as the result of market forces (commonly referred to as a *de facto* standard).¹⁴⁰ The second holdup or lock-in scenario is presented when a technically feasible, non-infringing alternative exists for a component of a product, but that alternative cannot practically be incorporated into the product because the cost of redesign would be commercially prohibitive.

As indicated in the discussion above, when the Working Group selected the Retrospective Model for the application of patent damages, we recognized that a departure from this model would be required to address the problem of lock-in. That is, for patent infringement that does not involve lock-in and the concomitant potential for hold-up, the Retrospective Model places valuation of the patented technology at the time of trial.

¹³⁸ *Microsoft Corp. v. Motorola, Inc.*, No. C10-1823JLR, 2013 WL 2111217, at *10 (W.D. Wash., Apr. 25, 2013); see also *In re Innovatio IP Ventures*, 2013 WL 5593609, at *8–9, *40–41.

¹³⁹ See, e.g., Thomas F. Cotter, *Patent Holdup, Patent Remedies, and Antitrust Responses*, 34 J. CORP. L. 1151 (2009); Joseph Scott Miller, *Standard Setting, Patents, and Access Lock-In: RAND Licensing and the Theory of the Firm*, 40 IND. L. REV. 351 (2007); Mark A. Lemley & Carl Shapiro, *Patent Holdup and Royalty Stacking*, 85 TEX. L. REV. 1991 (2007); Carl Shapiro, *Injunctions, Hold-Up, and Patent Royalties*, 12 AM. L. & ECON. REV. 280 (2010); but see Einer Elhauge, *Do Patent Holdup and Royalty Stacking Lead to Systematically Excessive Royalties?*, 4 J. COMP. L. & ECON. 535 (2008); J. Gregory Sidak, *Holdup, Royalty Stacking, and the Presumption of Injunctive Relief for Patent Infringement: A Reply to Lemley and Shapiro*, 92 MINN. L. REV. 714 (2008).

¹⁴⁰ Examples of such *de facto* standards include the QWERTY keyboard and the MP3 audio format. For more regarding the development and effects of *de facto* standards, see Janice M. Mueller, *Patent Misuse Through the Capture of Industry Standards*, 17 BERKELEY TECH. L.J. 623, 633–35 (2002).

However, where lock-in effects exist at the time of trial, the valuation of the patented technology must be performed at an earlier time, before the infringer was locked-in, so as to avoid the attachment of a premium to the value of the patent technology that results from the user's lock-in. Accordingly, the Working Group determined that, for purposes of addressing lock-in and avoiding holdup effects, the patented technology to which the infringer is locked in generally should be valued in a manner that would exclude any premium the patent would command as a result of the adoption of the standard, i.e., any premium divorced from the technical merits of the technology.

This approach is consistent with that articulated in the FTC Report: “A reasonable royalty damages award that is based on high switching costs, rather than the ex ante value of the patented technology compared to alternatives, overcompensates the patentee To prevent damage awards based on switching costs, courts should set the hypothetical negotiation at an early stage of product development, when the infringer is making design decisions.”¹⁴¹ Similarly, the FTC Report advocates for valuation of standards-essential patents “based on the ex ante value of the patented technology at the time the standard is set.”¹⁴²

In Chapter III, the Working Group recommends the best practices when calculating reasonable royalty patent damages in cases presenting the above-mentioned scenarios.¹⁴³

Principle II-8: The comparison of any proposed comparable license to the hypothetical license should itemize and separately value—to the extent possible—the material ways in which the two differ.

Comment

The first *Georgia-Pacific* factor considers “[t]he royalties received by the patentee for the licensing of the patent in suit, proving or tending to prove an established royalty.”¹⁴⁴ The second *Georgia-Pacific* factor is “the rates paid by the licensee for the use of other patents comparable to the patent in suit.”¹⁴⁵ While *Georgia-Pacific* factors 1, 2 and 12 allow the expert witness to consider certain license agreements in determining the proper royalty rate and royalty structure, courts have not provided a definitive, comprehensive outline stating what criteria must be evaluated to determine if a license agreement is properly “comparable.”

The Federal Circuit addressed comparability of license agreements in *Lucent*, during its consideration of *Georgia-Pacific* factor 2.¹⁴⁶ The Federal Circuit analyzed various license agreements relied upon by Lucent in its presentation of royalty damages figures to the jury, and found that the evidence presented at trial was not sufficient for Lucent to have met its burden that the licenses were sufficiently comparable to support the damages award.¹⁴⁷ The Federal Circuit considered multiple factors regarding the licenses’ comparability to the hypothetical negotiation for the patents-in-suit, including the similarity and importance of the technology licensed, the price of the licensed product, the complexity of the royalty rate, and the structure of payment (i.e., lump sum royalty payments as opposed to running royalty payments).¹⁴⁸

Although the *Lucent* decision does not forbid the use of license agreements that differ, even substantially, from the hypothetical license, including differences in the technology covered in the licenses versus the patents-

¹⁴¹ *FTC Report*, *supra* note 115, at 190–91.

¹⁴² *Id.* at 194. The FTC Report goes on to recommend “Courts should cap the royalty [for patents subject to a RAND commitment] at the incremental value of the patented technology over other alternatives available at the time the standard was defined.” *Id.* See also *In re Innovatio IP Ventures*, 2013 WL 5593609, at *40–41 (“The court must, however, not consider the effect of standardization when evaluating the *ex ante* negotiation in 1997.”).

¹⁴³ See *infra*, Chapter III, Best Practice Nos. 9, 15, and accompanying commentary.

¹⁴⁴ *Georgia Pacific Corp. v. U.S. Plywood Corp.*, 318 F. Supp. 1116, 1120 (S.D.N.Y. 1970).

¹⁴⁵ *Id.*

¹⁴⁶ *Lucent*, 580 F.3d at 1325–32.

¹⁴⁷ *Id.* at 1332.

¹⁴⁸ *Id.* at 1327–31 (addressing each of eight real-life licenses presented by Lucent’s damages expert to the jury).

in-suit, or differences in the royalty structure (e.g., lump sum versus running royalty), it does highlight the importance of having the damages expert witness conduct a rigorous comparison of the various terms of the real-world licenses to the hypothetical licenses so as to justify use of dissimilar real-life license agreements.¹⁴⁹

The Federal Circuit also addressed comparability of license agreements in *ResQNet.com, Inc. v. Lansa, Inc.*¹⁵⁰ and *Wordtech Sys., Inc. v. Integrated Network Solutions, Inc.*¹⁵¹ These decisions, also highlight the importance of evaluating and comparing the circumstances and considerations of a potentially comparable license agreement to the facts and circumstances of the hypothetical negotiation for the patent(s)-in-suit, including, but not limited to, demonstrating a link between the invention involved in a potentially comparable license agreement to the claimed invention in the patent(s)-in-suit. Furthermore, in *ResQNet.com*, the Federal Circuit criticized an expert's reliance on license agreements that included payments for add-ons, such as marketing and other services, unrelated to the licensed technology.¹⁵²

District court decisions vary in their approaches. Some articulate a standard similar to that of the Federal Circuit in *ResQNet*.¹⁵³ Other district courts have been less strict in analyzing what constitutes a comparable license.¹⁵⁴

The Working Group supports a rigorous analysis to determine the comparability of license agreements. Rigorously analyzing and adjusting for any material differences between a benchmark license and the hypothetical license provides a rational and justifiable basis for determining what royalty would result from the hypothetical negotiation.

This proposed construct of analyzing and adjusting for differences between a benchmark asset and the asset being valued is common practice in valuation analyses, and is analogous to adjusting the estimated value of a parcel of real estate based on the differing characteristics of a comparable, recently-sold parcel. To the extent that both properties are identical with respect to a given characteristic (e.g., square footage), no adjustment to the estimated value is necessary. Conversely, to the extent the properties differ with respect to a given characteristic (e.g., more desirable location), an adjustment to the estimated value may be warranted.

The factors one might consider in assessing the comparability, and therefore the probative value, of a benchmark license to the hypothetical license will vary, given the unique facts and circumstances of each license. However, the comparability factors that one would likely consider will fall within four primary categories: (1) comparability of the licensed technologies; (2) comparability of the terms of the licenses; (3) comparability of the commercial and legal circumstances in which the parties negotiated the licenses; and (4) the bona fide nature of the license, including whether royalties were actually paid under the agreement, and the circumstances surrounding any non-payment. In those instances where comparability factors differ as between a proposed comparable license and the hypothetical license, the reasonable royalty analysis should attempt to quantify as accurately as possible the amount by which the indicated royalty should be adjusted. In those instances where it is not possible to quantify the requisite adjustment, the reasonable royalty analysis should, nonetheless, indicate and reflect the general nature that each comparability factor would have on the indicated royalty (e.g., whether it would tend to raise or lower the royalty).

¹⁴⁹ See, e.g., *id.* at 1330 (“As we noted above, certain fundamental differences exist between lump sum agreements and running royalty agreements. This is not to say that a running royalty license agreement cannot be relevant to a lump sum damages award, and vice versa. 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.”).

¹⁵⁰ 594 F.3d 860 (Fed. Cir. 2010).

¹⁵¹ 609 F.3d 1308, 1320 (Fed. Cir. 2010).

¹⁵² *ResQNet.com*, 594 F.3d at 870.

¹⁵³ See, e.g., *IP Innovation*, 705 F. Supp. 2d at 691; *Fenner Imx.*, 2010 U.S. Dist. LEXIS 101384, at *5; *Ricob*, 2010 U.S. Dist. LEXIS 27301 at *26–27.

¹⁵⁴ See, e.g., *Saffran*, 2011 U.S. Dist. LEXIS 34858, at *31–32; *Finjan Software*, 2009 U.S. Dist. LEXIS 72825, at *41.

In Principle 8(a), we address bare patent licenses to the patent(s)-in-suit in the same field of use, i.e., a one-way license to patents with no cross-license or other technology transfer. Bare patent licenses to the patent(s)-in-suit in the same field of use may provide guidance to the appropriate royalty rate determination from a hypothetical negotiation, as the technology is identical; however, as addressed below, a proper and rigorous analysis is required to determine if the agreement is truly comparable.

In Principle 8(b), we address licenses that are not a bare patent license to the patent(s)-in-suit in the same field of use, but which license the patent(s)-in-suit as part of a more comprehensive license.

In Principle 8(c), we address licenses that do not involve the patent(s)-in-suit, but which may nevertheless provide guidance to the appropriate royalty rate reached in a hypothetical negotiation, if subjected to a rigorous analysis.

In Principle 8(d), we address license agreements arising from litigation settlements.

With respect to all scenarios encompassed by principles 8(a)–8(d), any prior license agreement that lacks sufficient indicia of comparability to the hypothetical license should be disregarded in a reasonable royalty analysis.

Principle II-8(a): Evidence of a bare patent license to the patent(s)-in-suit in the same field of use as the accused product/service is generally relevant to the reasonable royalty inquiry and should usually be considered in the determination of the reasonable royalty.

Comment

To be considered in the Retrospective Model, the license may have been entered into any time prior to trial.

When a bare patent license to the patent(s)-in-suit in the same field of use as the accused product/service exists, certain of the market factors, license terms and technological considerations listed in the section below may be relevant to the determination of the reasonable royalty. The ones relevant to this principle are so indicated.

Principle II-8(b): On a proper showing, evidence of a license that is not a bare patent license to the patent(s)-in-suit in the same field of use, but which does license the patent(s)-in-suit as part of a more comprehensive license, may be relevant to the reasonable royalty inquiry.

Comment

To be considered in the Retrospective Model, the license may have been entered into any time prior to trial.

When a license that is not a bare patent license to the patent(s)-in-suit in the same field of use as the accused product/service but rather is a license to the patent(s)-in-suit as part of a more comprehensive license, certain of the below listed license terms, market factors and technology considerations may be relevant to the determination of the reasonable royalty. The ones relevant to this principle are so indicated.

Principle II-8(c): On a proper showing, evidence of a license that does not license the patent(s)-in-suit may be relevant to the reasonable royalty inquiry.

Comment

To be considered in the Retrospective Model, the license may have been entered into any time prior to trial.

A license agreement that does not license the patent(s)-in-suit may (or may not) be relevant to the determination of the reasonable royalty rate depending on the outcome of a rigorous analysis that compares and contrasts the proposed license agreement to the hypothetical license, including an analysis of certain of the below listed technology considerations, the relevant product/service, license terms and market factors. The ones relevant to this principle are so indicated.

Principle II-8(d): On a proper showing, license agreements in settlement of litigation that license the patent(s) or technology-in-suit may be relevant to the reasonable royalty determination.

Comment

Courts have considered both the admissibility and the use of settlement agreements as comparables in patent damages determinations. Some district courts have denied the use of settlement agreements due to potential jury confusion and prejudice.¹⁵⁵ Other district courts have allowed the use of settlement agreements on a case-by-case basis if the settlement agreements are for the patent(s)-in-suit, are the only sufficiently comparable license agreement(s), and resemble agreements negotiated outside of litigation.¹⁵⁶ The Working Group supports a rigorous analysis to determine the comparability of settlement agreements and their use at trial.

To be considered in the Retrospective Model, the settlement license may have been entered into any time prior to trial.

A settlement license that licenses the patent(s)-in-suit may be relevant to the determination of the reasonable royalty rate depending on the outcome of a rigorous analysis that compares and contrasts the proposed settlement agreement to the hypothetical license including an analysis of certain of the below listed potential factors related to settlements of litigation, relevant license terms, product/service, market factors and technology considerations. The ones relevant to this Principle are so indicated.

FACTORS AND CONSIDERATIONS RELEVANT TO COMPARABILITY ANALYSIS

1. *Cross-license provisions:* Unless the potentially comparable license distinguishes/breaks-out the consideration/royalty of the intellectual property of each entity separately, licenses that include cross-license provisions are generally not useful for determination of the reasonable royalty rate. However, depending on the facts and circumstances, licenses that include cross-license provisions may still provide guidance for other damage related factors, including the appropriate royalty base and royalty structure (e.g., per unit v. running royalty). (Relevant to Principles II-8(b), 8(c), and 8(d)).
2. *Additional patents to patent(s)-in-suit:* If the potentially comparable license licenses the patent(s)-in-suit plus additional patents, but does not distinguish/break-out the consideration/royalty for the patent(s)-in-suit from the additional patents in the license, and the record does not provide guidance as to the licensor's and licensee's perceptions of the value of the patent(s)-in-suit separate from the additional patents, it may not be possible to determine the portion of the consideration/royalty attributable to the patent(s)-in-suit. However, depending on the facts and circumstances of the case, the consideration/royalty in the potentially comparable license may tend to indicate an upper bound to the royalty rate determination in the hypothetical negotiation, as the licensee in the hypothetical negotiation would not be granted rights to the additional patents.

¹⁵⁵ *Fenner Inns.*, 2010 U.S. Dist. LEXIS 41514, at *10; *Cornell Univ.*, 2008 U.S. Dist. LEXIS 39343, at *13–14.

¹⁵⁶ *ResQNet.com*, 594 F.3d at 872; *ReedHycalog*, 727 F. Supp. 2d at 546 (E.D. Tex. 2010).

Depending on the facts and circumstances, the potentially comparable license may also provide guidance for other damage related factors, including the appropriate royalty base and royalty structure. (Relevant to Principles II-8(b) and 8(d)).

3. *Different Patents/Technology from patent(s)-in-suit*: Different patents in the same technology “field” may have very different values, even where they are used in the same products. Thus, if the potentially comparable license contains a license to patents that are different from the patents(s)-in-suit, it may not be possible to reliably use the license as a comparable license. To assess comparability, as well as to quantify the relative royalty rates (after a determination that it can be done reliably), it is important to consider: (1) the relative importance of the licensed technology to the accused product/service in the potentially comparable license as compared to the relevant product/service in the hypothetical negotiation, including the importance of the licensed technology to demand, sales, profits and price of the relevant product/service; (2) whether the licensed technology is related to only one component of the overall relevant product/service and the number; and (3) importance of other technologies included in the relevant products/services. (Relevant to Principles II-8(b), 8(c), and 8(d)).
4. *Additional licensed property*: (e.g., trade secrets, know-how, technical assistance). If the potentially comparable license does not distinguish/break-out the consideration/royalty for each licensed property, and the record does not provide guidance as to the licensor’s and the licensee’s perceptions of the value of each licensed property, it may not be possible to determine the portion of the consideration/royalty attributable to the patent(s)-in-suit. However, depending on the facts and circumstances of the case, the consideration/royalty in the potentially comparable license may tend to indicate an upper bound to the royalty rate determination in the hypothetical negotiation, as the licensee in the hypothetical negotiation would not be granted the additional rights. Depending on the facts and circumstances, the potentially comparable license may also provide guidance for other damage related factors including the appropriate royalty base and royalty structure. (Relevant to Principles II-8(b), 8(c), and 8(d)).
5. *Additional business arrangements associated with the potentially comparable agreement*: (e.g., development agreements, marketing agreements, and supply agreements). Even if the potentially comparable license distinguishes/breaks-out the consideration/royalty of the patent(s)-in-suit separately from additional business arrangements between the licensee and licensor, licenses that include or are related to other agreements that include additional business arrangements may not be useful for determination of the reasonable royalty rate, as it may not be possible to determine what royalty rate would have been negotiated but for the additional business arrangements. Additionally, if the licensor and licensee are related parties, or one party is a supplier of the other party, the royalty rate in the potentially comparable license may not be an “arms-length” transaction. However, depending on the facts and circumstances, license (or settlement) agreements that include additional business arrangements may still provide guidance for other damage related factors, including the appropriate royalty base and royalty structure. (Relevant to Principles II-8(b), 8(c), and 8(d)).
6. *Relevant product/service*: When the potentially comparable license is related to a different product/service than what is accused in the hypothetical negotiation, it is important to consider and compare the sales, profits, and price of the relevant products/services

over the relevant period, the industry and competitive market for the relevant product/services, technological considerations (see below), and the relative importance of the relevant product/service to the overall business of the licensee. (Relevant to Principles II-8(b), 8(c), and 8(d)).

7. *Bargaining position of the parties/economic considerations*: It is appropriate to consider the relative bargaining positions of the licensor and licensee of the potentially comparable license to the bargaining positions of the licensor and licensee in the hypothetical negotiation. Potential relevant factors to consider include market position (e.g., competitors), anticipated sales volumes, anticipated profitability, anticipated market share, importance of the accused product/service to the overall business of the licensee, the business relationships of the parties (e.g., if one party is a supplier of the accused product), and the extent to which royalties were paid/obtained under the potentially comparable license (or settlement). (Relevant to Principles II-8(a), 8(b), 8(c), and 8(d)).
8. *Royalty structure*: It may be appropriate to consider the licensing practices of the patent holder, the alleged infringer, and the industry regarding royalty structure to the extent it is different from the royalty structure of the potentially comparable license (or settlement). Depending on the facts and circumstances, it may be appropriate to convert a lump sum royalty in a potentially comparable license to a running royalty for purposes of application to the hypothetical license, if there is evidence of the parties' expected volume of relevant sales. Similarly, it may be appropriate to convert a running royalty into a lump sum royalty where the facts and circumstances suggest that the accused infringer would have agreed to a lump sum royalty. (Relevant to Principles II-8(a), 8(b), 8(c), and 8(d)).
9. *Date of the agreement and term*: It may be appropriate to consider changes in the relevant market of the accused product/service over time if the potentially comparable license (or settlement) was negotiated at a different point in time or for a different length of time than the hypothetical negotiation, including, for example, factors such as price, sales and profitability of the accused product/service, competition, industry standards, regulatory changes, and adoption of new technology into the accused product/service. (Relevant to Principles II-8(a), 8(b), 8(c), and 8(d)).
10. *Scope of the license*: It may be appropriate to consider the scope of the license of the potentially comparable license to the scope of the license in the hypothetical negotiation including, for example, consideration of territory (U.S. v. worldwide), exclusivity, rights granted (e.g., make, use, sell, and sublicense), and field of use. (Relevant to Principles II-8(a), 8(b), 8(c), and 8(d)).
11. *Assumption (or not) of Validity and Infringement*: It may be appropriate to consider whether the potentially comparable license inherently or explicitly includes an assumption that the licensed patents are valid and infringed. The hypothetical license assumes validity and infringement, whereas license agreements and settlement agreements may be premised on a more uncertain picture of these merits-based issues. (Relevant to Principle II-8(d)).¹⁵⁷

¹⁵⁷ However, statements in litigation settlements (or other licenses, for that matter) to the effect that the license does not represent a reasonably negotiated value or that the patentee does not have full knowledge of the extent of infringement should be evaluated for possible consideration, appreciating that such statements may be motivated by an intention by one or both of the litigants to have the license excluded as a comparable license in later litigation, irrespective of its actual comparability.

12. *Litigation Factors*: In addition to consideration of the foregoing factors when evaluating a litigation settlement for comparability, it is appropriate to consider the facts and circumstances relating to the litigation itself, including the parties' desire to avoid legal fees, the financial condition of the parties, the uncertainty and risk of the litigation, and the legal positions of each party.

It should be appreciated, however, that where the presentation of the facts and circumstances of a settlement agreement at trial would significantly increase the time required for the presentation of damages evidence at trial and/or would be confusing to the jury, it may be appropriate for the court to exclude evidence of the settlement agreement at trial. Indeed, in some cases, the discovery of these facts and circumstances may impose a significant burden on one or both parties, such that it may be appropriate for the court to limit or preclude discovery of a settlement agreement during the discovery phase of the case. The admissibility and discoverability of a patent license agreement must be determined on a case-by-case basis in view of various factors. The Working Group does not herein express a view on admissibility or discoverability issues, but rather identifies the factors to be assessed in comparing a settlement license agreement to the hypothetical license at issue that may be useful to the threshold determinations of admissibility and/or discoverability, as well as to the use of settlement agreements in the reasonable royalty analysis in cases where they are admissible. (Relevant to Principle II-8(d)).

Principle II-9: Whether a reasonable royalty should be structured as a running royalty or a lump sum should be explicitly considered in the reasonable royalty analysis.

Comment

It is not a forgone conclusion that every reasonable royalty license must provide for a running royalty. Circumstances may dictate that a reasonable royalty should be paid as a lump sum. A reasonable royalty analysis, therefore, is not complete unless it explicitly considers the proper structure of the royalty payment.

Though royalties are often calculated on a running basis, there may well be factors that suggest the hypothetical negotiation would have led to a lump sum license or to a combination of a lump sum and a running royalty. Regardless of the conclusion, a party advocating a lump sum or a running royalty or some combination of the two must articulate an acceptable basis for its position, just as it must for any other element of a reasonable royalty calculation.

Significant factors that may support a lump sum or a running royalty include: (1) the licensing history of the industry and/or one or both of the parties; (2) the extent to which the financial or competitive situation of the parties favors a lump sum payment as opposed to a continuing running royalty, including: (a) the immediate need of either or both of the parties for capital, (b) each party's perception as to the degree of uncertainty associated with the likely future size of the royalty base, (c) either or both of the parties' risk tolerance as to the possibility that the future revenue stream generated by a running royalty may be unexpectedly large or small, or (d) the competitive burden that would be placed on a licensee by the ongoing payment of a running royalty or on the licensor by the absence of such a payment; (3) whether the benefits of the licensed technology are of a continuing nature, concern a one-time event, or whether the benefits of the technology represent some combination of the two.

With regard to factor (2), issues regarding uncertainty in the market and the risk tolerance of the parties may argue against a lump sum royalty, given that the lump sum structure is often adopted to avoid uncertainty about future sales, and hence, the future royalty stream. Consistent with the Working Group's adoption of the Retrospective Model, the question of uncertainty as it impacts the potential royalty structure should be evaluated in light of all of the information available. Thus, for example, a patented technology that turns out to have enjoyed far greater or far fewer sales during the damages period than what was anticipated at the start of that period might be a good candidate for a lump sum analysis where one or both of the patent owner and infringer were risk averse at the start of the damages period.

This list is not meant to be exclusive, and other factors may be considered in appropriate cases. Likewise, there may be cases where some of the listed factors are not properly considered. As with any other aspect of the reasonable royalty analysis, whether a lump sum royalty is appropriate will turn on the positions of the parties and the value of the invention at the time of the hypothetical negotiation.

If the reasonable royalty is determined to be a lump sum royalty, the size of the lump sum payment should be calculated bearing in mind the principles discussed elsewhere in this Commentary. For example, the difference between a running and a lump sum royalty may be nothing more (or less) than the difference between the present value of the anticipated revenue stream associated with the infringement at the time of the hypothetical negotiation and the present value of the actual revenue stream associated with the infringement during the period of infringement. Where the anticipated revenue stream was highly uncertain and the parties would have favored a lump sum, the lump sum might require adjustment up or down from the appropriately apportioned value of the actual revenue in order to adjust for the uncertainty avoided by the lump sum payment.

III. Pretrial Principles and Best Practices

Principle III: *If and when the court believes that significant questions may exist as to the admissibility of certain damages theories or determinations, then in the appropriate case, the court should consider conducting a hearing after the parties exchange damages contentions to determine: (1) if the parties' damages theories are legally cognizable; (2) if the damages evidence is reliable, relevant and/or admissible; and (3) other disputes relating to damages.*

Comment

Parties in patent litigation move to exclude damages experts' testimony, theories, and evidence in almost every patent case for a variety of reasons, including reliability, applicability, relevance, and prejudice. For example, parties often move to exclude damages experts and/or their theories pursuant to Federal Rule of Evidence 702.¹⁵⁸ Parties also seek to exclude specific damages theories and evidence pursuant to Federal Rules of Evidence 402 and 403.¹⁵⁹

Currently, there is no standard procedure or time for courts to consider the reliability and/or admissibility of damages experts' testimony, theories, and evidence. Often, damages expert reports are not disclosed until the end of discovery, after or near summary judgment deadlines. Disputes regarding damages issues therefore are infrequently raised in summary judgment motions. Instead, motions attacking damages theories and evidence are raised in motions *in limine* or in *Daubert* motions. Courts, however, may not want to consider disputes regarding damages issues at the motions *in limine* or *Daubert* stage, which is usually immediately before trial.¹⁶⁰

Furthermore, even if a court does consider motions *in limine*, raising damages issues, particularly on the eve of trial, via these motions may lead to the total exclusion of damages experts, damages theories, and/or evidence on the eve of or during trial. Exclusion of such evidence so late in the process could very likely significantly prejudice a party's ability to present its case at trial.

The parties should propose, and the courts should consider, setting dates for damage contentions to be exchanged by the parties. These contentions should be exchanged in advance of both the close of fact discovery and of the filing of damages expert reports.

In the appropriate case when the courts believe that significant questions may exist as to the admissibility of certain damages theories or determinations, the courts should consider adopting procedures to facilitate the consideration of motions related to the admissibility of damages contentions, theories, and evidence sufficiently in advance of trial such that the parties can account for any adverse rulings before trial. In conjunction with the recommendation that the parties exchange damages contentions, courts should consider conducting a hearing to determine if the parties' damages theories, as detailed in their damages contentions, are legally cognizable, the evidence is reliable, and to resolve any other disputes relating to the damages contentions and theories. Specifically, courts should consider conducting such a hearing, if possible, after any claim construction decision but before the exchange of damages expert reports. In the appropriate case,

¹⁵⁸ See FED. R. EVID. 702; *Daubert v. Merrell Dow Pharms., Inc.*, 509 U.S. 579 (1993); *Kumho Tire Co. v. Carmichael*, 526 U.S. 137 (1999).

¹⁵⁹ See FED. R. EVID. 402, 403.

¹⁶⁰ See e.g., *Emcore Corp. v. Optium Corp.*, 2009 U.S. Dist. LEXIS 96305, at *2-3 (W.D. Pa. Oct. 16, 2009) ("A motion *in limine* is not the proper procedural vehicle to raise these issues . . . Optium's Motion does not involve evidentiary rulings, or any other type of issue usually considered on an *in limine* basis. Rather, this Motion resembles a motion for summary judgment The time for filing Motions for Summary Judgment has long passed."); *Power Integrations, Inc. v. Fairchild Semiconductor Int'l, Inc.*, 2006 U.S. Dist. LEXIS 67562, at *3 (D. Del. Sept. 20, 2006) ("[T]he Court concludes that Defendant's second Motion *In Limine* is akin to a summary judgment motion. In this case, the jury will decide how many infringing sales and offers for sale took place in the United States based on the evidence submitted by the parties. Accordingly, the Court will deny Defendants' motion.")

guidance from the court on whether the parties' damages contentions are legally cognizable prior to the exchange of expert reports will significantly aid the parties and the court.¹⁶¹

As more experience is obtained from the bench and bar seeking to resolve such damages disputes earlier in the litigation, further work should be done by a Sedona Conference Working Group to define and develop how and when the best practices set forth below should be implemented.

BEST PRACTICES

1. *In appropriate cases, when the parties cannot resolve disagreements on the admissibility of certain damages theories, methods, contentions, and evidence, the courts should consider providing guidance to civil litigants in patent cases regarding the procedures for filing and resolving motions related to such disputes.*
2. *In such cases, courts can provide schedules that allow for hearings to determine if the parties' damages contentions are legally cognizable, the evidence is reliable, relevant and/or admissible, and other disputes relating to damages theories and contentions.*
3. *In such cases, the attorneys should propose hearings for damages issues after any claim construction decision and before the exchange of expert reports.*
4. *Both parties to a lawsuit should work together prior to the initial case management conference to facilitate the early disclosure of preliminary compensatory damages contentions (PCDCs) and supporting materials.*

Explanation: Federal Rule of Civil Procedure 26(f) requires the parties to meet and confer to discuss the nature and basis of their claims, the possibility for prompt settlement, and the timing of their Rule 26(a)(1) initial disclosures. This meeting must take place no later than twenty-one days before the initial case management conference. One category of information parties must include in their initial disclosure is a "computation of each category of damages and supporting materials."¹⁶² To allow the parties and the court to gain an early, initial understanding of the compensatory damages theories at issue, any preliminary supporting damages evidence, the potential settlement value of the case, and the scope of potential damages discovery, the parties should work cooperatively to facilitate the exchange of early damages information reasonably in their possession at the time of the Rule 26(f) conference. Further, early damages information may be important to ascertaining whether the scope and expense of discovery is warranted.¹⁶³

Any initial damages calculations and information provided reasonably and in good faith during the PCDCs process are considered preliminary or approximate and may be amended or supplemented. The PCDCs disclosures are not intended to confine a party to the contentions it makes at the outset of the case. It is not unusual for a party in a patent case to learn of additional facts and potential theories of recovery as the case progresses. At the same time, courts should not accept skeletal preliminary compensatory damages disclosures uncritically. Failure to provide good faith damages disclosures and at least "high level" damages discovery at an early stage of the litigation may hinder settlement discussions, and result in unnecessary expenditure of time, money, and judicial resources. Ultimately, in

¹⁶¹ Such procedures may have prevented the damages *Daubert* motions granted in *Apple, Inc. v. Motorola, Inc.*, No. 1:11-cv-8540, 2012 WL 1959560 (N.D. Ill. May 22, 2012), *rev'd*, 2014 WL 1646435 (Fed. Cir. April 25, 2014), where damages expert testimony from both sides was excluded and the case was ultimately dismissed.

¹⁶² FED. R. CIV. P. 26(a)(1)(iii).

¹⁶³ See *Eon Corp. IP Holding LLC v. Sensus USA Inc.*, No. C-12-01011 EMC (EDL), 2013 WL 3982994 (N.D. Cal. Mar. 8, 2013).

considering early disclosures, the court will need to balance competing considerations on a case-by-case basis.¹⁶⁴

5. *Both parties to a lawsuit should be required to disclose PCDCs and supporting materials concurrently with submission of infringement and invalidity contentions or within a set time after the initial case management conference.*

Explanation: Because of the complex nature of patent litigation, parties typically require a fair amount of fact discovery before they understand the other's information sufficiently to formulate even "ball park" damages contentions. Nevertheless, both sides should be required to provide preliminary damages disclosures that are as complete as is reasonably possible, as well as high-level documents in their possession that are likely relevant to a fair assessment of the damages issue. Disclosing initial damages contentions at a relatively early point in the case may allow the parties and the court to assess the value of the case, discuss the scope of potential discovery, make a preliminary evaluation of the possibility of early settlement, and potentially, identify damages issues that should be the subject of early partial summary judgment motions or an evidentiary hearing to test legal theories. Ideally, the parties will conduct their Rule 26(f) conference before the initial case management conference. In those instances, the parties should cooperate to set a time for exchange of PCDCs that is keyed to the submission of infringement contentions and/or the date of the case management conference. By way of example, in jurisdictions that require infringement contentions, the patentee would be expected to submit its PCDCs concurrently with submission of its infringement contentions. The parties accused of infringement would then be expected to submit their PCDCs thirty days thereafter. Alternatively, in jurisdictions that do not mandate infringement contentions, the parties should cooperate to establish a reasonable schedule for exchange of PCDCs subsequent to the case management conference but also keyed to the exchange of infringement contentions through interrogatories or otherwise. In any event, the parties should exchange preliminary damages contention materials and, if appropriate, make them available to the court, subject to appropriate measures to protect confidentiality, including interim protective orders.

6. *The party alleging patent infringement should identify all accused instrumentalities known to it at the time of filing as part of its PCDCs, to the extent not disclosed in any prior infringement contentions.*

Explanation: The notice pleading requirement of the Federal Rules of Civil Procedure under Rule 8(a)(2) requires only "a short and plain statement of the claim showing that the pleader is entitled to relief," in order to "give the defendant fair notice of what the . . . claim is and the grounds upon which it rests."¹⁶⁵ Complaints and counterclaims in most patent cases are worded in a bare-bones fashion, necessitating discovery to flesh out the basis for each party's contentions. To remove any potential ambiguity regarding the preliminary scope of the infringement claims set forth in the pleadings, as part of its PCDCs, the party alleging patent infringement should clearly identify all accused instrumentalities reasonably known to it when it filed its complaint.

¹⁶⁴ Compare *Eon Corp. IP Holding LLC*, 2013 WL 3982994 with *Brandywine Commc'ns Techs., LLC v. Cisco Systems, Inc.*, No. C 12-01669 WHA, 2012 WL 5504036 (N.D. Cal. Nov. 13, 2012).

¹⁶⁵ FED. R. CIV. P. 8(a)(2).

7. *As part of its PCDCs, the party alleging patent infringement should identify all theories upon which it bases its potential recovery of compensatory damages and provide a brief explanation of facts supporting those theories.*

Explanation: Compensatory patent damages traditionally fall into three categories: lost profits, established royalty, and reasonable royalty.

The party asserting patent infringement should identify the theory or combination of theories on which its PCDCs are based. In addition, the party should provide a brief, preliminary explanation of the factual bases that they reasonably know to support the stated theory or theories of recovery.

By way of example only, if a lost profits theory is being asserted, the party asserting patent infringement should explain the reasons and evidence reasonably supporting its contention that it would have made profits “but for” the infringement. One non-exclusive test for proving lost profits is set out in *Panduit Corp. v. Stablin Bros.*¹⁶⁶ If the party asserting infringement relies on the *Panduit* test, then it must provide an explanation of: (1) demand for the patented product during the relevant period; (2) the absence of acceptable non-infringing alternatives to the patented product; (3) manufacturing and marketing capacity to sell the products it claims it could have sold; and (4) if possible, a preliminary calculation of the incremental profit margin. This is just one example of a test for proving entitlement to lost profits, and it is being provided solely to demonstrate the nature and scope of information called for by Best Practice 7.

By way of further example, if a reasonable royalty theory of recovery is being asserted, the party asserting patent infringement should provide a preliminary explanation of the facts supporting its theory of recovery including an identification of the preliminary applicable royalty rate and base, if available, and a brief discussion of all other factors, including a discussion of any relevant *Georgia-Pacific* factors, that may bear on a calculation of a reasonable royalty.¹⁶⁷

The disclosures pursuant to this Best Practice are not intended to confine a party to the damages contentions it makes at the outset of the case. However, failure to provide good faith damages disclosures and at least high-level preliminary compensatory damages contentions at the outset of the litigation may hinder settlement discussions, and result in unnecessary expenditure of time, money and judicial resources.

8. *The party alleging patent infringement should produce to each opposing party, or identify for inspection and copying, all materials supporting its PCDCs theories of recovery.*

Explanation: A party asserting patent infringement should produce copies of all materials reasonably known to it that allegedly support its preliminary compensatory damages theories. This disclosure should be as complete as is reasonably possible and should include high-level documents in the party’s possession concerning its sales and profitability, and those of the industry; market share; comparable license agreements and royalty rates related to the patent at issue; evidence of demand for the patented features; and basic marketing, pricing, manufacturing, and sales information relating to any products or processes that embody the patented invention, that are licensed under the patent, that compete with, or that are sold with or as a result of products or processes that embody the patented invention or are licensed under the patent.

¹⁶⁶ 575 F.2d 1152, 1166 (6th Cir. 1978).

¹⁶⁷ *Georgia-Pacific*, 318 F. Supp. at 1120.

9. *The party responding to infringement allegations should provide a preliminary response to the PCDCs theories of recovery and, if necessary, identify any applicable alternative theories for calculating compensatory damages in the case.*
- a. *The accused infringer should identify any reasons why it is locked in to continuing to practice the asserted patent(s), and the time at which it contends that the lock-in occurred.*
- b. *Any proposed non-infringing alternative designs, or design arounds, must be identified sufficiently early in the fact discovery for the patent holder to take meaningful discovery of its technical and commercial viability.*

Explanation: Although the party responding to a patent infringement allegation may need discovery to fully understand the preliminary damages contentions, it should provide a preliminary high-level response to the theories asserted in the preliminary compensatory damages contentions. By way of example, if the PCDCs theory of recovery is lost profits and an accused infringer has evidence of acceptable non-infringing alternative designs, or design arounds, it should explain why lost profits are unavailable. By way of further example, if the PCDCs theory of recovery is a reasonable royalty and the accused infringer disagrees with the royalty rate because royalty stacking principles apply given marketplace realities, it should discuss this fact in its response.

10. *Each party accused of patent infringement should produce to the party asserting infringement, or identify for inspection and copying, all materials supporting its preliminary response to the PCDCs theories of recovery.*
- a. *That information should include information about any patents the alleged infringing products actually practice (whether its own or someone else's) and what royalties are paid for licenses to those patents, which is relevant to the royalty stacking inquiry.*
- b. *The accused infringer should identify, with specificity and clarity, the details of any proposed non-infringing design around alternatives, and identify the persons most knowledgeable about that proffered alternative so that appropriate discovery may be conducted by the patent owner.*

Explanation: A party responding to preliminary damages contentions should produce copies of all materials reasonably known to it that allegedly support its response to the preliminary compensatory damages theories. This disclosure should be as complete as is reasonably possible and should include high-level documents in the party's possession concerning license agreements and royalty rates that relate to the accused product or process; basic marketing, pricing and sales information relating to the accused products; any non-infringing design around alternatives; and any information that otherwise may be relied upon to define the royalty rate or base.

11. *The parties should establish a date for exchange of final damages contentions that are to be subject to further amendment or supplementation only for good cause.*

Explanation: The preparation of final damages contentions may require significant factual development and may entail involvement of technical and damages experts at considerable expense. Nevertheless, such contentions may be important in focusing and narrowing the damages issues. Ultimately, the timing of exchange of final damages contentions should be set in relation to the cutoff date(s) for fact and expert discovery and for the exchange

of final infringement and invalidity contentions. Preferably, the exchange of final damages contentions should occur before the inception of expert discovery but after fact discovery related to damages is sufficiently well developed, and ordinarily after exchange of final infringement and invalidity contentions. The parties would still have an opportunity to amend or supplement the contentions for good cause.

12. *Exchange of PCDCs materials should not be withheld on the basis of confidentiality. The parties should meet and confer in good faith to agree on the form of a suitable protective order.*

Explanation: Disclosure of PCDCs materials should not ordinarily be withheld on the basis of confidentiality. The parties should meet and confer in good faith to agree on the form of a protective order well in advance of the time for the first preliminary damages contention disclosure.

13. *If the parties cannot agree on the form of a protective order sufficiently providing for the protection of financial, licensing, and other confidential damages-related information, and the court where the case is pending does not have a standard protective order for patent cases, a party may apply to the court for a protective order under Fed. R. Civ. P. 26(c).*

Explanation: Where applicable, the protective order authorized by the local rules of the court should govern the disclosure of early compensatory damages contention materials unless the court enters a different protective order *sua sponte* or on motion by a party.

14. *If there is no protective order in place when the PCDCs materials are due, the parties should exchange those materials for “OUTSIDE ATTORNEYS’ EYES ONLY.” If one of the parties refuses to exchange on that basis, the other can make a motion as outlined above.*

Explanation: Because early disclosure of preliminary compensatory damages theories and support may facilitate settlement and help shape the scope of discovery in the case, the pendency of protective order issues before the court should not delay disclosure of PCDCs materials. If there is no standard protective order set forth by local rule of court, and if the court has not entered a protective order in the case, the parties should agree to exchange the PCDCs materials on an “outside attorneys’ eyes only” basis.

15. *The parties should encourage their damages experts to take care to exclude from their reasonable royalty determination any hold-up effects that may result from a valuation performed after the relevant lock-in date. The reasonable royalty analysis should assign the reasonable royalty value prior to the relevant lock-in date. Upon the filing of a Daubert motion challenging the reasonable royalty methodology, the court should explicitly consider whether lock-in/hold-up effects were properly accounted for in the challenged methodology.*
16. *The parties should encourage their damages experts to affirmatively address the issue of royalty stacking in their reports and explain what information they have considered to address this issue.*
17. *Any proposed non-infringing design around alternatives must be subject to the same level of technical expert analysis and judicial scrutiny in the matter that is afforded to the infringement and/or non-infringement analyses.*

- a. *If the patent holder seeks to challenge introduction of evidence and/or argument regarding the proposed non-infringing design around, it should file a motion with the district court sufficiently in advance of trial. The court should allow the introduction of the proposed alternative only if the accused infringer has shown, by a preponderance of the evidence, that the alternative design does not infringe the asserted claims of the patent(s) in suit.*

- b. *To the extent the proffered design around is viewed as infringing or unacceptable or both by the patent owner, if the patent owner wishes to prove this at trial, then during expert discovery, the patent owner should produce expert reports from appropriately qualified experts to explain, with specificity and clarity, the reasons why the proffered design around is either infringing or unacceptable.*
- c. *In response, the accused infringer's expert should provide expert reports from appropriately qualified experts to explain, with specificity and clarify, the reasons why the proffered design around is non-infringing and acceptable.*

IV. Trial Principles and Best Practices

Principle IV-1: Courts can assist in streamlining the presentation of damages evidence at trial to ensure that: (1) damages theories are tied to the specific facts of the case, and that damages experts use reliable methodologies; (2) the entire market value rule is applied only when appropriate; and (3) the comparability of license agreements is rigorously addressed.

Comment

In appropriate cases, courts can rule before trial on whether parties' damages theories are legally cognizable and, in appropriate circumstances, allow parties the opportunity for adjustment should they need to modify their theories.¹⁶⁸ Absent a showing of good cause (including lack of prejudice to the opposing party), the presumption should be that a party may not modify its damages analysis after some or all of it has been excluded. Courts should be mindful that the patent holder must maintain its burden of proof to establish a reasonable royalty. Some courts have taken the position that, absent an intervening change in the law that affects the admissibility of an expert's damages theory or analysis, it is unfair to give a party that has overreached an opportunity to modify its theories. Yet, as the following examples illustrate, courts can exercise their discretion and allow supplementation.

1. Three months before trial, a judge in the Northern District of California granted the defendant's motion to strike most of the plaintiff's damages expert report in which the expert opined that a royalty "could be as much as \$6.1 billion."¹⁶⁹ The court noted numerous ways in which the opinion was not based on sufficient facts, which included the expert equating the invention with the entirety of Java and Android and his reliance on a mathematical model—unrelated to the specific facts of the case—under which the patentee would be awarded half of the defendant's profits.¹⁷⁰

The court had specifically requested early damages reports, so it would have time to vet the parties' analyses and allow them to adjust their final reports accordingly. After chastising the plaintiff for overreaching in multiple ways, the court cautioned that the next report would be "for keeps" and that the plaintiff should take care to rectify the deficiencies, or the expert would be excluded altogether.¹⁷¹ The court suggested that the plaintiff start its damages analysis with the last offer that was made during negotiations, \$100 million, several years before suit.¹⁷²

2. A judge in the Southern District of California precluded a plaintiff from presenting some of its damages evidence to the jury. The plaintiff was precluded from presenting its theory that the parties would have agreed upon a royalty of \$70 million, which was halfway between the defendant's projected royalty of \$0 and the plaintiff's projected royalty of \$138.7 million. The plaintiff's expert had not, in his single-page analysis, explained why the parties would meet halfway, instead of agreeing upon any other number in that same range.¹⁷³ Similarly, the plaintiff was precluded from presenting evidence on the entire market value, where the plaintiff's expert had not properly apportioned between the accused product's patented and

¹⁶⁸ See, e.g., *Oracle Am., Inc. v. Google Inc.*, 798 F. Supp. 2d 1111 (N.D. Cal. 2011); *Lucent Techs., Inc. v. Microsoft Corp.*, No. 07-CV-2000 H(CAB), 2011 WL 2728317 (S.D. Cal. July 13, 2011).

¹⁶⁹ See *Oracle*, 798 F. Supp. 2d at 1114.

¹⁷⁰ *Id.* at 1115–16, 1119–21.

¹⁷¹ *Id.* at 1121–22.

¹⁷² *Id.* at 1121.

¹⁷³ See *Lucent*, 2011 WL 2728317, at *9.

unpatented features.¹⁷⁴ The court reserved the right, however, to revisit the ruling at trial, should the plaintiff meaningfully apportion the per unit price of the accused product.¹⁷⁵ Finally, the plaintiff was allowed to proceed to the jury under a “business realities” approach, wherein it was hypothesized—based on a host of factors—that it would have been unwilling to accept less than \$65–75 million as a lump sum royalty. The court noted, however, that the plaintiff would have to prove that this measure did not violate the entire market value rule, and that the factual bases for the expert’s calculations were credible.¹⁷⁶

Principle IV-2: A significant amount of trial time should be dedicated to the damages portion of a patent case.

Comment

Courts can ensure that the time allocated for trial is sufficient to permit both sides to fairly address all of the issues to be tried, including all damages issues, in light of the nature and complexity of those issues and the scope of testimony or other evidence needed to address them. Courts faced with busy dockets are, with increasing frequency, ordering timed trials. In light of changes in patent damages law at the Federal Circuit, it should be noted that while two hours for a damages case may have been appropriate in years past, it may not be sufficient today. Depending on the jurisdiction, patent litigants may find themselves in the position of having to put all of their evidence in during a timed trial. Given the recent, increased scrutiny on proof of damages, however, parties cannot afford to skimp on their presentation of damages evidence. In particular, damages experts must thoroughly explain their methodologies, show the evidence they considered, and demonstrate how the evidence impacted their conclusions.

BEST PRACTICES

1. *At or before trial, the parties, with guidance from the court, should determine a fair amount of time for the damages portions of the case; in cases in which there is a concern about the amount of time that a judge will allow for trial, parties should consider reaching agreement as to the admissibility of evidence summarizing an expert’s testimony.*
2. *Parties might consider stipulating to the admissibility of summaries under Rule 1006 of the Federal Rules of Evidence,¹⁷⁷ including even summaries that include an expert’s calculations, demonstrating the mathematical basis for the opinion.*

Principle IV-3: Bifurcation of a patent damages trial from a patent liability trial may be appropriate.

Principle IV-3(a): In cases involving a single defendant and a single patent, bifurcation of damages may not be appropriate given the relative lack of complexity in the case, potential overlap in proof on various liability and damages issues, and the risk of prejudice to the patentee if infringement continues unabated throughout the time that it takes to try both phases of a case.

¹⁷⁴ *Id.* at *5–7.

¹⁷⁵ *Id.* at 7.

¹⁷⁶ *Id.* at *7–8.

¹⁷⁷ FED. R. EVID. 1006.

Principle IV-3(b): In cases involving multiple defendants, multiple patents and multiple accused products, or those involving particularly complex damages theories, or those in which the courts order timed trials, bifurcation of damages may be appropriate to avoid juror confusion and unnecessary expense.

Principle IV-3(c): If a court decides to completely bifurcate liability discovery and trial from damages discovery and trial, it should consider also allowing time for an appeal to the Federal Circuit between trials.

Comment

Single-defendant, single-patent cases are unlikely to be bifurcated because they are often relatively straightforward and simple.¹⁷⁸ Proceedings in district court should be administered to be “just, speedy, and inexpensive.”¹⁷⁹ By contrast, the complexity of the evidence on both liability and damages may be overwhelming to a jury in multi-defendant, multi-patent cases.¹⁸⁰

In simple cases, some courts have considered the patentee’s chances of success when deciding whether bifurcation would be more efficient. In a case in the Eastern District of Wisconsin, for example, the court denied the defendant’s motion to bifurcate because it believed the plaintiff was likely to succeed and that a second trial would then be necessary.¹⁸¹ Similarly, in the District of Delaware, the court denied a motion to bifurcate because the defendant had not demonstrated that its “probability of prevailing in its infringement defense [was] incontrovertibly greater than” the patentee’s.¹⁸²

Other courts, however, have more routinely bifurcated cases, taking the view that in all but exceptional patent cases:

[T]he burden imposed on a jury in a patent trial is extraordinary. More specifically, juries are tasked with resolving complex technical issues regarding infringement and invalidity, many times with respect to multiple patents and/or multiple prior art references. Absent bifurcation, jurors then are expected to understand the commercial complexities of the relevant market (or, even more impenetrable, the commercial complexities of the hypothetical market) in order to determine the economic consequences of their liability decisions.¹⁸³

Courts also consider whether evidence related to liability impacts a determination on damages. For example, when an accused infringer mounts a validity challenge under 35 U.S.C. § 103, the patentee may wish to present evidence of secondary considerations of non-obviousness, such as the commercial success of products that practice the patent, the failure of others, and a long-felt need in the industry for the patented invention. This same evidence bears on the determination of a reasonable royalty. A patented invention’s commercial success may, for example, reflect the utility and advantages of the invention over old modes or devices (*Georgia-Pacific* factor 9). Additionally, the failure of others and existence of a long-felt need bear on the amount an accused infringer would have been willing to pay for the invention (*Georgia-Pacific* factors 12 and 15).

¹⁷⁸ See, e.g., *Baratta*, 05-cv-60187, slip op. at 9; *Nielsen*, 2010 U.S. Dist. LEXIS 26804 at *5; see also *BASF Catalysts*, 2009 U.S. Dist. LEXIS 16263 at *6. A “single-defendant, single-patent” case is meant to be only an example of a type of case that can be resolved in a single trial. Other types of cases may also be straightforward enough so that bifurcation is not advisable.

¹⁷⁹ FED. R. CIV. P. 1.

¹⁸⁰ See, e.g., *Wyeth v. Abbott Labs.*, No. 08-230 (JAP), 2010 U.S. Dist. LEXIS 116921, at *5 (D.N.J. Nov. 3, 2010); *Intel Corp. v. Commonwealth Sci. & Indus. Research Organisation*, Civ. Nos. 6:06-cv-552, 6:06-cv-549, 6:06-cv-550, 6:07-cv-204, 6:06-cv-324, 2008 U.S. Dist. LEXIS 103613, at *28 (E.D. Tex. Dec. 23, 2008); *William Reber, LLC v. Samsung Elecs. Am., Inc.*, 220 F.R.D. 533, 535 (N.D. Ill. 2004).

¹⁸¹ See *Kimberly-Clark Worldwide, Inc. v. First Quality Baby Prods., LLC*, No. 09-C-0916, 2010 U.S. Dist. LEXIS 98573, at *6 (E.D. Wis. Sept. 7, 2010).

¹⁸² *Masimo Corp. v. Philips Elecs. N. Am. Corp.*, 742 F. Supp. 2d 492, 500–01 (D. Del. 2010).

¹⁸³ *Dutch Branch*, 2009 U.S. Dist. LEXIS 76006, at *2–3.

Courts are also disinclined to bifurcate when doing so would severely prejudice a patentee by creating unnecessary delay, and when a defendant's principal goal appears to be to slow the proceedings.¹⁸⁴ Extensive motion practice regarding the admissibility of evidence following bifurcation—such as motion practice related to whether certain evidence should be presented to the jury during the liability trial or reserved for the damages trial—may cause excessive delays in a bifurcated case.¹⁸⁵ Additionally, a patentee is prejudiced by the fact that the appellate process is prolonged in bifurcated cases as each trial may be appealed separately. These separate appeals can cause significant delays in reaching finality, since the litigation must be entirely concluded such that nothing is left except to execute the judgment.¹⁸⁶ A patentee is further prejudiced by the fact that these delays allow for intervening judgments which may vacate an earlier liability judgment.¹⁸⁷

Parties seeking bifurcation should be aware that it is not guaranteed even in multi-defendant cases. Courts may take the view that limiting instructions will suffice to prevent any juror confusion.¹⁸⁸ Alternatively, courts may prefer to manage the complexities of a multi-defendant case in unique ways that are tailored to the parties. For example, the court in the Eastern District of Texas denied a bifurcation motion in a consolidated, multi-defendant case involving 124 defendants.¹⁸⁹ Recognizing that this was not a “typical” patent case—and that the district's local patent rules made defending the case prohibitively expensive—the court set an early *Markman* and summary judgment hearing, and stayed all unrelated discovery.¹⁹⁰ The court's rationale for declining to bifurcate damages was based in part on the patentee's stated strategy of seeking early settlements based on an analysis of each defendant's sales and the cost of defense.¹⁹¹ Given this strategy, damages discovery was necessary in order for the parties to be able to “fully and fairly” evaluate the case for settlement purposes.¹⁹²

Defendants seeking bifurcation should take care to consider the ramifications of a final liability determination. If, following such an outcome, the parties do not settle a case, the plaintiff's strategy during the damages trial will likely include multiple references to the defendant as an “infringer.” Such tactics have the potential to put the defendant at a distinct disadvantage.

The examples below illustrate the issues raised by recommendations made in Principle IV-3:

1. A motion to bifurcate was denied by a district court judge who held the view that “damages and liability are not easily compartmentalized.”¹⁹³ Sales and financial information would be considered by the jury in determining whether the patentee had proven “commercial success,” and that same information “is inherently intertwined with damages.”¹⁹⁴

¹⁸⁴ See, e.g., *BASF Catalysts*, 2009 U.S. Dist. LEXIS 16263, at *6; *Baratta*, 05-cv-60187, slip op. at 9.

¹⁸⁵ See *BASF*, 2009 U.S. Dist. LEXIS 16263, at *6 (quoting *Trading Technologies Intern., Inc. v. eSpeed, Inc.*, 431 F. Supp. 2d 834, 840 (N.D. Ill. 2006)) (“Given the nature of this case thus far, we would not be surprised if the parties engaged in extensive motion practice wrangling over whether certain pieces of discovery were applicable to the liability case or the willfulness/damages case. Thus we do not think that defendants have carried their burden of establishing that bifurcation of discovery and trial would promote judicial efficiency.”). See also *Baratta*, No. 05-cv-60187, slip op. at 9 (“In particular, the Court is concerned in this case, and in light of the lack of progress that has occurred in the past three and a half years, that bifurcation would serve to further prolong this matter by creating additional discovery periods, additional trials, and additional motions for relief.”).

¹⁸⁶ See e.g., *Fresenius USA, Inc. v. Baxter Intern., Inc.*, 721 F.3d 1330, 1341 (Fed. Cir. 2013) (*en banc* rehearing denied); see also, *Robert Bosch*, 719 F.3d at 1305 (holding that the Federal Circuit has jurisdiction to entertain appeals from patent infringement liability determinations when a trial on damages has not yet occurred).

¹⁸⁷ *Id.* at 1332 (The Federal Circuit remanded the initial case to the district court to reconsider its damages verdict. While the litigation was pending on remand, the United States Patent Office completed its re-examination proceedings and determined that all of the claims were invalid. The Federal Circuit affirmed the PTO's determination, vacated the district court's judgment, and remanded with instructions to dismiss the case).

¹⁸⁸ See *Lutron Elecs.*, 2010 U.S. Dist. LEXIS 49623, at *6.

¹⁸⁹ See *Parallel Networks LLC v. AEO, Inc.*, No. 6:10-cv-00111, Dkt. No. 338, slip op. at 8 (E.D. Tex. Mar. 15, 2011).

¹⁹⁰ *Id.* at 6.

¹⁹¹ See *id.* at 4.

¹⁹² *Id.* at 8.

¹⁹³ *Kimberly-Clark*, 2010 U.S. Dist. LEXIS 98573, at *5.

¹⁹⁴ *Id.*

2. In denying a bifurcation motion, a court may consider that an accused infringer's proof of non-infringement and invalidity has ramifications not only for a liability determination, but also for a determination of whether infringement was willful. The patentee must prove by clear and convincing evidence that an infringer acted despite "an objectively high likelihood that its actions constituted infringement of a valid patent."¹⁹⁵ The defendant's actions must have been "objectively reckless."¹⁹⁶ It is not likely that a defendant will be found to have acted willfully if it has raised a reasonable defense to infringement. For this reason, questions may exist as to whether willfulness is more appropriately tried with liability or damages, and ambivalence over when to hear evidence on willfulness may make a judge more inclined to deny a bifurcation motion.¹⁹⁷

Litigants relying on a retrospective approach to the determination of a reasonable royalty may consider the efficiencies in undertaking damages discovery just once, at a point in time that is late enough to allow them to gather all of the relevant discovery. Litigants should also be mindful, though, that regardless of whether their damages model is prospective or retrospective, a significant delay in taking damages discovery creates the risk that discovery closest in time to the date of first infringement will be lost. However, depending on the situation, it may be preferable to conclude all discovery and then have a staged trial with the same jury rather than different juries.

BEST PRACTICES

1. *Where a case is bifurcated, litigants should consider whether discovery should also be bifurcated in light of their damages theories, or whether it is preferable to conclude all discovery at once.*
2. *If discovery is completed on all issues, bifurcated trials would benefit from having the same jury, whereas in cases where discovery is bifurcated, the trials will be to different juries.*

Principle IV-4: In a typical case, a willfulness allegation should not itself dictate a bifurcation of damages from liability. To the extent possible, where a case is bifurcated, and willfulness is tried after liability is determined, it is preferable to have a staged trial with the same jury rather than different juries.

Comment

Courts have the authority and discretion to try the issues of liability, willfulness, and damages together or separately.¹⁹⁸ Appeals may be entertained on patent infringement liability determinations when willfulness issues are outstanding and remain undecided.¹⁹⁹

Courts that have refused to bifurcate willfulness from liability have declined to do so because "[m]any of the witnesses and evidence needed to address the willfulness issue are the same as that needed to address the liability issue."²⁰⁰ Because willfulness is determined from the totality of the circumstances, those courts have concluded it is necessary for a jury to "look at all of the evidence as a whole."²⁰¹

¹⁹⁵ *In re Seagate Tech., LLC*, 497 F.3d 1360, 1371 (Fed. Cir. 2007).

¹⁹⁶ *Id.*

¹⁹⁷ *See, e.g.*, Kathleen Burdette Shields & Jessica Gan Lee, *The Bifurcation Divide*, LAW360, (Nov. 18, 2009, 10:45 AM), <http://www.law360.com/articles/130440/the-bifurcation-divide>.

¹⁹⁸ *Robert Bosch*, 719 F.3d at 1319–20.

¹⁹⁹ *Id.* at 1317.

²⁰⁰ *Robotic Vision Sys., Inc. v. View Eng'g., Inc.*, No. 96-cv-2288, 1997 U.S. Dist. LEXIS 19157 at *8 (C.D. Cal. Nov. 6, 1997).

²⁰¹ *Real v. Bunn-O-Matic Corp.*, 195 F.R.D. 618, 626 (N.D. Ill. 2000).

By contrast, other courts have bifurcated liability from willfulness and damages to avoid juror confusion when there are multiple defendants, which requires inquiry into the state of mind of each of the defendants, as well as into the attendant facts and circumstances.²⁰²

In light of the Principle above, a party may consider seeking bifurcation of willfulness from liability to the extent that it plans to rely upon an “advice of counsel” defense against willfulness, but it does not want to prove up its attorney-client communications during the liability trial.²⁰³

However, because it is preferable to have the same jury determine liability and willfulness, discovery on willfulness should be completed before the liability trial, so the trials can be staged one after another with the same jury. Whether an infringer’s proofs on invalidity and non-infringement are consistent with its pre-infringement opinion of counsel may be probative to the infringer’s good faith.²⁰⁴

Principle IV-5: Jury instructions that are tailored to the case will be more suitable than model jury instructions.

Comment

When a jury is charged with making a reasonable royalty determination, litigants should consider what the jury is told about the *Georgia-Pacific* factors. For example, litigants should ask if the jury should even be aware of certain factors if there is no testimony on those particular factors, because the jury may draw inferences from the absence of testimony on those factors. A better approach in such cases may be to reframe the instructions to ask the jury to focus on the invention, its contribution over the prior art, and the *Georgia-Pacific* factors present in the case.

Accordingly, if the damages expert witnesses only rely upon a subset of *Georgia-Pacific* factors, the jury should only be instructed on those factors. If comparability of licenses is at issue, the jury should be given specific guidance on how to determine comparability. Moreover, model jury instructions do not adequately address the entire market value rule and how to determine an appropriate base; thus, courts must craft new instructions based on the particular facts of the case, current case law, and the principles articulated in this paper.

Principle IV-6: Jury verdict forms that are tailored to the case will be more suitable than general verdict forms. Thus, in most cases, the verdict form should ask the jury to determine an amount of damages adequate to compensate for the infringement, on a per patent/per claim basis. Also, special verdict forms may be preferable in cases involving ongoing damages.

Comment

Litigants should be aware of the risks and advantages of different verdict form formats. The jury verdict form should be sufficiently detailed to avoid the need for remand and retrial after appeal. For example, where there are multiple patents, damages should be identified for infringement of each patent and on each claim found infringed so that reversal of validity or infringement of one patent would not require remand and retrial of damages on all patents-in-suit. On the other hand, increased specificity can increase the risk of juror confusion and inconsistent verdicts.

A jury might simply be asked to determine a number adequate to compensate for infringement. In cases in which ongoing infringement is a concern, juries should be asked to determine both the damages base and the applicable royalty rate, but should not be asked to perform the ultimate calculation.

²⁰² See *Medpointe Healthcare Inc. v. Hi-Tech Pharamcal Co.*, No. 03-5550, 2007 U.S. Dist. LEXIS 4652 at *16–17 (D.N.J. Jan. 22, 2007).

²⁰³ See, e.g., *Real*, 195 F.R.D. at 625.

²⁰⁴ *Patent Holding Co. v. TG (USA) Corp.*, No. 96-cv-74721, 1997 U.S. Dist. LEXIS 22571 at *4–5 (E.D. Mich. Dec. 2, 1997).

In the alternative, jurors could be presented with special verdict forms where they are asked to make factual determinations, allowing the judge to apply the relevant law. Or, special verdict forms might be drafted to include special interrogatories. For example, in cases of ongoing infringement, the parties may desire that a jury determine whether an ongoing running royalty, or a lump sum payment, is appropriate. In other cases, where one party asserts that the reasonable royalty should take the form of a lump sum, but the parties do not agree to submit the question of future damages to the jury, it may be beneficial to instruct the jury as to the dates covered by the reasonable royalty the jury awards.

In cases involving multiple patents and/or multiple accused products, the parties should consider whether a special verdict form is warranted, to ensure clarity on remand. On the other hand, a patentee may take the approach that it is the defendant's burden to appeal any part of a damages determination that it wishes to challenge on remand.

V. Posttrial Principles and Best Practices

A. Injunctions

Principle V-1: *A patent is a property right and the patentee usually is irreparably harmed if the right to exclude is not enforced.*

Comment

The Supreme Court in *eBay, Inc. v. MercExchange, LLC*,²⁰⁵ held that to obtain a permanent injunction, a patentee must demonstrate that: (1) it has suffered an irreparable injury; (2) the remedies available at law are inadequate to compensate for that injury; (3) hardships between the plaintiff and defendant favors an injunction; and (4) the public interest would not be disserved by issuance of an injunction.²⁰⁶

The question of whether there is a rebuttable presumption of irreparable harm was left unanswered in *eBay*, but addressed in two concurring opinions.

Roberts Concurrence

Chief Justice Roberts's concurrence (joined by Justices Scalia and Ginsburg) paralleled the prior view of the Federal Circuit:

[The] 'long tradition of equity practice' [granting injunctive relief upon finding infringement] is not surprising, given the difficulty of protecting a right to *exclude* through monetary remedies that allow an infringer to *use* an invention against the patentee's wishes—a difficulty that often implicates the first two factors of the traditional four-factor test.²⁰⁷

Kennedy Concurrence

Justice Kennedy's concurrence (joined by Justices Stevens, Souter, and Breyer) expressed concern over the Federal Circuit's prior view:

In cases now arising trial courts should bear in mind that in many instances the nature of the patent being enforced and the economic function of the patent holder presents considerations quite unlike earlier cases.²⁰⁸

Justice Kennedy's concurrence specifically called out the following issues a court should consider when deciding whether to issue an injunction:

- a. non-practicing entities (NPEs) ("An industry has developed in which firms use patents not as a basis for producing and selling goods but, instead, primarily for obtaining licensing fees. For these firms, an injunction, and the potentially serious sanctions arising from its violation, can be employed as a bargaining tool to charge exorbitant fees to companies that seek to buy licenses to practice the patent.");²⁰⁹
- b. small patented components of a larger accused device ("When the patented invention is but a small component of the product the companies seek to produce and the threat of an injunction is employed simply for undue leverage in negotiations, legal damages may well

²⁰⁵ 547 U.S. 388 (2006).

²⁰⁶ *Id.* at 391, 393–94.

²⁰⁷ *Id.* at 395.

²⁰⁸ *Id.* at 396.

²⁰⁹ *Id.* (citations omitted).

be sufficient to compensate for the infringement and an injunction may not serve the public interest.”);²¹⁰ and

- c. business method patents (“In addition injunctive relief may have different consequences for the burgeoning number of patents over business methods, which were not of much economic and legal significance in earlier times. The potential vagueness and suspect validity of some of these patents may affect the calculus under the four-factor test.”).²¹¹

Federal Circuit Reaction

Subsequent to *eBay*, the Federal Circuit has interpreted the Supreme Court’s decision to have removed the presumption of irreparable harm. However, consistent with Chief Justice Roberts’s concurrence, the Federal Circuit in *Robert Bosch, LLC v. Pylon Manufacturing Corp.* clarified that although “*eBay* jettisoned the presumption of irreparable harm as it applies to determining the appropriateness of injunctive relief,” the right to exclude, fundamental to patent law, should not be ignored.²¹² Specifically, the Federal Circuit stated:

[a]lthough *eBay* abolishes our general rule that an injunction normally will issue when a patent is found to have been valid and infringed, it does not swing the pendulum in the opposite direction. In other words, even though a successful patent infringement plaintiff can no longer rely on presumptions or other short-cuts to support a request for a permanent injunction, it does not follow that courts should entirely ignore the fundamental nature of patents as property rights granting the owner the right to exclude. Indeed, this right has its roots in the Constitution, as the Intellectual Property Clause of the Constitution itself refers to inventors’ “*exclusive* Right to their respective . . . Discoveries.” U.S. Const. Art. I, § 8, cl. 8 (emphasis added).²¹³

Similarly, in *Edwards Lifesciences AG v. Corevalve, Inc.*, the Federal Circuit reiterated that “[t]he Court in *eBay* did not hold that there is a presumption *against* exclusivity on successful infringement litigation.”²¹⁴ Rather, “[a]bsent adverse equitable considerations, the winner of a judgment of validity and infringement may normally expect to regain the exclusivity that was lost with the infringement.”²¹⁵

The Federal Circuit has reiterated that there is neither a presumption for nor against an injunction. Whether an injunction should issue depends on the facts of the case and a proper weighing of the equitable considerations.

Thus, a district court must consider the patentee’s right to exclude in determining whether an injunction is an appropriate remedy. However, the district court must weigh the equities as set out by the Supreme Court in *eBay* and may not presume irreparable harm or the inadequacy of monetary relief.

Comparison to ITC

The Federal Circuit has held that the *eBay* decision does not apply to exclusion orders in patent cases before the International Trade Commission. In *Spansion, Inc. v. International Trade Commission*, the Federal Circuit found that the applicable statute requires the Commission to issue an exclusion order upon finding a violation under Section 337, noting that “[t]he legislative history of the amendments to Section 337 indicates that Congress intended injunctive relief to be the normal remedy for a Section 337 violation and that a showing of

²¹⁰ *Id.* at 396–97.

²¹¹ *Id.* at 397.

²¹² *Robert Bosch*, 659 F.3d at 1149.

²¹³ *Id.*

²¹⁴ *Edwards Lifesciences AG v. Corevalve, Inc.*, 699 F.3d 1305 (Fed. Cir. 2012) (emphasis added).

²¹⁵ *Id.* at 1314.

irreparable harm is not required to receive such injunctive relief.”²¹⁶ Rather, the statute requires consideration of specific public interest factors that include: the public health and welfare; competitive conditions in the United States economy; the production of like or directly competitive articles in the United States; and United States consumers.²¹⁷

Stay Pending Appeal

Where appropriate, a permanent injunction may be stayed pending appeal. A court may issue such a stay pursuant to FRCP 62(c), which states that “[w]hile an appeal is pending from an interlocutory order or final judgment that grants, dissolves, or denies an injunction, the court may suspend, modify, restore, or grant an injunction on terms for bond or other terms that secure the opposing party’s rights.”²¹⁸ A stay of an injunction pending appeal may be obtained at the district court or the Federal Circuit.²¹⁹

In determining whether to stay an injunction pending appeal, the district court and the Federal Circuit apply the same test, by considering the following four factors:

1. whether the stay applicant has made a strong showing that he is likely to succeed on the merits;
2. whether the applicant will be irreparably injured absent a stay;
3. whether issuance of the stay will substantially injure the other parties interested in the proceeding; and
4. where the public interest lies.²²⁰

Thus, for example, in a case in which the claim construction or other issues on the merits were not clearly in favor of one party, the presiding district court that enters an injunction in favor of a patent owner could stay the injunction pending resolution of the appeal. Under those circumstances, any settlement negotiations will be based on the parties’ evaluation of the strength of their respective positions on appeal, not on the *in terrorem* effect of the threat of being excluded from the market before the appeal can be decided. As noted below, the court did precisely that in *Smith & Nephew, Inc. v. Arthrex, Inc.*²²¹

As an alternative to staying an injunction pending appeal, another option available in appropriate circumstances is for a court to issue a permanent injunction, but provide for a sunset period for the defendant to implement a non-infringing alternative.²²² In these circumstances, the patentee is typically compensated for the continued use of its patent through the payment of sunset royalties.²²³

²¹⁶ *Spansion, Inc. v. International Trade Comm’n*, 629 F.3d 1331, 1358 (citing to 19 U.S.C. § 1337(d)(1)).

²¹⁷ *Id.*

²¹⁸ FED. R. CIV. P. 62(c).

²¹⁹ FED. R. APP. P. 8(a)(1)–(2).

²²⁰ *Standard Havens Prods., Inc. v. Gencor Indus., Inc.*, 897 F.2d 511, 512 (Fed. Cir. 1990) (quoting *Hilton v. Brannskill*, 481 U.S. 770, 776 (1987)).

²²¹ No. 2:07-cv-335, 2010 WL 2522428 (E.D. Tex. June 18, 2010).

²²² See, e.g., *Broadcom Corp. v. Emulex Corp.*, 732 F.3d 1325, 1339 (Fed. Cir. 2013) (“[T]he district court’s selection of an eighteen month sunset period was not an abuse of discretion. The eighteen months allowed for time to remove the infringing product from the market without causing significant downstream disturbance for OEMs and consumers. And the eighteen-month period is a compromise between the wide range of time estimates in the record relating to the design process and product qualification.”).

²²³ See e.g., *Active Video Networks, Inc. v. Verizon Comm’ns, Inc.*, 694 F.3d 1312, 1342–43 (Fed. Cir. 2012) (affirming district court’s imposition of a sunset royalty).

The following cases exemplify the use of a stay of injunction pending appeal:

a. *i4i v. Microsoft*

While a stay pending appeal was denied at the district court,²²⁴ a stay pending appeal was granted by the Federal Circuit.²²⁵ Thereafter, the Federal Circuit affirmed the finding of infringement and reinstated the injunction but modified the effective date of the injunction.²²⁶

b. *Verizon v. Vonage*

The Federal Circuit granted a stay pending appeal²²⁷ after the district court stayed the injunction pending appeal with respect to present or existing customers, provided Vonage escrowed the 5.5% royalty quarterly.²²⁸ The Federal Circuit later affirmed the injunction as to two patents but vacated the judgment of infringement with respect to a third patent, and remanded for a new trial.²²⁹

c. *NTP v. RIM*

The district court granted a stay of the permanent injunction pending appeal.²³⁰ The court granted the plaintiff's motion for permanent injunction, finding that:

1. NTP will be face [sic] irreparable harm if an injunction is not issued;
2. NTP has no adequate remedy at law to address future infringing sales;
3. an injunction in this case is in the public interest as it promotes protection of the rights gained through the patent process; and
4. the balance of hardships between NTP as the holder of the patents-in-suit, and Research in Motion, Ltd. ("RIM") as the infringing party, weighs more heavily towards NTP.²³¹

The above order notwithstanding, however, the court also granted the defendant's motion for a stay, finding that:

1. RIM will be irreparably injured absent a stay of the permanent injunction;
2. the issuance of the stay will not substantially injure NTP; and
3. issuance of the stay is in the public interest, as the public has a demonstrated and increasing use of the products and services involved in this litigation.²³²

The damage award and injunction were vacated on appeal.²³³

²²⁴ *i4i Ltd. P'ship v. Microsoft Corp.*, 670 F. Supp. 2d 568, 602–03 (E.D. Tex. 2009).

²²⁵ *i4i Ltd. P'ship v. Microsoft Corp.*, 343 Fed. Appx. 619 (Fed. Cir. 2009).

²²⁶ *i4i Ltd.*, 598 F.3d at 863–64.

²²⁷ *Verizon Servs. Corp. v. Vonage Holdings Corp.*, 228 Fed. Appx. 986 (Fed. Cir. Apr. 24, 2007).

²²⁸ *Verizon Servs. Corp. v. Vonage Holdings Corp.*, No. 1:06-CV-682 (E.D. Va. Apr. 12, 2007) (D.I. 549).

²²⁹ *Verizon Servs. Corp. v. Vonage Holdings Corp.*, 503 F.3d 1295 (Fed. Cir. 2007).

²³⁰ *NTP, Inc. v. Research in Motion, Ltd.*, No. 3:01CV767, 2003 WL 23100881 (E.D. Va. Aug. 5, 2003).

²³¹ *Id.* at *1.

²³² *Id.* at *2.

²³³ *NTP, Inc. v. Research in Motion, Ltd.*, 418 F.3d 1282, 1325 (Fed. Cir. 2005).

d. *Smith & Nephew v. Arthrex*

After considering the four-factor test reiterated in *eBay*, the district court granted Smith & Nephew's motion for a permanent injunction, but stayed the permanent injunction pending appeal, finding that "the facts and legal issues of this case are particularly close on the issue of infringement."²³⁴ The infringement decision was reversed on appeal.²³⁵

BEST PRACTICES

Guidance for various scenarios with respect to Principle V-1 is provided below, although each case should be decided on its specific facts:

1. *The presence of direct competitors presents the strongest case for the court to enter an injunction and deny a stay. The patent owner has a clear economic market interest in excluding the competing infringer from the marketplace, regardless of whether the patent owner practices the patented invention. This also presents the case where it is least likely that the patent owner is using the injunction to leverage a premium unrelated to the damages which could be suffered pending appeal.*
2. *A patent owner's practice of licensing the patent widely to whomever has requested a license presents a strong case for denial of the injunction.*
3. *In cases where the patentee practices the patent, but the litigants are not competitors, depending on the circumstances of the matter, the patentee may not be entitled to an injunction.*²³⁶
4. *In cases where the patentee does not practice the patent, but licenses it to an exclusive licensee who practices the patent and is a direct competitor with the infringer, the patentee may be entitled to an injunction. Similarly, in some circumstances where there was extremely limited licensing to licensees who practice the patent and are direct competitors with the infringer, the patentee may be entitled to an injunction.*
5. *In cases where the patentee does not practice the patent and licenses it to one or very few licensees who do not practice the patent, the patentee may not be entitled to an injunction.*
6. *An injunction should generally not be entered if the patentee is asserting that the patent is essential to a standard and the patentee has made a fair, reasonable, and non-discriminatory (FRAND) commitment.*
7. *A stay of the injunction pending appeal should be considered as part of the overall injunction analysis. For example, the district court should consider whether a stay of the injunction will cause irreparable harm to a patentee-competitor.*²³⁷

²³⁴ *Smith & Nephew, Inc. v. Arthrex, Inc.*, No. 2:07-cv-335, 2010 WL 2522428, at *4 (E.D. Tex. June 18, 2010).

²³⁵ *Smith & Nephew, Inc. v. Arthrex, Inc.*, 453 Fed. Appx. 977, 981 (Fed. Cir. 2011).

²³⁶ A common scenario where this occurs is when the patent covers only a component of a larger product. In that case, the importance of the component to the overall product will be an important factor to consider. If the invention is a critical component, a non-competitor patentee may still be entitled to an injunction. An additional example is when a patent covers a method of manufacture or chemical/biological intermediate that is capable of producing different end products, a particular product with multiple end uses, or results in significant production cost savings. Depending on the circumstances, an injunction might be appropriate, particularly if the patentee has exclusively licensed a competitor of the infringer, or if the infringement impacts the patentee's ability to grant field-of-use licenses or to comply with a requirements contract.

²³⁷ See *Robert Bosch*, 659 F.3d at 1151 ("[t]he existence of a two-player market may well serve as a substantial ground for granting an injunction—for example, because it creates an inference that an infringing sale amounts to a lost sale for the patentee."); *i4i v. Microsoft*, 598 F.3d 831, 861 (Fed. Cir. 2010).

B. Alternatives to Injunctions

Principle V-2: If an injunction is not available, then ongoing royalties may be available.

Comment

The Federal Circuit has held that “[t]he award of an ongoing royalty instead of a permanent injunction to compensate for future infringement is appropriate in some cases.”²³⁸

For example, in *Edwards Lifesciences AG v. Corevalve, Inc.*, the Federal Circuit outlined that:

Precedent illustrates the variety of equitable considerations, and responsive equitable remedy in patent cases; for example, the grant of a royalty-bearing license instead of imposing an injunction in situations where the patentee would experience no competitive injury, as in *ActiveVideo Networks, Inc. v. Verizon Communications, Inc.*, or where there is an overriding public interest in continued provision of the infringing product, as in *Bard Peripheral Vascular, Inc. v. W.L. Gore & Assocs., Inc.*, where the Gore vascular graft materials were not available from the successful patentee Bard. Another form of equitable response is illustrated in *Broadcom Corp. v. Qualcomm Inc.*, where the court postponed the effective date of an injunction for twenty months, to relieve hardship on the infringer.²³⁹

A judgment of an ongoing royalty for post-verdict infringement will only be granted where equitable relief, in the form of a permanent injunction, is not granted.

Recent Federal Circuit case law has explored the tension between awarding a patentee damages as opposed to an injunction. In *Paice LLC v. Toyota Motor Corp.*, the court stated that in certain cases, awarding the patentee with an ongoing royalty, rather than an injunction, may be the appropriate course of action.²⁴⁰ The Federal Circuit stated that the text of Section 283, that “empowers ‘courts . . . [to] grant injunctions in accordance with the principles of equity . . . on such terms as the court deems reasonable,’ leaves no doubt that Congress did not intend to statutorily entitle patentees to a jury trial for the purposes of awarding relief thereunder.”²⁴¹ The court accepted Paice’s argument that “the determination of damages is a legal question which carries a Seventh Amendment right to a jury trial,” but qualified this statement by stating that “not all monetary relief is properly characterized as ‘damages.’”²⁴² Several years later, the court addressed the same issues in *Telecordia Techs., Inc. v. Cisco Sys., Inc.*,²⁴³ and affirmed the views stated in *Paice*.

According to the Federal Circuit in *Paice*, the Seventh Amendment does not apply to an ongoing royalty determination because the court can determine the mandatory royalty as an *equitable* alternative to an injunction.²⁴⁴ This holding appears to present an inconsistent result in the following scenario: if a patentee sues only for back damages, never asking for an injunction or a forward royalty, and then sues every six months for damages, the patentee would be entitled to a jury trial in each of those cases. This practice would be highly inefficient, both for the patentee and the courts. While it is unclear why the result should be different when the patentee acts more efficiently by suing for both back damages and a forward royalty at once, *Paice* is the current law, although the Federal Circuit did not explain why patent damages should be treated differently than any other continuing tort.

²³⁸ *Bard Peripheral Vascular, Inc. v. W.L. Gore & Assocs., Inc.*, 670 F.3d 1171, 1192 (Fed. Cir. 2012) (citing *Paice*, 504 F.3d 1314).

²³⁹ *Edwards Lifesciences*, 699 F.3d at 1315.

²⁴⁰ *Paice*, 504 F.3d at 1314. The Federal Circuit also stated that should the district court decide that an ongoing royalty is the more appropriate remedy, the district court has the discretion to permit the parties to negotiate a license agreement themselves before imposing an ongoing royalty on the parties. *Id.* at 1315. In this way, the district court attempts to most closely approximate the hypothetical negotiation described *supra* in Chapter II.

²⁴¹ *Id.* at 1293, n.16 (emphases added).

²⁴² *Id.* at 1316.

²⁴³ *Telecordia Techs., Inc. v. Cisco Sys., Inc.*, 612 F.3d 1365, 1378–79 (Fed. Cir. 2010).

²⁴⁴ *Id.*

There are valid arguments on both sides of the Federal Circuit's decision in *Paice*. For that reason the Working Group states that ongoing royalties "may be available" as an alternative to an injunction. Opponents of the Federal Circuit's decision in *Paice* provided the following arguments: The Patent Act provides for the award of damages to the patentee upon a finding of infringement in Section 284.²⁴⁵ Title 35 also provides that in appropriate circumstances, a court *may* grant an injunction to a prevailing party "in accordance with the principles of equity to prevent the violation of any right secured by patent, on such terms as the court deems reasonable."²⁴⁶ Section 283 authorizes a court to grant an injunction if the circumstances warrant it, but does *not* authorize monetary damages as an equitable alternative to be determined *by the court* if it declines to enter an injunction. Further, Section 284 does not authorize monetary damages without a jury trial. The Seventh Amendment supports this view as well. It is well-established that if an issue was tried before a jury at common law at the time this country was founded, or is analogous to an issue that was so tried, the Seventh Amendment mandates a jury trial on that issue unless the parties waive this right.²⁴⁷ Under *Markman* and related precedent, the Federal Circuit should conclude that the assessment of monetary damages in patent cases is analogous to issues tried before a jury at common law, thus requiring a jury determination in cases today. Accordingly, contrary to the holding in *Paice*, both Section 284 and the Seventh Amendment require a jury to resolve the royalty rate applicable to post-verdict infringement. It seems most logical that if an action for past infringement and past damages entitles a patentee to a jury trial, then a judgment that the continued infringement (i.e., an ongoing tort) results in additional damages and the amount of those damages should be treated the same way. The reasoning in *Paice* does not sufficiently justify why an ongoing royalty ceases to be "damages" or is an equitable issue.

Principle V-3: An ongoing royalty should fairly compensate the patent holder for the ongoing use made by the infringer of the patented invention and should be determined by considering what fully informed and reasonable persons in the position of the patent owner (or owners throughout the period of infringement) and the infringer would agree to at the time of trial as a fair price for the license, from the time of trial through the expiration of the patent, taking into account all relevant facts and circumstances occurring before or during that period.

Comment

As discussed above with respect to a reasonable royalty for past damages, an ongoing royalty for future damages should fairly compensate the patent holder for the actual use made by the infringer of the patented invention. This view is consistent with the statutory mandate that damages should be "adequate to compensate for infringement." An ongoing royalty awarded at the conclusion of a trial is in lieu of the patent holder filing a later suit(s) for damages for the ongoing use. Of course, if the jury awarded a fully paid up lump sum amount, then no ongoing royalty would be owed.

BEST PRACTICES

1. *Rather than simply applying the pre-verdict royalty rate to post-verdict conduct, specific evidence should be presented as to a post-verdict royalty.*
2. *Courts should adhere to the following principles in addressing a post-verdict royalty:*
 - a. *Forward damages should start at the conclusion of the trial.*
 - b. *The royalty should fairly compensate the patent holder for the ongoing use made by the infringer of the patented invention.*

²⁴⁵ See *supra* Chapter II.

²⁴⁶ 35 U.S.C. § 283.

²⁴⁷ See *Markman v. Westview Instruments, Inc.*, 517 U.S. 370, 377 (1996) (holding that claim construction is a matter of law for the court to determine and distinguishing claim construction from issues historically left for the jury).

3. *Courts should also consider the following with respect to determining a post-verdict royalty:*
 - a. *How does the change in bargaining positions and/or economic conditions affect the royalty rate?*²⁴⁸
 - b. *Is the infringer now deemed to be willful?*
 - c. *Is the “willing licensee” and “willing licensor” paradigm still appropriate?*²⁴⁹
 - d. *Should the Georgia-Pacific factors be applied and, if so, which ones? Should the focus be on factors that may have changed from the original hypothetical negotiation, such as the existence of design around products, the value of the technology, and the willfulness of the post-verdict infringement?*
 - e. *Should there be a single ongoing royalty rate, or a varying rate (e.g., one that increases over time)?*
 - f. *Should different industries and/or technologies be treated differently? This consideration stems from the idea that what makes sense in one technical field might make little sense in another technical field, and a “one size fits all” approach is not good practice.*
4. *The following timing may be used to hear evidence on the post-verdict royalty:*
 - a. *After the motion for permanent injunction is denied;*
 - b. *During trial, while the jury is empaneled (e.g., presenting the issue of an ongoing royalty rate to the jury, notwithstanding that the patentee intends to seek an injunction); or*
 - c. *Through the filing of a separate complaint.*

C. Attorneys’ Fees and Fee Shifting²⁵⁰

Principle V-4: *Pursuant to 35 U.S.C. § 285, where a party to a patent lawsuit improperly initiates or maintains one or more claims or defenses, an award of attorneys’ fees is presumptively appropriate. Attorneys’ fees may be assessed against the party and/or its counsel as circumstances warrant.*

Comment

In April 2014, in addressing the standard for deciding whether a case is “exceptional” for the purpose of awarding attorneys’ fees under 35 U.S.C. § 285, the Supreme Court lowered the bar from the former “objectively and subjectively baseless” standard to one that covers litigation practices that “stand[] out from others with respect to the substantive strength of a party’s litigating position (considering both the governing

²⁴⁸ See *Amado* at 1362.

²⁴⁹ See *Sovereign Software*, 899 F. Supp. 2d at 589–90 (applying a 2.5x enhancement to the jury’s implied royalty rate for ongoing royalties).

²⁵⁰ This paper does not address willful patent infringement or the potential enhanced damages and attorneys’ fees recoverable after such a finding.

law and facts of the case) or the unreasonable manner in which the case was litigated.”²⁵¹ Reference in this section to claims or defenses that are “improperly” asserted or maintained should be understood to refer to the currently applicable Supreme Court standard.

Whether or not to award fees is typically within the discretion of the district court. The Working Group’s formulation that an award of fees is “presumptively appropriate” is meant to state the Working Group’s view that it is an abuse of the court’s discretion to refrain from awarding fees where litigation is improperly pursued.

We have noted that such fee shifting is appropriate where “one or more” claims or defenses are improper. This is meant to recognize that courts have the flexibility to sanction conduct, even where some claims or defenses in a case may be appropriately pursued. We expect that litigants and the courts will be self-regulating in seeking and applying fee shifting only to improper claims and defenses that *have a material impact* on the scope and cost of a litigation, and not to pursue sanctions with respect to each failed claim or defense without regard to whether it has had any material impact on the scope or burden of the litigation.

Principle V-5: A claim or defense is improper at whatever point in time it becomes the case that:

1. ***The patentee and/or its counsel had actual knowledge that (or were willfully blind as to the fact that) the asserted claim is either not valid, not infringed, or not enforceable;***
2. ***The accused infringer and/or its counsel had actual knowledge that (or were willfully blind as to the fact that), contrary to an asserted defense, the asserted claim is valid, infringed, or enforceable;***
3. ***In the case of a party to a patent lawsuit, a reasonable person in the position of the patentee and advised by competent counsel would understand that the pursuit of a claim or defense is without merit; or***
4. ***In the case of the party’s counsel, competent counsel in the position of the party’s counsel would understand that the pursuit of a claim or defense is without merit.***

Comment

This Principle is meant to make two points clear. First, the formulation that a claim “is improper *at whatever point in time*” it becomes clear that it lacks merit is meant to emphasize the current law’s recognition that the duty to assess the viability of a claim or defense in good faith is ongoing. Claims or defenses that were appropriate at the outset may turn out to be meritless and should not be pursued once that becomes clear. This is not to say that any adverse ruling at the trial level makes pursuit or defense of a claim improper, as a good faith basis for appeal may often exist, and maintenance of the case or its defense is proper under such circumstances. However, an adverse ruling is an occasion on which the continuation of the lawsuit or its defense should be assessed, and where no good faith basis for appeal exists, the lawsuit or its defense should not be maintained.

Second, the aspect of the guideline that deals with addressing the circumstances under which initiating or maintaining a claim or defense becomes improper—namely, when competent counsel (or a party advised by competent counsel) would recognize the lack of merit—is meant to hold parties to a standard of conduct consistent with professional norms, and to eliminate “white heart, empty head” as an excuse for any otherwise inappropriate claims or defenses.

²⁵¹ See *Octane Fitness*, 134 S.Ct. at 1756; see also *Highmark Inc. v. Allcare Health Mgmt. Sys.*, 134 S.Ct. 1744, 1746 (2014) (holding that a district court’s award of attorneys’ fees will no longer be reviewed *de novo*, but rather will now be reviewed on appeal under the more deferential “abuse of discretion” standard).

Finally, it must be emphasized that the mere fact that a claim or defense is abandoned by a litigant is not a basis for inferring that the claim or defense was improperly asserted or maintained prior to that time. Claims or defenses may be abandoned during a case for many perfectly legitimate reasons unrelated to their merits. Even where a claim or defense is abandoned because it is lacking in merit, this is, as a general matter, behavior that is to be encouraged rather than punished. As with everything else, there may well be exceptions to this generalization. For example, where a claim or defense is improperly pursued long past the point when its lack of objective validity had become clear, simply for its *in terrorem* value, such conduct may be sanctionable. The point is simply that the mere abandonment of a claim or defense is not in and of itself evidence of anything improper.

Principle V-6: *Indicators that a reasonable person in the position of a party and/or the party's counsel would know that the initiation or maintenance of a claim or defense is improper include, but are not limited to, the following:*

1. *The claim or defense rests on a construction of a claim limitation that (a) was explicitly disclaimed during prosecution or in the specification, or (b) is objectively inconsistent with the plain meaning of the limitation, and the plain meaning of the limitation is not disclaimed elsewhere in the intrinsic record;*
2. *The party or original patentee (where the original patentee is not a party) or its counsel previously had made a statement about the patent to a court, the Patent and Trademark Office, or another administrative body that cannot reasonably be reconciled with the initiation or the maintenance of a claim or defense;*
3. *There is evidence (a) which establishes as a matter of law that a claim or defense is objectively baseless, and (b) which, after the initiation of a lawsuit, is actually called to the party's attention through discovery, or, prior to the initiation of a lawsuit, was obtained, or through the exercise of reasonable diligence could have been obtained, from the public record or from witnesses under the control of the party; or*
4. *There is a reasonable basis to believe that a case was brought for the purpose of obtaining a settlement of a meritless claim for materially less than the likely cost of litigation.*

Comment

The listing of “indicia” of improper conduct is intended to provide guidance as to particular practices which should be viewed with skepticism. Broadly speaking, indicators 1 and 2 are meant to suggest that a court should view skeptically a litigant who seeks to turn a blind eye to the clearly formulated public record concerning the scope of the patent claims being asserted. Indicator 3 is meant to suggest that a court should view skeptically a litigant who seeks to turn a blind eye to obviously inconvenient facts. Indicator 4 is meant to suggest that a court should view skeptically a litigant who gives the appearance of abusing the litigation process.

The indicators, however, are not meant to be dispositive of the question of when a claim or defense is improperly made or maintained, as there may be facts that justify or explain any *prima facie* impropriety. Thus, for example, with respect to indicators 1 and 2, there are clearly cases where a good faith dispute exists as to what has been “objectively” disclaimed by the language of the limitation in question, the specification, the prosecution, or by statements in other proceedings.

Likewise, with respect to indicator 3, undisputed facts that are dispositive on one claim construction may not be dispositive on a different claim construction; and even where judgment is properly entered as a matter

of law, the question of whether a court should do so may be a close one. Further, a litigant does not act in a sanctionable manner when it fails to recognize the significance of facts that are buried in a massive discovery record and not disclosed in expert reports, contention interrogatories, or other pleadings designed to set forth a party's position on the merits.

Finally, the mere fact that a litigant negotiates multiple cost of litigation settlements may simply be indicative of a valid and infringed patent of limited economic significance or of a calculated funding strategy to support a good faith claim against one or more particularly significant infringers.

In short, we characterize the listed fact patterns as *indicators* both because they describe circumstances that ought to cause a presiding judge to inquire as to the bona fides of a claim or defense, and because they do not necessarily dictate what conclusion that inquiry ought to reach.

VI. Conclusion

In conclusion, the principles and best practices recommended by this paper represent Working Group 9's guidance with respect to important patent damages issues. This paper obviously does not attempt to address all patent damages issues, or even to provide comprehensive coverage for the issues it does address. Instead, the paper addresses currently debated issues for which Working Group 9 feels well-situated to propose solutions that would move the law forward, albeit incrementally, in a reasoned and just way.

The most significant departure from the current reasonable royalty framework is the new Retrospective Model of reasonable royalty damages, which: (1) reduces the uncertainty resulting from an *ad hoc* application of the "book of wisdom"; and (2) better captures the statutory requirement that impliedly suggests a retrospective look at the circumstances of the infringement and the resulting damage—i.e., that damages be "adequate to compensate for infringement."

The paper also provides practical guidance for those involved in the nuts and bolts of patent litigation. For example, the paper sets forth a series of best practices regarding early disclosure of damages contentions, early resolution of the challenges to damages theories, and proposes a rubric for evaluating the comparability of patent licenses. Finally, there are a series of proposals for trial and posttrial considerations—relating to bifurcation, to trial time, to posttrial royalties, and lastly, to the question of awarding attorneys' fees in appropriate cases—because these issues are important to the just resolution of these complex patent damages disputes.

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