

Client Alert

Latham & Watkins Litigation Department

The Law of Patent Damages: Who Will Have the Final Say?

On September 11, 2009, the US Court of Appeals for the Federal Circuit held that the damages award in *Lucent Technologies v. Gateway, Inc.* was inadequately supported.¹ The court affirmed an infringement judgment against Microsoft, but vacated a \$357 million damages award, finding that the jury's damages calculation lacked sufficient evidentiary support.

This decision follows on the heels of *Cornell University v. Hewlett-Packard Company*,² a March 30, 2009 decision in which Judge Rader of the Federal Circuit (sitting by designation in the US District Court for the Northern District of New York) reduced the size of a jury award by more than 70 percent, from \$184 million to \$53 million. Judge Rader found that the jury award was impermissibly based upon revenue derived from the sale of non-infringing components.

Proponents of patent reform have been lobbying Congress to legislatively rein in what some critics contend are oversized damages awards based on the sale of products that contain patented features. The *Lucent v. Gateway* and *Cornell v. HP* decisions support the argument that courts are fully equipped to police patent damages awards without legislative intervention. These decisions also highlight for litigators the importance of presenting thoroughly supported damages analyses, particularly in complex patent cases.

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Patent Damages

Damages awards under patent law compensate a prevailing claimant with 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."³ The purpose is to put the patentee in the same pecuniary condition it would have been in had there been no infringement.⁴ The burden is on the claimant to prove damages.⁵

The calculation of a reasonable royalty requires the determination of a royalty base (the revenue pool implicated by the infringement) and a royalty rate (the percentage of that pool that is adequate to compensate for infringement). Courts generally have relied on the 15 factor test first set forth in *Georgia-Pacific Corp. v. U.S. Plywood Corp.*,⁶ in order to determine the reasonable royalty. This analysis involves determining the terms on which the patent holder and the infringer, assuming they were willing to do so, would have licensed the patent, at the time the infringement began.⁷

Lucent v. Gateway

The Facts

In 2002, Lucent sued Microsoft for infringement of a patent called the Day Patent, a method of entering information into fields on a computer

screen without the use of a keyboard.⁸ Lucent claimed that the Day Patent was infringed by Microsoft Outlook's "date picker" tool — a graphical calendar that allows the user to select a date with the tool, which then automatically enters numerical information into the correct form.⁹ Infringement of the method thus allegedly occurred each time a user entered a date using the date picker tool, but not if the user entered the date using a keyboard.

The jury found the patent valid and infringed, and issued a judgment in Lucent's favor for nearly \$358 million, which rose to more than \$511 million with prejudgment interest.¹⁰ Microsoft appealed after its motion to have the judgment set aside was denied.

The Federal Circuit affirmed the validity and infringement decisions, but vacated the damages award and remanded to the district court.¹¹ The court found that Lucent did not present substantial evidence that could support the jury's damages award.¹²

The Lucent v. Gateway Damages Analysis

At trial, Lucent asked the jury to award \$561.9 million based on Microsoft's allegedly infringing sales of its popular software Outlook and two other software products.¹³ Lucent's claim was based upon a reasonable royalty of 8 percent of the sales of the accused products, which totaled approximately \$8 billion.¹⁴ Microsoft argued instead for a lump-sum award of \$6.5 million, which it contended was the amount that the parties would have negotiated in a hypothetical negotiation for a license to the asserted patent.¹⁵

The jury's award of \$357,693,056.18 appeared to be based on a lump-sum calculation.¹⁶ Thus, the question presented to the court was "whether substantial evidence supports the jury's implicit finding that Microsoft would have agreed to, at the time of the hypothetical negotiation, a lump-sum, paid-in-full royalty of about \$358 million."¹⁷

Judge's Role as Gatekeeper

As an initial matter, Chief Judge Paul R. Michel noted that because Microsoft failed to object at trial to any of the evidence on damages, all of the evidence presented was properly before the jury.¹⁸ The court rejected Microsoft's suggestion on appeal that the district court judge had "abdicated" her role as a gatekeeper, noting that "[t]he responsibility for objecting to evidence . . . remains firmly with the parties."¹⁹

The Georgia-Pacific Factors

The court engaged in a detailed analysis of the evidence regarding damages presented to the jury, and assessed the evidence in accordance with the 15 *Georgia-Pacific* factors. Judge Michel focused on factor two, "the rates paid by the licensee for the use of other patents comparable to the patent in suit."²⁰

Lucent pointed to eight license agreements that it had presented at trial, in support of its contention that the lump-sum award was appropriate.²¹ But the court was not persuaded. Judge Michel found that some of the agreements involved different subject matter and thus were not applicable to the circumstances here, and also found that Lucent did not establish the subject matter of several of the agreements.²² The court found that Lucent failed to meet its evidentiary burden to support the jury award:

Having examined the relevant *Georgia-Pacific* factors, we are left with the unmistakable conclusion that the jury's damages award is not supported by substantial evidence, but is based mainly on speculation or guesswork . . . the jury's award of a lump-sum payment of about \$358 million does not rest on substantial evidence and is likewise against the clear weight of the evidence We need not identify any particular *Georgia-Pacific* factor as being dispositive. Rather, the flexible analysis of all applicable *Georgia-Pacific* factors provides a useful and legally-required framework for assessing the damages award in this case.²³

Judge Michel also admonished both sides for poorly presenting evidence of damages and cautioned district court judges to “scrutinize the evidence carefully to ensure that the ‘substantial evidence’ standard is satisfied . . .”²⁴

The Entire Market Value

The court concluded with an analysis of the “entire market value” rule. This doctrine “permits recovery of damages based on the value of the entire apparatus containing several features, where the patent related feature is the basis for customer demand[.]”²⁵ Microsoft argued that the jury had relied on the rule even though it was not applicable. The court agreed that if the jury did rely on the entire market value rule, it had erred.²⁶ Since Lucent’s own expert testified that there was “no evidence that anybody anywhere at any time ever bought Outlook . . . because it had a date picker,”²⁷ the entire market value rule was inapplicable.

Interestingly, the court suggested that although application of the entire market value rule requires that the patented feature be a basis of customer demand, one way to deal with the absence of such a showing is to reduce the royalty rate: “[s]imply put, the base used in a running royalty calculation can always be the value of the entire commercial embodiment, as long as the magnitude of the rate is within an acceptable range (as determined by the evidence).”²⁸ In other words, since any running royalty must have both a base number and a royalty rate, even if the infringing product is a very small component of a larger product, the entire market value rule is economically justifiable as long as the rate is appropriate.²⁹ The court found that Lucent’s attempted use of the rule was flawed because (aside from the absence of evidence of customer demand) Lucent failed to use an appropriately small royalty given the size of the base to which it was applied.³⁰

Cornell v. HP

In recent months, another member of the Federal Circuit (sitting by designation at the trial court level) explored the contours of the entire market value rule in a published decision. In December 2001, Cornell University sued Hewlett-Packard for infringement of a patent that describes an invention to enhance performance of computer microprocessors.³¹ Cornell sought damages based upon revenue for HP’s server and workstation systems.³² However, only a small component of these products came within the scope of the asserted patent claims.³³ Judge Rader excluded the market value rule testimony of Cornell’s expert as insufficiently supported.³⁴ Cornell then introduced damages evidence based on sales of CPU bricks — again encompassing much more than the microprocessor — and HP was found liable for infringement on that basis.³⁵ The jury awarded Cornell \$184,044,048 by applying a 0.8 percent royalty rate to a \$23 billion royalty base for the CPUs.³⁶

HP moved for judgment as a matter of law to reduce the royalty base to earnings attributable to the infringing technology.³⁷ In March 2009, Judge Rader found that Cornell failed to demonstrate entitlement to the entire market value of HP’s CPUs, and granted HP’s motion.³⁸ Judge Rader found that the royalty base was overbroad and that Cornell instead should have chosen a royalty base that was “more clearly relevant to the value of the patented invention.”³⁹ Both parties have appealed.

The Implications for Patent Reform

The decisions in *Lucent v. Gateway* and *Cornell v. HP* suggest that courts have tools at their disposal to control damages awards so that they reflect proper compensation for the patented technology. Judges Michel and Rader sent strong signals to judges, litigants

and legislative reformers alike that courts may effectively police patent damages awards by engaging in thoughtful analysis when scrutinizing the theories and evidence presented to juries. Undoubtedly, these decisions will impact the course of ongoing congressional debate over patent damages reform.

Advocates of patent reform claim that large verdicts and systematic overcompensation are products of the current Patent Act framework and warrant amendment of the statute. These advocates, such as the Coalition for Patent Fairness, cite economic analyses which they claim indicate that patent reform could benefit the economy by creating new jobs.⁴⁰ Opponents assert that by making the potential cost of infringement lower, emphasis on innovation could decrease, adversely affecting jobs in a slumping economy.⁴¹

Of course, courts have traditionally been the primary source of evolution in patent law, as "Congress has not enacted comprehensive patent law reform in more than 50 years."⁴² Since 2005, however, members of Congress have proposed several acts to overhaul patent law. The Patent Reform Act of 2005, proposed in the 109th Congress, reflected the first Congressional effort to modernize patent laws. However, the 109th Congress concluded without passing the bill. Likewise, the Patent Reform Act of 2007, which included significant, substantive portions of its predecessor, passed in the House but failed to pass in the Senate. The 111th Congress is considering the most recent version of the bill, which bears the markers of its predecessors, including a provision which creates a more structured approach to damages calculations.⁴³

As originally proposed, the House and Senate versions of the Patent Reform Act of 2009 provided a statutorily-prescribed approach to determining damages. Reasonable royalty damages based on the entire market value of the infringing product would be allowed only "upon a showing to the satisfaction

of the court that the claimed invention's specific contribution over the prior art is the predominant basis for market demand."⁴⁴ In addition, damages would be limited to only the portion of the economic value of the infringing product or process attributable to the claimed invention's specific contribution over prior art. Under this approach, damages for patent infringement arguably would be reduced.

The approach advanced in the Senate Judiciary Committee's revised version of the bill does not directly address the entire market value rule,⁴⁵ but instead sets forth a "more robust, procedural, gate keeping role" for judges, enabling them to assess the basis for specific damages theories and jury instructions.⁴⁶ As stated in the proposal:

The court shall identify the methodologies and factors that are relevant to the determination of damages, and the court or jury, shall consider only those methodologies and factors relevant to making such determination. . . . Prior to the introduction of evidence concerning the determination of damages . . . the court shall consider whether one or more of a party's damages contentions lacks a legally sufficient evidentiary basis. . . . [T]he court shall identify on the record those methodologies and factors as to which there is a legally sufficient evidentiary basis, and the court or jury shall consider only those methodologies and factors in making the determination of damages under this section. The court shall only permit the introduction of evidence relating to the determination of damages that is relevant to the methodologies and factors that the court determines may be considered in making the damages determination.⁴⁷

This gatekeeper role would permit courts to ascertain whether evidence of damages is legally sufficient before such evidence is presented to the jury,⁴⁸ and preserve a more detailed record for appeal. A report submitted on May 12, 2009 by Senator Patrick Leahy

(D-Vt.) accompanies this revised Senate version of the bill, and acknowledges that damages analyses are best left to the judiciary. The report states that the Senate Judiciary Committee's proposal has "not altered existing substantive law on patent damages and the Committee expects that the courts will develop the law of remedies in patent cases . . ." ⁴⁹

Neither version of the most recent Patent Reform Act has passed the House or Senate. As stated by Senator Arlen Specter (D-Penn.), the "critical factor" if the legislation is to succeed is the question of damages. ⁵⁰

The gatekeeper role envisioned by the Senate Judiciary Committee is illustrated in the recent decisions previously discussed. Chief Judge Michel in *Lucent v. Gateway* carefully scrutinized the record before him on appeal and found that the evidence presented was not sufficient to justify the jury's damages award. Judge Rader in *Cornell v. HP* recognized the situations in which the entire market value rule might apply and excluded the plaintiff's expert testimony because it did not supply sufficient proof to support application of the entire market value rule. Both judges took an active role in limiting, or suggesting limitations on, the evidence and theories that are presented to a jury when calculating damages, signaling that the need for legislative reform with respect to damages may be overstated. Only time will tell.

Endnotes

¹ *Lucent Techs. Inc. v. Gateway, Inc.*, 580 F.3d 1301 (Fed. Cir. 2009).

² *Cornell University v. Hewlett-Packard Company*, 609 F. Supp. 2d 279 (N.D.N.Y. 2009).

³ *Lucent*, 580 F.3d at 1324 (quoting 35 U.S.C. § 284).

⁴ *Lucent*, 580 F.3d at 1324.

⁵ *Id.*

⁶ *Georgia-Pacific Corp. v. U.S. Plywood Corp.*, 318 F. Supp. 1116 (S.D.N.Y. 1970), *modified and aff'd*, 446 F. 2d 295 (2nd Cir. 1971).

⁷ *Lucent*, 580 F.3d at 1324.

⁸ *Id.* at 1308.

⁹ *Id.*

¹⁰ *Id.*; Lucent's \$358M Award In Microsoft Suit Overturned, Law 360, <http://www.law360.com/articles/121754>.

¹¹ *Lucent*, 580 F.3d at 1324.

¹² *Id.*

¹³ *Id.* at 1323.

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ *Id.* at 1325. At trial Lucent argued for only a running royalty rate, but on appeal it contended that evidence also supported a lump-sum award. The jury's verdict form indicated that the entire amount was a lump-sum award.

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ *Id.* (quoting *Georgia-Pacific Corp. v. U.S. Plywood Corp.*, 318 F. Supp. 1116, 1120 (S.D.N.Y. 1970)).

²¹ *Lucent*, 580 F.3d at 1327.

²² *Id.* at 1327-32.

²³ *Id.* at 1335. The court also found factors 10 (nature of the patented invention), 11 (extent to which the infringer has made use of the invention), and 13 (portion of the realizable profit credited to the invention) to be unsupported by the evidence presented.

²⁴ *Id.* at 1336.

²⁵ *Imonex Services v. W.H. Munzprufer Dietmar Trenner*, 408 F.3d 1374, 1379 (Fed. Cir. 2005).

²⁶ *Lucent*, 580 F.3d at 1336.

²⁷ *Id.* at 1337-38.

²⁸ *Id.* at 1338-39.

²⁹ *Id.*

³⁰ *Id.* at 1338.

³¹ *Cornell*, 609 F. Supp. 2d at 283.

³² *Id.*

³³ *Id.* at 282.

³⁴ *Id.* at 284.

³⁵ *Id.* at 284-85.

³⁶ *Id.* at 282.

³⁷ *Id.*

³⁸ *Id.* at 283.

³⁹ *Id.* at 285.

⁴⁰ *Legislation/Patent Reform: Incoming Commerce Secretary Locke Sends Signals on Patent Reform*, 77 PAT. TRADEMARK & COPYRIGHT J. 557 (BNA).

⁴¹ *Id.*

⁴² S. REP. NO. 111-18, at 2 (2009).

⁴³ *Federal Circuit Chief Judge Challenges Hearing Testimony on Patent Reform*, 78 PAT. TRADEMARK & COPYRIGHT J. 82 (BNA).

⁴⁴ H.R. 1260, § 5 (as introduced Mar. 3, 2009); S. 515, 111th Cong. § 4 (as introduced Mar. 3, 2009).

⁴⁵ Diane Bartz, *U.S. Battle Over Patent Reform Headed for Compromise*, REUTERS, Mar. 10, 2009, <http://www.reuters.com/article/technologyNews/idUSTRE5295J920090310>.

⁴⁶ S. REP. NO. 111-18, at 9 (2009).

⁴⁷ S. 515, 111th Cong. § 4 (as reported Apr. 2, 2009).

⁴⁸ Damages Provisions of the Patent Reform Act, Law 360, <http://www.law360.com/articles/99166>.

⁴⁹ S. REP. NO. 111-18, at 9 (2009).

⁵⁰ Diane Bartz, *U.S. Battle Over Patent Reform Headed for Compromise*, REUTERS, Mar. 10, 2009, <http://www.reuters.com/article/technologyNews/idUSTRE5295J920090310>.

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