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Initial Case Strategy Should Account For **Jurisdictional Variances** in Damages

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Damages theories are often far from litigants' minds when determining initial case strategy. This would be a mistake. The growing jurisprudence on patent damages indicates that both patentees and accused infringers should consider a venue's perspective on this important aspect of a case. Three issues with significant implications on the amount of damages at issue include apportionment, the discovery of negotiation documents, and bifurcation.

Background

Patent damages are generally awarded in the form of lost profits, reasonable royalties, or a combination thereof. Recovering lost profits requires a showing that the patentee would have made the sale that the infringer did but for the infringement. Patentees may also be required to demonstrate the demand for the patented product, the absence of non-infringing substitutes, its own manufacturing and marketing capability to exploit the demand, and the profit it would have made but for the infringe-

ment. See *Panduit v. Stahl Bros. Fibre Works*, 575 F.2d 1152, 1156 (6th Cir. 1978). In the alternative, a court may award a reasonable royalty. A reasonable royalty is commonly based on a "hypothetical negotiation" between a willing licensor and willing licensee prior to the first infringing act. Typically, courts require an analysis of 15 factors from *Georgia-Pacific v. U.S. Plywood*, 318 F. Supp. 1116, (S.D.N.Y. 1970), mod. and aff'd, 446 F.2d 295 (2d Cir. 1971), cert. denied, 404 U.S. 870 (1971). Among these factors are licensing royalties received for the patent, rates paid by the licensee for other comparable patents, patent duration and license term, commercial success, and

patentee's exploitation of the patent.

Lost Profits; Apportionment

Generally, there have been two approaches to establish a base for patent damages pertaining to complex multi-component products and services. The entire market value rule (EMVR) allowed patentees to assess damages based on the entire product, and not just the patented component, if the infringing component was the basis for customer demand of the entire product. *Uniloc USA v. Microsoft*, 632 F.3d 1292, 1318 (Fed. Cir. 2011). In instances where the infringing component did not drive customer demand for the product, the alternate theory was the



smallest saleable patent-practicing unit (SSU). *LaserDynamics v. Quanta Computer*, 694 F.3d 51, 67 (Fed. Cir. 2012). The contours of what constitutes the SSU has until recently been unclear. Some courts had indicated that mere identification of the smallest saleable unit was acceptable as the base for a reasonable royalty calculation, while others required further apportionment. See, e.g., *Axcess Int'l v. Savi Tech.*, No. 3:10-cv-1033-F, D.E. 272 (N.D. Tex. Jan. 25, 2013) (even though the SSU contained features or functionalities beyond the claimed technology, it was “nevertheless, the appropriate unit for calculating the royalty.”); but see, e.g., *Rembrandt Social Media v. Facebook*, 1:13-cv-158, D.E. 350 (E.D. Va. Dec. 3, 2013) (requiring apportionment of SSU to ensure that damages are for infringing features only). The Federal Circuit resolved this split when it upended a \$368 million jury verdict in the recent case *VirnetX v. Cisco Systems and Apple*. In so doing, the court explained: “[W]e have previously permitted patentees to base royalties on the ‘smallest salable patent-practicing unit.’” 767 F.3d 1308, 1327 (Fed. Cir. 2014) (quoting *LaserDynamics*, 694 F.3d at 67). The Federal Circuit continued:

However, the [jury] instruction mistakenly suggests that when the smallest salable unit is used as the royalty base, there is necessarily no further constraint on the selection of the base. That is wrong. For one thing, the fundamental concern about skewing the damages horizon—of using a base that misleadingly suggests an inappropriate range—does not disappear simply because the smallest salable unit is used.

Id. While the apportionment issue in the SSU reasonable royalty context appears clearly resolved, apportionment in the context of lost profits remains murky. In *Brocade Communications Systems v. A10 Networks*, Case No.

C 10-3428 PSG (N.D. Cal. May 15, 2013) (D.I. 998), the Northern District of California court discussed in a footnote that the Federal Circuit had opined in the recent *Versata Software v. SAP America* (Fed. Cir. 2013) that the “but-for” *Panduit* factors “place no qualitative requirement on the level of demand necessary to show lost profits.” *Versata Software v. SAP Am.*, 717 F.3d 1255, 1265 (Fed. Cir. 2013) cert. denied, 134 S. Ct. 1013 (2014). The court in *Brocade* then went on to explain that “apportionment ... is unnecessary under *Panduit*.” *Brocade*, Slip Op. at 4, n.12. Other jurisdictions have, nonetheless, reinterpreted apportionment in the context of lost profits to mean customer demand within the *Panduit* “but for” test. For example, in *Universal Elecs. v. Universal Remote Control*, Case No. SACV 12–00329 AG (JPRx), 2014 WL 3605937, *23-25 (C.D. Cal. March 24, 2014), the court reinforced that “defendant may attack plaintiff’s but-for causation proof by demonstrating that factors other than the asserted patents were the but-for cause of the lost sales.” A similarly conservative view was expressed in *Electro-Mech. v. Power Distribution Products*, where the court stated that in a lost profits scenario, the patentee would still need to prove “that the customer’s decision to buy the larger product in the first place is motivated by the presence of the patented component.” *Electro-Mech.*, 970 F. Supp. 2d 485 at 492.

in a hypothetical negotiation analysis. *Georgia-Pacific*, 318 F. Supp. at 1120. One class of such documents are settlement materials. While settlement documents containing royalty rates are usually discoverable, *ResQNet.com v. Lansa*, 594 F.3d 860 (Fed. Cir. 2010), case law concerning the underlying negotiation materials is unclear. A good starting point is the Federal Circuit and its 2012 decision that the Northern District of Illinois did not abuse its discretion by ordering production of negotiation documents underlying discoverable settlement agreements. *In re MSTG*, 675 F.3d 1337 (Fed. Cir.), reh’g denied, 468 F. App’x 994 (Fed. Cir. 2012). *MSTG* held that “settlement negotiations related to reasonable royalties and damage calculations are not protected by a settlement negotiation privilege.” Id. at 1348. That holding, while potentially a narrow one, has exposed varying district court perspectives on this topic.

In one judicial camp, certain jurisdictions have taken a narrow view of the *MSTG* case. For example, the Eastern District of Missouri in *ABT Systems v. Emerson Electric* explained that, in *MSTG*, the expert’s reliance on the negotiations created a need for the opposing party to discover whether the expert’s conclusions were erroneous, “[a]nd it was on this narrow basis that the Federal Circuit held on mandamus review that the district court did not clearly abuse its discretion.” No. 4:11CV00374 AGF, 2012 WL 6594996, at *2 (E.D. Mo. Dec. 18, 2012). For that reason,

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Discovery

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the court denied a motion to compel settlement-related correspondence between the plaintiff and other defendants in the case without a showing of the “particularized relevance” to the information it

sought. *Id.* at *3. Taking a similarly narrow view of *MSTG*, the Northern District of California in *Implicit Networks v. Juniper Networks* limited the discovery of negotiation materials to instances where an expert's reliance on negotiations had placed the documents in question in dispute. Case3:10-cv-04234-SI (N.D. Cal. June 5, 2012) (D.I. 89), Slip Op. at 2-3.

On the other side, certain district courts have taken a more liberal view to such requested discovery. In the Southern District of New York, a court denied a motion to compel negotiation communications, but only on grounds of vagueness, overbreadth, and relevance. *Wu v. Pearson Educ.*, No. 09 CIV. 6557 KBF JCF, 2012 WL 1232958, at *1 (S.D.N.Y. April 12, 2012). The court was careful to emphasize:

This is not to say that such documents are immune from discovery: there is no settlement negotiation privilege . . . [T]o the extent that the plaintiff has otherwise identified specific categories of discoverable documents, those documents shall be produced even if they were created in the context of settlement negotiations.

Id. at *2 (citing *MSTG*). Similarly, in *Sciele Pharma v. Lupin*, Civil No. 09-37 (RBK/JS) (D. Del. Jan. 31, 2013) (D.I. 611), the District of Delaware granted a motion requiring the production of license agreements and underlying negotiation documents. There, the court acknowledged that, generally, "license negotiations are less probative and more prejudicial than the licenses themselves," but ultimately determined that certain negotiation communications were indeed discoverable. Slip Op. at 9-10.

Bifurcation

Another issue that litigants should consider is whether a court or specific judge tends to bifurcate patent litigation by first assessing liability issues, then damages. Rule 42(b) of the Federal Rules of Civil

Procedure states that a court may order a separate trial of any claim or issue "[f]or convenience, to avoid prejudice, or to expedite and economize." The benefits of bifurcation are unclear. Sometimes the evidence involved in reasonably royalty calculations, for example, can be voluminous and complicated, with little bearing on the underlying infringement issues. However, bifurcation can also result in duplicative discovery and trial presentations.

In the Northern District of Georgia, the Patent Local Rules establish a rebuttable presumption against bifurcation of damages in patent cases for purposes of discovery or trial. Patent L.R. 5.1 (N.D. Ga.), available at <http://www.gand.uscourts.gov/pdf/NDGARulesPatent.pdf>. Other courts have stated their preferences in case law. Similarly, in *DSM Desotech v. 3D Sys.*, the Northern District of Illinois stated that "bifurcation in patent cases, as in others, is the exception, not the rule" and that "separate trials should not be ordered unless such a disposition is clearly necessary." No. 08 CV 1531, 2008 WL 4812440, at *3 (N.D. Ill. Oct. 28, 2008) (internal quotation marks and citations omitted). Similar "presumptions" have been cited in other jurisdictions, including the Northern District of California (see, e.g., *Lam Research v. Schunk Semiconductor*, No. C-03-1335 EMC, 2014 WL 4180935, at *1 (N.D. Cal. Aug. 22, 2014)) and the District of New Jersey (see, e.g., *ZoomEssence v. Int'l Flavors & Fragrances*, No. CIV.A. 12-1471 TJB, 2013 WL 2285863, at *5 (D.N.J. May 23, 2013) ("Patent cases . . . are the one type of case in which courts generally are more willing to bifurcate trials and even in patent cases bifurcation remains the exception rather than the rule[.]" (internal quotation marks and citations omitted)).

Meanwhile, until recently, Judge Sue L. Robinson of the District of Delaware actively encouraged bifurcation and required in her patent scheduling order that "[t]he issues of willfulness and dam-

ages shall be bifurcated for purposes of discovery and trial, unless good cause is shown otherwise." Judge Sue Robinson, Standard Scheduling Order, ¶ 2(a) (revised 06-09), available at <http://deptentlaw.morrisjames.com/files/2014/03/Robinson-form-scheduling-order.pdf>. It should be noted that Robinson's current scheduling order for patent cases does not address bifurcation. Available at <http://www.ded.uscourts.gov/sites/default/files/Chambers/SLR/Forms/Sched-Order-Patent-03-24-14.pdf> (revised March 24, 2014).

While district courts will continue to have broad discretion on bifurcation, the Federal Circuit has at least clarified that bifurcation will not delay the ability to appeal on infringement, as it can hear an appeal on liability before the trial on damages has occurred. *Robert Bosch v. Pylon Mfg.*, 719 F.3d 1305, 1313 (Fed. Cir. 2013).

Conclusion

While the Federal Circuit has recently resolved a number of jurisdictional splits among district courts, many damages issues continue to create inconsistencies. A court or judge's past treatment of relevant damages issues should be an early consideration for both plaintiffs and defendants.

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