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Calculating patent damages

A recent Federal Circuit decision encourages trial courts to require specific proof of reasonable royalty.

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Are damage awards in patent cases too large or too unpredictable? Although those issues generate a good deal of heated debate, there is little hard data. Critics of patent litigation—who point to studies showing that the typical jury verdict is many times the average amount awarded in bench trials—have argued that the Patent Act should be amended to make the rules governing damages more explicit and restrictive and to direct federal judges to take a more active role in monitoring damage theories presented to juries. A particular target of critics is the "entire market value rule," which, in some circumstances, permits a patent holder to recover damages based on the value of an entire product including a patented invention, even if the patented feature is only a small part of the product as a whole.

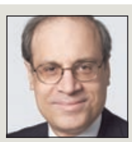
THE PRACTICE

Commentary and advice on developments in the law

Echoes of this debate can be heard in the U.S. Court of Appeals for the Federal Circuit's recent decision in *Lucent Tech. Inc. v. Gateway Inc.*, 580 F.3d 1301 (Fed. Cir. 2009), in which the court vacated a $357 million damage award against Microsoft Corp., remanding for a new trial on damages. Lucent owns a patent covering a method of entering information into fields on a computer screen without the need for a keyboard—for example, by using predefined tools such as an on-screen graphical keyboard, a menu or a calculator. Lucent claimed that Microsoft Outlook, Microsoft Money and Windows Mobile infringed the patent.

The vast bulk of the alleged infringement was attributed to Outlook, Microsoft's well-known "personal organizer" program, which allows users to send e-mails and maintain contact lists and calendars. Lucent alleged infringement based on Outlook's "date picker," a tool that displays a monthly calendar in grid form. Users can scroll through the calendar and select a date for entry into an appointment form. About 110 million units of the three software products were sold, accounting for approximately $8 billion in sales. The jury's $357 million award represented a lump-sum, paid-in-full royalty, covering all of Microsoft's use of the patented method, rather than a "running royalty," which is based on how often the patent is used by the defendant.

The Patent Act provides little guidance on damages. Section 284 provides for damages "adequate to compensate for the infringement, but in no event less than a reasonable royalty." The U.S. Supreme Court recently cautioned that "the primary purpose of our patent laws is not the creation of private fortunes for the owners of patents, but is 'to promote the progress of science and useful arts.' " *Quanta Computer Inc. v. LG Elecs. Inc.*, 128 S. Ct. 2109 (2008). A patent holder may recover lost profits if it can show demand for the patented product, that there are no noninfringing substitutes and that it had the ability to bring a patented product to market. In other cases—for example, when the patent holder is not a competitor in the marketplace—damages are equal to a reasonable royalty.



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To determine a reasonable royalty, juries are typically told to consider a group of broad, overlapping factors set out in a 1970 district court opinion to explain a damage award after a bench trial. Known as the *Georgia-Pacific* factors, these considerations focus on royalties received for "comparable" patents, the relationship between the patent holder and the defendant, the profitability of the infringing product and the importance and benefits of the patented invention. Jurors are to envision a hypothetical negotiation between the parties and determine what royalty a "willing licensor and a willing licensee" would have agreed to at the time infringement began. This reasonable-royalty approach was at issue in *Lucent*.

PROBLEMS WITH EVIDENCE

The court identified several fundamental problems with Lucent's proof of damages. The patented date-picker feature included in Outlook was "but a tiny feature of one part of a much larger software program." The court found it "inconceivable to conclude" that use of the date picker "constitutes a substantial portion of the value of Outlook," justifying a $357 million award. Although Microsoft enjoyed a 70% to 80% profit margin on the infringing software, the "glaring imbalance" between the "infringing and non-infringing features" of the program "must impact the analysis of how much profit can properly be attributed to the use of the date picker compared to non-patented elements and other features of Outlook." The patented method appeared to offer only a "slight advantage" over nonpatented methods, and Lucent provided no evidence showing what the parties' expectations about future usage of the method would have been at the time of a hypothetical license negotiation.

Much of Lucent's case depended upon eight license agreements covering other products that it said justified the jury's award. The Federal Circuit found this evidence insufficient, insisting on specific evidence showing how these licenses were comparable to the outcome of a hypothetical negotiation between Lucent and Microsoft over the date-picker feature. Several agreements provided for running royalties, and the jury was given no basis to translate those amounts into a lump-sum award. Nor did Lucent provide evidence to show the degree to which the licensed technology was similar or dissimilar to Lucent's patent.

The Federal Circuit was sympathetic to the fact that a plaintiff's damages case normally has to rely on reasonable inferences, not direct proof. "Creating a licensing agreement for patented technology is, at best, an inexact science. In actual licensing negotiations, willing parties negotiating at arms length do not necessarily generate and analyze precise economic data concerning the perceived value of a patented invention." Yet the court had no difficulty concluding that, without firm evidence of the value and projected use of the patented technology or the comparability of the license agreements Lucent proffered, the jury's award was "based mainly on speculation or guesswork."

The court also held that Lucent, in defending the jury's award as a percentage of total sales of Outlook and other products, had failed to satisfy a condition for use of the entire-market-value rule—a showing that the patented invention is a substantial basis for consumer demand for the entire product. Lucent's expert had conceded that there was "no evidence that anybody...ever bought Outlook...because it had a date picker." Without such proof, the rule was inapplicable. In addition, the expert failed to come up with a reasonable basis for the royalty rate he sought to apply to total software sales.

On the other hand, the Federal Circuit firmly rejected the views of commentators and several amici who argued that the rule should never be applied in reasonable-royalty (as opposed to lost-profits) cases. The court found that "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)." Therefore, there is "nothing inherently wrong with using the market value of the entire product, especially when there is no established market value for the infringing component or feature, so long as the multiplier accounts for the proportion of the base represented by the infringing component or feature."

In some ways, *Lucent* is an unusual case. Indeed, the Federal Circuit described it as "a complicated case," in which "the damages evidence of record was neither very powerful, nor presented very well by either party." Animating the opinion, however, is the idea that a district court must be an active monitor of a plaintiff's damage theories and proof, to reduce the possibility that a jury award is based on guesswork. Some proposals to amend the Patent Act would require parties to specify prior to trial the damage theories and evidence they intend to present to the jury. The trial court would then determine which methods and arguments are permissible and limit the parties to those approved theories. *Lucent* imposes no such requirements. But it will encourage trial courts—at least on post-trial motions for judgment as a matter of law—to require specific and definite proof to support a damages verdict. ■