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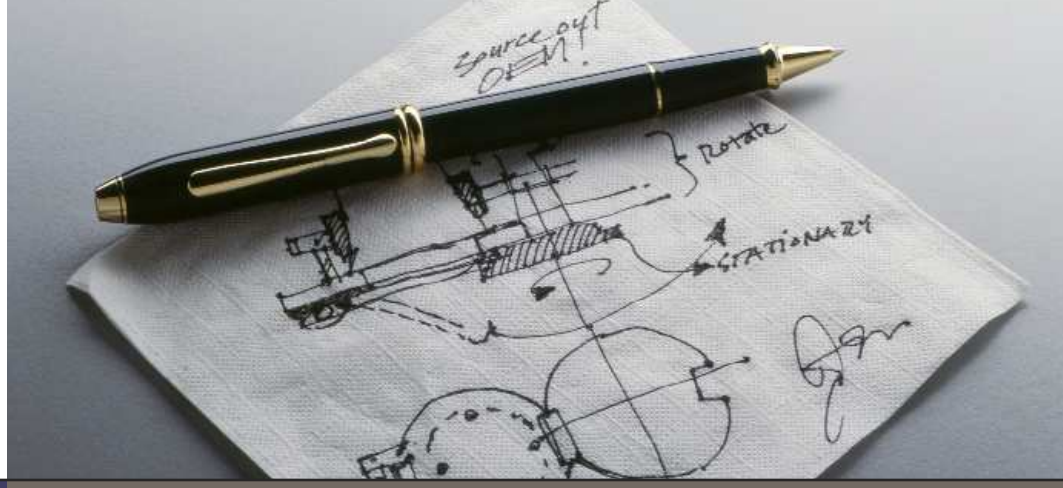

Intellectual Property Bulletin

FEDERAL CIRCUIT CONTINUES TIGHTENING STANDARDS IN PATENT DAMAGES CASE LAW

The Federal Circuit has issued another decision refining its damages case law. In *Uniloc USA, Inc. v. Microsoft Corp.*, __ F.3d __ (Fed. Cir. 2011), the Federal Circuit rejected the 25% rule of thumb often used by experts in calculating damages for patent infringement. The 25% rule (or "profit-split" approach) is founded on the principle that a prospective licensee generally would be willing to pay a royalty equivalent to 25% of its expected profits from the sale of a patented product. The Court's decision follows a line of cases, such as *ResQNet.com, Inc. v. Lansa, Inc.*, 594 F.3d 860 (Fed. Cir. 2010), and *Lucent Techs., Inc. v. Gateway, Inc.*, 580 F.3d 1301 (Fed. Cir. 2009), that many believe signal the Court's desire to tighten the standards for determining damages in patent infringement cases.

The appeal follows the district court's ruling in favor of Microsoft on noninfringement and willful infringement, and its grant of a new trial in the alternative on the issue of damages. At trial, the jury awarded Uniloc $388 million in damages, finding that Microsoft's "Product Activation" anti-piracy technology, found in the ubiquitous Microsoft Word and Windows products, infringed Uniloc's patent. Prior to the verdict, the district court rejected Microsoft's motions *in limine* to exclude the testimony of Uniloc's damages expert that were based in part on the expert's use of the 25% rule.

Under the patent statute, patent infringement damages are required to compensate the patent owner for the infringement in an amount no less than a reasonable royalty. Litigants frequently use experts to provide opinion testimony on the amount an accused infringer would have agreed to pay for a license as a result of a "hypothetical negotiation" occurring at the time infringement began. The factors experts consider in applying the "hypothetical negotiation" framework are called the *Georgia-Pacific* factors, named after the seminal case that cataloged them.

In his expert report, Uniloc's expert (Dr. Gemini) concluded that infringement damages should be $565 million. This conclusion was based on an internal pre-litigation document from Microsoft that placed a value range for Product Activation at "anywhere between $10 to $10,000…." To calculate damages, Gemini took the lowest value in this range, $10, as "the isolated value for Product Activation" in each copy of Microsoft Word and Windows, essentially serving as a proxy for the profit from those products attributable to Product Activation. He then applied the 25% rule of thumb to reach a $2.50 royalty for each copy of Word and Windows. When he multiplied this amount by the over 225 million copies of the software sold by Microsoft, Gemini arrived at his $565 million figure. Gemini justified his use of the 25% rule of thumb because it had "been accepted by Courts as an appropriate methodology in determining damages…." Slip op. at 34. Gemini further opined that his $565 million figure would represent a 2.9% royalty on gross revenue of $19 billion—a rate he considered reasonable. To "check" his damages calculation, Gemini applied the entire market value rule, which assumes that the patented feature is the basis for consumer demand.

In addressing the 25% rule, the Federal Circuit stated that the "admissibility of the bare 25% rule has never been squarely presented to this court. Nevertheless, this court has passively tolerated its use where its acceptability has not been the focus of the case…." Slip op. at 39. The Court also mentioned (and dispensed with) the most well known article in patent licensing literature concerning the rule—Robert Goldscheider et al., *Use Of The 25 Per Cent Rule in Valuing IP*, 37 les Nouvelles 123 (2002)—an article that seemingly undergirded the rule with academic research. Id. at 123-24. After the Court summarized the legal literature and case law concerning the rule, it reached its unequivocal conclusion:

> This court now holds as a matter of Federal Circuit law

> that the 25 percent rule of thumb is a fundamentally flawed tool for determining a baseline royalty rate in a hypothetical negotiation. Evidence relying on the 25 percent rule of thumb is thus inadmissible under Daubert and the Federal Rules of Evidence, because it fails to tie a reasonable royalty base to the facts of the case at issue.

Slip op. at 41. The Court emphasized that the rule of thumb was not tied to the facts of the case, and as such was "arbitrary, unreliable, and irrelevant." Slip op. at 47.

The Court also rejected the damages expert's use of the entire market value rule in his "check" on the damages figure. In this regard, the Court's holding continues the recent trend of cases requiring proof that the accused feature drives demand for a patented product before an expert may rely on the entire market value rule as a basis for a damages calculation.

In all, the Federal Circuit's holding in *Uniloc v. Microsoft* marks a significant shift in how damages experts may justify their calculations and will also likely affect numerous damages expert reports issued in currently pending litigations.

Additional Information

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