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It's Not An Inappropriate Reasonable Royalty Rule

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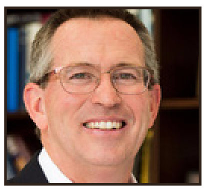
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In their recent IP Law360 guest article titled "The Latest Inappropriate Reasonable Royalty Rule of Thumb[1]," William Rooklidge and Andrew Brown discuss the decision in Good Technology Corporation v. MobileIron Inc[2]. to deny a motion to exclude damages testimony. The economist in that case had concluded that the reasonable royalty owed to the patent holder was equal to 100 percent of the (expected) incremental profits that the infringer earned on the smallest saleable patent practicing unit ("SSPPU"). The relevant language in the court's opinion provides:

> *As to whether [the patent holder's expert] puts forth adequate support to sustain an allocation of 100 percent of incremental profits to [the patent holder], … this is not a problem of methodology. Rather, it is a question of fact properly left for the jury. On the one hand, [the accused infringer] argues that there is no evidence that [it] would ever have agreed to an arrangement that would have left it with no profits whatsoever. But [the patent holder] counters that [its expert] allocates 100 percent of [the accused infringer's] incremental operating profit to [the patent holder] because [the royalty base used] is the SSPPU, which is closely related to the claimed functionality of the [asserted] patent. Whatever its ultimate merit, as gatekeeper, the court cannot say that [the patent holder's expert's] allocation methodology is unsound[3].*

Rooklidge and Brown wrote, "In allowing the expert to allocate 100 percent of expected profits to the patentee, the Good court has essentially endorsed as legally sound an allocation methodology that 'gobbles up all of [the alleged infringer]'s expected profit,' an outcome that [many courts] have rejected[4]." According to the authors, such a result is impermissible because "[a] fundamental premise of the hypothetical negotiation form of reasonable royalty analysis is that the suppositious licensee would be left with some incremental profit after paying the royalty[5]." Further, they characterize this decision as a new "rule of thumb" (which they anointed "the 100 percent rule[6]"). They conclude that "[t]he Federal Circuit should restore the fundamental premise ... and ban the use of the 100 percent rule[7]."

Contrary to the views of Rooklidge and Brown, the Good decision appears to be good law, consistent with recent Federal Circuit guidance concerning the proper determination of reasonable royalty damages.

Federal Circuit Guidance

In recent years, the Federal Circuit has emphasized the importance of isolating, to the extent possible, the specific incremental value contributed by the alleged infringement when assessing reasonable royalty damages. The court explained in Uniloc USA Inc. v. Microsoft Corp. 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[8]." In ResQNet.com Inc. v. Lansa Inc., the court emphasized that "the trial court must carefully tie proof of damages to the claimed invention's footprint in the market place[9]." And in VirnetX Inc. v. Cisco Sys. Inc, the court wrote, "a patentee must take care to seek only those damages attributable to the infringing features[10]." The court's guidance has led it to consistently support the use of SSPPU as a royalty base[11], and to require further apportionment as between the contributions of infringing and non-infringing elements when evaluating the benefits (i.e., profits) generated by the SSPPU[12].

Simply put, the Federal Circuit has directed litigants to isolate the incremental benefits (profits) associated with the specific patented technology at issue. In theory, if this isolation is done perfectly (which is often not the case), the benefits generated by the accused product could be divided into two mutually exclusive parts — one part consisting of the benefits contributed by the patented technology at issue and one part consisting of all the benefits provided by other factors (such as nonpatented product features and non-product specific contributions of the alleged infringer). In practice, the determination of true incremental benefits (profits) generated by the SSPPU represents an attempt to quantify the benefits contributed by the patented technology at issue. In any given case, it is a factual inquiry as to whether the calculation of incremental benefits (profits) accurately reflects the contribution of the patented technology.

If the incremental benefits (profits) of the patented technology at issue are accurately captured, a reasonable royalty damages award equal to that amount is precisely what the Federal Circuit seems to require. That is, it will represent the value of the contribution of the patent, and nothing else. From a statutory perspective, such an award would adequately compensate the patent holder for the infringement. At the same time, it would not provide any compensation to the patent holder that was attributable to nonpatented drivers of value. Moreover, such a result would be consistent with the purpose and spirit of the hypothetical negotiation construct as described by Rooklidge and Brown, as the alleged infringer would retain all of the benefits (profits) that were not attributable to the technology at issue.

There is no reason to ban the use of properly measured incremental benefits (profits) as the basis for a reasonable royalty damages determination. In fact, they should be embraced. A rule that such incremental benefits (profits) may be used as the basis for determining reasonable royalty damages is no more an impermissible "rule of thumb" than is the (undisputed) rule that a patent holder is entitled to 100 percent of the lost profits damages that it is able to prove. As with the calculation of lost profits damages, the calculation of such damages is subject to challenge, but the principle underlying the damages determination is not.

Incremental Profits and the Hypothetical Negotiation

In their article, Rooklidge and Brown contend that potentially awarding 100 percent of incremental profits generated by the SSPPU is impermissible because it is inconsistent with a "fundamental premise of the hypothetical negotiation form of reasonable royalty analysis [which] is that the suppositious licensee would be left with some incremental profit after paying the royalty[13]." From our perspective, there are several flaws in this reasoning.

First, as we have discussed elsewhere[14], consistency or inconsistency with the precepts of the hypothetical negotiation construct should not be the basis for assessing whether a particular analytical approach to the determination of reasonable royalty damages is permissible. The statute (which provides for damages that are "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[15]") does not require the use of a hypothetical negotiation, and the Federal Circuit has acknowledged that other approaches to the determination of reasonable royalty damages are valid[16]. Rather, the hypothetical negotiation was developed as a heuristic that could be used to assist in the determination of such damages, not as a standard against which all damages awards must be measured[17].

Second, awarding 100 percent of the incremental benefits (profits) to the party responsible for those benefits generated by the SSPPU is a reasonable outcome of a hypothetical negotiation between an alleged infringer and the patent holder. Contrary to the suggestion that such a result would deprive the alleged infringer of "100 percent of expected profits," such an award would allow the alleged infringer to retain 100 percent of the benefits (profits) generated by its efforts and investments. Given that the infringement was assumed to be unlawful (because damages are being awarded), there is no reason that the alleged infringer should expect to retain any of the fruits that are exclusively attributable to the unlawful activity. Rather, that portion of the profits (and only that portion of the profits) belongs to the patent holder.

Third, even the Georgia-Pacific case does not suggest that the alleged infringer is entitled to any of the incremental benefits (profits) that are due solely to the efforts of the patent owner[18]. Georgia-Pacific Factor 15 defines the results of a reasonable hypothetical negotiation as a payment that a "prudent licensee...would have been willing to pay as a royalty and yet be able to make a reasonable profit[19]." Basing a reasonable royalty on the incremental benefits (profits) provided by the patented technology at issue allows the alleged infringer to continue to operate in the business and obtain a reasonable profit associated with all of the contributions that it has made to product success, while still compensating the patent owner for the contributions that it has made to the product's success.

Finally, by allowing the patent owner to obtain compensation associated with the precise (but no greater than the) contributions that it has made to a product's value, proper innovative incentives will be preserved. If the patent owner is awarded an amount that is systematically less than its actual contributions, infringement will be encouraged and patented innovation stifled.

Conclusion

A rule of thumb is a broadly accurate guide or principle, based on experience or practice, rather than theory, that is not intended to be strictly accurate or reliable for every situation. It is an easily learned and applied procedure for approximately calculating or recalling some value, or for making some determination[20]. Awarding damages to a patent owner that is consistent with the incremental contributions that the patent owner made to a product's success is not a rule of thumb. Although there may be disputes about whether the contributions are properly measured, the rule is good law, and good economics.

Endnotes

1 William Rooklidge and Andrew Brown, “The Latest Inappropriate Reasonable Royalty Rule of Thumb,” Law360, July 28, 2015.

2 No. 5:12-cv-5826-PSG (N.D. Cal. 2015).

3 Id., Order Granting-In-Part Motion to Exclude Testimony, No. 296, slip op. at 8 (July 10, 2015).

4 William Rooklidge and Andrew Brown, “The Latest Inappropriate Reasonable Royalty Rule of Thumb,” Law360, July 28, 2015.

5 Id.

6 Id.

7 Id.

8 Uniloc USA Inc. v. Microsoft Corp., 632 F.3d 1292, 1318 (Fed. Cir. 2011).

9 ResQNet.com Inc. v. Lansa Inc., 594 F.3d 860, 869 (Fed. Cir. 2010).

10 VirnetX Inc. v. Cisco Sys. Inc., 767 F.3d 1308, 1326 (Fed. Cir. 2014).

11 LaserDynamics Inc. v. Quanta Computers, 694 F.3d 51, 67 (Fed. Cir. 2012).

12 VirnetX Inc. v. Cisco Sys. Inc., 767 F.3d 1308, 1326-8 (Fed. Cir. 2014).

13 William Rooklidge and Andrew Brown, “The Latest Inappropriate Reasonable Royalty Rule of Thumb,” Law360, July 28, 2015.

14 John C. Jarosz and Michael J. Chapman, “The Hypothetical Negotiation And Reasonable Royalty Damages: The Tail Wagging The Dog,” 16 Stan. Tech. L. Rev. 769 (2013).

15 35 U.S.C. § 284.

16 See, e.g., VirnetX Inc. v. Cisco Sys. Inc., 767 F.3d 1308, 1326 (Fed. Cir. 2014) and Apple Inc. v. Motorola Inc., 757 F.3d 1286, 1315 (Fed. Cir. 2014.

17 John C. Jarosz and Michael J. Chapman, ”The Hypothetical Negotiation And Reasonable Royalty Damages: The Tail Wagging The Dog,” 16 Stan. Tech. L. Rev. 769, 782-83 (2013).

18 See Georgia-Pacific Corp. v. U.S. Plywood-Champion Papers, Inc., 446 F.2d 295, 299-300 (2d Cir. 1971)(calculating infringer’s post-damages profit rate based on profits earned on non-infringing products).

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

20 http://www.oxforddictionaries.com/us/definition/american_english/rule.