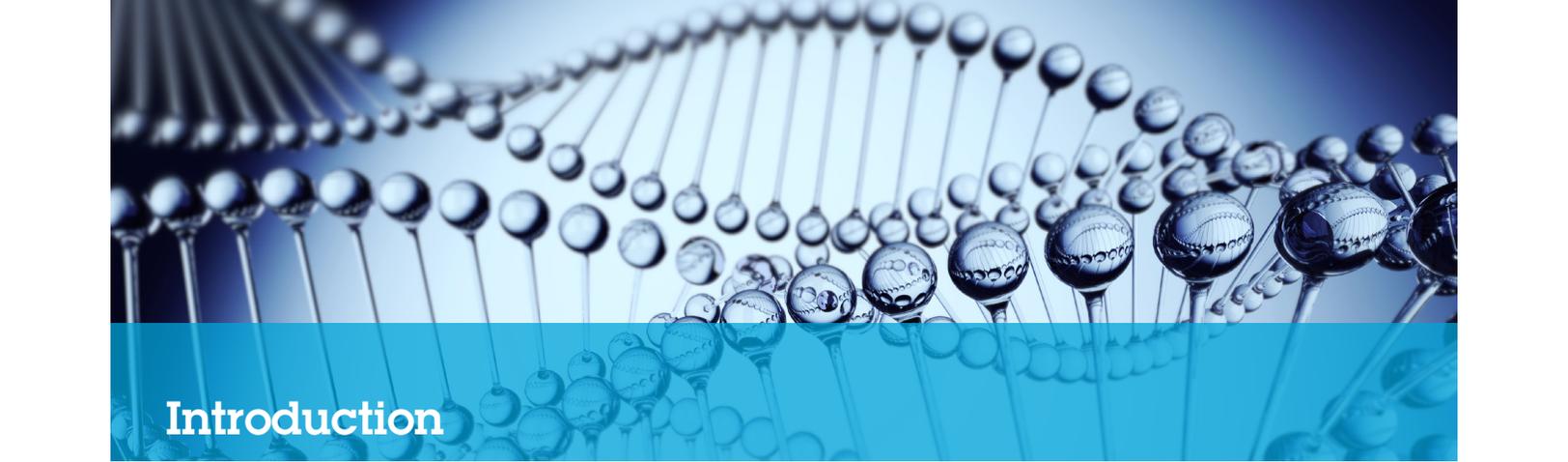


2014

# Patent Damages Year In Review

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## Introduction

In last year's inaugural issue of our Patent Damages Year in Review, we highlighted three developing issues that we believed would reshape the landscape of patent damages law for years to come:

- 1) apportionment and the entire market value rule;
- 2) damages available for standard essential patents encumbered by fair, reasonable and non-discriminatory licensing obligations; and
- 3) the increased use of *Daubert* challenges to the admissibility of patent damages experts' analyses and testimony.

In 2014, the Federal Circuit addressed each of these issues in three important decisions: *VirnetX v. Cisco Sys., Inc.*,<sup>1</sup> *Ericsson, Inc. v. D-Link Systems, Inc.*<sup>2</sup> and *Apple, Inc. v. Motorola Inc.*<sup>3</sup> While these decisions provided welcome clarity in some respects, they also failed to address other key issues and raised additional issues for the district courts to sort out. In this year's issue of our Patent Damages Year in Review, we will discuss these key Federal Circuit cases in detail, and then address how these cases impact the law of patent damages as a whole as well as the three specific developing issues that we highlighted last year.

As discussed more fully below, in *VirnetX*, which is perhaps the most important of the three cases, the Federal Circuit resolved the open question of whether the royalty base for a multi-component product that represents the smallest patent practicing unit may be the revenue for the entire product, or whether the base must be further apportioned down to the value of the patented component. Specifically, in rejecting the patent holder's damages expert's testimony, the Federal Circuit held that, unless the entire market value (EMV) rule is satisfied, damages must **always** be apportioned between patented and unpatented features — even in cases in which the smallest salable unit is the accused device itself. Thus, patentees arguing for reasonable royalty damages must be prepared either to prove that the technology qualifies for the EMV rule because the patented invention drives demand for the entire commercial product or to apportion value between the patented and unpatented features of the accused product or component. While no specific methodology was

identified for accomplishing this apportionment, the Federal Circuit appeared willing to allow experts to utilize any methodology so long as it is demonstrated to be generally reliable or commercially reasonable. The Federal Circuit explicitly rejected off-the-cuff or rule-of-thumb starting points that were not tied to the specific facts of the case.

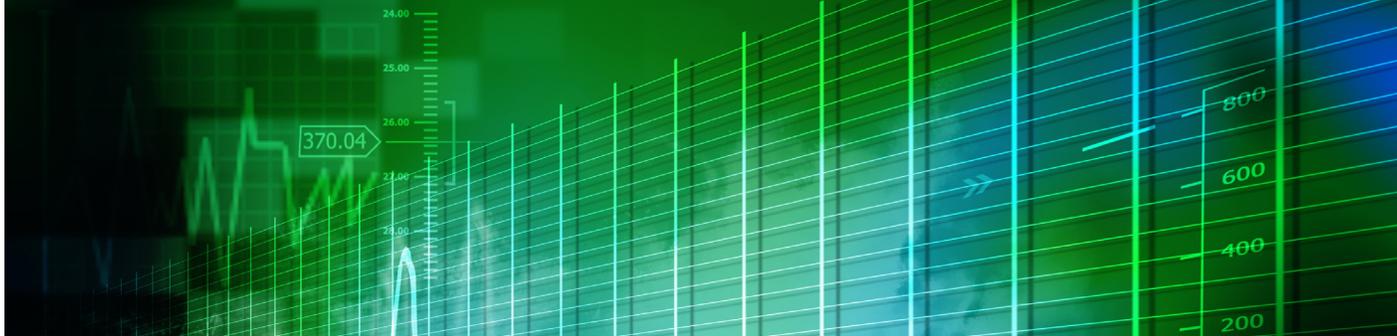
In *Ericsson*, the Federal Circuit addressed both the royalty rate for standard essential patents and how the concept of apportionment impacts such a rate. The Federal Circuit held that there was no *per se* set of factors for determining a royalty rate for RAND-obligated patents — that is, there is no set of modified *Georgia-Pacific* factors that can be used for every RAND case — and indicated that courts must utilize damages instructions that are crafted to address the specific circumstances and evidence presented in a particular case. The Federal Circuit reiterated that a patentee must apportion the value of the invention to the accused product from other nonpatented features, and made it clear that district courts must instruct the jury that any royalty awarded must be based on the incremental value of the invention, rather than the value of the standard as a whole or any increased value the patented feature gains from its inclusion in the standard.

Finally, in *Apple v. Motorola*, the Federal Circuit reversed a decision from Judge Posner, sitting by designation, excluding both parties' damages experts under *Daubert* and awarding zero damages based on a lack of admissible expert testimony. Both experts had attempted to determine the value of the patented technology in various ways, all of which the district court found unreliable. The Federal Circuit held that the district court improperly substituted its own opinion for that of the experts, rather than focusing on the reliability of the expert's methodology, and found the testimony admissible. Moreover, the Federal Circuit held that, even if all expert testimony were excluded, the fact finder must still determine what royalty is supported by the record because no less than a reasonable royalty must be awarded if infringement is found. Thus, a fact finder may award no damages only when the record supports a zero royalty award, and the Federal Circuit stated that it was unaware of any case where it had upheld a zero royalty award.

<sup>1</sup> 767 F.3d 1308 (Fed. Cir. 2014).

<sup>2</sup> 773 F.3d 1201 (Fed. Cir. 2014).

<sup>3</sup> 757 F.3d 1286 (Fed. Cir. 2014).



## Apportionment And The Entire Market Value Rule

Under the Patent Act, if infringement is found “the court shall award the [patentee] 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[.]” 35 U.S.C. § 284. The most prevalent damage measure is a reasonable royalty, whereby the patentee seeks damages based upon an appropriate royalty base multiplied by an acceptable royalty rate. Patentees understandably want to establish the largest possible royalty base to maximize their recovery, and often seek to use the revenue from the entire accused product, even for multi-component products that contain both accused and non-accused features. As discussed in last year’s Review, the Federal Circuit held in 2012 in *LaserDynamics, Inc. v. Quanta Computer*, 694 F.3d 51, 68 (Fed. Cir. 2012) that “it is generally required that royalties be based ... on the ‘smallest salable patent-practicing unit.’” The Federal Circuit further explained that the EMV rule, which allows damages based on the entire revenue for a multi-component product, “is a narrow exception to this general rule” in order to ensure that the damage amount is “reasonable in light of the technology at issue.” *Id.*

While many courts viewed *LaserDynamics* as all but eliminating the EMV rule, other courts interpreted *LaserDynamics* as permitting the use of the “smallest salable patent-practicing unit” (SSPU) as an alternative to allocating value between patented and unpatented features of an accused product. For example, one court noted: “If the patentee seeks to use something larger than the smallest salable unit as the royalty base for a multi-component product, the patentee must demonstrate that ‘the patented feature drives the demand for an entire multi-component product[.]’” *MediaTek Inc. v. Freescale Semiconductor, Inc.*<sup>4</sup> The Federal Circuit squarely addressed this conflict in 2014.

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

In *VirnetX, Inc. v. Cisco Sys., Inc.*,<sup>5</sup> the Federal Circuit vacated a \$386 million damages award against defendant Apple Inc. and resolved the conflicting treatment of the application of the entire market value (EMV) rule by the district courts in cases in which the smallest saleable unit

is the entire accused device. Finding the district court’s jury instruction improper, the Federal Circuit explained that, unless the EMV rule is satisfied, damages **always** must be apportioned between patented and unpatented features — even in cases in which the smallest salable unit is the accused device itself. Second, the Federal Circuit held that the patentee’s damages expert improperly relied on the Nash Bargaining Solution because he failed to sufficiently tie the controversial theory (positing a 50/50 profit split between the patentee and accused infringer) to the specific facts of the case.

The *VirnetX* case involved four patents directed to providing secure communication links over networks like the Internet. The patent owner, VirnetX, accused Apple’s popular FaceTime and VPN On Demand features of infringement.<sup>6</sup> Following a five-day jury trial in the Eastern District of Texas before Chief Judge Leonard Davis, the jury found the asserted claims valid and infringed and awarded damages of \$386 million.<sup>7</sup> The district court denied Apple’s post-trial motions.<sup>8</sup>

On appeal, Apple challenged certain claim constructions, the jury’s infringement and validity findings, and the jury’s damages award. The Federal Circuit affirmed one claim construction and literal infringement of two of the four asserted patents, but modified the construction of another claim term and remanded the infringement case regarding the other asserted patents.<sup>9</sup> The court also affirmed the validity of the patents.<sup>10</sup> The most noteworthy aspect of the opinion, however, concerned the disputed damages award.

At trial, VirnetX’s expert relied on three theories to support his damages opinion. First, the expert applied a reasonable royalty of 1 percent to Apple’s revenue from the sale of devices (iPhone, iPod, iPad and Mac devices incorporating the accused features, FaceTime and VPN On Demand).<sup>11</sup> The expert’s second and third theories were based on applications of the Nash Bargaining Solution, whereby VirnetX and Apple hypothetically would have negotiated to split the additional incremental profits realized by Apple for including the FaceTime feature.<sup>12</sup>

<sup>6</sup> *Id.* at 1314-1315.

<sup>7</sup> *Id.* at 1315.

<sup>8</sup> *Id.*

<sup>9</sup> *Id.* at 1316-1320.

<sup>10</sup> *Id.* at 1320-1321.

<sup>11</sup> *Id.* at 1322.

<sup>12</sup> *Id.*

<sup>4</sup> 2014 U.S. Dist. LEXIS 131275, \*8 (N.D. Cal. Sept. 17, 2014) (quoting *Laser Dynamics*, 694 F.3d at 67)).

<sup>5</sup> 767 F.3d 1308 (Fed. Cir. 2014).



The Federal Circuit first addressed VirnetX's reasonable royalty theory, explaining that it improperly relied on the EMV rule without establishing that the patented feature "drove the demand for accused products."<sup>13</sup> The EMV rule permits patentees to apply a royalty rate to sales of an entire multicomponent or multifeature device when the patented feature "constitutes the basis for customer demand."<sup>14</sup> VirnetX failed to establish that the accused FaceTime and VPN On Demand features created the basis for customer demand of the accused products, but it nevertheless used the base price of the accused products to calculate its royalty base and excluded only charges associated with additional memory purchased.<sup>15</sup>

The damages analysis also was infected by the district court's improper jury instruction regarding when a patentee may invoke the EMV rule. Relying on an improper interpretation of *LaserDynamics, Inc. v. Quanta Computer, Inc.*,<sup>16</sup> the district court instructed the jury that the EMV rule was available when the patented feature creates the customers' demand for the product *or* when "the product in question constitutes the smallest salable unit containing the patented feature."<sup>17</sup> While *LaserDynamics* did state that in cases "involving multi-component products, patentees may not calculate damages based on sales of the entire product, as opposed to the smallest salable patent-practicing unit, without showing that the demand for the entire product is attributable to the patented feature," the Federal Circuit clarified in *VirnetX* that a patentee cannot invoke the EMV rule simply because an entire product constitutes the smallest saleable unit containing the patented feature.<sup>18</sup> Instead, unless the patented feature drives the demand for the entire product and the EMV rule is satisfied, a patentee must always apportion damages and "take care to seek only those damages attributable to the infringing features."<sup>19</sup>

Here, the record was clear that VirnetX "made no attempt to separate software from hardware, much less to separate the FaceTime software from other valuable software components."<sup>20</sup> The Federal Circuit noted certain evidence in the record that could have been used — but was not used — to apportion damages, namely a \$29 software

upgrade to enable FaceTime on Mac computers and a calculation of incremental revenue of \$15 per mobile device attributable to FaceTime.<sup>21</sup> Thus, in addition to the improper jury instruction, the district court should have excluded testimony on VirnetX's reasonable royalty theory because it failed to "apportion the royalty down to a reasonable estimate of the value of its claimed technology."<sup>22</sup>

Next, the court rejected VirnetX's other two damages estimates that relied on the Nash Bargaining Solution. The Nash Bargaining Solution generally describes a solution reached by two bargaining parties under which each party receives the same amount of profit.<sup>23</sup> District courts have reached inconsistent conclusions regarding the admissibility of damages testimony based on the Nash Bargaining Solution.<sup>24</sup> The Federal Circuit likened the Nash Bargaining Solution to the dubious "25 percent rule of thumb," which posited an outcome in a hypothetical negotiation under which 25 percent of the value of the infringing technology remains with the patentee and 75 percent of the value goes to the licensee. In *Uniloc USA, Inc. v. Microsoft Corp.*,<sup>25</sup> the court held the 25 percent rule not sufficiently reliable or relevant to be used in ascertaining reasonable royalty damages, presumably in any patent case.<sup>26</sup> The *VirnetX* court did not reject the reliability of the Nash Bargaining Solution out of hand, noting that the Nash Bargaining Solution avoids some of the problems associated with the 25 percent rule because the Nash Bargaining Solution "focuses only on the incremental profits earned by the infringer from the use of the asserted patents."<sup>27</sup> Nonetheless, the court concluded that VirnetX's expert failed to sufficiently tie the applicability of the premises of the Nash Bargaining Solution to the specific facts of the case.

Finally, the court rejected VirnetX's argument that its expert applied the Nash Bargaining Solution to the facts of the case because he made a 10 percent deviation from the 50/50 baseline split.<sup>28</sup> While deviation from the 50/50 baseline may be warranted by the facts of a particular case, it remains the patentee's burden to justify why the baseline starting point is appropriate under the facts of the case in the first place.<sup>29</sup> The court explained the need to justify the applicability of the Nash Bargaining Solution to future litigants: "[a]nyone seeking to invoke the theorem as applicable to a particular situation must establish that fit, because the 50/50 profit-split result is proven by the theorem only on those premises."<sup>30</sup>

The Federal Circuit remanded the case back to the district court for further proceedings. Meanwhile, VirnetX has several pending lawsuits involving the patents at issue, including a second lawsuit against Apple's newer generation

<sup>13</sup> *Id.* at 1323.

<sup>14</sup> *Lucent Techs., Inc. v. Gateway, Inc.*, 580 F.3d 1301, 1336 (Fed. Cir. 2009).

<sup>15</sup> *VirnetX*, 767 F.3d at 1324.

<sup>16</sup> 694 F.3d 51 (Fed. Cir. 2012).

<sup>17</sup> *VirnetX*, 767 F.3d at 1323.

<sup>18</sup> *Id.* at 1323.

<sup>19</sup> *Id.* at 1322.

<sup>20</sup> *Id.*

<sup>21</sup> *Id.* at 1324-1325.

<sup>22</sup> *Id.* at 1325.

<sup>23</sup> *Id.* at 1322.

<sup>24</sup> *Id.* at 1326.

<sup>25</sup> 632 F.3d 1292, 1315 (Fed. Cir. 2011).

<sup>26</sup> *Id.* at 1316-18.

<sup>27</sup> *VirnetX*, 767 F.3d at 1328.

<sup>28</sup> *Id.* at 1327-1328.

<sup>29</sup> *Id.*

<sup>30</sup> *Id.* at 1327.

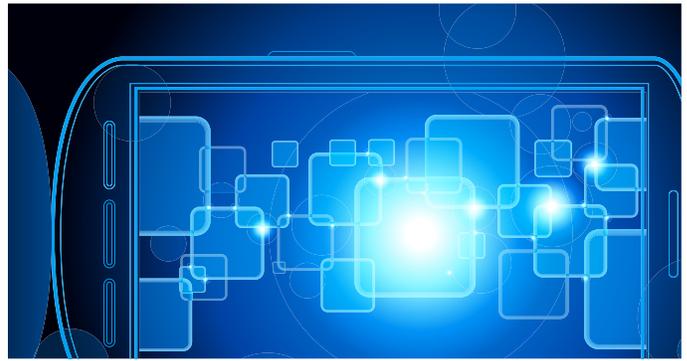
of devices (the iPad mini and iPhone 5) and Microsoft's Skype service. These cases no doubt will be affected by this decision, as will future cases involving accused products with both patented and unpatented features or damages theories that rely on the Nash Bargaining Solution.

***Ericsson, Inc. v. D-Link Sys., Inc.*,  
773 F.3d 1201 (Fed. Cir. 2014)**

The entire market value rule was front and center again in *Ericsson*, in which the Federal Circuit addressed the accused infringer's claim that Ericsson's damages expert violated the entire market value rule by relying on license agreements that were tied to the entire value of the licensed products. The patented technology related to Wi-Fi technology used by devices to wirelessly access the Internet. The accused products included various devices, such as laptop computers and routers, but there was no dispute that the patented technology resided entirely in the Wi-Fi chips and not in any of the other components of the accused products.

In pretrial and post-trial motions, D-Link argued that Ericsson's damages expert should not have been allowed to rely on license agreements that were based on the entire value of the end products. Judge Leonard Davis in the Eastern District of Texas denied D-Link's motions and refused to set aside the jury's damages award of approximately \$10 million, or about \$0.15 per infringing device. In response to D-Link's appeal, Ericsson defended Judge Davis's ruling by arguing that the Federal Circuit has repeatedly found comparable license agreements to be the best evidence of a reasonable royalty rate and that its expert testified that he discounted his reliance on the license agreements to account only for the value attributed to the patented technology at issue.<sup>31</sup>

The Federal Circuit agreed with Ericsson, concluding that Judge Davis did not abuse his discretion in refusing to exclude the expert's testimony relying on the license agreements. The court explained its reasoning by first noting that the entire market value rule actually consists of two different parts, a substantive legal rule and a separate evidentiary principle. The substantive legal rule demands that "where multicomponent products are involved ... the ultimate combination of royalty base and royalty rate must reflect the value attributable to the infringing features of the product, and no more."<sup>32</sup> The evidentiary principle assists courts in implementing the substantive rule where the fact finder is "asked to choose a royalty base as the starting point for calculating a reasonable royalty award."<sup>33</sup> The evidentiary principle demands that care be taken to prevent a jury from placing undue emphasis on the value of the entire product when the patented technology relates to only one feature or component of the accused product.<sup>34</sup>



Here, the court concluded that the district court violated neither the substantive rule nor the evidentiary principle. Judge O'Malley, writing for the Federal Circuit panel, explained that license agreements are often used to help juries decide an appropriate jury award and that most licenses are not "perfectly analogous to the infringement action."<sup>35</sup> Due to this reality, experts "must account for such distinguishing facts when invoking them to value the patented invention."<sup>36</sup> But the fact that a license agreement is not "perfectly analogous generally goes to the weight of the evidence, not its admissibility."<sup>37</sup> The court noted that "[m]aking real world, relevant licenses inadmissible on the grounds D-Link urges would often make it impossible for a patentee to resort to license-based evidence." License-based evidence is generally relevant and reliable, however, as long as expert testimony explains the need to discount reliance on a given license in order to account only for the value attributed to the licensed technology.<sup>38</sup>

Significantly, the panel also held that, when licenses based on the value of a multi-component product are admitted or even referenced in expert testimony, the court should "give a cautionary instruction regarding the limited purposes for which such testimony is proffered" and also should provide instructions that "fully explain the need to apportion the ultimate royalty award to the incremental value of the patented feature from the overall product."<sup>39</sup> As the court vacated the damages award on other grounds, however, it did not need to address the court's failure to provide such instructions in this case.

Various district court decisions also addressed the EMV rule and related issues, many before the Federal Circuit's *VirnetX* and *Ericsson* rulings. As discussed above, the *VirnetX* decision effectively overturned several earlier district court rulings that reached the opposite conclusion on whether further apportionment was required when the smallest saleable unit was the device itself.

For example, in *Honeywell Int'l Inc. v. ICM Controls Corp.*, the court denied the accused infringer's *Daubert* motion to exclude the testimony of the patentee's damages expert

<sup>31</sup> *Ericsson*, 773 F.3d at 1228.

<sup>32</sup> *Id.* at 1228 (citing *VirnetX, Inc. v. Cisco Sys., Inc.*, 767 F.3d 1308 (Fed. Cir. 2014)).

<sup>33</sup> *Id.* at 1226.

<sup>34</sup> *Id.*

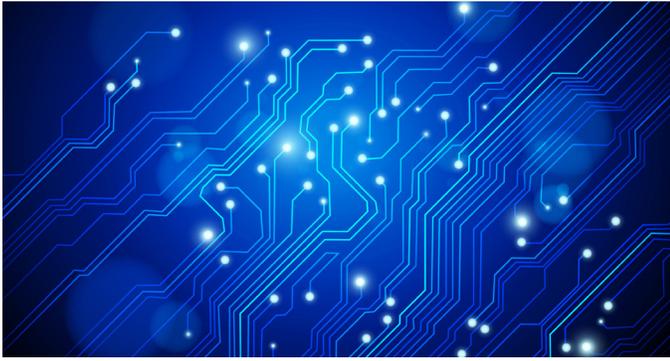
<sup>35</sup> *Id.* at 1227.

<sup>36</sup> *Id.*

<sup>37</sup> *Id.*

<sup>38</sup> *Id.* at 1228.

<sup>39</sup> *Id.*



for not complying with the entire market value rule.<sup>40</sup> In addressing the situation in which the smallest saleable unit was the device itself, the Minnesota court reached the opposite conclusion from the *VirnetX* court, reasoning that “[t]he absence of a readily-apparent severable component, whether physical or otherwise, distinguishes this case from those in which a violation of the entire market value rule has been found.”<sup>41</sup> The court also disagreed with the accused infringer regarding whether Federal Circuit precedent required further apportionment when the device was the smallest saleable unit.<sup>42</sup>

Similarly, the Northern District of California concluded in *MediaTek Inc. v. Freescale Semiconductor, Inc.* that further apportionment was not required if the expert’s royalty base consisted of revenue of the smallest saleable unit even though the smallest saleable unit included features that did not practice the asserted patent.<sup>43</sup> In *MediaTek*, the patentee’s damages expert conceded that the accused computer chip was the smallest saleable unit and that the chip included components that did not practice the asserted patent.<sup>44</sup> But the expert concluded that “currently available information is insufficient to estimate the amount of profit that can be properly attributed to the patented inventions.”<sup>45</sup> On this record, the court refused to exclude the patentee’s damages expert, holding that “there is a disputed issue requiring further evidence to determine whether ... it would be possible to apportion the value of the patent-practicing technology compared to that of the apparent smallest saleable unit here, the chip.”<sup>46</sup> *Id.* at \*13. The court’s holding appears to violate the Federal Circuit’s instruction in *VirnetX* that patentees “must ... estimate what portion of the value of [the] product is attributable to the patented technology” when the smallest saleable unit includes non-infringing components or features.<sup>47</sup>

As highlighted below, other district courts appear to have applied the Federal Circuit’s *LaserDynamics* holdings in a manner consistent with the later *VirnetX* decision.

<sup>40</sup> 2014 U.S. Dist. LEXIS 119466 (D. Minn. Aug. 27, 2014).

<sup>41</sup> *Id.* at \*86.

<sup>42</sup> *Id.* at \*89 (prior Federal Circuit cases “do not state a rule to the effect that after reaching the smallest saleable patent-practicing unit, further apportionment is always necessary.”).

<sup>43</sup> 2014 U.S. Dist. LEXIS 85438 (N.D. Cal. June 20, 2014).

<sup>44</sup> *Id.* at \*11-12.

<sup>45</sup> *Id.* at \*12.

<sup>46</sup> *Id.* at \*13.

<sup>47</sup> *VirnetX*, 767 F.3d at 1322.

***Apple, Inc. v. Samsung Elec. Co.*,  
2014 U.S. Dist. LEXIS 17204 (N.D. Cal.,  
Feb. 7, 2104)**

In post-trial motions following a jury verdict awarding Apple approximately \$290 million in damages for Samsung’s infringement of three utility patents and two design patents, Apple sought additur, supplemental damages and prejudgment interest, while Samsung sought remittitur and a new trial.

Among other things, the court concluded that substantial evidence supported the jury’s award of reasonable royalty damages, which was the same amount requested by Apple. Samsung made two arguments with respect to the propriety of the reasonable royalty award. First, Samsung argued that Apple’s damages expert’s analysis of the *Georgia-Pacific* factors was cursory and insufficient to support the award under the Federal Circuit’s decision in *Whitserve, LLC v. Computer Packages, Inc.*, 694 F.3d 10 (Fed. Cir. 2012). The court disagreed, finding that the expert’s analysis emphasized certain GP factors over others and that the expert’s report — while not in evidence — provided additional support for the *Georgia-Pacific* analysis, reasoning that Samsung should have filed a *Daubert* challenge to the expert’s analysis rather than challenge the sufficiency of evidence presented at trial.<sup>48</sup>

Relying on *Uniloc USA, Inc. v. Microsoft Corp.*, 632 F.3d 1292 (Fed. Cir. 2011), Samsung also challenged the reasonable royalty award as improper for Apple’s alleged failure to apportion the defendant’s profits and the patentee’s damages between the patented feature and the unpatented features. The court noted that Samsung largely criticized the way in which Apple’s expert apportioned, rather than a failure to apportion at all.<sup>49</sup> The court also distinguished Apple’s analysis from the *Uniloc* case, noting that while the patentee in *Uniloc* improperly invoked the entire market value rule, it was undisputed that Apple’s expert did not rely on the entire market value rule.<sup>50</sup>

***Digital Reg. of Texas, LLC v. Adobe Sys., Inc.*,  
2014 U.S. Dist. LEXIS 115565 (N.D. Cal.  
Aug. 19, 2014)**

***Digital Reg. of Texas, LLC v. Adobe Sys., Inc.*,  
2014 U.S. Dist. LEXIS 120293 (N.D. Cal.  
Aug. 27, 2014)**

The case involved patented technology for protecting software from piracy. Adobe originally challenged the patentee’s damages expert based on (1) use of unreliable data, (2) improper use of a 50/50 profit split to calculate royalty rate and (3) a failure to apportion the royalty base.<sup>51</sup> The court agreed that the expert’s estimate of the amount of software sales saved by Adobe due to the patented

<sup>48</sup> *Apple*, 2014 U.S. Dist. LEXIS 17204, at \*58 (N.D. Cal., Feb 7, 2104).

<sup>49</sup> *Id.* at \*61-62.

<sup>50</sup> *Id.* at \*62-63.

<sup>51</sup> *Digital Reg. of Texas, LLC v. Adobe Sys., Inc.*, 2014 U.S. Dist. LEXIS 115565 (N.D. Cal. Aug. 19, 2014).

antipiracy technology was based on unreliable data.<sup>52</sup> The court also agreed that the patentee's expert relied on piracy data regarding the entire software industry and data specific to another defendant (Symantec) that settled, without establishing that Symantec's and Adobe's products were similar or attempting to show that Adobe's piracy rates were equal to the average of the entire software industry.<sup>53</sup> The court rejected the patentee's contention that Adobe failed to produce piracy data, relying on Adobe's representation that it did not track the requested data. Noting that piracy "may vary widely across the industry," the court concluded that the expert's underlying data was "inherently unreliable."<sup>54</sup>

The court also rejected the patentee's assumption in the context of the hypothetical negotiation that the parties would begin a negotiation splitting the saved profits 50/50. Although this was a pre-*VirnetX* decision, the court relied on a 2013 decision from the Northern District of California<sup>55</sup> to hold that the use of an arbitrary starting point for the hypothetical negotiation is improper under Federal Circuit precedent.<sup>56</sup> Instead, parties are required to tie the starting point of a hypothetical negotiation to "case-specific factors grounded in reliable data."<sup>57</sup>

Finally, the court rejected the patentee's use of the revenue of the entire product in the royalty base as an improper invocation of the entire market value rule. Relying on case law from the Eastern District of Texas, the patentee argued that the entire product revenue could be used as the royalty base "as long as it is 'economically justified.'"<sup>58</sup> The court noted the patentee's acknowledgement that Adobe's customers did not seek out the patented features and held that the Federal Circuit's decision in *Uniloc USA, Inc. v. Microsoft Corp.*, 632 F.3d 1292, 1306 (Fed. Cir. 2011) precluded the use of the EMV rule without establishing that the patented feature drives the customers' demand.<sup>59</sup>

With the court's permission, the patentee served a revised expert report that purportedly cured those deficiencies identified by the court. Adobe, though, again moved to exclude the patentee's revised damages report, arguing that the revisions failed to cure the deficiencies identified by the court.<sup>60</sup> Adobe first challenged the patentee's apportionment of the royalty base to 30 percent of the sales because it relied on data from other companies' content delivery fees (charging 30 percent of sales revenue to deliver applications) that are distinct from the antipiracy technology at issue in the case. Noting that Adobe's argument may have "some merit," the court nonetheless allowed the apportionment because it appeared in the original expert report and Adobe failed to raise this criticism earlier.<sup>61</sup> Adobe



also challenged the patentee's calculation of the royalty base, arguing that the base improperly included revenue associated with unaccused products. The court concluded that a jury could conclude that base was proper and that Adobe's criticisms went to the weight of the testimony rather than the propriety of the methodology used.<sup>62</sup> Finally, Adobe challenged the expert's revised methodology used to calculate the royalty base. Prohibited from relying on the 50/50 split starting point, the expert's revised report relied on various Adobe license agreements. Although the court found it "troubling" that the revised report still ended up at the same 2.5 percent royalty rate, the court concluded that the revised report cured the issue raised in the court's initial opinion.<sup>63</sup>

***Emblaze Ltd. v. Apple Inc.*,  
2014 U.S. Dis. LEXIS 87371 (N.D. Cal.  
June 25, 2014)**

The accused product in this case was Apple's http live streaming (HLS). Patentee's expert used the "income approach" valuation method to estimate damages due to infringement by "calculat[ing] the additional gross profit margin on each of the accused products" from the date that Apple introduced HLS.<sup>64</sup>

Apple made a number of arguments challenging the patentee's expert's damages analysis. First, Apple argued that the expert violated the entire market value rule because she used a royalty base consisting of "Apple's unapportioned, additional gross margin" following Apple's introduction of the accused HLS. The court rejected Apple's argument because it mischaracterized the royalty base employed by the expert. Contrary to Apple's assertion, it was clear to the court that the expert used the number of units associated with infringement as the base and then applied a per unit royalty to each unit.<sup>65</sup> \*17-18. The court went on, however, to question the way in which the expert relied in her calculation of the per-unit royalty rate estimate on the total dollar value of the additional gross margin since Apple's introduction of HLS. Explaining that the expert's use of the aggregate gross margin number was "plainly and nothing more than a big number used to justify a small number" in violation of the Federal Circuit's decision in

<sup>52</sup> *Id.* at \*5-6.

<sup>53</sup> *Id.*

<sup>54</sup> *Id.* at \*7.

<sup>55</sup> *Dynetix Design Solutions, Inc. v. Synopsys, Inc.*, 2013 U.S. Dist. LEXIS 120403 (N.D. Cal. Aug. 22, 2013).

<sup>56</sup> *Digital Reg. of Texas, LLC*, 2014 U.S. Dist. LEXIS 115565, at \*9-10 (Aug. 19, 2014 N.D. Cal.).

<sup>57</sup> *Id.* at \*9.

<sup>58</sup> *Id.* at \*11.

<sup>59</sup> *Id.* at \*12.

<sup>60</sup> *Digital Reg. of Texas, LLC v. Adobe Sys., Inc.*, 2014 U.S. Dist. LEXIS 120293 (N.D. Cal. Aug. 27, 2014).

<sup>61</sup> *Id.* at \*5.

<sup>62</sup> *Id.* at \*7-8.

<sup>63</sup> *Id.* at \*9.

<sup>64</sup> *Emblaze Ltd. v. Apple Inc.*, 2014 U.S. Dis. LEXIS 87371, at \*3-4 (N.D. Cal. June 25, 2014).

<sup>65</sup> *Id.* at \*17-18.



*Uniloc USA, Inc. v. Microsoft Corp.*, the court ruled that the expert could not reference an aggregate gross margin dollar amount at trial.<sup>66</sup>

Apple also argued error in the patentee's royalty base consisting of all units sold, arguing that the Apple devices did not directly infringe the claims. The court rejected Apple's criticism, however, noting that the patentee accused Apple of indirect infringement and that Apple cited no case "suggesting that the royalty base of a hypothetical negotiation must be limited to units deemed to directly infringe."<sup>67</sup>

Finally, Apple challenged the expert's methodology for calculating the royalty rate and her reliance on incomparable licensing and litigation demands. In contrast to simply relying on her personal experience, the court noted that the expert "analyzed the licenses and demands." The court declined to exclude her testimony on the rate calculation on this basis, but noted that Apple could challenge the comparability of the licenses on cross examination.<sup>68</sup> The court did, however, conclude that patentee's expert failed to do anything to establish that the licenses and demands were "technically and economically similar" to the facts of this case. Accordingly, the court prohibited the expert from relying on those materials at trial.<sup>69</sup>

***Golden Bridge Tech., v. Apple Inc.*,  
2014 U.S. Dist. LEXIS 68564 (N.D. Cal.)  
May 18, 2014)**

In *Golden Bridge*, the court excluded the patentee's damages expert from offering testimony that Golden Bridge's damages were roughly \$38–\$54 million based on a 0.05 percent to 0.07 percent royalty rate applied to all revenues realized by the accused iPhones and iPads. The court flatly rejected the expert's implicit invocation of the entire market value rule without making any effort to establish that the accused functionality in the baseband processor drives the demand for the accused products.<sup>70</sup> Notwithstanding the Federal Circuit's holding in *Lucent*

*Techs Inc. v. Gateway, Inc.*,<sup>71</sup> Golden Bridge argued that it was appropriate to use all revenue from the accused products as the royalty base (with no royalty cap) because it was industry practice to do so.<sup>72</sup> Without deciding whether an accepted industry practice of using the value of an entire device could allow application of the EMV rule without establishing the patented feature driving customer demand for the device, the court concluded that the expert's "industry practice" assertion was unsupported.<sup>73</sup> The court noted that none of the articles or licenses relied upon by the patentee's damages expert showed that industry participants have actually agreed to use the entire value of smartphones or tablets as the royalty base without any cap or limit on total royalties.<sup>74</sup> The court also rejected Golden Bridge's assertion that the devices themselves were the smallest salable unit, noting that Golden Bridge took the position that "the entire infringing functionality lies in the baseband processor."<sup>75</sup>

***Helios Software, LLC v. Spectorsoft Corp.*,  
2014 U.S. Dist. LEXIS 135379 (D. Del.)  
Sept. 18, 2014).**

In *Helios*, the district court excluded the patentee's damages expert from testifying because the expert admitted that the accused product included both patented and unpatented features but, nevertheless, failed to apportion the royalty base. The patentee argued that it satisfied the entire market value rule because its expert discussed the importance of the patented features to the accused products and testified that "it is the features covered by the patents-in-suit that created a sub-market for the Accused Products."<sup>76</sup> The court concluded that Helios's expert failed to satisfy the entire market value rule because the expert did not conduct a market analysis and the expert "needed to provide 'a higher degree of proof' that 'the presence of [the patented] functionality is what motivates consumers to buy the [accused product] in the first place.'"<sup>77</sup> The court did, however, allow the expert to submit a revised report addressing the failure to apportion.

***Sloan Valve Co. v. Zurn Indus., Inc.*,  
2014 U.S. Dist. LEXIS 39678 (N.D. Ill.)  
March 26, 2014)**

In *Sloan*, the court addressed a number of interesting issues related to the proper application of the entire market value rule and apportionment. The patented technology related to manual dual flush (MDF) valves used in toilets. The patentee's damages model was based on a per-unit royalty of \$106 for each accused product. The accused products included stand-alone MDF valves, packages that included the MDF valves and other components such as toilet bowls,

<sup>66</sup> *Id.* at \*19.

<sup>67</sup> *Id.*

<sup>68</sup> *Id.* at \*20-21.

<sup>69</sup> *Id.* at \*22.

<sup>70</sup> *Golden Bridge Tech., v. Apple Inc.*, 2014 U.S. Dist. LEXIS 68564 (N.D. Cal. May 18, 2014) at \*14-15.

<sup>71</sup> 580 F.3d 1301 (Fed. Cir. 2009).

<sup>72</sup> *Golden Bridge Tech.*, at \*15-16.

<sup>73</sup> *Id.* at \*16.

<sup>74</sup> *Id.*

<sup>75</sup> *Id.* at \*16-17.

<sup>76</sup> *Helios Software, LLC v. Spectorsoft Corp.*, 2014 U.S. Dist. LEXIS 135379, at \*18 (D. Del. Sept. 18, 2014).

<sup>77</sup> *Id.* at \*19 (quoting *LaserDynamics, Inc. v. Quanta Computer, Inc.*, 694 F.3d 51 (Fed. Cir. 2012)).

and handles. The court separately addressed apportionment and application of the entire market value rule to each accused product.

With respect to the stand-alone MDF valves, the court concluded that the patentee's expert satisfied the entire market value rule because he relied on sufficient evidence that MDF valves were the smallest saleable patent-practicing unit and that customers purchased the MDF valves due to the patented technology.<sup>78</sup> The court rejected the defendant's assertions that there were other features and reasons why customers purchased the MDF valves, including price, brand, loyalty to the manufacturer's representative and performance, concluding that the patentee "presents a credible argument and evidence that the patented technology is the basis for the customer's willingness to pay a premium" for the MDF valves.<sup>79</sup> The court also rejected defendant's argument that the patentee was required to use econometric studies, customer surveys, regression analyses or other fact-based evidence of demand sensitivities to satisfy the entire market value rule, explaining that the Federal Circuit requires only "sound economic proof" that is "reliable and tangible."<sup>80</sup> The court also rejected the defendant's argument that rules of apportionment "required" the patentee to value the patented technology as the improvement of the dual-flush valve over the single-flush valve by comparing the price difference between the dual- and single-flush valve products, finding that the MDF valve was "an entirely new product," as opposed to an improvement on an existing product.<sup>81</sup>

Addressing the other accused products — packages and handles — the court agreed with the defendant that the patentee improperly applied the entire market value rule to these products. The court explained that the patentee did not assert that the MDF valves drove the customer demand of the packages or handles and that it was improper to include the entire revenue for such sales in the damages analysis.<sup>82</sup>

The court also rejected the patentee's reliance on the EMV rule to recover profits on collateral sales. The patentee asserted that the collateral products, together with the accused MDF valve, could be considered a single functional unit.<sup>83</sup> The court disagreed, noting that, in addition to establishing that the infringing components must be the basis for the demand of the entire functional unit, the patentee failed to present any evidence establishing that the infringing and non-infringing products constitute a single functioning unit and the patentee failed to cite to any evidence establishing that fact.<sup>84</sup>



Although the court agreed that parts of the patentee's expert's reasonable royalty analysis were sound (e.g., application of the entire market value rule for the accused MDF valve products), the court ultimately excluded the expert's testimony in its entirety, concluding that his overall methodology and use of a per-unit royalty improperly including lost profits was "unreliable and it bears no resemblance to a reasonable royalty analysis."<sup>85</sup>

***ThinkOptics, Inc. v. Nintendo of Am., Inc.*,  
2014 U.S. Dist. LEXIS 84529 (E.D. Tex.  
June 21, 2014)**

In *ThinkOptics*, defendant Nintendo sought to exclude the testimony of the patentee's damages expert based on an improper application of the entire market value rule. ThinkOptics' expert opined that ThinkOptics was entitled to a royalty of \$5.00 per infringing console unit sold or, as an alternative theory, \$3.25 per remote control sold.<sup>86</sup>

Nintendo argued that the damages model invoked the entire market value rule without establishing that the patented technology drove customer demand for the accused Wii system.<sup>87</sup> In response, ThinkOptics asserted that its expert did not rely on the entire market value rule, but nevertheless could establish that the patented technology drove customer demand with evidence that the accused "active play" feature of the Wii system drove that demand. The court disagreed, explaining that the patented "direct pointing technology" was just one aspect of the "active play" feature and that various instances of active play did not utilize "direct pointing technology" at all.<sup>88</sup>

Moreover, while ThinkOptics argued that its expert apportioned "the profitability of those products' non-accused features by considering the value of the non-accused features 'in totality,'" <sup>89</sup> the court faulted the expert for failing to include an apportionment calculation or otherwise explain how he isolated the asserted patents' contribution to the total profits of the entire accused products.<sup>90</sup> This "lack of transparency" prevented the court from finding that the testimony was based in sufficient facts or data.<sup>91</sup>

<sup>78</sup> *Sloan Valve Co. v. Zurn Indus., Inc.*, 2014 U.S. Dist. LEXIS 39678, at \*23 (N.D. Ill. March 26, 2014).

<sup>79</sup> *Id.* at \*19-20.

<sup>80</sup> *Id.* at \*20-21 (quoting *Grain Processing v. American Maize-Products Co.*, 185 F.3d 1341 (Fed. Cir. 1999) and *Uniloc USA, Inc. v. Microsoft Corp.*, 632 F.3d 1292 (Fed. Cir. 2011)).

<sup>81</sup> *Id.* at \*22-23.

<sup>82</sup> *Id.* at \*25-27.

<sup>83</sup> *Id.* at \*32-33.

<sup>84</sup> *Id.* at \*33.

<sup>85</sup> *Id.* at \*40-43.

<sup>86</sup> *ThinkOptics, Inc. v. Nintendo of Am., Inc.*, 2014 U.S. Dist. LEXIS 84529, at \*3-4 (N.D. Cal. June 21, 2014).

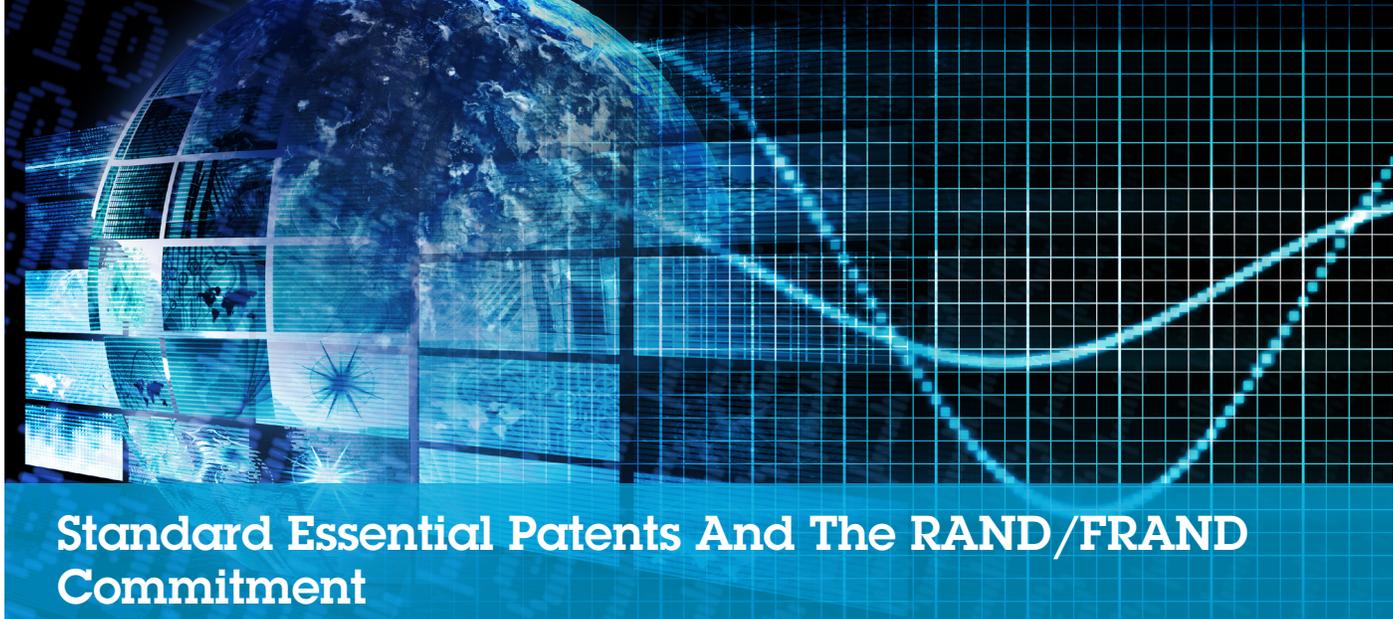
<sup>87</sup> *Id.* at \*6.

<sup>88</sup> *Id.*

<sup>89</sup> *Id.* at \*8.

<sup>90</sup> *Id.* at \*8-9.

<sup>91</sup> *Id.* at \*9.



## Standard Essential Patents And The RAND/FRAND Commitment

As expected, 2014 brought clarification of some issues relevant to litigations involving patents subject to RAND (“reasonable and non-discriminatory”) or FRAND (“fair, reasonable and non-discriminatory”) obligations.<sup>92</sup> On an issue of first impression, for example, the Federal Circuit answered important questions about how appropriate RAND royalty rates are to be determined. In another case, the Federal Circuit made clear that injunctions are available to owners of standard essential patents, even if such relief is seemingly at odds with general FRAND obligations and principles. Despite the welcome decisions, though, uncertainty continues to rule the day and litigants — whether patent owner or accused infringer — need to be mindful of the myriad potential pitfalls that await.

Standard-setting organizations (SSOs) play an important role in developing technical standards and promoting their widespread implementation. To achieve these goals, SSOs rely on voluntary participation from individual and industry representatives.<sup>93</sup> The benefits of joint collaboration and development in the standard-setting process are undisputed. Through development and adoption of standards, for example, industry participants can realize a larger market for products that are standard-compliant, identify new innovations in which to apply the standards, and benefit through revenue streams achieved through licensing of standard-essential patents (SEPs) — patents that necessarily would be infringed if the standard is adopted.

<sup>92</sup> Courts refer to both “RAND” and “FRAND”; this overview uses both terms interchangeably. Generally, in the U.S. and for U.S.-based SSOs, RAND is the more commonly used term, while FRAND is the more common term outside the U.S.

<sup>93</sup> Different SSOs use different terminology to refer to those parties obligated to abide by the SSO’s Intellectual Property Rights policies, such as “members,” “participants” and “contributors,” each of which can infer different obligations.

The potential downside of joint collaboration and development, however, can also be significant. Because a standard by definition eliminates alternative technologies, owners of SEPs are in a position to exercise monopoly power that can create the potential for “hold-up.”<sup>94</sup> The Third Circuit in *Broadcom Corp. v. Qualcomm Inc.* described the scenario as follows:

An [SSO] may complete its lengthy process of evaluating technologies and adopting a new standard, only to discover that certain technologies essential to implementing the standard are patented. When this occurs, the patent holder is in a position to “hold up” industry participants from implementing the standard. Industry participants who have invested significant resources developing products and technologies that conform to the standard will find it prohibitively expensive to abandon their investment and switch to another standard. They will have become “locked in” to the standard. In this unique position of bargaining power, the patent holder may be able to extract supracompetitive royalties from the industry participants.<sup>95</sup>

Another significant concern is “royalty stacking.” Royalty stacking arises when implementers of a standard are required to pay royalties to multiple SEP-holders on the same product. These royalties are considered to accumulate, or “stack,” on top of each other. To preserve the integrity of the standard-setting process and alleviate the risks of patent hold-up and royalty stacking, most SSOs have established intellectual property rights (IPR) policies. IPR policies generally outline the obligations

<sup>94</sup> *Broadcom Corp. v. Qualcomm Inc.*, 501 F.3d 297, 314 (3rd Cir. 2007) (internal citations omitted).

<sup>95</sup> *Id.* at 310.

of SSO participants that have SEPs to standards under development. Generally, IPR policies also require participants in the standards-development process to disclose any patents or patent applications that may be essential to the standard before the standard is adopted.

In addition to the requirement to identify SEPs, SSOs often require their members to commit to license SEPs on FRAND or RAND terms.<sup>96</sup> Some SSOs ask participants to submit a letter of assurance (LOA), promising to license SEPs on FRAND terms and conditions. Other SSOs include the FRAND-licensing obligation in their membership agreement, effectively conditioning membership in the SSO on the applicant's promise to license SEPs on FRAND or RAND terms and conditions.

While there is a consensus that FRAND commitments create binding contracts,<sup>97</sup> the foundational details of the contractual commitments remain murky. For example, as set forth below, questions may arise as to whether a contract has been formed at all, who can enforce the contract and what the terms of the actual obligations might be.

### **Contract Formation and the FRAND Commitment**

Clearly defining the parties to the FRAND commitment (e.g., promisor, promisee, etc.) and defining the type of contract (e.g., bilateral, unilateral) may seem an unnecessary, or even wasted, effort. In many cases, courts have adopted the commonly accepted position that every party implementing a standard is a third-party beneficiary and can enforce an SEP-holder's FRAND commitments.

However, the basic contractual elements are predicates to answering a number of emerging questions:

- Who has standing to enforce the FRAND commitment?
- When SEPs include claims directed to components and the SEP-holder seeks royalties for an end product or from an end user, does the component manufacturer have standing to enforce the FRAND commitment?
- Can an SEP-holder unilaterally restrict or modify the terms of the FRAND commitment?
- The analyses continue to be incomplete and the conclusions mixed.

<sup>96</sup> *Id.* at 313.

<sup>97</sup> See, e.g., *Apple, Inc. v. Motorola Mobility, Inc.*, 886 F. Supp.2d 1061, 1081-87 (W.D. Wis. 2012); *Microsoft Corp. v. Motorola, Inc.*, 854 F. Supp.2d 993, 999 (W.D. Wash. 2012); *Research in Motion Ltd. v. Motorola, Inc.*, 644 F. Supp.2d 788, 797 (N.D. Tex. 2008); *Rambus, Inc. v. Infineon Technologies AG*, 155 F. Supp.2d 668 (E.D. Va. 2001), *rev'd in part, vacated in part*, 318 F. 3d 1081 (Fed. Cir. 2003).

### **Defining Fair, Reasonable and Non-Discriminatory**

No matter the context in which it arises, adjudicating cases involving FRAND-obligated SEPs requires developing a framework for "reasonable" (or "fair and reasonable") and "non-discriminatory" terms. Yet, most SSO IPR policies do not provide guidance for understanding these abstract concepts. As Judge Davis succinctly stated, "RAND creates an obligation that must be followed, but it provides no guidance on how to follow that obligation. This creates a situation ripe for judicial resolution."<sup>98</sup>

As to whether any particular terms are "reasonable," past district court decisions reflect that courts are divided on whether the reasonableness element should be interpreted as subjective reasonableness or objective reasonableness. Moreover, while "non-discriminatory" was thought to be the more straightforward of the inquiries, recent cases suggest that this assumption may not be true, as several decisions introduced an issue that is sure to come to the forefront in future cases: Is an SEP-holder prohibited from extracting different FRAND rates from potential licensees that are not similarly situated (i.e., situated at different points in the value chain)?

In the coming section, we discuss the 2014 Federal Circuit decisions that addressed SEP.

### ***Ericsson, Inc. et al. v. D-Link Systems, Inc. et al.*, 773 F.3d 1201 (Fed. Cir. 2014)**

In *Ericsson*, a number of wireless equipment makers were accused of infringing Ericsson's patents related to the IEEE 802.11 standard. The defendants, asserting their rights as third-party beneficiaries, raised the affirmative defenses and counterclaims of promissory estoppel and breach of contract.<sup>99</sup> Intel intervened on the basis that, as a supplier of 802.11-compliant chips to the defendants, it faced indemnification obligations in the case. In its complaint in intervention, Intel alleged that Ericsson breached the contractual obligations created by its LOAs to the IEEE by

<sup>98</sup> *Ericsson Inc. v. D-Link Sys.*, 2013 U.S. Dist. LEXIS 110585 (E.D. Tex. Aug. 6, 2013);

*Ericsson Inc. v. D-Link Corp.*, 2013 U.S. Dist. LEXIS 32729 (E.D. Tex. Mar. 8, 2013).

<sup>99</sup> See Dell Inc.'s First Amended Answer, Defenses and Counterclaims to First Amended Complaint, *Ericsson Inc. v. D-Link Corp.*, No. 6:10-cv-00473 (E.D. Tex. Apr. 12, 2012) (ECF No. 181); First Amended Answer and Affirmative Defenses of Toshiba Corporation and Toshiba America Information Systems, Inc., and First Amended Counterclaims of Toshiba America Information Systems, Inc. to First Amended Complaint, *Ericsson Inc. v. D-Link Corp.*, No. 6:10-cv-00473 (E.D. Tex. Apr. 12, 2012) (ECF No. 182); Acer, Inc. Acer America Corporation and Gateway, Inc.'s First Amended Answer to First Amended Complaint and Counterclaims, *Ericsson Inc. v. D-Link Corp.*, No. 6:10-cv-00473 (E.D. Tex. Apr. 12, 2012) (ECF No. 183); D-Link Systems Inc.'s First Amended Answer to First Amended Complaint and Counterclaims, *Ericsson Inc. v. D-Link Corp.*, No. 6:10-cv-00473 (E.D. Tex. Apr. 12, 2012) (ECF No. 184); and Netgear Inc.'s First Amended Answer to First Amended Complaint and Counterclaims, *Ericsson Inc. v. D-Link Corp.*, No. 6:10-cv-00473 (E.D. Tex. Apr. 12, 2012) (ECF No. 185).



“failing to offer licenses for the Patents on fair, reasonable and non-discriminatory terms, and by seeking to enjoin Intel’s customers from making and selling products that include Intel components that operate in accordance with at least the 802.11a, 802.11g, and 802.11n standards.”<sup>100</sup> The court allowed Intel to intervene.

The case progressed to a jury trial, with the jury finding infringement and awarding roughly \$10 million in damages, or approximately 15 cents per infringing device.<sup>101</sup> After post-trial motions, the district court upheld the jury’s infringement and validity findings and refused to grant a new trial based on (1) an alleged violation of the entire market value rule<sup>102</sup> and (2) allegedly deficient jury instructions regarding the standard-setting context and Ericsson’s “reasonable and non-discriminatory” licensing obligations derived from that context.<sup>103</sup>

On the RAND issue, which the Federal Circuit considered one of first impression, the parties agreed that Ericsson was obligated to license the patents at issue on RAND terms; the issue on appeal stemmed from the district court’s instruction to the jury on that RAND obligation. According to the defendants, the enforcement of RAND commitments is critical to preserving the benefits of standards and must be considered in any damages award. They argued that the district court reversibly erred by instructing the jury on the customary *Georgia-Pacific* factors because many of those either were not applicable, or may be misleading, in the RAND context. The defendants further argued that the district court erred by refusing to instruct the jury to consider patent hold-up and royalty stacking.

Ericsson argued that the district court did not err in refusing to instruct the jury about patent hold-up and royalty stacking because the *Georgia-Pacific* factors already encompassed

these concerns and, to the extent they did not, the inclusion of a “sixteenth” factor referring to Ericsson’s RAND obligations was sufficient. According to Ericsson, a jury instruction regarding patent hold-up or royalty stacking also would have been inappropriate because the defendants failed to present any evidence regarding either patent hold-up or royalty stacking to the jury.

To some extent, the Federal Circuit agreed with both sides. On the appropriateness of the *Georgia-Pacific* factors, the Federal Circuit agreed with the defendants, explaining that “[i]n a case involving RAND-encumbered patent, many of the *Georgia-Pacific* factors are not relevant; many are even contrary to RAND principles.”<sup>104</sup> For example, the Federal Circuit found that factor 4, which considers “[t]he licensor’s established policy and marketing program to maintain his patent monopoly by not licensing others to use the invention or by granting licenses under special conditions designed to preserve that monopoly,” is entirely inconsistent with Ericsson’s RAND commitment.<sup>105</sup> Factor 5 — which accounts for the “commercial relationship between the licensor and licensee” — likewise was found irrelevant.<sup>106</sup>

The Federal Circuit also found that several *Georgia-Pacific* factors would at least need to be adjusted for RAND-encumbered patents. For example, the court found that factor 8, which accounts for an invention’s “current popularity,” is likely inflated because a standard requires the use of the technology.<sup>107</sup> Similarly, the court found that factor 9, which considers the “utility and advantages of the invention,” is also skewed because the technology is used because it is essential, not necessarily because it is an improvement over the prior art.<sup>108</sup>

Taking all of this into account, the Federal Circuit found that “the district court erred by instructing the jury on multiple *Georgia-Pacific* factors that are not relevant, or are misleading, on the record before it.”<sup>109</sup> Instead, the court concluded that a “trial court must carefully consider the evidence presented in the case when crafting an appropriate jury instruction.”<sup>110</sup> The Federal Circuit made clear, however, that it was not holding that there is a modified version of the *Georgia-Pacific* factors that should be used for all RAND-encumbered patents. Indeed, it found such an approach “unwise,” mandating instead that district courts “consider the facts of record when instructing the jury and should avoid rote reference to any particular damages formula.”<sup>111</sup>

<sup>100</sup> Intel Corporation’s Complaint in Intervention, *Ericsson Inc. v. D-Link Corp.*, No. 6:10-cv-00473 (E.D. Tex. Apr. 12, 2013) (ECF No. 237), at ¶94.

<sup>101</sup> *Ericsson*, 773 F.3d at 1207.

<sup>102</sup> The district court’s and Federal Circuit’s rulings on the entire market value rule are addressed above.

<sup>103</sup> *Ericsson*, 773 F.3d at 1208.

<sup>104</sup> *Id.* at 1230.

<sup>105</sup> *Id.*

<sup>106</sup> *Id.* at 1230-1231.

<sup>107</sup> *Id.* at 1231.

<sup>108</sup> *Id.* at 1231.

<sup>109</sup> *Id.*

<sup>110</sup> *Id.*

<sup>111</sup> *Id.* 1232.

Lastly, on the appropriateness of jury instructions for patent hold-up and stacking, the Federal Circuit agreed with Ericsson, holding that a district court need not instruct the jury on hold-up or stacking unless the accused infringer presents actual evidence of hold-up or stacking. The court specifically noted that “[s]omething more than a general argument that these phenomena are possibilities is necessary.”<sup>112</sup>

The Federal Circuit found the district court’s errors prejudicial, and remanded the matter for further proceedings consistent with its opinion.

***Apple, Inc., et al. v. Motorola, Inc., et al.*,  
757 F.3d 1286 (Fed. Cir. 2014)**

Plaintiffs Apple, Inc., and Next Software, Inc. (Apple) filed a complaint against defendants Motorola, Inc., and Motorola Mobility, Inc. (Motorola) on October 29, 2010, in the US District Court for the Western District of Wisconsin, asserting infringement of three patents. Motorola counterclaimed, asserting six of its own patents, one of which is a FRAND-committed patent. Both parties also sought declaratory judgments of non-infringement and invalidity.

After claim construction began in Wisconsin, the case was transferred to the US District Court for the Northern District of Illinois, Judge Posner sitting by designation. The district court in Illinois completed claim construction and, based thereon, granted summary judgment of non-infringement with respect to certain claims and excluded the vast majority of both parties’ damages expert’s evidence for the remaining claims. With little evidence deemed admissible, the district court granted summary judgment that neither side was entitled to any damages or an injunction.<sup>113</sup>

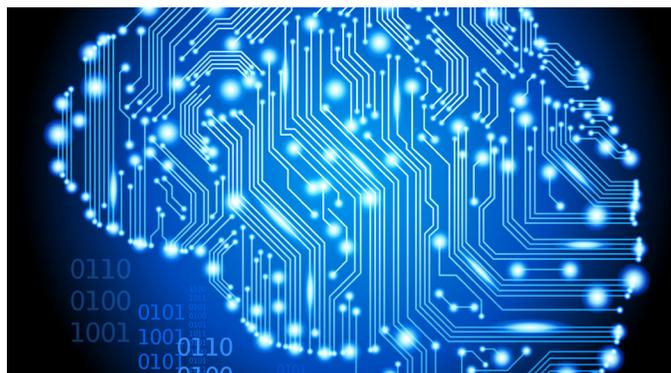
In response to Apple’s motion for summary judgment that Motorola was not entitled to an injunction for infringement of the FRAND-committed patent, the district court explained:

I don’t see how, given FRAND, I would be justified in enjoining Apple from infringing the ‘898 unless Apple refuses to pay a royalty that meets the FRAND requirement. By committing to license its patents on FRAND terms, Motorola committed to license the ‘898 to anyone willing to pay a FRAND royalty and thus implicitly acknowledged that a royalty is adequate compensation for a license to use that patent. How could it do otherwise? How could it be permitted to enjoin Apple from using an invention that it contends Apple must use if it wants to make a cell phone with UMTS telecommunications capability – without which it would not be a cell phone.<sup>114</sup>

<sup>112</sup> *Id.* 1234.

<sup>113</sup> *Apple*, 757 F.3d at 1294.

<sup>114</sup> *Id.* at 1331 (emphasis in original).



On appeal, the Federal Circuit held that “[t]o the extent that the district court applied a *per se* rule that injunctions are unavailable for SEPs, it erred.”<sup>115</sup> While the court acknowledged that Motorola’s FRAND commitments should be considered when evaluating the merits of an injunction, it saw no reason to create a separate rule or framework for addressing FRAND-committed patents.<sup>116</sup> The court held that the framework laid out by the Supreme Court in *eBay*, as interpreted by subsequent decisions, provides ample “strength and flexibility” for addressing the unique aspects of FRAND-committed patents.<sup>117</sup>

While acknowledging that a patentee subject to FRAND commitments may have difficulty establishing irreparable harm, the court explained that an injunction may be justified where an infringer unilaterally refuses a FRAND royalty or unreasonably delays negotiations to the same effect.<sup>118</sup> This does not mean, though, that refusing a license exposes a litigant to an injunction. After all, the license offer may not be on FRAND terms, and the public has an interest in ensuring SEPs are not overvalued.<sup>119</sup>

Applying the asserted principles, the Federal Circuit agreed with the district court that Motorola is not entitled to an injunction. Motorola’s licensing history suggested that money damages were more than adequate to compensate for the infringement, and Motorola had failed to demonstrate any irreparable harm.<sup>120</sup>

<sup>115</sup> *Id.*

<sup>116</sup> *Id.*

<sup>117</sup> *Id.* at 1332.

<sup>118</sup> *Id.*

<sup>119</sup> *Id.*

<sup>120</sup> *Id.*



## Daubert Challenges To Damages Experts

Last year we highlighted an apparent increase in the use of *Daubert* challenges to the admissibility of damages opinions and analyses. In 2014, this trend continued and *Daubert* challenges to damages experts appear to be a somewhat routine procedure in patent litigation. As courts have started scrutinizing damages experts' application of the entire market value rule, use of supposedly comparable licenses, and attempts to craft new approaches for arriving at a reasonable royalty from the hypothetical negotiation, *Daubert* motions have proven an effective way of gaining an advantage at trial.

This section highlights some of the more procedural issues and methods used by courts to dispose of *Daubert* motions pertaining to damages, as well as points of differentiation as to what affects admissibility appropriate for exclusion under *Daubert*. Other sections of this publication address the more substantive aspects of damages issues being analyzed by courts, whether through *Daubert* motions, on summary judgment or as the finder of fact.

### ***Apple Inc. v. Motorola, Inc.*, 757 F.3d 1286 (Fed. Cir. 2014)**

In one of the few cases from the Federal Circuit in 2014 to address a *Daubert* motion pertaining to damages, the court reversed (for the most part) the district court's decision to exclude both parties' damages experts.<sup>121</sup> In *Apple*, the court telegraphed the crux of its decision by focusing its discussion of *Daubert* standards on the gatekeeper role as distinct from the trier of fact: "A judge must be cautious not to overstep its gatekeeping role and weigh facts, evaluate the correctness of conclusions, impose its own preferred methodology, or judge credibility, including the credibility of one expert

over another. These tasks are reserved solely for the fact finder."<sup>122</sup> The court further emphasized that "[a]ll approaches have certain strengths and weaknesses and, depending upon the facts, one or all may produce admissible testimony in a single case. It is common for parties to choose different, reliable approaches in a single case and, when they do, the relative strengths and weaknesses may be exposed at trial or attached during cross-examination."<sup>123</sup>

Given such language, it was not surprising that the court concluded that the district court improperly substituted its own opinions and evaluations of the experts' analyses and testimony instead of "focusing on the reliability of the principles and methods used or the sufficiency of the facts and data relied upon."<sup>124</sup> Otherwise, the court noted that each expert's analysis, though different from the other, relied on typical methodology to arrive at a reasonable royalty, and that each expert at least accounted for the issues raised in the competing *Daubert* motions. The court also noted that it is appropriate for a damages expert to rely on the opinions of technical experts to justify comparisons and explanations of potential non-infringing alternatives, even if inherently biased.<sup>125</sup> There was a caveat to reliance on other experts, however: the court rejected one expert's opinion to the extent it relied on a separate economic opinion attempting to apportion the value of the patent-in-suit among the rest of a licensed portfolio.<sup>126</sup>

The Federal Circuit further noted that damages experts need not perform specific, mathematical valuations for all their conclusions, especially in the context of

<sup>122</sup> *Id.* at 1314.

<sup>123</sup> *Id.* at 1315.

<sup>124</sup> *Id.* at 1316.

<sup>125</sup> *Id.* at 1320-21.

<sup>126</sup> *Id.* at 1324-25.

<sup>121</sup> *Apple Inc. v. Motorola, Inc.*, 757 F.3d 1286 (Fed. Cir. 2014).

simply dismissing comparable licenses or potential non-infringing alternatives. The fact that an expert has considered and analyzed such issues can be sufficient, as long as it is reasonable to do so. “That a party may choose to pursue one course of proving damages over another does not render its expert’s damages testimony inadmissible.”<sup>127</sup>

***GPNE Corp. v. Apple, Inc.*,  
2014 U.S. Dist. LEXIS 53234 (N.D. Cal.)  
Apr. 16, 2014)**

In another case involving Apple, the Northern District of California first excluded a damages expert, but then gave him an opportunity to prepare a new report, which the court accepted in a second opinion. First, the court excluded the reasonable royalty analysis and opinions of the patent owner’s expert because he failed to perform any reasonable, reproducible calculations or determinations of the rate.<sup>128</sup> “Experts must follow some discernable methodology, and may not be ‘a black box into which data is fed at one end and from which an answer emerges at the other.’” (citations omitted).<sup>129</sup> The court observed that, while some approximation is allowed and even necessary, an expert still must provide some factual, economic analysis to support the approximation.<sup>130</sup> Importantly, although the expert had performed a specific calculation of incremental profit per unit (\$86), he provided no reliable explanation for how he arrived at the final per-unit royalty (\$1).<sup>131</sup> As a result, the court found no reasonable way to cross-examine him on the final result, rendering his opinion no different from the discredited 25% Rule.<sup>132</sup>

In reviewing the defendant’s expert’s opinion and denying the plaintiff’s competing *Daubert* motion, the court accepted his “Component Royalty Stack Approach” used to apportion value among a portfolio of licenses. Although that approach had been criticized in several cases, the expert in this case took sufficient steps to account for each of the various issues that could undermine his particular use of that approach.<sup>133</sup> The court also noted that a lack of peer-reviewed articles or opinions sanctioning the specific method does not render a methodology inadmissible, so long as the methodology has an objective basis that can be reviewed. Moreover, the court pointed out that other courts had in fact approved methods “essentially identical” to the approach used here.<sup>134</sup>

<sup>127</sup> *Id.* at 1325.

<sup>128</sup> *GPNE Corp. v. Apple, Inc.*, 2014 U.S. Dist. LEXIS 53234 (N.D. Cal. Apr. 16, 2014).

<sup>129</sup> *Id.* at \*18.

<sup>130</sup> *Id.* at \*18-19.

<sup>131</sup> *Id.* at \*10-11.

<sup>132</sup> *Id.* at \*25.

<sup>133</sup> *Id.* at \*29-35.

<sup>134</sup> *Id.* at \*33-34.

Given “a second bite at the apple,” the plaintiff’s expert fared somewhat better four months later.<sup>135</sup> While the defendant challenged the second report’s calculation of the \$86 per unit incremental profit, the court deemed this issue waived because the defendant had failed to challenge that calculation in the first motion and in subsequent opportunities.<sup>136</sup> And because the plaintiff’s expert borrowed the defense expert’s methodology to apportion the royalty among patented and unpatented features, the court accepted this new analysis, even though it resulted in an identical \$1 per-unit royalty.<sup>137</sup>

An “alternative” calculation introduced in the revised report, however, was held inadmissible because the expert essentially ignored the court’s prior ruling establishing the smallest saleable unit.<sup>138</sup> The court refused to allow the plaintiff to “manufacture a factual dispute” about the smallest saleable unit where the court had already settled the dispute as a matter of law.<sup>139</sup>

***Emblaze Ltd. v. Apple Inc.*,  
2014 U.S. Dist. LEXIS 87371 (N.D. Cal.)  
June 25, 2014)**

In another *Daubert* “split decision,” the Northern District of California declined to exclude the patent owner’s damages expert entirely, but did limit some of the testimony. In *Emblaze Ltd. v. Apple Inc.*,<sup>140</sup> the court rejected arguments about a failure to apportion damages because the alleged failure related to a calculation of the royalty rate, not the royalty base.<sup>141</sup>

The court also rejected arguments that the royalty base may include only units that directly infringe, especially given the express allegations of indirect infringement.<sup>142</sup> The court did exclude, however, the expert’s reliance on two specific licenses that the expert failed to establish as technically or economically similar to the patents and facts in this particular case.<sup>143</sup> Lastly, the court excluded the expert’s “Apple bashing” that included characterizations of “paranoid security Nazis,” Steve Jobs as a thief and bad discovery tactics.<sup>144</sup>

<sup>135</sup> *GPNE Corp. v. Apple, Inc.*, 2014 U.S. Dist. LEXIS 108686 (N.D. Cal. Aug. 6, 2014).

<sup>136</sup> *Id.* at \*15-17.

<sup>137</sup> *Id.* at \*17.

<sup>138</sup> *Id.* at \*20-22.

<sup>139</sup> *Id.*

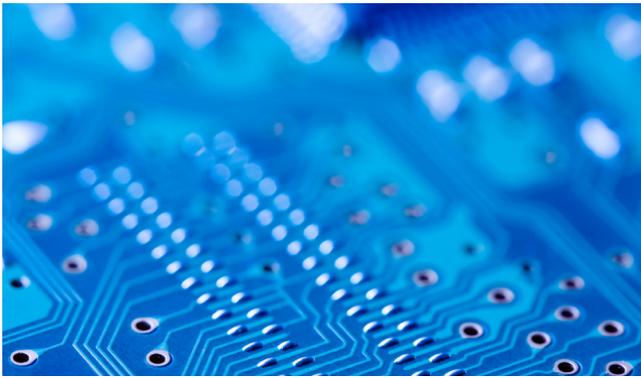
<sup>140</sup> 2014 U.S. Dist. LEXIS 87371 (N.D. Cal. June 25, 2014).

<sup>141</sup> *Id.* at \*17-18.

<sup>142</sup> *Id.* at \*18.

<sup>143</sup> *Id.* at \*22.

<sup>144</sup> *Id.* at \*24-25.



***Co-Star Realty Info., Inc. v. CIVIX-DDI, LLC*,  
2014 U.S. Dist. LEXIS 138617 (N.D. Ill.  
Sept. 30, 2014)**

Some courts still appear skeptical of excluding expert damages opinions on *Daubert* grounds and prefer to have the issues resolved as a matter of fact at trial. In *Co-Star Realty Info., Inc. v. CIVIX-DDI, LLC*,<sup>145</sup> the Northern District of Illinois issued a somewhat cursory opinion denying a *Daubert* motion in favor of leaving the challenges as “fodder for examination at trial.”<sup>146</sup> Of course, the issue was somewhat simple as well, with the main complaint based on the expert’s use of an incorrect hypothetical negotiation date, and reliance on facts occurring after the 2002 date to verify the opinion.<sup>147</sup> The court decided that the hypothetical negotiation date is a factual dispute. The court further stated that an expert’s use of subsequent events “to check the veracity of her opinion about hypothetical negotiations in 2002 actually enhances her opinion’s reliability,” and called into question the defense expert’s failure to check his assumptions against subsequent reality.<sup>148</sup> Curiously, the court summarily rejected the accused infringer’s argument relating to violations of the entire market value rule, allowing the expert to testify at trial where “[f]urther scrutiny will take place” to determine if the opinion should be excluded.<sup>149</sup>

***B-50.com, LLC v. InfoSync Servs., LLC*,  
2014 U.S. Dist. LEXIS 142762 (N.D. Tex.  
Oct. 7, 2014)**

In another case quickly denying a motion to strike a damages expert report under *Daubert*, the court in *B-50.com, LLC v. InfoSync Servs., LLC*,<sup>150</sup> deferred to

<sup>145</sup> 2014 U.S. Dist. LEXIS 138617 (N.D. Ill. Sept. 30, 2014).

<sup>146</sup> *Id.* at \*10.

<sup>147</sup> *Id.* at \*9-10.

<sup>148</sup> *Id.* at \*10.

<sup>149</sup> *Id.*

<sup>150</sup> 2014 U.S. Dist. LEXIS 142762 (N.D. Tex. Oct. 7, 2014).

the expert’s reliance on a fairly typical *Georgia-Pacific* royalty analysis to reach a 3.5 percent royalty rate without a specific mathematical calculation of that rate.<sup>151</sup> Defendant “attacks only the reliability of [expert’s] report, contending that it is not grounded in a proper analysis of factual basis. ‘As a general rule, questions relating to the bases and sources of an expert’s opinion affect the weight to be assigned that opinion rather than its admissibility and should be left for the [trier of fact’s] consideration.’”<sup>152</sup> The court did not engage in a detailed analysis, but noted that the expert himself had cited specific facts and testimony, applied them to the *Georgia-Pacific* framework and estimated the royalty rate. That was enough to meet the threshold for admissibility.

***France Telecom S.A. v. Marvell Semiconductor Inc.*,  
2014 U.S. Dist. LEXIS 121568 (N.D. Cal.  
Aug. 28, 2014)**

Following similar reasoning deferring to a damages expert so long as that expert accounts for an alleged failure or otherwise provides an adequate explanation of why she did or did not include certain analyses, the court in *France Telecom S.A. v. Marvell Semiconductor Inc.*<sup>153</sup> rejected the accused infringer’s *Daubert* challenge. Because the expert offered a plausible explanation for why her proposed lump sum royalty payment was appropriate, the testimony was permissible.<sup>154</sup> Similarly, because the expert offered an appropriate explanation for how the damages analysis accounted for sales limited to the United States, even related to foreign activity, the opinions were admissible.<sup>155</sup>

***Everlight Elecs. Co. v. Nichia Corp.*,  
2014 U.S. Dist. LEXIS 132439 (E.D. Mich.  
Sept. 22, 2014)**

In *Everlight Elecs. Co. v. Nichia Corp.*,<sup>156</sup> the district court also denied the parties’ competing *Daubert* challenges to opposing damages experts. The court rejected a challenge to the patent owner’s lost profits analysis because the expert followed the four-factor guidelines from *Panduit*.<sup>157</sup> While the expert’s opinions and analysis “could have been more detailed” in distinguishing among products and functionality for competition and market demand, they were not inadmissible because there were

<sup>151</sup> *Id.* at \*26.

<sup>152</sup> *Id.* at \*32 (citations omitted).

<sup>153</sup> 2014 U.S. Dist. LEXIS 121568 (N.D. Cal. Aug. 28, 2014).

<sup>154</sup> *Id.* at \*23-25.

<sup>155</sup> *Id.* at \*26-27.

<sup>156</sup> 2014 U.S. Dist. LEXIS 132439 (E.D. Mich. Sept. 22, 2014).

<sup>157</sup> *Id.* at \*14 (citing *Panduit Corp. v. Stahl Bros. Bibre Works, Inc.*, 575 F.2d 1152 (6th Cir. 1978)).

facts to support them.<sup>158</sup> Notably, the court reaffirmed the principle that experts may rely on the opinions of others regarding competitive products, embodiments that practice the patents-in-suit and smallest saleable units.<sup>159</sup>

***Prism Techs. LLC v. AT&T Mobility, LLC*,  
2014 U.S. Dist. LEXIS 132619 (D. Neb.  
Sept. 22, 2014)**

Though *Daubert* case law has taught away from experts' being required to follow "generally accepted" methodologies, some courts still are reluctant to admit opinions resulting from entirely new methodologies. For example, in *Prism Techs. LLC v. AT&T Mobility, LLC*,<sup>160</sup> the District of Nebraska excluded a damages expert's reasonable royalty analysis because it essentially combined two accepted, reliable methodologies into a hybrid approach. The court acknowledged that both the revenue-generation approach and a cost-savings analysis were acceptable methods, independently, used by experts to calculate a royalty base.<sup>161</sup> However, the expert's hybrid "methodology and model has never before been attempted."<sup>162</sup> "[T]he Court can find no case law to support Prism's claim that the product revenue as a fraction of cost savings is permissible, let alone logical. [Expert's] model is the first of its kind in patent cases."<sup>163</sup> Importantly, the expert's failure to correlate the two approaches to justify their combination in his model doomed his conclusions.<sup>164</sup>

***Rembrandt Social Media, LP v. Facebook, Inc.*,  
561 Fed. Appx. 909 (Fed. Cir. 2014)**

Rembrandt sued Facebook in the United States District Court for the Eastern District of Virginia for patent infringement and sought reasonable royalty damages.<sup>165</sup> Rembrandt proffered the report of its expert on damages, who calculated a royalty in a running-royalty form, using a royalty base multiplied by a royalty rate. Facebook moved to exclude the expert's opinions under Federal Rule of Evidence 702 and *Daubert v. Merrell Dow Pharmaceuticals, Inc.*<sup>166</sup>

<sup>158</sup> *Id.* at \*15-16.

<sup>159</sup> *Id.* at \*19, 31-33.

<sup>160</sup> 2014 U.S. Dist. LEXIS 132619 (D. Neb. Sept. 22, 2014).

<sup>161</sup> *Id.* at \*17-22.

<sup>162</sup> *Id.* at \*18-19.

<sup>163</sup> *Id.* at \*19.

<sup>164</sup> *Rembrandt Social Media, LP v. Facebook, Inc.*, 561 Fed. Appx. 909 (Fed. Cir. 2014).

<sup>165</sup> 509 U.S. 579 (1993).

<sup>166</sup> *Rembrandt*, at \*910.



The district court granted Facebook's motion, finding that the expert's proposed testimony had two flaws: (1) the expert had not properly apportioned Facebook's revenue to the features associated with the alleged infringement; and (2) the expert had equated percentages from surveys about the importance of various features to Facebook users with percentages of advertising revenue received by Facebook without adequate analysis. The court held that the flaws "infected" both the proposed royalty base and the royalty rate.<sup>167</sup>

At the request of both parties, the district court then certified the inadmissibility ruling for interlocutory appeal under 28 U.S.C. § 1292(b) and stayed further district court proceedings.<sup>168</sup> The Federal Circuit, though, denied Rembrandt's petition for appeal, expressing concern about inviting interlocutory reviews of damages rulings before a liability determination, as such rulings could end up having no consequence where subsequent proceedings result in a determination of no liability.<sup>169</sup> And, as pointed out by the panel, the district court had not ruled that the parties could not go to trial on liability without the excluded expert evidence, had not foreclosed Rembrandt from presenting other damages evidence and had not foreclosed the possibility of nominal damages or declaratory or injunctive relief.<sup>170</sup> Further, neither the district court's order nor the parties' submissions made clear that the case would not go to trial on liability if the Federal Circuit agreed to permit the appeal and affirmed the order. Thus, there was no basis to suggest that permitting the interlocutory appeal would save resources or shorten the time to resolve the case.

<sup>167</sup> *Id.*

<sup>168</sup> *Id.* at 912.

<sup>169</sup> *Id.* at 912.

<sup>170</sup> *Id.* at \*911.



## Conclusion

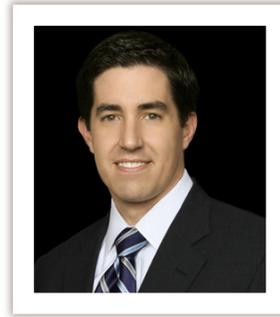
This was an extremely important year in the developing law of patent damages. In *VirnetX*, the Federal Circuit reiterated the district court's gatekeeping role against unreliable expert testimony that fails to apportion damages even for multi-component products that are the "smallest salable unit" or that relies on rules of thumb or generic assumptions untethered to the underlying facts of the case. Patentees arguing for a reasonable royalty measure of damages likely will face increased difficulty in using completed product sales as a royalty base, and may turn to alternative damages models such as those based on a lump-sum or per-unit royalty, rather than a traditional royalty rate times revenue base approach. District courts are left to grapple

with how patentees can properly establish when the entire market value rule applies and how patentees can defensibly calculate the value attributable to the patented technology compared to other component features. As patent owners develop new damages methodologies to address these issues, defendants will likely continue to mount *Daubert* challenges, arguing that these approaches are not founded on scientific or generally accepted methodologies. Finally, the Federal Circuit provided additional guidance on royalties for FRAND-obligated patents, but eschewed any *per se* rules, leaving many issues for the district courts to sort out in the coming years.

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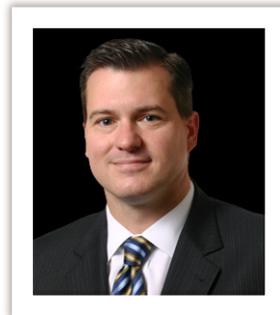
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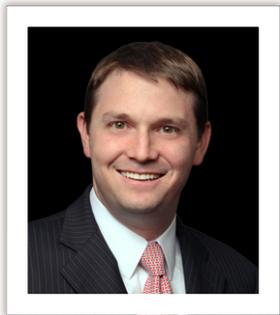
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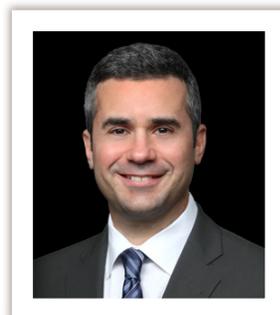
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