



CRA Insights: Intellectual Property

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Lucent v. Gateway Damages Award Vacated and Remanded for Insufficient Evidentiary Support

In *Lucent Technologies, Inc. v. Gateway, Inc., et al.*,¹ the CAFC vacated and remanded the damages award due to insufficient evidentiary support. Separately, the court affirmed that the prior decisions establishing the patent as valid and infringed were supported by the evidence and not contrary to law.

Background

In 2002, Lucent sued Gateway and Dell, among others, for infringement of US patent No. 4,763,356 (“the ‘356 Patent”), and Microsoft subsequently intervened.² Following trial, the jury found Microsoft liable for infringing the ‘356 Patent, but it did not find Dell liable. The jury awarded a single lump sum of \$357,693,056 against Microsoft for all products involved, excluding prejudgment interest.³

Following the verdict, Microsoft moved for judgment as a matter of law (“JMOL”) arguing that the jury’s verdict violated the entire market value rule and was not supported by the evidence.⁴ In ruling on the JMOL damages motion, the district judge held that the jury’s award did not reflect an entire market value rule calculation “on its face,” and also that substantial evidence supported the jury’s verdict.⁵ Microsoft then appealed to the Federal Circuit.

¹ CAFC 2008-1485, -1487, -1495.

² 2069 U.S. App. LEXIS 20325, p. 2. Additional patents were also asserted as part of the suit, but the issues addressed herein only relate to the ‘356 Patent. The ‘356 Patent is also referred to as the “Day Patent” in the case filings, see 580 F. Supp. 2d 1016.

³ 07-cv-2000 Special Verdict, Apr. 4th 2008 DN 735. Infringing products include Microsoft Money, Windows Mobile, and Microsoft Outlook. The CAFC focused its analysis on the infringing use of Outlook as it believed that this was the basis for a substantial part of the damages award. 2009 U.S. App. LEXIS 20325, p. 14.

⁴ 580 F. Supp. 2d 1016, p. 29.

⁵ *Ibid.*, p. 29.

On appeal, Microsoft argued that the jury should not have applied the entire market value rule to the value of its three software products and that, for method claims, damages should be limited to the proven number of instances of actual infringing use.⁶ The Federal Circuit rejected both arguments as presented by Microsoft but held that substantial evidence does not support the jury's verdict of a lump sum royalty payment of approximately \$358 million.⁷ A detailed discussion of the Federal Circuit ruling regarding the damages issues follows.

Hypothetical negotiation

Both parties followed a hypothetical negotiation approach to determine reasonable royalty damages. This approach tries, as best as possible, to recreate the *ex ante* licensing negotiation scenario and to describe the resulting agreement.⁸ The court summarized its role as determining whether substantial evidence supports the jury's implicit finding that Microsoft would have agreed to, at the time of the hypothetical negotiation, a lump sum paid-in-full royalty of about \$358 million. The court examined specific Georgia-Pacific factors in performing this analysis.⁹

Georgia-Pacific Factor #2

Georgia-Pacific Factor #2 is "[t]he rates paid by the licensee for the use of other patents comparable to the patent in suit."¹⁰ Under this factor, the court also addressed the question of whether the reasonable royalty should be in the form of a running royalty or lump sum. The court identified a number of factors that shift the balance of risks between the licensor and the licensee depending on whether the agreement is structured as a lump sum or a running royalty. Lucent's licensing expert testified to a damages number based solely on a running royalty of 8% while Microsoft's expert testified that a lump sum of \$6.5 million would be appropriate. In evaluating Georgia-Pacific Factor #2, the court analyzed whether or not the license agreements introduced into evidence supported the lump sum royalty awarded and held that this factor strongly weighed against accepting the jury's verdict because the \$358 million lump sum royalty was three to four times the size of the average lump sum royalty in the other agreements.¹¹

Georgia-Pacific Factors #10 and #13

Georgia-Pacific Factor #10 is "[t]he nature of the patented invention; the character of the commercial embodiment of it as owned and produced by the licensor; and the benefits to those who have used the invention." Factor #13 is "[t]he portion of the realizable profit that should be credited to the

⁶ 2009 U.S. App. LEXIS 20325, p. 13, citing *Dynacore Holdings Corp. v. U.S. Philips Corp.* 363 F.3d 1263 (Fed. Cir. 2004).

⁷ *Ibid.*, p. 13.

⁸ *Ibid.*, p. 14.

⁹ The term "Georgia-Pacific factor" refers to the opinion *Georgia-Pacific Corp. v. U.S. Plywood Corp.*, 318 F.Supp. 1116 (S.D.N.Y. 1970) wherein 15 factors were identified and considered in determining the amount of a reasonable royalty.

¹⁰ 2009 U.S. App. LEXIS 20325, p. 14, citing 318 F. Supp. at 1120.

¹¹ *Ibid.*, pp. 18-19. The court noted that the jury's verdict of \$358 million was outside the range of cited agreements as the largest agreement was for \$290 million and there was insufficient evidence in the record to establish the level of comparability between the agreements.

invention as distinguished from non-patented elements, the manufacturing process, business risks, or significant features or improvements added by the infringer."¹²

The court construed both of these factors as addressing the question of how the parties would have valued the patented feature during the hypothetical negotiation. The court held that the evidence supported a finding that the infringing feature contained in Microsoft Outlook is but a tiny feature of one part of a much larger software program. Further, the court determined that it was "inconceivable to conclude, based on the present record, that the use of one small feature, the date-picker, constitutes a substantial portion of the value of Outlook."¹³

Georgia-Pacific Factor #11

Georgia-Pacific Factor #11 is "[t]he extent to which the infringer has made use of the invention; and any evidence probative of the value of that use."¹⁴ In evaluating this factor, the court stated that consideration of evidence of usage after infringement started can, under appropriate circumstances, be helpful to the jury and the court in assessing whether a royalty is reasonable. Although the court considered evidence of actual use to be relevant, in this case the court held that no evidence described how many Microsoft Outlook users had ever performed the patented method or how many times.¹⁵

The court mentioned the other Georgia-Pacific factors, but stated that, to the extent they were relevant, they tended to offset each other. The court concluded that the evidence does not sustain a finding that, at the time of infringement, Microsoft and Lucent would have agreed to a lump sum royalty payment subsequently amounting to approximately 8% of Microsoft's revenues for the sale of Outlook (and necessarily a larger percentage of Outlook's profits).¹⁶

Entire market value rule

The court held that for the entire market value rule to apply, the patentee must prove that "the patent-related feature is the 'basis for customer demand.'"¹⁷ The court specifically identified two flaws related to the use of the entire market value rule in this case. The first flaw with the application of the entire market value rule is the lack of evidence demonstrating that the patented method forms the basis—or even a substantial basis—of the consumer demand for Outlook. In fact, the court held that the infringing use of the date-picker tool in Outlook is but a very small component of a much larger software program. Finally, considering the importance of the many non-infringing features compared to the one infringing feature in Outlook, the court concluded that the claimed invention is not the reason consumers purchase Outlook.

¹² *Ibid.*, p. 19, citing *Georgia-Pacific Corp. v. U.S. Plywood Corp.*, 318 F. Supp. at 1120.

¹³ *Ibid.*, p. 19.

¹⁴ *Ibid.*, p. 19, citing *Georgia-Pacific Corp. v. U.S. Plywood Corp.*, 318 F. Supp. at 1120.

¹⁵ *Ibid.*, p. 20.

¹⁶ *Ibid.*, pp. 20-21.

¹⁷ *Ibid.*, p. 22, citing *Rite-Hite Corp. v. Kelley Co.*, 56 F.3d 1538, 1539 (Fed. Cir. 1995) (*en banc*).

A second “flaw” with the application of the entire market value rule in this case was in the approach adopted by Lucent’s licensing expert. Originally, Lucent’s expert opined to a 1% royalty rate applied to the price of the entire computer that contained the Outlook software. The district judge granted a motion in limine to exclude such testimony that resulted in Lucent’s expert changing his opinion to include a royalty base of the infringing software (and not the whole computer), but increasing his reasonable royalty rate to 8%.¹⁸ The court criticized Lucent’s expert for changing his opinion and ignoring “what the district court’s evidentiary ruling tried to accomplish” in order “to reach the damages number he would have obtained had he used the price of the entire computer as a royalty base.”¹⁹ In summary, although there are certain mandatory conditions for applying the entire market value rule, “the base used in a running royalty calculation can always be the value of the entire commercial embodiment, as long as the magnitude of the rate is within an acceptable range (as determined by the evidence).”²⁰

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¹⁸ *Ibid.*, p. 23.

¹⁹ *Ibid.*, p. 23.

²⁰ *Ibid.*, p. 23.