UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS

APPLE INC. and NeXT SOFTWARE, INC. (f/k/a NeXT COMPUTER, INC.), Plaintiffs, v. MOTOROLA SOLUTIONS, INC. and MOTOROLA MOBILITY, INC. Defendants.	))))))))))))	Case No. 1:11-cv-08540 (RAP)

MOTOROLA'S BRIEF ADDRESSING THE PROPER STANDARD FOR THE DETERMINATION OF DAMAGES FOR PATENT INFRINGEMENT

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Pursuant to Paragraph 3 of the Court's January 24, 2012 Order, Motorola hereby submits its brief setting forth its views of "the proper standard for the determination of damages for patent infringement." (DN 551.) As described more fully below, the touchstone for determining the amount of damages is the question: What monetary loss did the patentee suffer by the infringement. Although case law offers several methods to arrive at an answer, at the heart of each method lies an analysis of the actual market compared to the "but for" market absent the infringement, and an analysis of the accused products compared to any noninfringing substitutes.

Motorola asserts three patents in this action: U.S. Patent Nos. 5,311,516; 6,175,559; and 6,359,898. Each of Motorola's asserted patents are part of Motorola's standards portfolio. Without the technology claimed in these patents, one could not make a product compliant with the standards for (and thus operable on) 2G and 3G cellular networks and Wi-Fi networks. For example, Motorola's expert Dr. Kenney has explained that a user of a 3G/UMTS-capable device must practice the method of claims 4 and 5 of the '559 Patent in order to use the device on a 3G/UMTS-compatible network. (*See* DN 461-10 at ¶ 17).

Apple asserts six patents in this action: U.S. Patent Nos. 5,519,867; 5,566,337; 5,946,647; 6,343,263; 6,493,002; and 7,479,949. Apple's patents, by contrast, primarily cover specific individual features of a computer, none of which are essential to any standard, nor necessary to the use of any accused product. For example, Apple's patents purport to cover particular software and user interface features, such as various mechanisms for executing object-oriented applications on a procedural operating system (the '867 Patent), and certain information management systems that coordinate the display of information to the user (the '002 Patent).

The legal standards for determining damages, should the Court find infringement of any of the parties' asserted patents, are discussed below.

I. GENERAL STANDARDS AND PRINCIPLES

A. Section 284: "Damages Adequate to Compensate for the Infringement"

The Patent Act confers the right to exclude others from making, using, selling, or offering for sale a patented invention in the United States for the term of the patent. 35 U.S.C. § 271(a). If infringement is found, the remedy of monetary damages is available to the patentee. Damages are addressed in Section 284 of Title 35, which provides:

> Upon finding for the claimant the court shall award the claimant 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, together with interest and costs as fixed by the court.

Damages "adequate to compensate" under Section 284 equal the amount necessary "to return the patent owner to the financial position he would have occupied but for the infringement." *Carborundum Co. v. Molten Metal Equip. Innovations, Inc*., 72 F.3d 872, 881 (Fed. Cir. 1995). As the Supreme Court has explained:

> [Damages] have been defined by this Court as "compensation for the pecuniary loss [the patentee] has suffered from the infringement, without regard to the question whether the defendant has gained or lost by his unlawful acts." They have been said to constitute "the difference between [a patentee's] pecuniary condition after the infringement, and what his condition would have been if the infringement had not occurred." The question to be asked in determining damages is "how much had the [patentee] suffered by the infringement. And that question [is] primarily: had the Infringer not infringed, what would [the patentee] have made?"

Aro Mfg. Co. v. Convertible Top Replacement Co., 377 U.S. 476, 507 (1964) (quoting *Coupe v. Royer*, 155 U. S. 565, 582 (1895); *Yale Lock Mfg. Co. v. Sargent*, 117 U.S. 536, 552 (1886)); *see also Rite-Hite Corp. v. Kelley Co*., 56 F.3d 1538, 1544-45 (Fed. Cir. 1995) (en banc) (discussing Supreme Court cases and the "but for" test for compensatory damages).

This measure of damages—the economic harm that would not have occurred but for the unlawful act—"parallels the criterion long applicable in other fields of law." *Fromson v. W. Litho Plate & Supply Co*., 853 F.2d 1568, 1574 (Fed. Cir. 1988). The Supreme Court has noted:

> [W]here a legal injury is of an economic character, "[t]he general rule is, that when a wrong has been done, and the law gives a remedy, the compensation shall be equal to the injury. The latter is the standard by which the former is to be measured. The injured party is to be placed, as near as may be, in the situation he would have occupied if the wrong had not been committed."

Albemarle Paper Co. v. Moody, 422 U.S. 405, 418-19 (1975) (quoting *Wicker v. Hoppock*, 73 U.S. 94, 99 (1867)).

To measure the loss to the patentee caused by the infringement, it is necessary make "a fair and accurate reconstruction of the 'but for' market" that "takes into account any alternatives available to the infringer." *Grain Processing Corp. v. Am. Maize-Prods. Co.*, 185 F.3d 1341, 1350-51 (Fed. Cir. 1999). "The 'but for' inquiry therefore requires a reconstruction of the market, as it would have developed absent the infringing product, to determine what the patentee 'would . . . have made.'" *Id*. at 1350 (quoting *Grain Processing Corp. v. Am. Maize-Products Co.*, 979 F. Supp. 1233, 1236 (N.D. Ind. 1997)). The Court explained:

> Without the infringing product, a rational would-be infringer is likely to offer an acceptable noninfringing alternative, if available, to compete with the patent owner rather than leave the market altogether. The competitor in the "but for" marketplace is hardly likely to surrender its complete market share when faced with a patent, if it can compete in some other lawful manner.

Id. at 1351 (internal citations omitted). Accordingly, "only by comparing the patented invention to its next-best available alternative(s)—regardless of whether the alternative(s) were actually produced and sold during the infringement—can the court discern the market value of the patent owner's exclusive right, and therefore his expected profit or reward, had the infringer's activities not prevented him from taking full economic advantage of this right." *Id*.

Last, "the 'test' for compensability of damages under § 284 is not solely a 'but for' test in the sense that an infringer must compensate a patentee for any and all damages that proceed from the act of patent infringement." *Rite-Hite*, 56 F.3d at 1546. Harm that is not reasonably foreseeable generally is not redressable. *Id.* ("Notwithstanding the broad language of § 284, judicial relief cannot redress every conceivable harm that can be traced to an alleged wrongdoing . . . the balance between full compensation, which is the meaning that the Supreme Court has attributed to the statute, and the reasonable limits of liability encompassed by general principles of law can best be viewed in terms of reasonable, objective foreseeability.”).

B. Burden of Proof

The question of damages is highly dependent on the facts of each case: “The general principles expressed in the common law tell us that the question of legal compensability is one ‘to be determined on the facts of each case upon mixed considerations of logic, common sense, justice, policy and precedent.’” *Rite-Hite*, 56 F.3d at 1546 (citations omitted); *see also Mars, Inc. v. Coin Acceptors, Inc*., 527 F.3d 1359, 1366 (Fed. Cir. 2008) (“The correct measure of damages is a highly case-specific and fact-specific analysis.”).

In any case however, “the amount of a prevailing party’s damages is a finding of fact on which the plaintiff bears the burden of proof by a preponderance of the evidence.” *SmithKline Diagnostics, Inc. v. Helena Labs. Corp*., 926 F.2d 1161, 1164 (Fed. Cir. 1991). Although “the patent owner’s burden of proof is not an absolute one, but rather a burden of reasonable probability,” *Lam, Inc. v. Johns-Manville Corp*., 718 F.2d 1056, 1065 (Fed. Cir. 1983), any damages award nevertheless must be based on “sound economic and factual predicates.” *Riles v. Shell Exploration & Prod. Co*., 298 F.3d 1302, 1311 (Fed. Cir. 2002).

C. Standard of Review

Paragraph 2 of Section 284 provides in part that “[w]hen the damages are not found by a jury, the court shall assess them.” Where assessed by the court, “review is in accordance with the clearly erroneous standard of Fed. R. Civ. P. 52(a).” *SmithKline*, 926 F.2d at 1164. “However, certain subsidiary decisions underlying a damage theory are discretionary with the court, such as, the choice of an accounting method for determining profit margin, or the methodology for arriving at a reasonable royalty. Such decisions are, of course, reviewed under the abuse of discretion standard." *Id*. (internal citations omitted); *see also Home Sav. of Am. v. United States*, 399 F.3d 1341, 1347 (Fed. Cir. 2005) ("[T]he clear error standard governs a trial court's findings about the general type of damages to be awarded (e.g., lost profits), their appropriateness (e.g., foreseeability), and rates used to calculate them (e.g., discount rate, reasonable royalty). The abuse of discretion standard applies to decisions about methodology for calculating rates and amounts.").

Damages found by a jury are "reviewed under the more restrictive substantial evidence standard when we review a denial of a motion for" judgment as a matter of law. *SmithKline*, 926 F.2d at 1164 n.2; *see also Fujifilm Corp. v. Benun*, 605 F.3d 1366, 1372 (Fed. Cir. 2010) ("The jury's award should stand unless it is grossly excessive, not supported by evidence, or based on only speculation or guesswork.").

II. APPROPRIATE MEASURE OF COMPENSATORY DAMAGES

There are two general methods of calculating damages under Section 284: "assessment of actual damages (the profits the patentee lost due to the infringement) or, if actual damages cannot be ascertained, determination of a reasonable royalty." *Trell v. Marlee Elecs. Corp*., 912 F.2d 1443, 1445 (Fed. Cir. 1990).[1]

A. Lost Profits

The first general method of calculating compensatory damages is the lost profits caused by the infringement. Consistent with the general principle that the measure of damages is the harm that would not have occurred but for the unlawful act, the Federal Circuit has explained

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[1] A patentee may also recover a mixed award with lost profits on some sales and a reasonable royalty on other sales. *See State Indus., Inc. v. Mor-Flo Indus., Inc*., 883 F.2d 1573, 1577 (Fed. Cir. 1989) ("the award may be split between lost profits as actual damages to the extent they are proven and a reasonable royalty for the remainder").

that "[t]o recover lost profits, the patent owner must show 'causation in fact,' establishing that 'but for' the infringement, he would have made additional profits." *Grain Processing*, 185 F.3d at 1349 (Fed. Cir. 1999); *see also Ericsson, Inc. v. Harris Corp.*, 352 F.3d 1369, 1377 (Fed. Cir. 2003) ("To recover lost profits, a patent owner must prove 'a causal relation between the infringement and its loss of profits.'" (citation omitted)).

1. The Four-Factor Panduit *Test*

The primary test for determining lost profits is that set forth in *Panduit Corp. v. Stahlin Brothers Fibre Works, Inc.*, 575 F.2d 1152 (6th Cir. 1978). There, Chief Judge Markey, sitting by designation from the Court of Customs and Patent Appeals, "articulated a four-factor test that has since been accepted as a useful, but non-exclusive, way for a patentee to prove entitlement to lost profits damages." *Rite-Hite*, 56 F.3d at 1545. "The *Panduit* test requires that a patentee establish: (1) demand for the patented product; (2) absence of acceptable non-infringing substitutes; (3) manufacturing and marketing capability to exploit the demand; and (4) the amount of the profit it would have made." *Id*. (citing *Panduit*, 575 F.2d at 1156). "A showing under *Panduit* permits a court to reasonably infer that the lost profits claimed were in fact caused by the infringing sales, thus establishing a patentee's prima facie case with respect to 'but for' causation." *Id*. "Once this reasonable probability is shown, the burden shifts to the infringer to show that the 'but for' causation analysis is unreasonable under the specific circumstances." *Am. Seating Co. v. USSC Group, Inc.*, 514 F.3d 1262, 1269 (Fed. Cir. 2008).

2. Application of the Panduit *test*

The first *Panduit* factor—"demand for the patented product"—may be shown in some circumstances by evidence of actual sales by either the patentee or the infringer, and if both sell products, evidence that their products compete in the market. *See BIC Leisure Prods., Inc. v. Windsurfing Int'l, Inc*., 1 F.3d 1214, 1218-19 (Fed. Cir. 1993).[2]

The second factor—"absence of an acceptable noninfringing alternative"—can be shown in some circumstances by evidence that "(1) the purchasers in the marketplace generally were willing to buy the patented product for its advantages, or (2) the specific purchasers of the infringing product purchased on that basis." *Standard Havens Prods. Inc., v. Gencor Indus., Inc*., 953 F.2d 1360, 1373 (Fed. Cir. 1991). If an infringer cannot "drop or replace" the patented features, or if it otherwise cannot sell a competing product without infringement, an absence of alternatives may also be shown. *See Grain Processing*, 185 F.3d at 1354; *Panduit*, 575 F.2d at 1160 ("Illustrative of the absence of acceptable substitutes is [defendant's] inability to avoid infringement, even if it had ever wanted to.").

The Federal Circuit in *Standard Havens* further explained:

> [T]he mere existence of a competing device does not necessarily make that device an acceptable substitute. A product on the market which lacks the advantages of the patented product can hardly be termed a substitute acceptable to the customer who wants those advantages. Accordingly, if purchasers are motivated to purchase because of particular features available only from the patented product, products without such features—even if otherwise competing in the marketplace—would not be acceptable noninfringing substitutes.

Id. Conversely, even without particular features, a noninfringing alternative will be "acceptable" if those features do not drive consumer demand. For instance in *Grain Processing*, the Federal Circuit affirmed a district court's finding that a noninfringing alternative was adequate, where there was evidence that consumers found the patented features "irrelevant." The Court explained

[2] "If the products are not sufficiently similar to compete in the same market for the same customers, the infringer's customers would not necessarily transfer their demand to the patent owner's product in the absence of the infringer's product. In such circumstances [] the first *Panduit* factor does not operate to satisfy the elemental 'but for' test." *Id*. at 1219. For example, in *BIC Leisure* the Court reversed an award of lost profits because the infringer sold lower-priced products that were not competitive given the price sensitivity of consumers in the market. *Id*.

that, given such evidence, "the prospect of an available, acceptable noninfringing substitute expands because a competitor may be able to drop or replace the 'irrelevant' elements from its product." *Id.*, 185 F.3d at 1354. At bottom, "[c]onsumer demand defines the relevant market and relative substitutability among products therein." *Id*. at 1355.[3]

To satisfy the third factor—"manufacturing and marketing capability"—the patent holder must show that it had, or could have achieved, the capability to exploit the market demand, as measured by "the total sales, by the patentee and the infringer, of the patented product." *Datascope Corp. v. SMEC, Inc*., 879 F.2d 820, 825 (Fed. Cir. 1989).

Finally, the fourth factor—"the amount of the profit [the patentee] would have made"—is generally determined by calculating the margin of profit that the patentee would have made on the lost sales, using any reasonable accounting method. *See SmithKline*, 926 F.2d at 1164 n.2; *Ryco, Inc. v. Ag-Bag Corp*., 857 F.2d 1418, 1428 (Fed. Cir. 1988). "The amount of lost profits awarded cannot be speculative but the amount need not be proven with unerring precision." *Bio-Rad Labs., Inc. v. Nicolet Instrument Corp*., 739 F.2d 604, 616-17 (Fed. Cir. 1984). "When the amount of the damages is not ascertainable with precision, reasonable doubt is appropriately resolved against the infringer." *Del Mar Avionics, Inc. v. Quinton Instrument Co*., 836 F.2d 1320, 1327 (Fed. Cir. 1987).

B. Reasonable Royalty

The second general measure of compensatory damages is a "reasonable royalty."[4] This "may be based upon an established royalty, if there is one, or if not, upon the supposed result of

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[3] "Important factors shaping demand may include consumers' intended use for the patentee's product, similarity of physical and functional attributes of the patentee's product to alleged competing products, and price." *Id.*

[4] Under § 284, a reasonable royalty "is the minimum permissible measure of damages." *Deere & Co. v. Int'l Harvester Co*., 710 F.2d 1551, 1558 n.9 (Fed. Cir. 1983); *see also Dow*

hypothetical negotiations between the plaintiff and defendant." *Rite-Hite*, 56 F.3d at 1554 (citing *Hanson v. Alpine Valley Ski Area, Inc.*, 718 F.2d 1075, 1078 (Fed. Cir. 1983)).

1. Established Royalty

"When the patentee has consistently licensed others to engage in conduct comparable to the defendant's at a uniform royalty, that royalty is taken as established and indicates the terms upon which the patentee would have licensed the defendant's use of the invention." *Monsanto Co. v. McFarling*, 488 F.3d 973, 978-79 (Fed. Cir. 2007). An established royalty, however, only sets the minimum royalty and does not preclude the patentee from recovering a greater sum under a reasonable royalty theory, where there is evidence that the established rate was depressed or is otherwise inadequate. *See id.*; *Mobil Oil Corp. v. Amoco Chems. Corp.*, 915 F. Supp. 1333, 1342-43 (D. Del. 1994) (observing that "an established royalty may be too low to be 'reasonable' under certain circumstances" and collecting authority).

An established royalty can be determined from prior negotiated royalties, if they were: (1) paid or secured before the infringement complained of; (2) paid by such a number of persons as to indicate a general acquiescence in its reasonableness; (3) uniform at the places where the licenses are issued; (4) not paid under threat of suit or in settlement of litigation; (5) for comparable rights or activity under the patent. *See Rude v. Westcott*, 130 U.S. 152 (1889); *Monsanto*, 488 F.3d at 979; *Hanson*, 718 F.2d at 1075.

2. Reasonable Royalty Based on a "Hypothetical Negotiation"

"As Judge Learned Hand put it: The whole notion of a reasonable royalty is a device in aid of justice, by which that which is really incalculable shall be approximated, rather than that the patentee, who has suffered an indubitable wrong, shall be dismissed with empty hands."

Chem. Co. v. Mee Indus., 341 F.3d 1370, 1381-82 (Fed. Cir. 2003) ("The statute is unequivocal that the district court must award damages in an amount no less than a reasonable royalty.").

Georgia-Pacific Corp. v. US Plywood-Champion Papers Inc., 446 F. 2d 295, 300 n.5 (2d Cir. 1971) (citing *Cincinnati Car Co. v. N.Y. Rapid Transit Corp*., 66 F.2d 592, 595 (2d Cir. 1933)). This approximation takes the form of determining the outcome of a "hypothetical negotiation" between the parties.

As the Federal Circuit has explained, the "hypothetical negotiation or the 'willing licensor-willing licensee' approach, attempts to ascertain the royalty upon which the parties would have agreed had they successfully negotiated an agreement just before infringement began." *Lucent Techs., Inc. v. Gateway, Inc*., 580 F.3d 1301, 1325 (Fed. Cir. 2009). That is to say:

> The hypothetical negotiation tries, as best as possible, to recreate the *ex ante* licensing negotiation scenario and to describe the resulting agreement. In other words, if infringement had not occurred, willing parties would have executed a license agreement specifying a certain royalty payment scheme.

Id.; *see also Rite-Hite*, 56 F.3d at 1554 ("The hypothetical negotiation requires the court to envision the terms of a licensing agreement reached as the result of a supposed meeting between the patentee and the infringer at the time infringement began.");[5] *Panduit*, 575 F.2d at 1157-58 ("A reasonable royalty is an amount 'which a person, desiring to manufacture and sell a patented article, as a business proposition, would be willing to pay as a royalty and yet be able to make and sell the patented article, in the market, at a reasonable profit.'" (citations omitted)). The hypothetical negotiation presumes that "the patent was valid, enforceable, and infringed." *IP Innovation LLC, et al. v. Red Hat, Inc.*, 705 F. Supp. 2d 687, 689 (E.D. Tex. 2010) (Rader, J., by designation) (citing *Georgia-Pacific*, 318 F. Supp. at 1120).

To determine the relevant royalty rate that would result from such a negotiation, courts typically consider a number of overlapping factors, referred to as the *Georgia-Pacific* factors,

[5] Although the hypothetical negotiation occurs "at the time infringement began," post-infringement evidence is still probative in certain circumstances. *See Lucent*, 580 F.3d at 1333.

after *Georgia-Pacific v. United States Plywood Corp.*, 318 F. Supp. 1116 (S.D.N.Y. 1970). Although consideration of the *Georgia-Pacific* factors is a common method for calculating a reasonable royalty, it is not the exclusive method. *See Lucent*, 580 F.3d at 1324 ("Litigants routinely adopt several approaches for calculating a reasonable royalty.").[6]

Moreover, *Georgia-Pacific* described the factors as simply "some of the factors" "seemingly more pertinent" to determining a reasonable royalty, and noted that "there is no formula by which these factors can be rated precisely in the order of their relative importance or by which their economic significance can be automatically transduced into their pecuniary equivalent." *Id.*, 318 F. Supp. at 1120-21. "In discharging its responsibility as fact finder," a Court should thus "exercise a discriminating judgment reflecting its ultimate appraisal of all pertinent factors in the context of the credible evidence." *Id.* Nevertheless, the factors provide a useful framework for discussing the contours of the hypothetical negotiation. *See Uniloc USA, Inc. v. Microsoft Corp.*, 632 F.3d 1292, 1317 (Fed. Cir. 2011) ("This court has sanctioned the use of the *Georgia-Pacific* factors to frame the reasonable royalty inquiry. Those factors properly tie the reasonable royalty calculation to the facts of the hypothetical negotiation at issue.").[7] The more important *Georgia-Pacific* factors can be separated into several categories.[8]

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[6] For instance, courts have also applied the "analytical method" which "focuses on the infringer's projections of profit for the infringing product." *Id.*; *see also TWM Mfg. Co. v. Dura Corp.*, 789 F.2d 895, 899 (Fed. Cir. 1986) (analytical method "subtract[s] the infringer's usual or acceptable net profit from its anticipated net profit realized from sales of infringing devices").

[7] The type of royalty being considered affects the analysis: "Significant differences exist between a running royalty license and a lump-sum license. . . . Compared to a running royalty analysis, a lump-sum analysis involves different considerations." *Lucent*, 580 F.3d at 1326.

[8] The specific fifteen factors enumerated in *Georgia-Pacific* are: (1) "royalties received by the patentee for the licensing of the patent in suit, proving or tending to prove an established royalty"; (2) "rates paid by the licensee for the use of other patents comparable to the patent in suit"; (3) "nature and scope of the license, as exclusive or non-exclusive; or as restricted or non-restricted in terms of territory or with respect to whom the manufactured product may be sold"; (4) "licensor's established policy and marketing program to maintain his patent monopoly by not

(a) Noninfringing Substitutes and Apportionment

Similar to *Panduit* factor two ("absence of an acceptable noninfringing alternative"), a number of the *Georgia-Pacific* factors recognize the importance of considering noninfringing alternatives in the hypothetical royalty calculation, particularly the "utility and advantages of the patent property over the old modes or devices" (factor 9); the "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 10); and the "portion of the realizable profit that should be credited to the invention as distinguished from non-patented elements, the manufacturing process, business risks, or significant features or improvements added by the infringer" (factory 13). These factors are also relevant to the apportionment of damages to a patented feature.

For instance, in *Lucent*, Lucent brought suit against Microsoft for infringement of a patent directed to filling a data entry field with data selected by the user from an on-screen tool.

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licensing others to use the invention or by granting licenses under special conditions designed to preserve that monopoly"; (5) "commercial relationship between the licensor and licensee, such as, whether they are competitors in the same territory in the same line of business; or whether they are inventor and promoter"; (6) "effect of selling the patented specialty in promoting sales of other products of the licensee; the existing value of the invention to the licensor as a generator of sales of his non-patented items; and the extent of such derivative or convoyed sales"; (7) "duration of the patent and the term of the license"; (8) "established profitability of the product made under the patent; its commercial success; and its current popularity"; (9) "utility and advantages of the patent property over the old modes or devices, if any, that had been used for working out similar results"; (10) "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"; (11) "extent to which the infringer has made use of the invention; and any evidence probative of the value of that use"; (12) "portion of the profit or of the selling price that may be customary in the particular business or in comparable businesses to allow for the use of the invention or analogous inventions"; (13) "portion of the realizable profit that should be credited to the invention as distinguished from non-patented elements, the manufacturing process, business risks, or significant features or improvements added by the infringer"; (14) "opinion testimony of qualified experts"; and (15) "amount that a licensor (such as the patentee) and a licensee (such as the infringer) would have agreed upon (at the time the infringement began) if both had been reasonably and voluntarily trying to reach an agreement." *Georgia-Pacific*, 318 F. Supp. at 1120.

The jury found infringement, and awarded Lucent a lump-sum reasonable royalty based upon the total sales value of Microsoft's accused Outlook software, which included as one feature the infringing date-picker tool. The Federal Circuit, discussing the *Georgia-Pacific* factors noted above, vacated the jury's damages award because "the infringing use of Outlook's date-picker feature is a minor aspect of a much larger software program" and "the portion of the profit that can be credited to the infringing use of the date-picker tool is exceedingly small." *Lucent*, 580 F.3d at 1331-34. In support of its decision, the Court also observed that "the infringing feature contained in Microsoft Outlook is but a tiny feature of one part of a much larger software program. . . . Outlook is an enormously complex software program comprising hundreds, if not thousands or even more, features. . . . Outlook consists of millions of lines of code, only a tiny fraction of which encodes the date-picker feature."

(b) Value of a Patented Feature to the End User

Other *Georgia-Pacific* factors take into account the value of a patented feature to an end user. Factor 11, for instance, is the "extent to which the infringer has made use of the invention; and any evidence probative of the value of that use."[9] Factor 10 is in part directed to the "benefits to those who have used the invention."

(c) Similar Licenses and Other Licensing Considerations

The first two *Georgia-Pacific* factors are to the royalties received for licensing the patent, and the rates paid by the licensee for the use of other similar patents. Hence, where arm's length negotiations for the same or similar technology exist, the rates established in those negotiations may guide the choice of the reasonable royalty. However, as further discussed below in Part

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[9] In a claim for induced infringement, the consumer typically is the direct infringer. *See DSU Med. Corp. v. JMS Co.*, 471 F.3d 1293, 1305-06 (Fed. Cir. 2006) (en banc in relevant part).

III.1, evidence of license agreements to be considered must be "sufficiently comparable to the hypothetical license at issue in suit." *Lucent*, 580 F.3d at 1325.

Georgia-Pacific factors three, four, five, and seven set forth additional considerations regarding licensing, and also focus on the license at issue in the hypothetical negotiation; these include: the nature and scope of the license, such as whether it is exclusive or nonexclusive, restricted or nonrestricted in terms of territory or customers; the patentee's policy of maintaining its patent monopoly by licensing the use of the invention only under special conditions designed to preserve the monopoly; the commercial relationship between the patentee and licensee, such as whether they are competitors; and the duration of the patent and the term of the license.

III. THE USE OF EXPERT TESTIMONY TO DETERMINE PATENT DAMAGES

Paragraph 3 of Section 284 provides that "[t]he court may receive expert testimony as an aid to the determination of damages or of what royalty would be reasonable under the circumstances." Although the court may receive such testimony, to be admissible, expert testimony "must 'carefully tie proof of damages to the claimed invention's footprint in the market place.'" *Uniloc*, 632 F.3d at 1317 (quoting *ResQNet.com, Inc. v. Lansa, Inc*., 594 F.3d 860, 869 (Fed. Cir. 2010)). "If the patentee fails to tie the theory to the facts of the case, the testimony must be excluded." *Id*. at 1315; *accord Grain Processing*, 185 F.3d at 1350 (the patent law "requires sound economic proof of the nature of the market and likely outcomes with infringement factored out of the economic picture" in all damages calculations); *ResQNet*, 594 F.3d at 869 ("Any evidence unrelated to the claimed invention does not support compensation for infringement but punishes beyond the reach of the statute."). Courts have excluded damages evidence in various circumstances for failure to be tied to the facts of the case.

In *Uniloc*, for instance, the Federal Circuit rejected the "25 percent rule of thumb," which previously had been used to approximate a reasonable royalty rate. *Id*., 632 F.3d at 1312. The

Federal Circuit held that the 25 percent rule is a "fundamentally flawed tool for determining a baseline royalty rate in a hypothetical negotiation. Evidence relying on the 25 percent rule of thumb is thus inadmissible under *Daubert* and the Federal Rules of Evidence, because it fails to tie a reasonable royalty base to the facts of the case at issue." And in *Fractus, S.A. v. Samsung Electronics Co.*, No. 6:09-cv-0203, Dkt. No. 896 (E.D. Tex. April 29, 2011), the Court excluded consumer survey data, explaining that they "do not measure the value of Plaintiff's technology, but merely measure the perceived consumer value of cell phones with any internal antennas. Survey evidence purportedly demonstrating the value of internal antennas not tied directly to Plaintiff's technology confuses the issues and must be excluded."

Two general areas where damages evidence has been excluded are the use of license agreements and the application of the entire market value rule.

1. Exclusion of Expert Testimony on License Agreements

In several cases, courts have excluded evidence of license agreements which were not "sufficiently comparable to the hypothetical license at issue in suit." *Lucent*, 580 F.3d at 1325. In *ResQNet*, for example, the patentee's expert "used licenses with no relationship to the claimed invention to drive the royalty rate up to unjustified double-digit levels," looking at licenses that did not mention the patents and had no "other discernible link to the claimed technology." *Id.*, 594 F.3d at 870. The Federal Circuit rejected the proffered expert's testimony, explaining that the district court "must consider licenses that are commensurate with what the defendant has appropriated. If not, a prevailing plaintiff would be free to inflate the reasonable royalty analysis with conveniently selected licenses without an economic or other link to the technology in question." *Id*. at 872. The Federal Circuit thus held that on remand, "the trial court should not rely on unrelated licenses to increase the reasonable royalty rate above rates more clearly linked to the economic demand for the claimed technology." *Id*. at 872-73.

In *Wordtech*, the patentee "introduced thirteen patent licenses that it previously granted to third parties for rights to some or all of the patents-in-suit" in support of its damages theory. *Wordtech Sys. v. Integrated Networks Solutions*, Inc., 609 F.3d 1308, 1319 (Fed. Cir. 2010). The Federal Circuit rejected eleven of the licenses because they were running royalty licenses, and the patentee had only asked for a lump sum payment. *Id*. at 1320-21. The Federal Circuit rejected the remaining two licenses (both for lump sum payments) because "[n]either license describes how the parties calculated each lump sum, the licensees' intended products, or how many products each licensee expected to produce." *Id*. at 1320.

2. Exclusion of Expert Testimony on the Entire Market Value Rule

Courts have also excluded evidence relating to the entire market value rule.[10] In *IP Innovation*, Judge Rader, sitting by designation, rejected the patentee's expert's application of the entire market value rule and excluded his testimony on reasonable royalty damages because his methodology "does not show a sound economic connection between the claimed invention and [his] broad proffered royalty base." *Id*., 705 F. Supp. 2d at 689. The claimed invention in *IP Innovation* was a "workspace switching feature" that was "but one relatively small component of the accused operating systems." *Id*. at 689-90. To satisfy the entire market value rule, the patentee sought to have its expert rely on user statements touting the switching feature as "essential." Judge Rader, however, found that these "selected users' statements in isolation and without a relationship to the actual claimed technology do not show an accurate economic measurement of total market demand for the switching feature, let alone its contribution to the demand for the entire product asserted as the royalty base." *Id*. Judge Rader thus precluded the

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[10] "When a patentee seeks damages on unpatented components sold with a patented apparatus, courts have applied a formulation known as the 'entire market value rule' to determine whether such components should be included in the damage computation, whether for reasonable royalty purposes, or for lost profits purposes." *Rite-Hite*, 56 F.3d at 1549.

patentee's expert from testifying at trial, explaining that he "improperly inflates both the royalty base and the royalty rate by relying on irrelevant or unreliable evidence and by failing to account for the economic realities of this claimed component as part of a larger system." *Id*. at 691.

Similarly, in *Cornell University v. Hewlett-Packard Co.*, 609 F. Supp. 2d 279 (N.D.N.Y. 2009), Judge Rader, again sitting by designation, reduced the damages award after finding that the patentee's damages expert inappropriately applied the entire market value rule. *Id*. at 285. In *Cornell*, a component incorporating patented technology (a CPU) was combined with many other components to form one part (a CPU Brick) of a larger product (computer servers and workstations). Judge Rader granted judgment as a matter of law in favor of the infringer, holding that no reasonable jury could have used the CPU Brick as a royalty base, and explaining:

> At [the damages] hearing, neither Cornell nor [its expert] Dr. Stewart offered credible and sufficient economic proof that the patented invention drove demand for Hewlett-Packard's entire server and workstation market. In sum, Dr. Stewart did not supply credible and sufficient economic proof to support application of the entire market value rule. Rather Dr. Stewart tried to present evidence that would mislead the jury to award damages far in excess of their compensatory purpose. As this court noted during its inquiry, "[a]t best, the record shows that purchasers opt for Hewlett-Packard products because of their superior performance. Yet the patented invention is still merely one of several—what Dr. Steward calls a 'handful of components'—in the Hewlett-Packard processor 'Performance Formula.'" Moreover, "Cornell did not offer a single demand curve or attempt in any way to link consumer demand for servers and workstations to the claimed invention." In light of these evidentiary shortcomings, this court found that Dr. Stewart and Cornell have not drawn any connection between the market for servers and workstations and the patented invention.

Id. Damages were thus reduced to a royalty based on the CPU alone, noted as the "smallest salable patent-practicing unit," and the royalty base sought by the infringer. *Id*.[11]

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[11] Judge Rader has elsewhere stated that: "So, it is the marketplace that drives this, and economists need to do a better job of factoring out the value of the claimed invention. It has to be economic evidence, and it has to be limited to the scope of the claimed invention, but it should show the full value of that invention in the marketplace." "An Interview with Chief Judge Randall R. Rader," IP Litigator, Aspen Publishers, July/August 2010.

IV. CONCLUSION

The correct measure of patent damages is a highly case-specific and fact-specific analysis. The frameworks set forth in *Panduit* and *Georgia-Pacific* are not exclusive, but both provide a useful starting point. Moreover, both are largely influenced by the same factors. For at heart, the damages determination is about analyzing the actual market and the "but for" market, using sound economic principles, and estimating how best to return the patentee to the financial position he would have occupied absent the infringement.

Dated: February 13, 2012

Respectfully submitted,

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CERTIFICATE OF SERVICE

The undersigned certifies that all counsel of record will be served with a true and correct copy of the foregoing by electronic mail, on this the 13th day of February, 2012.

/s/ Stephen Swedlow
Stephen Swedlow