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Vol. IV, No.8 NOVEMBER 2012

KEY IDEAS:

LUMP SUM UNDER THE CARPET? CAN'T SWEEP 29 LICENSE AGREEMENTS UNDER REASONABLE ROYALTY RUG

Ignoring prior licenses of the patent-in-suit can cause you to stub your toe when seeking reasonable royalty damages. The Federal Circuit recently tossed out an expert's opinion that disregarded prior licenses when calculating damages.

In its precedential opinion, *LaserDynamics, Inc. v. Quanta Computer, Inc.*,[1] the Federal Circuit provides helpful guidance for cases in which the patent owner seeks reasonable royalty damages for infringement of already-licensed patents.

A History of Granting Patent Licenses

LaserDynamics, Inc., a company exclusively in the business of licensing its patents, sued Quanta Computer, Inc. (QCI) and others in the Eastern District of Texas, alleging patent infringement.[2] Before bringing the lawsuit, LaserDynamics had licensed the patent-in-suit at least 29 times.[3]

Between 1998 and 2001, LaserDynamics entered into 16 one-time lump-sum licenses in exchange for payments ranging from $57,000 to $266,000.[4]

Between 1998 and 2003, the company granted several additional licenses "via more aggressive licensing efforts involving actual or threatened litigation by LaserDynamics."[5] In early 2006, LaserDynamics entered into a license with BenQ Corp. for a lump sum of $6 million to settle a contentious two-year lawsuit (the BenQ License). The settlement came within two weeks of trial. The district court had severely restricted BenQ's time for *voir dire* and its opening and closing statements, and repeatedly levied severe sanctions, including imposing attorney's fees and assessing $500,000 as a punitive and deterrent measure.[6]

Finally, in 2009 and 2010, LaserDynamics entered into two additional licenses for lump-sum payments of $1 million or less.[7]

First Trial

Emmett Murtha testified as LaserDynamics' damages expert. During the first trial, Murtha arrived at his opinion on reasonable royalty damages in the form of a *running* royalty based, in part, on two other licensing programs and a survey, none of which involved the patented technology[8] In reaching his conclusion, Murtha simply ignored the 16 *lump-sum* licenses LaserDynamics had entered into between 1998 and 2001 because they preceded the August 2006 hypothetical negotiation date adopted by the trial court.[9]

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1 *LaserDynamics, Inc. v. Quanta Computer, Inc.*, 694 F.3d 51 (Fed, Cir. 2012).
2 *Id.* at 57, 59.
3 *Id.* at 58.
4 *Id.*
5 *Id.* at 57.
6 *Id.* at 58.
7 *Id.*
8 *Id.* at 60, 61.
9 *Id.* at 61, 57.

At the second trial, the district court excluded Murtha's first-trial royalty opinion because it misapplied the entire market value rule, but it admitted the BenQ License over QCI's objection.

The Federal Circuit agreed with QCI, ruling that the trial court erred by (1) adopting an incorrect hypothetical negotiation date, (2) admitting the $6-million BenQ settlement license, and (3) allowing Murtha's running royalty opinion that was "untethered" from the patented technology.

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In contrast, during the first trial, QCI's expert argued that $500,000 would be a reasonable lump-sum royalty given the 16 prior licenses in evidence, all of which ranged between $50,000 and $266,000.[10] The jury found that the patent was not invalid and that QCI had infringed it. LaserDynamics was awarded $52 million in actual damages, apparently based on Murtha's calculation of the appropriate reasonable royalty.[11]

QCI filed a motion seeking remittitur or a new trial. The district court agreed, granting QCI's motion and giving LaserDynamics the option of remittitur or a new trial on damages.[12] LaserDynamics opted for a new damages trial.[13]

Second Trial

At the second trial, the district court excluded Murtha's first-trial royalty opinion because it misapplied the entire market value rule,[14] but it admitted the BenQ License over QCI's objection.[15]

Ignoring the 29 *lump-sum* licenses of the patent-in-suit entered in evidence, Murtha again testified at the second trial that damages should be based on a *running* royalty.[16] The jury awarded a *lump-sum* royalty of $8.5 million. QCI moved for judgment as a matter of law *inter alia* on the ground that the evidence did not support the verdict and also argued that the trial court erred by improperly setting the hypothetical negotiation date. The court denied the motion, and the appeal followed.[17]

Appeal

The Federal Circuit agreed with QCI, ruling that the trial court erred by (1) adopting an incorrect hypothetical negotiation date, (2) admitting the $6-million BenQ settlement license, and (3) allowing Murtha's running royalty opinion that was "untethered" from the patented technology.

Importance of Hypothetical Negotiation Date

During both trials, the district court ruled that the date for the hypothetical negotiation for the *Georgia-Pacific* analysis was August 2006.[18] In setting the date, the court reasoned that (1) QCI was accused of active inducement of infringement, (2) active inducement of infringement requires knowledge of the patent,[19] and (3) QCI was not notified of the patent until suit was filed in August 2006.[20]

Based on that pivotal August 2006 hypothetical negotiation date, Murtha chose to ignore the 16 earlier lump-sum licenses. He argued that the economic landscape had changed between the dates of the earlier licenses (1998–2001) and the date set for the hypothetical negotiation.[21] The 2006 $6-million BenQ License was not, however, cast aside.

The Federal Circuit rejected the district court's hypothetical negotiation date in a three-step analysis. First, case law is clear that the date of the hypothetical negotiation is the date infringement began.[22] Second, numerous cases distinguish the hypothetical negotiation date from other

10 *Id.* at 61.

11 *LaserDynamics, Inc. v. Quanta Computer, Inc.*, No. 2:06-CV-348-TJW, 2010 WL 2331311, at *1, *2 (E.D. Tex. June 9, 2010).

12 *LaserDynamics, Inc.*, 694 F.3d at 63-64; *LaserDynamics, Inc.*, 2010 WL 2331311, at *4.

13 *LaserDynamics, Inc.*, 694 F.3d at 64.

14 *See* P. Strand, *EMVR = Unobtanium? Federal Circuit Sets Unreachable Bar,* IpQ -- Enhancing Your IP IQ, October 2012.

15 *LaserDynamics, Inc.*, 694 F.3d at 58, 77.

16 *Id.* at 65.

17 *Id.*

18 *Id.* at 75.

19 *Id.* at 60 (citing *Global-Tech Appliances, Inc. v. SEB S.A.*, __ U.S. __, 131 S. Ct. 2060, 2068 (2011)).

20 *Id.* at 75.

21 *Id.*

22 *Id.*

Thus, in the context of active inducement of infringement, a hypothetical negotiation is deemed to take place on the date of the first direct infringement traceable to the accused infringer's inducement conduct.

First, the rules of evidence are clear—otherwise relevant evidence may be excluded where the probative value of that evidence is substantially outweighed by the danger of unfair prejudice, and evidence of settlement offers and negotiations to prove the amount of damages is inadmissible. Second, the Federal Circuit has long disapproved relying on settlement agreements to establish reasonable royalty rates.

dates that trigger infringement.[23] Third, there was no dispute that directly infringing sales began in 2003.[24]

Thus, in the context of active inducement of infringement, a hypothetical negotiation is deemed to take place on the date of the first direct infringement traceable to the accused infringer's inducement conduct.[25] In *LaserDynamics,* that was 2003.[26] The effect of the Federal Circuit's ruling was to make most of the 29 prior licenses relevant to showing an established royalty. It also made the 2006 BenQ License even less probative.

Limits on Relevance of Settlement Licenses

The Federal Circuit also concluded that the district court erred in allowing the BenQ License into evidence. First, the rules of evidence are clear—otherwise relevant evidence may be excluded where the probative value of that evidence is substantially outweighed by the danger of unfair prejudice,[27] and evidence of settlement offers and negotiations to prove the amount of damages is inadmissible.[28] Second, the Federal Circuit has long disapproved relying on settlement agreements to establish reasonable royalty rates.[29] The exception to this line of cases came in *ResQNet*[30] which permitted reference to a settlement license when that license was the most reliable evidence in the record.[31]

The situation in *LaserDynamics* was distinguishable from *ResQNet* in that, "far from being the most reliable license in the record," the BenQ License "appears to be the least reliable license by a wide margin."[32] The BenQ License (1) came immediately before a trial where the licensee would have been at a severe disadvantage and showed a strong desire to avoid further litigation, (2) was six times greater than the next largest amount paid for a license to the patent-in-suit, and (3) was entered into three years after the correct hypothetical negotiation date.[33] Thus, the BenQ License was "well outside" the limited scope of circumstances under which the settlement license in *ResQNet* was deemed admissible and probative.[34]

Comparable Licenses Must Be Comparable

The Federal Circuit also decided that the district court erred by not excluding Murtha's opinion as to a reasonable running royalty. Referencing the first *Georgia Pacific* factor that points to an established royalty,[35] the court said, "Actual licenses to the patented technology are highly probative as to what constitutes a reasonable royalty . . ."[36] Such licenses are probative not only of the amount of a reasonable royalty, but also the proper royalty structure (e.g., lump sum vs. running).[37]

By allowing Murtha to testify on the basis of two licensing programs and a licensing survey from 1997, the district court "erroneously permitted continued reliance on this evidence where comparability between it and a hypothetical license to the [patent-in-suit] was absent."[38]

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23 *Id.*
24 *Id.* at 75-76.
25 *Id.* at 76.
26 *Id.* at 76.
27 Fed. R. Evid. 403.
28 Fed. R. Evid. 408.
29 *LaserDynamics, Inc.*, 694 F.3d at 77.
30 *ResQNet.com, Inc. v. Lansa, Inc.*, 594 F.3d 860 (Fed. Cir. 2010).
31 *LaserDynamics, Inc.*, 694 F.3d at 77.
32 *Id.* at 77-78.
33 *Id.* at 78.
34 *Id.*
35 *Georgia-Pacific Corp. v, U.S. Plywood Corp.*, 318 F. Supp. 1116, 1120 (S.D.N.Y. 1970) ("The royalties received by the patentee for the licensing of the patent in suit, proving or tending to prove an established royalty.").
36 *LaserDynamics, Inc.*, 694 F.3d at 79.
37 *Id.* at 79-80.
38 *Id.* at 80.

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Relying on a license unrelated to the patent to prove a reasonable royalty merely by alleging a "loose or vague comparability between different technologies or licenses does not suffice."[39] In fact, relying on such evidence to the exclusion of the many licenses to the patent-in-suit, "served no purpose other than to [sic] 'to increase the reasonable royalty rate above rates more clearly linked to the economic demand for the claimed technology.'"[40]

A patent owner's failure to prove requisite comparability weighs strongly against the jury's award based on non-comparable licenses.[41] If this were not the case, a patent owner would be free to inflate the reasonable royalty with "conveniently selected" licenses lacking any economic link to the patent technology.[42]

Aside from the BenQ License, all of the previous licenses in *LaserDynamics* were for $1 million or less.[43] Murtha dismissed the prior licenses because they were entered into before the hypothetical negotiation date. In his view, those licenses did not reflect the economic realities of the 2006 hypothetical negotiation date.[44] The record did not, however, support this view. First, the evidence was that the market already recognized the value of the patented technology by 2000. Second, the resetting of the hypothetical negotiation date further undercut Murtha's opinion. Finally, the licensing survey on which Murtha relied was from 1997.[45]

Thus, Murtha's opinion could not be reconciled with the actual licensing evidence which the court concluded was highly probative of the economic value of the technology in the marketplace.[46] In sum, Murtha's opinion was "untethered from the patented technology" and was, therefore, arbitrary and speculative.[47]

Having rendered its opinion, the court specifically noted it was *not* holding that (1) past licenses create an absolute ceiling on the amount of damages to which a patent owner may be entitled, or (2) a history of lump-sum licenses precludes a patent owner from seeking damages in the form of a running royalty.[48] Full consideration of the *Georgia-Pacific* factors may justify a departure from the amount or even the form of past licenses.[49]

Conclusion

In a case involving prior licenses of the patented technology, keep four things in mind:

1. Search out all prior licenses of the patent. As often as not, they become the best evidence of the amount and form of a reasonable royalty. Understand the circumstances surrounding the licenses. Be sensitive to settlement-driven licenses.

2. Compare and contrast the patented technology and prior licenses with proffered "comparables." Are the comparable licenses related to similar technology? Make a chart of similarities and dissimilarities. Resist using "comparable" licenses that simply aren't comparable even if the royalty rates are great for your client.

3. Subject even existing licenses to a "comparability smell test." What were the circumstances surrounding the license? Was it a settlement license? Do those circumstances set it apart from preexisting and truly comparable licenses to the same patent or even other comparable licenses?

4. What is the correct date of first infringement (hypothetical negotiation)? Does that make prior licenses more or less comparable?

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39 *Id.* at 79.
40 *Id.* at 80 (citing *ResQNet.com, Inc. v. Lansa, Inc.,* 594 F.3d 860, 872-73 (Fed. Cir. 2010)).
41 *Id.* at 79.
42 *Id.*
43 *Id.* at 80.
44 *Id.* at 81.
45 *Id.*
46 *Id.* at 80-81.
47 *Id.* at 81.
48 *Id.*
49 *Id.*