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FEDERAL CIRCUIT REFINES RULES FOR APPORTIONMENT OF DAMAGES IN PATENT INFRINGEMENT CASES

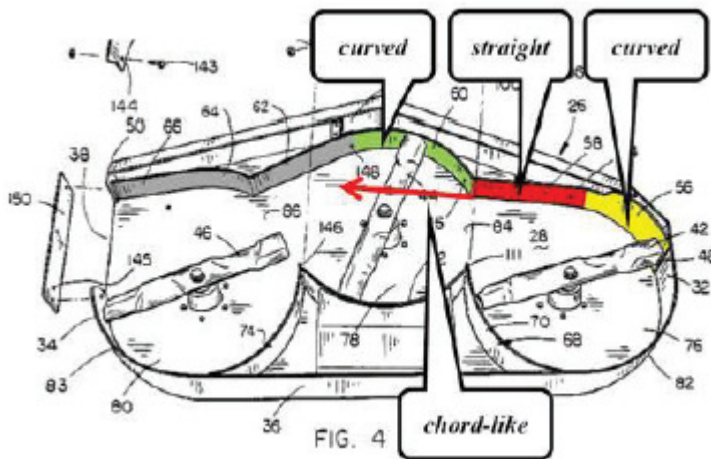
The Federal Circuit recently decided two patent infringement cases where they overturned jury verdicts that had awarded damages to the patent owners. In each case, the Federal Circuit found that the patent owner had not presented evidence of the portion of the value of the infringing products that was attributable to the patented inventions that was sufficient to support the juries' award of a reasonable royalty as damages. In doing so, the Court adopted a strict approach to the analysis of the award of a reasonable royalty as damages for patent infringement, and it provided guidelines that can be used by future patent infringement litigants when preparing their case for damages when the patented invention comprises only a component or feature of a larger product or system.

In *Exmark Manufacturing Co., Inc. v. Briggs & Stratton Power Products Group, LLC*, the Court overturned a \$24 million award of damages against Briggs & Stratton for infringing Exmark's U.S. Patent No. 5,987,863, which is directed to a multi-blade lawn mower invention. Although the '863 Patent recites standard components of a commercial lawn mower, such as mower deck, a side discharge opening and power source, the innovative aspect of the invention was focused on the shape and configuration of flow control baffles on the underside of the mower deck, which directed the flow of air and grass clippings across the three cutting blades to a side discharge opening.

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On appeal, Briggs & Stratton argued that Exmark should not have been allowed to use the sales price of the accused mowers as the royalty base instead of the sales price of the flow control baffles themselves. Briggs & Stratton also argued that Exmark's damages expert should not have been allowed to testify to the jury because she failed to adequately explain how she arrived at her proposed 5% royalty rate. Finally, Briggs & Stratton argued that the district court improperly excluded certain evidence relevant to damages.

With respect to Briggs & Stratton's first argument, the Federal Circuit disagreed. At trial, Exmark had requested that the jury award it a "reasonable royalty" as a result of the infringement. Exmark asserted (through the testimony of its damages expert) that the royalty rate should be 5%, and that this rate should be applied to a royalty base comprised of the sale price of the infringing commercial lawn mowers. In cases such as this, where the patented invention is directed only to a component of the accused commercial lawn mower products, the reasonable royalty must be based on an apportionment (or separation) of the incremental value that the patented invention contributes to the accused product. This ensures that the patent owner is compensated only for the value of the patented improvement, rather than the entire mower. Briggs & Stratton argued that this apportionment must take place with respect to the royalty base, so that the base to which the royalty rate is applied is not the value of the entire commercial lawn mower, but only the value of the flow control baffles used with the mower deck.

The Federal Circuit disagreed. Applying its prior precedents on this

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issue, the Court held that his apportionment can be made either “by careful selection of the royalty base to reflect the value added by the patented feature [or] ... by adjustment of the royalty rate so as to discount the value of a product’s non-patented features; or by a combination thereof.” As long as Exmark adequately and reliably apportions between the improved and conventional features of the accused mower, using the accused mower as the royalty base, and apportioning through the use of an appropriately lower royalty rate was an acceptable methodology. In this case, the Court found that using the mowers as a royalty base was “particularly appropriate” because the ‘863 Patent was directed to a “multiblade lawn mower,” and that the entire accused mowers infringe the patent’s claims, not just the innovative flow control baffle. Thus, the patent’s claims were found to cover the product as a whole, and there were no “unpatented” and “patented” features that must be separated.

Therefore, the Court agreed with Exmark that the apportionment can be done “through a thorough and reliable analysis to apportion the royalty rate,” such as through the application of the multi-factor test set forth in *Georgia Pacific Corp. v. U.S. Plywood Corp.*, which considers a “hypothetical negotiation” between the patent owner and infringer to arrive at the reasonable royalty that the infringer would have been willing to pay at the time it began the infringement. The Court noted, in particular, that “sophisticated parties routinely enter into license agreement that base the value of the patented invention on a percentage of the commercial products’ sales price,” so that “[t]here is nothing inherently wrong with using the market value of the entire product, especially when there is no established market value for the infringing component or feature, so long as the multiplier accounts for the proportion of the base represented by the infringing component or feature.”

However, the Federal Circuit held that the testimony of Exmark’s damages expert was not sufficient to support the jury’s damages award. Although Exmark’s expert discussed each of the *Georgia Pacific* factors, including the benefits of the patented technology, sales and profitability of the infringing products, and the competitive relationship of the parties, she concluded with little explanation that Exmark and Briggs & Stratton would have agreed to a 5% reasonable royalty rate. The Court noted that nowhere in her written report or testimony did she tie the 5% royalty rate to the relevant *Georgia Pacific* factors, or explain how she calculated a 5% rate using these factors. Thus, it was not enough for Exmark’s expert to explain the advantages of the baffle claimed in the ‘863 patent and state that they would have been important in a hypothetical negotiation. To sufficiently tie the advantages of the patented baffles to the royalty rate in this case, Exmark’s expert was required to explain the extent to which they factored into the value of the lawn mower and her 5% royalty rate.

The Court found fault, in particular, with the expert’s discussion of *Georgia Pacific* factor thirteen, which is directed to the portion of the realized profits attributable to non-patented elements. Although the expert acknowledged that other elements of the mowers affect sales and profits, including durability, reliability, brand position, dealer support, and warranty, she failed to conduct any analysis indicating the degree to which these considerations impact the market value or profitability of the mower and therefore impacted her suggested 5% royalty rate. The Federal Circuit also found problematic the fact that Exmark’s expert failed to assign any value to the patents that Briggs & Stratton had for other components of their infringing mowers. The Court was skeptical that those patents did not contribute to the overall value of the mowers, and that they would not influence the royalty rate that would be applied to the patented flow control baffles.

Finally, the Federal Circuit found that the district court should not have excluded Briggs & Stratton's evidence of the prior art, and its impact on the damages analysis under *Georgia Pacific* factor nine. In particular, Briggs & Stratton attempted to present evidence of prior conventional modes of mowing in order to rebut Exmark's claim that the mower claimed in the '863 Patent was a big advancement over the prior art, arguing instead that the patented flow control baffles were only a small improvement over the prior art. The district court had excluded all evidence of prior art inventions that had not been commercialized. The Federal Circuit ruled instead that whether some prior art mowers were not commercialized was not relevant to determining the extent to which the mower claimed in the '863 Patent provides utility and advantages over the prior art. However, the Federal Circuit also found that the district court was reasonable in excluding evidence of prior art that was directed to mowers, such as mulching mowers, that were of a different type than the side discharge mowers claimed by the '863 Patent.

In *Finjan, Inc. v. Blue Coat Systems, Inc.*, the Federal Circuit dealt with similar apportionment issues. *Finjan* involved assertions of infringement of four (4) U.S. patents that were directed to techniques for enhancing the security of computer systems. After a trial, the jury found that Blue Coat infringed the four Finjan patents and awarded a total of \$39.5 million as a reasonable royalty for that infringement, with different amounts awarded for each patent. With respect to Finjan's U.S. Patent No. 6,154,844, the Federal Circuit found that when calculating a royalty base, Finjan failed to apportion damages to the functionality of the infringing software product.

In drawing this conclusion, the Court analyzed the same case law precedent that it reviewed in the *Exmark* decision discussed above. In *Finjan*, the '844 Patent was directed to a method of providing computer security by scanning a downloadable file and attaching the results of that scan to the downloadable itself, in the form of a security profile. The infringing Blue Coat cloud-based software product included an infringing "DRTR" module which analyzes URLs for security categorization, including its use of malicious or suspicious code. However, the infringing DRTR module also evaluates whether the URL fits into many other non-security-related categories, such as social media or adult content, which are valuable to employers who wish to control their employees' computer usage.

At trial, Finjan attempted to show apportionment by using the percentage of users of the overall Blue Coat system who also used the infringing DRTR module (*i.e.*, 4%). Although the infringing DRTR module performs several non-infringing functions, Finjan did not perform any further apportionment on the royalty base between the value of the infringing and non-infringing functions. Finjan argued that its apportionment of the royalty base was sufficient, because the infringing DRTR module was the "smallest, identifiable technical component" that is tied to the scope of the patented invention. Generally, in patent cases, the value of the smallest salable unit is selected for use as the royalty base because "in any case involving multicomponent 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 Court disagreed with Finjan's argument, and found that basing the royalty on the "smallest, identifiable technical component" does not insulate Finjan from the "essential requirement" that the "ultimate

reasonable royalty award must be based on the incremental value that the patented invention adds to the end product.” The Court found that its earlier precedents required Finjan to perform further apportionment between the value of infringing and non-infringing functions even within the smallest identifiable technical component. The percentage of web traffic that used the infringing module could not be used as a proxy for the incremental value contributed by the patented technology.

Finally, the Court rejected Finjan’s use of \$8 per user as the reasonable royalty rate, finding that there was no evidence supporting it. This royalty rate was based on the royalty rate of 8-16% that was used in another published court decision – *Secure Computing* - which did not involve the ‘844 Patent. Finjan failed to establish that the technology at issue in *Secure Computing* was comparable to the technology claimed by the ‘844 Patent. The mere fact that the infringing products in *Secure Computing* were in the computer security field, and that *Secure Computing* was a competitor of Blue Coat was deemed by the Court to be too general a similarity for the 8-16% royalty rate to be used.

There are several general principles that may be taken away from the Federal Circuit’s decisions in *Exmark* and *Finjan* that are relevant to the issue of reasonable royalty damages and claim drafting strategies:

- If the patented invention is directed only to a component or feature of an assembled product, or integrated system or process, then the reasonable royalty must be based on an apportionment of the incremental value that the patented invention contributes to the assembled product, or the integrated system or process.
- A royalty base must be selected that is appropriate for the patented technology and the accused product, method or system. This can be the entire product, method or system if the patent claims cover that product, method or system, or if the patented invention provides most of the product’s or system’s market value (*i.e.*, the entire market value rule). Alternatively, it may be a component, if that component may be separated from the assembled product or system, if it has separate value or is sold separately, or if it provides most of the product or system’s market value.
- A royalty rate must be selected, based on the incremental value that is contributed to the assembled product, or integrated method or system by the patented invention. The fifteen *Georgia Pacific* factors should usually be considered when determining the reasonable royalty.
- When relying on a royalty rate that is already established for a particular type of product or system within an industry, care must be taken to ensure that the technology used by the product or system is closely analogous to the technology that is covered by the patent. Superficial or general similarities are not enough, as the Court instructed in *Finjan*.
- When determining the incremental value that is contributed by the patented invention, it is important to consider the value that is contributed by the other components of the product, system or method, and the impact that the value of the other components have on the relative value contributed by the patented invention. The value of other patents which cover components, features or functions of

the product, system or method are also important to consider, relative to the value that is added by the patented invention.

- If it is appropriate to use the smallest identifiable technical component of a product as the royalty base, then it is important to consider whether that component has non-infringing uses, functions or features, and that the relative value of those non-infringing elements is considered by the damages expert when formulating the royalty rate.
- Each factor within the *Georgia Pacific* factors must be considered, with a detailed explanation of how it influences or affects the royalty rate (either up, down or neutral), or the incremental value that the patented invention contributes to the product or system. Reference to specific evidence and information is critical.
- The prior art should be consulted to determine how large an improvement the patented invention is over the state of the art at the time of the invention, as an element of determining its incremental value to the product, system or method.
- Consider disclosing the invention in the specification and claiming it in such a way as to maximize the royalty base, and the flexibility that the patent owner has to enforce the patent's claims against the broadest array of potential infringers.
 - Draft the specification disclosure broadly to support the claiming of the invention as an entire product or system, as well as the method that is used to make and/or use it. This enables the patent owner to potentially enforce its patent against multiple potential infringers within the manufacturing or supply chain for the product.
 - When the invention is a component or feature of a larger product or system, consider drafting the disclosure and claims to include a description of the known standard components of the larger product or system, as was done with respect to the '863 Patent in *Exmark*, in addition to the elements of the inventive improvement itself. If the component or feature is used in different products or systems, detailed descriptions and claims directed to each product or system should be included. According to the Federal Circuit's decision in *Exmark*, this may enable the patent owner to use the entire sale price of the finished product or integrated system as the royalty base, potentially increasing the reasonable royalty that is recovered.
 - Consider how the inventive improvement can be used across different technologies or industries in the future. Draft the specification disclosure to include descriptions of the technologies or types of products that the invention may be used for. This will also enhance the patent owner's ability to expand its enforcement efforts to additional potential infringers in the future, as the patented invention becomes widely accepted and used.

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