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2011: A Case Odyssey — Part 2


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Law360, New York (March 30, 2012, 1:20 PM ET) -- In the first installment of this article, we examined developments in the area of reasonable royalty damages law, noting that for the first time in several years, the most noteworthy developments occurred almost exclusively at the district court level rather than appellate.

The first case examined was Oracle v. Google in the Northern District of California, where Judge William Alsup has and continues to take a very “hands-on” approach to handling the parties’ vigorous damages disputes and essentially forced Oracle’s damages expert to make several trips back to the drawing board, each time reducing the requested reasonable royalty.

In part two, we examine several other 2011 cases involving noteworthy damages disputes and varying outcomes, beginning first with a discussion of the long-running and notorious litigation between Lucent Technologies Inc. and Microsoft Corp.

Lucent v. Microsoft

No exploration of the last year’s developments in reasonable royalty law would be complete without examining the very litigation that, after producing arguably the most landmark Federal Circuit damages decision of the decade, went on remand in 2011. Lucent v. Microsoft, as the following discussion will reveal, was a true “redo” on damages. A new jury would evaluate new damages theories and expert disclosures, and both Judge Marilyn Huff and counsel for the parties were tasked with the burden of advocating their royalty positions in the new era that their clients had already helped usher in.

Although Lucent v. Microsoft, at the time of its filing in late 2007, originally involved several patents and several additional defendants (namely, Gateway), the crux of the conflict was eventually narrowed down to one patent, No. 4,763,356, entitled “Touch screen form entry system,” otherwise known as the Day patent. At its core, the technology claimed in the Day patent related drop-down menus used to populate forms on a computer screen, and it was read against and found to be infringed by the “date picker” function in Microsoft Outlook. How to value the reasonable royalty for the infringement became the focus of much further scrutiny.

On April 4, 2008, the jury awarded Lucent a lump-sum royalty of over $350 million for Microsoft's infringement of the Day patent. The Federal Circuit famously unleashed its wrath upon this award on appeal, criticizing several aspects of the underlying testimony and evidence. Such aspects included, most notably, the patentee's reliance on broad, cross-licenses with no relationship to the hypothetical license apart from "personal computer kinship." The Federal Circuit remanded to the trial court to determine the proper reasonable royalty.

On remand and in light of the new law, the patentee in Lucent v. Microsoft took an entirely different approach to quantifying its damages. Lucent hired a survey expert, Deborah Jay, to attempt to quantify the value of the date-picker function to consumers of Microsoft Outlook; and an economic expert, Raymond Sims, to use the results of this survey in conducting a Georgia-Pacific analysis and formulating an ultimate lump-sum royalty opinion.[1]

Jay's survey showed that 7 percent of Outlook "purchase-decision makers" who use the drop-down feature would not have purchased Outlook if it lacked that feature.[2] Sims then multiplied this 7 percent by 43 percent — the percentage of all Outlook users who use the drop-down calendar — to arrive at 3 percent.[3] Finally, Sims applied the 3-percent multiplier against 109.5 million total Outlook licenses granted during the damages period to arrive at 3.3 million license sales that Microsoft "would potentially lose if the Day patent technology was not included in Outlook."[4]

To formulate the lump-sum, it was then a matter of multiplying the number of lost licenses (3.3 million) by a per-unit value for Microsoft Office. Sims chose $67 as this value, relying on several internal Microsoft documents and witness testimony.[5]

The resulting value, $221.4 million, was then adjusted downward to account for profit margin and the "business realities" approach to the hypothetical negotiation.[6] "Based on his apportionment, the Georgia-Pacific factors, and business realities, Sims testified that a conservative lump-sum royalty would be $70 million."[7] Interestingly, Microsoft did not put its own survey or economic experts in front of the jury, choosing instead to put Lucent to its proof.[8] The jury sided with Lucent, awarding $70 million in damages, and post-trial briefing ensued.

In Daubert rulings prior to trial, the parties fought vigorously over application of the entire market value rule and whether Lucent's analysis properly apportioned between patented and unpatented features in Microsoft Outlook.[9] After the jury verdict of $70 million based on the calculation above, many of the same arguments were raised on judgment as a matter of law

Judge Marilyn Huff carefully weighed requirements of the Federal Circuit, particularly as laid out in Lucent and Uniloc, against the record to evaluate whether the $70 million award was supported by substantial evidence. This involved a two-part analysis of whether Lucent had presented a "legally sufficient basis of apportionment between the patented and unpatented features of the Day patented technology within Outlook and Office" as required by Uniloc.[10] In other words, did Lucent properly apportion? The answer: in some ways, yes, and in others, no.

Lucent conceded it could not meet the entire market value rule, which would have allowed it to capture the entire price of Microsoft Outlook or Office licenses in its royalty base, because the date-picker tool was not the basis for consumer demand.[11] Lucent was instead required to apportion the profit from accused Outlook and Office licenses, and Judge Marilyn Huff credited Lucent for its effort to apportion through the survey conducted by Jay.[12]

Judge Huff concluded that Lucent's calculation of 7 percent (users who would not purchase Outlook without the date picker) times 43 percent (Outlook users who use the date picker) times 109.5 million total licenses was an appropriate apportionment under Uniloc.[13] Judge Huff also rejected a renewed Daubert challenge to Jay's survey and testimony.[14]

The portion of Lucent's calculation that eventually doomed the $70 million verdict, however, was Sims' use of a $67 per-unit value to apply against the 3.3 million Microsoft Office licenses.[15] Upon review of the evidence, Judge Huff agreed that Lucent's use of a $67 million figure assumed that Outlook represented 68 percent of the revenue of Office, which would put the collective value of other Office components, such as Word, Excel and PowerPoint, at only $31 combined.[16]

In briefing, Microsoft suggested an alternative apportionment of $24.55 of revenue attributable to each Office component, including Outlook, and Judge Huff agreed with this figure.[17] Inserting $24.55 as the per-unit value for Outlook licenses into the otherwise acceptable Lucent calculation (including acceptable use of survey evidence, the "business realities" approach, and Georgia-Pacific factors), yielded a lump sum of $26.3 million.[18] The court held that $26.3 million was the maximum amount supported by substantial evidence.[19]

Although the parties submitted notices of appeal to the Federal Circuit, they have since apparently settled the matter.[20] Judge Huff, therefore, had the last public word on the value of Microsoft's infringement of the Day patent, and that value was a shade over $26 million. This is less than 8 percent of the original $358 million awarded for the same infringing acts of the same claims more than three years prior. Although Lucent did an admirable job to quantify its damages and win a jury verdict of $70 million on remand, in the end, a highly factual disagreement over the correct value of Outlook proved to be its downfall.

The several opinions coming out of the Lucent v. Microsoft remand should serve as guideposts for litigants seeking to adequately quantify the value of an invention when included in a much larger framework. In particular, this litigation is a clinic on how courts might treat the concepts of the entire market value rule and apportionment in the future.

Is it a largely overlooked reality that both concepts serve the same basic purpose of preventing overcompensation of the patentee. Just as it would have been arguably unjust for Lucent to collect a royalty on a base consisting of the entire price of Microsoft Outlook or Microsoft Office, it would have been similarly unjust for that royalty to be applied against all of those sales, given how few consumers felt that the date-picker tool was important to them.

The litigation is further illustrative of the need to carefully quantify the extent of use of an invention. Before trial, Judge Huff warned Lucent that it "must properly introduce evidence as to the extent of the use of the Day patent technology in Microsoft's products and, while damages do not have to be strictly tied to their usage numbers in a lump sum payment, Lucent must correlate its damage numbers to that usage."[21]

Lucent did so through the consumer survey designed and executed by Jay, and her analysis held up through both Daubert and post-trial briefing. Indeed, notwithstanding internal Microsoft documents and testimony, the Jay survey proved to be the key piece of quantitative evidence underlying the eventual award.

Taking into account the Jay survey, the conservative approaches taken by Sims, and the further reduction of the award by Judge Huff upon the urging of Microsoft through its apportionment arguments, it is difficult to see how the Federal Circuit could have further eviscerated Lucent's $26.3 million award. For better or worse, it will no longer have an opportunity to do so.

DataQuill v. HTC

The federal district courts of California remain among the most popular patent infringement filing venues in the country. Because of this, naturally, they have been on the forefront in evaluating the appropriateness of damages evidence in 2011. DataQuill Ltd. v. High Tech Computer Corp., venued in the Southern District of California, provides another key example of a court parsing several distinct aspects of a damages experts' opinion in view of the evolving law.

DataQuill, like Oracle, is an infringement case focused on the Android operating system. The plaintiff's two asserted patents read on the marketplace, camera phone and Web browsing capabilities of accused smartphones.[22] In a Daubert ruling, Judge Irma Gonzalez ruled that DataQuill's expert, Joseph Gemini, came close to having a Rule 702-proof report but for a key shortcoming related to licenses.

The court held that Gemini correctly opined that there should be three separate dates of hypothetical negotiation and therefore three separate royalty rates applied to infringements that occurred at three different times.[23] The court also endorsed Gemini's approach of relying on the plaintiff's technical expert in assuming that certain functions of HTC smartphones infringed the asserted claims.[24]

However, Gemini's reliance on certain licenses was held improper. Although he survived the technological comparison prong of the comparable licenses analysis, he failed the economic comparison prong, placing specious reliance on licenses "between HTC and heavyweights in the telecommunications industry such as Qualcomm ... for entire portfolios of patents."[25]

Perhaps most interestingly, Judge Gonzalez allowed Gemini to include the entire market value of the accused products in his royalty base. The court first rejected DataQuill's argument that the entire market value rule should not apply because the asserted claims recited and were read against the entire smartphone apparatus.

The HTC smartphones, held the court, "are complex products with multiple features that are clearly not claimed by the patents-in-suit, such as the ability to make phone calls and the ability to send and receive text messages."[26] In other words, because the claims-in-suit represented only "an improvement on an invention," the plaintiffs could not collect damages for features or functionalities that existed in the prior art, even when those features appeared in the asserted claims.[27]

DataQuill's fallback position, however, was that even if the entire market value rule applied, it was met because the claimed features were indeed the basis for consumer demand. The court agreed.[28] Gemini relied on various documents stating that the patented features were "vital to HTC's competitive position in the smart-phone market" and were "important to HTC's ability to compete with the Apple iPhone."[29]

DataQuill, held Judge Gonzalez, had thus presented enough evidence from which a jury could find that the entire market value rule had been satisfied.[30] Indeed a lesson to all litigants to conduct damages discovery in a way that allows for qualitative positioning of asserted claims against accused products.

Unlike Lucent, the eventual impact of Judge Gonzalez's Daubert ruling in DataQuill will remain unknown for some time. Trial is currently scheduled for July 2012.[31] Like both Lucent and Oracle, which involved multiple, lengthy Daubert rulings related to expert damages opinions, DataQuill has already examined at least five discrete aspects of Gemini's work. This case is thus another following the trend of early and heavy analysis of reasonable-royalty advocacy.

ActiveVideo v. Verizon

It might be said that Oracle and Lucent occupy one end of the post-Uniloc spectrum, wherein damages opinions and underlying evidence are scrutinized heavily and reduction of potential recovery results. In Lucent, recall that the original jury verdict of over $350 million was vacated, and the jury's award on remand of $70 million was further reduced on JMOL to $26.3 million. In Oracle, though no trial or verdict has yet occurred, recall that Oracle's expert originally opined that the parties would have agreed to a $2.6 billion license, and has since been effectively forced by the court to reduce this number to $201.8 million, with possible further reductions coming in a third report.

These data points may indicate a trend of smaller reasonable royalty awards that many commentators predicted would result in the post-Uniloc era. But every trend has its exceptions, and ActiveVideo Networks Inc. v. Verizon Communications Inc. is hard evidence that reasonable royalty awards in the nine-figure range are still attainable if careful attention is paid to the facts and the law.

ActiveVideo involved claims by the plaintiff that Verizon infringed five patents with claims related to two-way interactive cable services.[32] Specifically, the claims of one patent describe interactive television information system that supplies information services and distributes information to subscriber televisions.[33]

Another patent describes a cable system with several "assignable interactive controllers" to communicate with subscriber televisions.[34] Yet another patent describes an apparatus for accessing the Internet using a television and set top box.[35] Generally, these are all the necessary components of an "on-demand" video system that most are familiar with.

Upon submission of expert reports, Verizon brought a motion to exclude the report of ActiveVideo's damages expert Michael Wagner. While most of the motion is liberally redacted, it is clear that a major component of Verizon's exclusion strategy was to argue that Wagner misapplied the entire market value rule. Judge Raymond Jackson dismissed this argument rather swiftly, however, holding that "ActiveVideo has submitted substantial evidence to demonstrate that [video on-demand] (or the patented feature) is the basis for consumer demand for the [accused] Verizon FiOS system or substantially contributed to the value of the system."[36] The court did not explain what this evidence was or how it demonstrated the basis for consumer demand.

The court handily dismissed several other of Verizon's arguments against Wagner's opinion. Qualms that Wagner "cherry-picked" license agreements with unacceptable benchmarks and failed to establish causation between availability of on-demand services and subscriber attrition went to the weight and not the admissibility of the evidence, held Judge Jackson.[37]

A few short weeks later, the jury reached a verdict, finding that Verizon infringed all eight of the claims that remained asserted at the time of trial.[38] For this infringement, the jury awarded $115 million in reasonable royalty damages.[39]

On JMOL, Verizon re-raised its argument that Wagner incorrectly applied the entire market value rule in his testimony, and the court, again, dismissed this argument, albeit on slightly different grounds. This time, Judge Jackson ruled that reading Lucent in light of Uniloc led to the conclusion that a royalty may be based on the entire market value of a product where the evidence shows that this would have been appropriate in the hypothetical negotiation.[40]

Judge Jackson noted further that the evidence presented showed that the infringing on-demand services were “at least a substantial basis of consumer demand,” and even though Wagner admitted that other factors influenced customer demand, he was not precluded from using the entire market value.[41] In other words, the patented features did not have to be the only basis for consumer demand — a ruling that will surely receive much attention in briefing to the Federal Circuit.

From that point, the damages continued to pile on top of Verizon. Judge Jackson subsequently found that ActiveVideo was entitled to: (1) supplemental damages (to account for infringement from the date of Wagner’s report through verdict) in the amount of about $17.5 million; (2) prejudgment interest in the amount of $6.7 million; and (3) post-judgment interest accruing from the date of verdict.[42] This bumped the reasonable royalty award to a total of over $139 million.

The parties have filed notices of appeal to the Federal Circuit, and as of Feb. 10, 2012, there is an appeal number assigned.[43] There is no outward indication of settlement. Of all the cases discussed herein, and likely all of the patent infringement trials in 2011 that resulted in a reasonable royalty damages award, ActiveVideo v. Verizon seems most ripe for the Federal Circuit to revisit its prior damages ruling and determine whether Judge Jackson and the parties were in compliance with the evolving law.

Looking beyond the obvious distinction of a large royalty verdict, there are other stark contrasts between the rulings issued in ActiveVideo and those issued in the three other cases discussed herein and venued in California. Judge Jackson allowed more damages issues to reach the jury without substantive comment than did judges in Lucent, DataQuill and especially Oracle. Where Judge Alsup in Oracle demanded a claim-by-claim damages analysis and further provided clear direction to the parties on which starting benchmark to adopt and how to adjust that benchmark, Judge Jackson was comparatively “hands-off.”

Judge Jackson’s rulings in ActiveVideo involved very few serious forays into damages law other than some abbreviated commentary on the entire market value rule and one or two other evidentiary issues, and it is unclear whether the parties even pushed for as much. There is no indication, for instance, that Verizon argued that there should be different dates of hypothetical negotiation for different asserted claims, or that the value of the asserted claims should be apportioned between truly inventive aspects and those existing in the prior art. In any event, issues like these were not ruled upon by the court.

One thing is clear: If Oracle represents one end of the post-Uniloc spectrum of district court gatekeeping intensity, ActiveVideo is certainly at the opposite end of that spectrum. If the case results in a Federal Circuit opinion, we may see which part of this spectrum the court of appeals would prefer all district courts to occupy.

Conclusion

As 2012 forges forward, litigations such as those highlighted above will undoubtedly continue to produce new and creative expert analysis, spirited advocacy, and thoughtful opinions from the bench. So far, the Federal Circuit has not issued an opinion further delving into what is proper and improper in the post-Uniloc era. The next time it does, whether in ActiveVideo or elsewhere, such an opinion will undoubtedly be underscored by robust records, careful findings by the trial court, and of course a rich context of interpretations among our federal judges. Thanks to the work of the attorneys, experts and judges in cases like above, the Federal Circuit will certainly have received what it asked for.

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[1] Lucent v. Microsoft, No. 7-2000, Dkt. 1478 (S.D. Cal. Nov. 10, 2011) at 3.

[2] Id. at 7.

[3] Id.

[4] Id.

[5] Id. at 7-8.

[6] Id. at 10.

[7] Id. at 11.

[8] Id. at 3.

[9] See, e.g., Lucent v. Microsoft, Dkt. 1284 (June 16, 2011) and Dkt. 1323 (July 13, 2011).

[10] Lucent v. Microsoft, Dkt. 1478 (Nov. 10, 2011) at 11.

[11] Id. at 12.

[12] Id. at 13.

[13] Id. at 13.

[14] Id. at 22.

[15] Id. at 15-17. Note that $67 was held appropriate for the relatively small number of standalone Outlook licenses.

[16] Id. at 16.

[17] Id. at 18. This figure was calculated simply by dividing the per-unit revenue of Office, $98, by its four main components: Word, Excel, PowerPoint and Outlook. In view of Uniloc, it may seem slightly ironic that Outlook was held as a matter of law to be worth 25 percent of the value of the Microsoft Office.

[18] Id. at 19.

[19] Id.

[20] Lucent filed a Stipulation of Dismissal with Prejudice on Jan. 13, 2012. See Dkt. 1488.

[21] Lucent v. Microsoft, Dkt. 1284 (Jun. 16, 2011) at 11.

[22] DataQuill v. HTC, No. 8-543, Dkt. 192 (S.D. Cal. Dec. 1, 2011) at 26.

[23] Id. at 32.

[24] Id. at 33.

[25] Id. at 30.

[26] Id. at 35.

[27] Id.

[28] Id. at 36-37.

[29] Id. at 37.

[30] Id.

[3]1] See DataQuill v. HTC, Dkt. 202 (Dec. 22, 2011).

[32] ActiveVideo Networks Inc. v. Verizon Comm’ns Inc., No. 10-248, Dkt. 408 (E.D. Va. April 7, 2011).

[33] Id. at 4.

[34] Id. at 7.

[35] Id. at 10.

[36] ActiveVideo v. Verizon, Dkt. 785 at 6 (July 15, 2011).

[37] Id. at 6-7.

[38] ActiveVideo v. Verizon, Dkt. 927 (Aug. 2, 2011).

[39] Id. (For its part, Verizon offset this award by $16,000 for ActiveVideo’s infringement of two Verizon patents).

[40] ActiveVideo v. Verizon, Dkt. 937 at 4 (Aug. 3, 2011).

[41] Id.

[42] ActiveVideo v. Verizon, Dkt. 1149 (Oct. 13, 2011).

[43] ActiveVideo v. Verizon, Dkt. 1239 (Feb. 10, 2012).