

Reasonable Royalties and the Federal Circuit in 2015: Evolution of the Revolution

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Introduction

After many years of issuing “revolutionary” decisions related to the analysis of reasonable royalty damages in patent infringement cases, 2015 was a year of comparative quiet for the Federal Circuit. Revolutionary decisions such as [Uniloc](#), which abolished the use of the 25% Rule, [LaserDynamics](#), which codified consideration of the “smallest salable patent-practicing unit,” and [ResQNet](#), which suggested that settlement agreements may be admissible, led to immediate changes in how reasonable royalties are determined. Rather, 2015 saw the Federal Circuit issue a series of more “evolutionary” decisions that refined key principles and provided guidance and clarification in interpreting the more “revolutionary” decisions of prior years.

This article provides a summary of the main takeaways from three Federal Circuit opinions in 2015 relating to reasonable royalty damages, and provides practitioners with practical guidance from these decisions.¹

AstraZeneca AB v. Apotex Corp.

[This case](#) involved [patents related to the formulation of drugs containing omeprazole](#), the active ingredient in [AstraZeneca's](#) blockbuster drug, [Prilosec](#). In a bench decision, the district court awarded AstraZeneca royalty damages equal to 50% of [Apotex's](#) profits from its infringing sales of generic [omeprazole](#). Apotex appealed the decision on several grounds, including that the district court's royalty award violated the Entire Market Value Rule (“EMVR”) by “improperly bas[ing] its damages calculation on the value of the omeprazole product as a whole.”² In particular, Apotex argued that it was necessary to reduce the royalty base to account for “the relative contribution of value between the active ingredient” (which was the subject of different, expired patents held by AstraZeneca) and the “inventive element” of the formulation patents in this case, which Apotex asserted was limited to the subcoating of the drug.

The Federal Circuit rejected Apotex's argument, explaining that the EMVR did not apply since the claims of the asserted formulation patents covered the combination of three elements (the drug core, the

¹ In addition to reasonable royalties, in 2015 the Federal Circuit also issued decisions related to lost profits ([Warsaw Orthopedic, Inc. v. Nuvasive, Inc.](#) and [Smith & Nephew Inc. v. Arthrex, Inc.](#)), design patent damages ([Apple Inc. v. Samsung Elecs. Co.](#) and [Nordock, Inc. v. Systems Inc.](#)), issues relating to damages and extraterritoriality ([WesternGeco LLC v. Ion Geophysical Corp.](#) and [Carnegie Mellon Univ. v. Marvell Tech. Group, Ltd.](#)), and the need for a district court to determine an amount of damages despite the exclusion of expert testimony ([Info-Hold, Inc. v. Muzak LLC](#)). Given this article's focus on reasonable royalties, these decisions have not been addressed here, as they merit a full discussion on their own.

² The Federal Circuit's decision also addressed issues related to non-infringing alternatives and settlement agreements, with the Court confirming the general relevance of these facts in determining reasonable royalties.

enteric coating, and the subcoating) that comprised the entire accused product, not only one component of the overall product. However, the Court cautioned that where the claims of a patent cover the entire infringing product by reciting both “conventional and unconventional elements,” it is still necessary to determine a royalty that “account[s] for the relative value of the patentee’s invention in comparison to the value of the conventional elements recited in the claim, standing alone.”

The Federal Circuit then explained that the [Georgia-Pacific](#) factors traditionally used by damages experts to determine a royalty rate “bear directly on this issue” as they address the advantages of the patented technologies over prior inventions, and the portion of the profit that should be credited to the invention as opposed to other factors. Citing its prior decision in [University of Pittsburgh v. Varian Medical Systems, Inc.](#), the Court explained that “guarding against compensation for more than the added value attributable to the invention is ‘precisely what the *Georgia-Pacific* factors purport to do.’”

The *AstraZeneca* decision emphasizes the Federal Court’s focus on the importance of apportionment, and confirmed the need for properly apportioned royalty awards in circumstances where the claims of the asserted patent may cover the entire product by including “conventional” elements. In such instances, the Court concluded that “it is not the case that the value of all conventional elements must be subtracted from the value of the patented invention as a whole when assessing damages.” This suggests that in some circumstances, if a patent claims a combination of elements that form the entire accused product, a patent holder may rely on the entire value of the accused product as the royalty base. However, the royalty rate used in such circumstances must isolate the value of the inventive contribution of the patent so that the ultimate royalty amount is properly apportioned.

Summit 6 LLC v. Samsung Elecs. Co. Ltd.

In [this case](#), [Samsung](#) was found to infringe [a patent related to the processing of digital photos](#), and [Summit](#) was awarded royalty damages of \$15 million. Samsung appealed the award on several bases, including that the district court erred in allowing the testimony of Summit’s damages expert.³ The Federal Circuit rejected Samsung’s arguments, and in doing so, provided helpful guidance on the variety of methods that can be used to determine reasonable royalties and the district court’s role as a gatekeeper of expert testimony under [Daubert](#).

First, the Court echoed its long-standing recognition that “estimating a reasonable royalty is not an exact science.” Repeating its finding from [Apple Inc. v. Motorola Inc.](#), the Federal Circuit emphasized that there are multiple ways of determining a royalty, and that whether “one approach may better account for one aspect of a royalty estimation does not make other approaches inadmissible.” The Court went on to examine the apportionment methodology used by Summit’s damages expert, concluding that even though the methodologies used may not have been peer-reviewed or published, that did not necessitate their exclusion.

³ Summit also appealed the district court’s finding that the jury’s award represented a lump sum payment that compensated for both past and future infringement. This was rejected by the Federal Circuit, as it found there was sufficient support for the finding that the jury award represented a lump sum, such as the fact that the jury handwrote the phrase “lump sum” on the verdict sheet, and expert testimony at trial described a lump-sum as providing compensation through the life of the patent.

The Federal Circuit also addressed the gatekeeping role of the district court under *Daubert* to ensure that expert testimony is sufficiently reliable to support a properly apportioned damages award.⁴ In doing so, the Court stressed that a district court’s gatekeeping role is limited to ensuring that methodologies used by damages experts are reasonable and sound, and that the facts relied upon are sufficiently tied to the case. Once those thresholds are met, “the inquiry on the correctness of the methodology and of the results produced thereunder belongs to the fact finder.” This is consistent with the Federal Circuit’s decision in *Apple v. Motorola* that emphasized how a district court “must be cautious not to overstep its gatekeeping role and weigh facts, evaluate the correctness of conclusions, impose its own preferred methodology, or judge credibility, including the credibility of one expert over another. These tasks are solely reserved for the fact finder.” It remains to be seen whether the Federal Circuit’s guidance from *Apple* and *Summit* will affect the number and outcome of *Daubert* motions filed related to expert testimony on reasonable royalties, which have seen a dramatic increase in recent years.

Commonwealth Scientific and Industrial Research Organisation (“CSIRO”) v. Cisco Sys., Inc.

The Federal Circuit addressed several issues relating to apportionment and the determination of royalties for standard-essential patents in [this decision](#). In a bench decision, the district court awarded [CSIRO](#) royalties of \$16.2 million for [Cisco’s](#) infringement of [a patent related to wireless signal transmissions](#). Cisco appealed the damages award on several grounds, including that the district court erred by not beginning its damages analysis with the wireless chip, which was the smallest-salable patent practicing unit (“SSPPU”), and by failing to account for the fact that the asserted patent was a standards-essential patent (“SEP”).⁵

In addressing Cisco’s claims that the district court erred by not basing its royalty analysis on the SSPPU, the Federal Circuit provided helpful clarification on the role of the SSPPU in determining royalty damages. The Federal Circuit explained that the SSPPU principle relates specifically to the royalty base used in a royalty calculation, and states that “where a damages model apportions from a royalty base, the model should use the [SSPPU] as the base.” In contrast, the district court’s royalty analysis was based on licensing negotiations between the parties for the asserted patents, where the royalties were structured on a dollar per unit basis, and did not use the value of the end product or SSPPU as the royalty base. Accordingly, the Federal Circuit rejected Cisco’s claims, finding that the SSPPU principle was “irrelevant” to the royalty analysis performed by the district court, which “already built in apportionment” since it was based on the amounts from licensing evidence for the patent-in-suit. Further, the Federal Circuit emphasized that requiring all damages models to begin with the value of the

⁴ The importance of the district court’s gatekeeping role was emphasized by the Federal Circuit in [CSIRO](#), as the court explained that “given the great financial incentive parties have to exploit the inherent imprecision in patent valuation, courts must be proactive to ensure that the testimony presented—using whatever methodology—is sufficiently reliable to support a damages award.”

⁵ Cisco also appealed the district court’s decision to discount the relevance of a license agreement entered into by CSIRO in its royalty determination. The Federal Circuit found that several of the reasons provided by the district court for discounting this license agreement were “flawed” and in its remand, ordered the court to “reevaluate the relevance” of this license to its royalty analysis.

SSPPU is “untenable” as it would “necessitate exclusion of comparable license valuations that—at least in some cases—may be the most effective method of estimating the asserted patents’ value.”

The Federal Circuit’s decision in *CSIRO* continued its guidance from [*Ericsson, Inc. v. D-Link Sys., Inc.*](#) regarding the role of the EMVR and SSPPU in determining reasonable royalties. These cases clarify that the EMVR and SSPPU relate to defining the royalty base used in a royalty calculation, and are effectively evidentiary tools intended to help the jury system reliably meet the requirements of awarding a royalty amount that is properly apportioned to the patented technology. In *CSIRO* and *Ericsson*, the Federal Circuit recognized that the EMVR and SSPPU principles—which are at the center of the recent changes in how royalties are determined—may not apply in every royalty analysis, and that applying these principles requires flexibility in order to strike “an appropriate balance between the probative value of admittedly relevant damages evidence and the prejudicial impact of such evidence.”

Lastly, the Federal Circuit accepted Cisco’s arguments that the district court’s royalty analysis failed to properly account for the fact that the asserted patent was declared essential to the Wi-Fi standard. Referring once again to its decision in *Ericsson*, the Court found that the district court’s royalty analysis erred by not modifying its consideration of certain of the *Georgia-Pacific* factors that can be “misleading or irrelevant” in determining royalties for SEPs. The Court also suggested that an adjustment to the royalty rates in *CSIRO*’s licensing offers may be necessary as “*CSIRO* may have been trying to capture the standard’s value” in these licenses. Overall, the Court reiterated its guidance from *Ericsson*, emphasizing that royalty analyses for SEPs—including those not subject to fair, reasonable and non-discriminatory (FRAND) obligations—must focus on the incremental value of the patented invention, and not include “any value flowing to the patent from the standard’s adoption.”

Conclusion & Takeaways for Practitioners

In 2015, the Federal Circuit issued several decisions that continued the “evolution” of requiring methodologically rigorous, fact specific analyses to prove reasonable royalties. Consistent with prior years, a common theme among these decisions was an emphasis on the need to apportion reasonable royalty damages to the value of the patented invention. In particular, the Court discussed how reasonable royalties should be determined in cases where the claims of a patent cover the entire product, but include “conventional” elements. The Court also clarified aspects of the role of the SSPPU doctrine in royalty analyses. Lastly, the Court provided further guidance on determining royalties for SEPs, and the importance and proper role of *Daubert* challenges to damages experts.

Consistent with other evolving areas of patent law, the Federal Circuit did not provide any bright line rules on these issues, but rather broad concepts that continue to generate somewhat unpredictable outcomes in the district courts. In preparing an admissible royalty analysis in such a climate, practitioners are advised to keep in mind the guiding principles set forth by the Federal Circuit:

- Focus on damages evidence that is case and fact specific;
- Use damages methodologies that are reliable and fit the facts of the case;

- Avoid presenting damages evidence (often the amount of revenues or profits associated with the accused product) in a manner that may “skew the damages horizon” for the jury; and
- Ensure that the ultimate royalties concluded reflect the “footprint” of the patented technology in the marketplace.

Practitioners that focus on integrating these core principles into comprehensive, credible, and balanced royalty analyses are more likely to have success in the ever-evolving world of reasonable royalty damages.