



IP: Follow the rules and do the surveys during a patent damages analysis

TWO RECENT FEDERAL CIRCUIT DECISIONS DEMONSTRATE THE IMPORTANCE OF CONSUMER SURVEYS WHEN USING THE MARKET VALUE RULE

Last month, the Federal Circuit issued two decisions that emphasize the importance of the rules of civil procedure and the benefit that consumer surveys can provide in a patent damages analysis.

Failure to supplement interrogatory answer bars use of allegedly prior art

The first case was *Woods v. Deangelo Marine Exhaust, Inc.* In the trial court, plaintiffs served an interrogatory requesting that Deangelo identify all prior art that anticipated or rendered obvious one or more of the asserted patent claims (involving a marine exhaust system) and describe why the identified prior art did so. Deangelo responded by stating that the interrogatory sought work product information and that it had not yet decided which prior art it would rely on for validity purposes. Deangelo also stated that it would disclose the prior art before trial pursuant to 35 U.S.C. §282.

The day before discovery closed, Deangelo located some engineering drawings that allegedly predated the patents

in suit. The same day, Deangelo forwarded the drawings to the plaintiffs, stating in a cover letter that the drawings may anticipate the claims or may show the state of the art prior to the invention date.

At trial, the plaintiffs moved to strike the drawings from Deangelo's exhibit list and preclude their use, arguing that Deangelo had failed to supplement its response to the interrogatory and, consequently, had not properly identified. The district court concluded that there was a violation of Rule 26(e) of the Federal Rules of Civil Procedure. Even though the plaintiffs learned of the drawings the day Deangelo located them, the district court considered this to be untimely, given the discovery cut-off the next day.

The Federal Circuit affirmed this holding. Although the disclosure of the drawings met the 30-day notice requirement of 35 U.S.C. §282, the Federal Circuit noted that §282 does not eliminate a party's obligations under the Federal Rules of Civil Procedure.

Here, the interrogatory did

more than seek identification of documents. It was a contention interrogatory that sought specific information as to why the alleged prior art anticipated or rendered obvious each asserted claim. It was undisputed that Deangelo did not provide this information before discovery closed.

Because a district court has wide discretion in overseeing compliance with the procedural rules, the Federal Circuit concluded that the district court properly found Deangelo violated Rule 26(e) and did not abuse its discretion in prohibiting Deangelo's use of the drawings at trial.

The case highlights the importance of full compliance with discovery rules, such as supplementation. Otherwise, potentially case-dispositive evidence may never go before the jury.

Do a consumer survey if you want to rely on the entire market value rule

In the second case, *Laserdynamics, Inc. v. Quanta Computer, Inc.*, the Federal

Circuit revisited the entire market value rule as applied to patent damages. The case reached the Federal Circuit after two trials in the district court, a first trial involving liability and damages and a retrial of the damages. The case involved a patent on a method of reading optical discs so that the type of disc (e.g., compact disc vs. digital video disc) can be automatically identified.

In the first damages trial, damages were based on a reasonable royalty analysis using the *Georgia Pacific* factors. The plaintiff's damages expert applied the entire market value rule to conclude that the entire value of laptops containing optical drives that the method was the proper royalty base. Using this approach and the expert's opinion that a royalty of 2 percent on the value of each laptop was the proper royalty rate, the jury returned a damages award of \$52 million.

The defendants then filed post-trial motions, including one asking for a new damages trial because the plaintiffs did not establish that the patented feature drove the demand for the entire laptop, and thus there was no support for using the entire market value rule. The district court granted that motion and gave the defendants the option of a damages retrial or a damages remittitur to \$6.2 million. The defendants opted for a new damages trial. In the damages retrial, the plaintiff shifted its damages theory and asserted that damages should be measured as a 6 percent royalty on the value of the optical disc drives (not the laptop). By this approach, plaintiff sought \$10.2 million. The jury ultimately awarded \$8.5 million.

Both parties appealed. The remainder of this article will focus on plaintiff's appeal of the district court's decision to order a new damages trial, because the Federal Circuit's comments provide explicit guidance on how the entire market value rule should be applied and the type of evidence needed to support its application.

The court started with the "general rule" that a reasonable royalty determination should not be based on the value of the entire product but instead be based on the "smallest saleable patent-practicing unit." This approach is designed to avoid overcompensating the patent owner for non-infringing components of the product.

However, the court noted that the entire market value rule is "a narrow exception to this general rule." Thus, if one shows that the patented feature drives the market demand for the entire multi-component product, then damages may be based on a percentage of the revenues or profits attributed to the entire product. The Federal Circuit has made this point a number of times over the last five years, and the *Laserdynamics* case reiterated it in direct and clear language:

In any case involving multi-component products, patentees may not calculate damages based on sales of the entire product, as opposed to the smallest saleable patent-practicing unit, without showing that the demand for the entire product is attributable to the patented feature.

Having set forth this rule, the court then provides some suggestion about the evidence

needed to support the use of the entire market value rule.

According to the court, the following would not be enough to support the entire market value rule:

- ◆ Showing that patented item/feature is viewed as valuable, important, or even essential to the use of the multi-component product
- ◆ Showing that the multi-component product without the patented item/feature would not be commercially viable

On the other hand, the court crisply noted that use of the entire market value rule can be supported by if it is demonstrated that the presence of the functionality provided by the patented item/feature is what motivates consumers to buy the product in the first place.

The head-scratching question arising from the court's commentary is simply: "What kind of proofs will provide this evidence?" The court's decision essentially states what it has alluded to in earlier decisions. If you want to use the entire market value rule, do market and consumer surveys.

Conclusion

Apparently the court believes that surveys of the reasons a company includes a particular component in its product—or of consumers motivations to actually buy the product—will yield useful information as to whether a given patent item/feature actually drives the market demand for a multi-component product.

However, these types of studies typically are able to uncover only what consumers know or perceive. Thus, to rely on the entire market value theory, companies may have to adjust their marketing strategies to highlight a patented item/feature so that it becomes known to consumers and then convince consumers to buy a product because of that item/feature. This could result in a substantial shifting of advertising approaches for many companies. And, if the multi-component product contains several patented items/features, focusing on one item/feature might be seen to reduce the damages values of the others.

In essence, the Federal Circuit's belief in market and consumer surveys as a basis for applying the entire market value rule may be good for the folks who design and perform surveys and the experts who testify about them. Whether the approach will be good for patent owners remains to be seen.

DISCLAIMER: The views in this article are those of the author, and not of Marshall, Gerstein & Borun LLP or its past, present or future clients. The contents of this article are not intended as, and should not be taken as, legal advice, legal opinion, or any other advice. Please contact an attorney for advice on specific legal problems.

Donald W. Rupert is a litigation partner at Marshall, Gerstein & Borun LLP. For over 35 years, Don has litigated patent and other IP cases in federal and state courts throughout the U.S. He has acted as first chair trial attorney in jury and bench trials, has argued cases before state and federal appellate courts and is a member of the Commercial Panel of the American Arbitration Association, arbitrating IP disputes. Mr. Rupert may be reached at (312)-474-9571 or drupert@marshallip.com.

Counsel Commentary is a column published by InsideCounsel.com. Updated daily, it features commentary on and analysis of legal issue affecting in-house counsel. Written by senior level law firm lawyers, the columns cover various fields of law including labor & employment, IP, litigation and technology.