

Farewell, Entire Market Value Rule

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Goodbye, entire market value “rule.” Thank you for your efforts in patent damages jurisprudence. Asked to go above and beyond the principles from which you arose, you did your level best.

Alas, you are no longer needed. Your name alone introduces ambiguity. Your title as a “rule” has expanded your influence beyond your utility. Your results as applied to specific facts have been mixed, at best.

You may have taken a glimmer of hope from the Federal Circuit’s opinion in *Ericsson*, where you received praise and vitality as a “substantive legal rule” derived from the damages statute, 35 U.S.C. § 284.[1] Your component principles were described better than at any other time. By all express indications, you live on.

Ericsson’s exposure of your underlying principles, however, may be your undoing. A deeper read reveals that the whole does not contribute more than the sum of the parts, a special “rule” unnecessary. To put it another way, you have exercised more power than the incremental value contributed by your underlying principles. Or you have claimed more value and impact than you deserve. Familiar?

By your own standards, it is time to exit and return to your roots — basic principles of causation, relevance, prejudice, and the burden of proof. This graceful exit will serve well the entire patent bar — plaintiffs and defendants — to increase certainty in patent damages disputes, protecting plaintiffs from undeserved eviscerations of valuable claims and defendants from surprise windfall judgments. And your departure will prevent cases from reaching those stages, as parties will have a better view into the potential value of patent infringement cases and an opportunity to negotiate accordingly and reach earlier resolution. It’s time to go.

Origins of EMVR

The entire market value rule as currently described arose from lost profits cases decided long before the existence of § 284 or a reasonable royalty measure of damages. Modern cases cite *Garretson v. Clark* as the EMVR’s origin — a five-paragraph opinion relating to lost profits for a patent claiming an improvement to mop-heads.[2]



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From this quote, a substantive patent-law “rule” was born:

The patentee ... must in every case give evidence tending to separate or apportion the defendant’s profits and the patentee’s damages between the patented feature and the unpatented features, and such evidence must be reliable and tangible, and not conjectural or speculative; or the [sic] must show, by equally reliable and satisfactory evidence, that the profits and damages are to be calculated on the whole machine, for the reason that the entire value of the whole machine, as a marketable article, is properly and legally attributable to the patented feature.[3]

A few notes about this statement. It has nothing to do with calculation of a reasonable royalty, which did not yet exist. It describes a binary choice with no middle ground — either the patented invention is responsible for the entire value of the machine, or it is not. For all its sophisticated language (in particular the word “apportion”), it is describing the value of mops.

But one aspect of this statement seems to have been overlooked entirely in modern applications: It describes only basic evidentiary and tort principles, but its descriptions happen to have been made in the context of a patent case. The requirement that the “patentee apportion ... damages between the patented feature and the unpatented features” is a statement that the tort claimant must establish causation between the tort (infringement) and damages. The demand for “reliable and satisfactory evidence” merely describes evidentiary standards and the burden of proof. In short, a tort claimant — even for patents — has to prove causation and damages with sufficient evidence.

That’s it. Did this statement deserve interpretation as a substantive patent law rule? The time for that question, for better or worse, has passed. In modern patent law, Garretson has been drawn upon for a variety of applications of the entire market value rule extending beyond Garretson’s actual words.

Modern EMVR Applications

Over the course of the 20th century, Garretson’s statement transformed into a rule applied to reasonable royalty calculations.[4] The Federal Circuit articulated existing precedent on the EMVR in the 1995 Rite-Hite case.[5] Specifically, the court explained that damages could be based on the value of unpatented features only if the “patent-related feature is the basis for consumer demand.”[6] It further explained that to obtain such damages, under the EMVR, “the unpatented components must function together with the patented component in some manner so as to produce a desired end product or result”; that is, “[a]ll the components together must be analogous to components of a single assembly or be parts of a complete machine, or they must constitute a functional unit.”[7] The EMVR does not allow damages that “include items that have essentially no functional relationship to the patented invention and that may have been sold with an infringing device only as a matter of convenience or business advantage.”[8]

This complicated language does not track the basic evidentiary and tort principles set forth in Garretson. Instead, it begins to predefine and limit — based on a narrow set of factual scenarios — the types and weight of evidence that might establish causation between infringement and damages. This transition from basic principles to a complex substantive patent law rule opened the door to a variety of the EMVR arguments and applications.

For example, in Cornell, former Chief Judge Randall Rader relied upon EMVR precedent to coin a new term, the “smallest salable infringing unit.”[9] That term, now expressed as its own substantive patent

law rule like the EMVR, arose on the mere basis that calculating damages based on the “smallest salable infringing unit” was “logical and readily available” under the specific facts of that case.[10]

In *Lucent*, the Federal Circuit again revisited the language from *Garretson*, concluding that “the Supreme Court seemingly set forth rigid rules concerning the entire market value rule.”[11] The uncertainty expressed in “seemingly” was appropriate, but the court nonetheless continued its line of holdings that “our law on the entire market value rule is quite clear,” and the EMVR requires that “the patentee must prove that the patent-related feature is the basis for customer demand.”[12] However, the court seems to have reflected some anxiety about the weak economic foundation of the EMVR, recognizing that “the base used in a running royalty calculation can always be the value of the entire commercial embodiment, as long as the magnitude of the rate is within an acceptable range (as determined by the evidence).”[13] A glimmer of recognition, perhaps, that arbitrary general rules are unnecessary if the patentee appropriately proves damages with sufficient evidence.

Uniloc wiped out this opening, drawing again from *Garretson* to rule that this last quote from *Lucent* meant something different “in context.”[14] “In context,” it apparently meant nothing, because *Uniloc* immediately concluded that “[t]he Supreme Court and this court’s precedents do not allow consideration of the entire market value of accused products for minor patent improvements simply by asserting a low enough royalty rate.”[15] The primary authority? *Garretson*, again.

Uniloc, however, may have been the turning point at which the EMVR was given too substantial a role in patent damages law. An overstep in the EMVR’s reach was adopted in *Lucent* — and it created an opportunity to expose the EMVR for the basic evidentiary and causation principles it really is, rendering the “rule” ultimately unsustainable.

The Finale

The EMVR’s Achilles’ heel was revealed in this statement from *Uniloc*:

This case provides a good example of the danger of admitting consideration of the entire market value of the accused [product] where the patented component does not create the basis for customer demand . . . The disclosure that a company has made \$19 billion dollars in revenue from an infringing product cannot help but skew the damages horizon for the jury, regardless of the contribution of the patented component to this revenue.[16]

The court had thus moved from a substantive “rule” spawned from *Garretson* — a case about damages determined by the court — to what sounds suspiciously like a rule of evidence directed at avoiding misleading the jury. The *VirnetX* case picked up on this thread, explaining that the EMVR ensures that “a reasonable royalty does not overreach” and protects against “using a base that misleadingly suggests an inappropriate range” of damages.[17] These applications of the EMVR opened the door to its potential end, to the benefit of both patentees and accused infringers.

After *VirnetX*, these authors suggested that the EMVR had become merely an application of Federal Rule of Evidence 403 — an evaluation of whether otherwise admissible evidence (see *Lucent*) would cause undue prejudice to the accused infringer (see *Uniloc*).[18] Six weeks after that article published, the Federal Circuit confirmed the accuracy of this interpretation in the *Ericsson* case.[19]

Ericsson explained that “the legal standard [for EMVR] has two parts . . . one substantive legal rule, and . . . a separate evidentiary principle.”[20] The evidentiary principle requires “an appropriate balance

between the probative value of admittedly relevant damages evidence and the prejudicial impact of such evidence caused by the potential to mislead the jury into awarding an unduly high royalty.”[21] This “important evidentiary principle” is appropriately covered by Federal Rule of Evidence 403.

Separating the evidentiary principle from the “substantive legal rule” brings into focus what remains of the substance. Ericsson re-articulated the standard EMVR language about determining whether “the entire value of a machine as a marketable article is properly and legally attributable to the patented feature” and focusing on “the smallest salable unit,” but it stated a much firmer, definite, and “essential” conclusion:

When the accused infringing products have both patented and unpatented features, measuring this value requires a determination of the value added by such features. ... Logically, an economist could do this in various ways — by careful selection of the royalty base to reflect the value added by the patented feature, where that differentiation is possible; by adjustment of the royalty rate so as to discount the value of a product’s non-patented features; or by a combination thereof. The essential requirement is that the ultimate reasonable royalty award must be based on the incremental value that the patented invention adds to the end product.[22]

This statement, for the first time in over 100 years, aligns with what was actually said in Garretson. The patentee must establish causation between the infringement and the damages. The type of proof does not matter, as long as it is reliable and sufficient. The components of the EMVR are merely evidentiary rules (relevance and reliability), causation, and the patentee’s burden of proof on damages.

An analysis tailored to these basic principles has since been applied by two judges in the Northern District of California. In *Sentius International v. Microsoft Corp.*, Judge Paul Grewal relied on Rule 403 to grant-in-part and deny-in-part Microsoft’s motion to exclude the plaintiff’s damages expert’s opinion, citing both *VirnetX* and *Ericsson* in his opinion.[23]

First, Judge Grewal analyzed Microsoft’s arguments regarding plaintiff’s damages experts’ various theories, including an “income approach theory” and the use of Microsoft’s overall profitability.[24] The plaintiff’s “income approach theory” calculated a reasonable royalty by first determining the percentage of the overall sales of Microsoft’s products that would be lost without the infringing feature, and then apportioning that percentage of lost sales based on an analysis of each party’s bargaining power.[25] In rejecting Microsoft’s claim that this theory must be excluded under the EMVR, Judge Grewal held that this approach “is not a hidden attempt to avoid the entire market value rule because [plaintiff’s expert] did not derive damages using Microsoft’s revenue and profit from all sales of the accused products,” but instead based damages only on the profit and revenue “Microsoft would have lost without the inclusion of the accused features in its products.”[26]

Judge Grewal also ruled in favor of Microsoft, however, regarding the presentation of evidence showing Microsoft’s overall profitability at trial, limiting the evidence to the profit margin for the accused product, Microsoft Office, alone.[27] Based on Judge Grewal’s analysis of the facts of the case, such a ruling would allow the plaintiff to present its damages theory “without unfairly prejudicing the jury against Microsoft” — or in other words, not running afoul of FRE 403.[28]

Similarly, in *Synopsys v. Mentor Graphics*, Judge Maxine Chesney denied a motion to exclude plaintiff’s damages expert’s theory for an alleged failure to base the royalty on the “smallest salable patent-practicing unit.”[29] Judge Chesney ruled that because the accused software suite “was never sold as a separate product,” the “use of [the software suite] as a separate starting point in [the expert’s]

apportionment analysis is not outweighed by the asserted prejudicial effect of such evidence, see Fed. R. Evid. 403.”[30]

Having identified the true makeup of the entire market value rule, there is no reason to continue to use the term and the myriad descriptions of how it applies to any given case. It is a glaring example of the difficulty of adopting a bright-line legal rule to govern greatly varied situations that depend on their unique sets of facts and the sufficiency of the patentee’s evidence.

What Happens If EMVR Is Gone?

This article should not be taken as a critique of parties currently discussing the EMVR in their cases. It is still the law. However, ending the use of the term “EMVR” will benefit both patent holders and accused infringers by increasing certainty in damages law. Plaintiffs and defendants both can work toward this brighter future.

Expanding upon basic evidentiary and legal principles with a special “rule” has had an effect of creating ambiguity around damages proof, reducing efficiency and increasing the costs of patent litigation for both sides. Many patent holders view the EMVR as an ambiguous and shape-shifting defense against their damages case. From the defendant’s perspective, the EMVR is often seen as allowing for a potential windfall for the patentee if the court and jury adopt the patentee’s view of consumer demand for a multicomponent product.

These views are counterproductive for encouraging rational and objective valuations of patent cases and for encouraging resolution without significant consumption of the parties’ and the courts’ resources. Instead, these views often result in cases needlessly proceeding all the way through at least Daubert motions, if not trial and appeal. The patent laws should allow litigants the clarity necessary to evaluate whether the patentee adequately has established its damages without requiring taking a shot in the Federal Circuit, regardless of who wins at trial.

Litigants can rationally evaluate the risks and likelihood of success on issues such as economic causation, admissibility of evidence, and the burden of proof. These will guide settlement negotiations better than continuously changing case law around an unnecessary rule. To increase clarity in patent damages law, and to reduce both plaintiffs’ and defendants’ litigation costs caused by ambiguity and uncertainty, the term “entire market value rule” should be removed from the patent law lexicon.

Conclusions

So, EMVR, where do we go from here? Your advocates still give you name recognition, but their devotion seems to be fading. Your departure may not be immediate, but perhaps it’s time to move on. Through your development over time, you have facilitated your own replacement by the basic evidentiary and causation principles from which you came. These basic principles are both your ancestors and your progeny, and we will be better served by them going forward. Thank you, but goodbye.

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[1] *Ericsson Inc. v. D-Link Sys. Inc.*, 773 F.3d 1201, 1226 (Fed. Cir. 2014).

[2] *Garretson v. Clark*, 111 U.S. 120 (1884).

[3] *Id.* at 121.

[4] See *Marconi Wireless Telegraph Co. v. United States*, 99 Ct. Cl. 1, 53 U.S.P.Q. (BNA) 246, 250 (Ct. Cl. 1942), *aff'd* in part and vacated in part, 320 U.S. 1 (1943).

[5] *Rite-Hite Corp. v. Kelley Co. Inc.*, 56 F.3d 1538, 1549-50 (Fed. Cir. 1995) (citing and quoting *Garretson* at 1549).

[6] *Id.* at 1549.

[7] *Id.* at 1550.

[8] *Id.*

[9] *Cornell Univ. v. Hewlett-Packard Co.*, 609 F. Supp. 2d 279, 288-89 (N.D.N.Y. 2009).

[10] *Id.*

[11] *Lucent Techs. Inc. v. Gateway Inc.*, 580 F.3d 1301, 1336-37 (Fed. Cir. 2009).

[12] *Id.* at 1336.

[13] *Id.* at 1338-39. The court also recognized that “[s]ome commentators suggest that the entire market value rule should have little role in reasonable royalty law.” *Id.* at 1339.

[14] *Uniloc USA, Inc. v. Microsoft Corp.*, 632 F.3d 1292, 1319-20 (Fed. Cir. 2011).

[15] *Id.*

[16] *Id.* at 1320.

[17] *VirnetX, Inc. v. Cisco Sys., Inc.*, 767 F.3d 1308, 1326-27 (Fed. Cir. 2014)

[18] A. Fahrenkrog et al., *A Guide To Understanding Fed. Circ.’s VirnetX Opinion*, Law360 (Oct. 14, 2014).

[19] 773 F.3d at 1226-27.

[20] *Id.* at 1226.

[21] *Id.* at 1227.

[22] Id. at 1226.

[23] Sentius Int'l, LLC v. Microsoft Corp., No. 5:13-cv-00825-PSG, 2015 U.S. Dist. LEXIS 10423 (N.D. Cal. Jan. 27, 2015).

[24] Id. at *3.

[25] Id. at *31-32.

[26] Id. at *38-39.

[27] Id. at *41-42.

[28] Id.

[29] Synopsys, Inc. v. Mentor Graphics Corp., No. 12-cv-6467, 2014 U.S. Dist. LEXIS 165525, at *5 (N.D. Cal. Nov. 26, 2014).

[30] Id. at *5-6.