

## A Back-To-Basics Approach To Patent Damages Law

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For the last 10 years, the Federal Circuit has issued a series of damages opinions specific to the facts of each case, such as Lucent, LaserDynamics and VirnetX.[1] In several of these opinions, it has generalized prior fact-specific holdings into patent law “rules” and attempted to fit each rule to the next unique fact pattern. By converting fact-specific holdings into patent-specific “rules” without acknowledging fundamental legal principles, the Federal Circuit has created a substantial risk of uncertainty in the trial courts and in the patent system as a whole. The patent community would benefit from the law of patent damages going back to fundamental tort and evidentiary principles.



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The Federal Circuit’s recent decision in *Finjan v. Blue Coat*[2] demonstrates how creating patent-specific rules for damages creates uncertainty for future litigants. In *Finjan*, the court found that the patentee failed to properly apportion the royalty base to the infringing functionality. The Federal Circuit identified a patent-specific “rule” — the need to “apportion” the royalty base — instead of articulating how patent damages, like all tort damages, depend on basic principles of causation and evidence. Accordingly, *Finjan* demonstrates the need for clarity from either the Federal Circuit or the U.S. Supreme Court (see below, regarding *WesternGeco*) on patent damages and a return to basic damages principles.



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The infringing product in *Finjan* was a software service for which Blue Coat sold individual user licenses. *Finjan* calculated the royalty base by multiplying the accused product’s total number of users by the percentage of web traffic that passes through a particular portion of the product that includes the infringing feature. The court found that “in calculating a royalty base (the number of infringing licenses), *Finjan* failed to apportion damages to the infringing functionality.”[3] Notably, *Finjan*’s model used that base to calculate a reasonable royalty by multiplying its base by a fixed per-license rate, not by taking a percentage of infringing revenue.



Danielle Rosenthal

This appears to be the first time the Federal Circuit has vacated a damages verdict based on a per-unit royalty (and not a percentage of revenue) for failure to apportion the royalty base. It has not happened before because the “base” for a

per-unit royalty is simply the number of infringing units. Whether the patentee used the complete product, the “smallest salable unit,” or some smaller component where the invention resides, the number of infringing units remains the same. As long as the patentee establishes that each unit infringes, there is no need for further “apportionment” of the unit base to account for the accused functionality. But the court found otherwise in *Finjan*.

The court’s decision demonstrates the risks of generalizing fact-specific decisions into “rules” like “apportionment” and attempting to apply those rules to every case. Here, the court expanded the concept of “royalty base apportionment” — which arose in the context of percentage royalties — into a different model based on a per-unit royalty methodology. And yet two days later, in *Exmark v. Briggs & Stratton*,<sup>[4]</sup> the court concluded that royalty base apportionment is not an absolute requirement even for percentage royalties.<sup>[5]</sup>

This practice and the resulting disparate outcomes decrease certainty for the system as a whole. The courts, litigants and the patent system all would benefit from a back-to-basics approach to patent damages, focused on tort principles of causation, evidentiary principles, and rigorous application of appellate standards of review.

### **Apportionment: What Standard of Review?**

An initial question about the apportionment decision in *Finjan* demonstrates the concern regarding uncertainty: What standard of review did the court apply?

The opinion doesn’t say. By contrast, the opinion does explain that it applied *de novo* review to subject matter eligibility.<sup>[6]</sup> It also states that it applied substantial evidence review to the jury’s infringement findings,<sup>[7]</sup> the jury’s award of an \$8 per unit royalty rate,<sup>[8]</sup> and the patentee’s damages apportionment for two other patents.<sup>[9]</sup> But where it found a failure of royalty base apportionment, it did not address the standard of review.

The apportionment analysis merely describes the patentee’s trial burden of proving damages by a preponderance of the evidence.<sup>[10]</sup> This standard has no relevance on appeal, where the court reviews legal issues *de novo*, evidentiary decisions for abuse of discretion, and the jury’s findings of fact for substantial evidence. The Federal Circuit, as an appellate court, does not (or should not) re-evaluate where the preponderance lies.

The amount of damages to be awarded for infringement is a question of fact.<sup>[11]</sup> The jury’s damages award, therefore, is subject to review for substantial evidence.<sup>[12]</sup> But in *Finjan*, the Federal Circuit found error in the patentee’s royalty base apportionment without articulating any factual finding not supported by substantial evidence.<sup>[13]</sup>

As discussed below, had the court simply applied substantial evidence review of the patentee’s methodology, it may have issued a straightforward opinion finding a failure of evidence on the key point of causation — that because the infringer’s use of the invention caused it additional economic success, it would have been willing to pay the reasonable royalty awarded by the jury. Instead, the court revisited “required” standards for “apportionment,”<sup>[14]</sup> leaving litigants and courts without guidance as to the actual standards of law, proof and appellate review.

### **Finjan’s Methodology**

An overview of the damages methodology used in Finjan provides a framework for the court's opinion. Blue Coat sold its customers licenses to WebPulse, its cloud-based service for analyzing downloadable files.[15] WebPulse contains several software components, including a dynamic real-time rating engine (DRTR), which included the infringing functionality.[16] DRTR was not used every time WebPulse was used.[17] DRTR also included functions that do not infringe the '844 patent.[18]

Finjan attempted to prove damages by multiplying a royalty "base" by an \$8 per-unit royalty rate. It established that 4 percent of WebPulse web traffic actually passed through DRTR, and therefore multiplied the total number of WebPulse licenses (75 million) by 4 percent to create a royalty "base" for its damages calculation.[19] Then it multiplied that base by an \$8 per-unit rate.[20] The jury adopted this amount, awarding \$24 million.[21]

### **Fact-Finding and "Required" Apportionment**

The court found two independent flaws in Finjan's analysis. First, it found that, "in calculating a royalty base, Finjan failed to apportion damages to the infringing functionality." [22] Second, it found that Finjan did not introduce evidence sufficient to support the \$8 per-unit rate.[23]

As to the \$8 rate, the court found that substantial evidence did not support the jury's verdict — a straightforward application of the substantial evidence standard of review.[24]

As to apportionment, however, the court reached this conclusion:

Because DRTR is itself a multi-component software engine that includes non-infringing features, the percentage of web traffic handled by DRTR is not a proxy for the incremental value of the patented technology to WebPulse as a whole. Further apportionment was required to reflect the value of the patented technology compared to the value of the unpatented elements.[25]

The statement that "DRTR is not a proxy for the incremental value of the patented technology to WebPulse as a whole" is a statement of fact. The court, however, did not address whether the jury implicitly made the same finding, a different finding, or no finding on this point. Was the court reviewing the jury's findings for substantial evidence, or re-weighing the evidence and making new findings of its own?

The rest of the conclusion that "DRTR is not a proxy for the incremental value" of the invention and thus "[f]urther apportionment was required" is unclear: Did the court find that the jury's verdict was not supported by substantial evidence on these specific facts, or did it find that royalty base apportionment is required as a matter of law to establish reasonable royalty damages?

If the latter, the legal conclusion would be a departure from precedent. As an initial matter, the royalty "base" calculation, alone, is not a threshold issue for establishing reasonable royalty damages. Indeed, the patentee may elect to calculate its damages using a methodology other than base-times-rate.[26] Also, § 284 requires merely that the patentee must introduce evidence to establish "a reasonable royalty for the use made of the invention by the infringer." [27] This necessarily turns on the entire royalty calculation, not on either the base or the rate standing alone, as the Federal Circuit has explained elsewhere.[28] Whether the base is adequate thus depends on what the patentee does with it to reach a final royalty determination.

For example: Finjan introduced evidence that 4 percent of WebPulse users actually used the DRTR functionality.[29] The opinion does not say that this fact was not supported by substantial evidence. The 4 percent figure therefore could be a reasonable approximation of the “use made of the invention by the infringer” under § 284. The opinion does not articulate a basis to find that this “base” is flawed on its face, other than the generalized application of prior, fact-specific precedents requiring “apportionment.”[30]

But then Finjan asserted that Blue Coat would have agreed to pay \$8 for each of those users.[31] Under basic principles of causation, this would demand evidence that the invention caused Blue Coat to receive such value that Blue Coat would have reasonably paid an \$8 royalty per user. It does not appear from the opinion, however, that Finjan introduced any evidence to link its proposed “base” to its proposed \$8 rate[32] — and there may lie the potential flaw in the analysis.

Potentially, this would be a failure of evidence regarding causation (the link between infringement and value),[33] not of royalty base “apportionment.” But the opinion did not say this, leaving litigants and district courts to speculate as to how to interpret the court’s ruling. As a result, it remains ambiguous as to what methodology and evidence a patentee must use to establish reasonable royalty damages and how to address “apportionment” of the royalty base.

### **A Solution: Back to Basics**

The law of damages would be greatly clarified by a return to the application of the tort requirement of causation: What value was caused by the infringement, and how much should the infringer reasonably have paid in royalties based on that value? “Apportionment” is just one expression of this fundamental tort principle.

This framework would benefit patent cases at many stages. Litigants can tailor discovery to a more clear view of the ultimate proof needed. In motions for judgment as a matter of law, trial courts could consider whether the patentee introduced sufficient causation evidence such that a reasonable jury could have found in her favor, instead of having to consider whether the patentee complied with “rules” like “apportionment” and the “entire market value rule” (“EMVR”). Trial courts could evaluate the patentee’s causation evidence pursuant to the standard rules of evidence like relevance and prejudice, instead of the “evidentiary principle” part of (again) EMVR[34] or case-specific decisions on comparability of prior licenses.[35] On appeal, the Federal Circuit would consider whether the factual findings on causation are supported by substantial evidence.

Deconstructing current patent-specific rules like “apportionment” into these basic component parts would increase certainty and benefit courts, patent litigants and others who participate in the patent system more broadly, including inventors, patent owners, and those accused of infringement. The current ambiguity in patent-specific damages rules creates uncertainty in patent damages law and thus uncertainty in the patent system as a whole. The system would benefit from clear delineation of legal standards, evidentiary standards and the standards of review on appeal.

### **WesternGeco: A Potential Catalyst for Change**

We may soon see a shift in that direction. Two days after the Finjan opinion, the Supreme Court granted review in *WesternGeco v. ION Geophysical*. [36] That case may direct the Federal Circuit to apply basic causation and evidentiary principles in lost profits damages cases instead of unnecessary and imprecise legal “rules.” If that happens, the principles articulated by the Supreme Court could redirect the Federal

Circuit's current practices for reasonable royalty damages as well.

In *WesternGeco*, the “rule” at issue is a limitation on extraterritorial damages caused by domestic infringement.[37] Ion infringed WesternGeco's patents by supplying oil and gas surveying components from the United States for use in international waters.[38] WesternGeco argued that the domestic infringement resulted in Ion's ability to sell competing oil and gas surveys worldwide, causing a decrease in WesternGeco's profits.[39]

The Federal Circuit found that U.S. patent laws do not allow the patentee to collect damages for acts occurring abroad.[40] But the infringement under § 271 occurred in the United States, establishing a domestic nexus. The Federal Circuit thus effectively required a new element of domestic nexus not only for infringement but also — and separately — for damages flowing from the U.S. infringement. Judge Evan Wallach dissented, arguing that the court's opinion introduces the “possibility that patent owners will be unable to obtain full compensation.”[41]

WesternGeco petitioned the Supreme Court for certiorari. The U.S. solicitor general filed an amicus brief in support of the petition, arguing that lost profits damages should be judged by traditional tort principles of causation and not by patent-specific rules like the one created by the Federal Circuit.[42] In short: Patent damages should be evaluated based on basic causation and evidentiary principles.[43] The Federal Circuit's practice, argued the solicitor general, “systematically undercompensates prevailing patentees.”[44]

The solicitor general's argument rests on solid footing. In fact, the Supreme Court has consistently rejected specific rules created by the Federal Circuit in favor of more basic, general standards.[45] If the Supreme Court rejects the territorial restriction on lost profits damages, it likely will direct the Federal Circuit to apply traditional tort standards of but-for and proximate cause.

This development may affect reasonable royalty damages as well. As the Federal Circuit currently relies on an 1884 Supreme Court lost profits case, *Garretson v. Clark*, in its EMVR and apportionment jurisprudence (including *Finjan*),[46] the Supreme Court's decision in *WesternGeco* could provide valuable updated guidance useful for deconstructing these “rules” into their fundamental components and applying those instead. EMVR, apportionment, license comparability, and even the Georgia-Pacific factors all could see the end of their days as “rules” in patent damages law, replaced with fundamental principles of causation and evidence.

## **Conclusion**

The practice of generalizing case-specific decisions into “rules” and applying them to each subsequent unique factual scenario has introduced uncertainty into patent damages law and into the patent system as a whole. The courts, litigants and the patent system would benefit from deconstruction of these “rules” into their fundamental components and rigorously applying that fundamental framework in each case, both in the trial courts and on appeal. The outcome of *WesternGeco* at the Supreme Court could take a helpful step in that direction. Patent litigants should begin preparing their current cases to comply with this potential shift in patent damages law.

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[1] See, e.g., *Lucent Techs., Inc. v. Gateway, Inc.*, 580 F.3d 1301 (Fed. Cir. 2009); *LaserDynamics, Inc. v. Quanta Computer, Inc.*, 694 F.3d 51 (Fed. Cir. 2012); *VirnetX, Inc. v. Cisco Sys., Inc.*, 767 F.3d 1308 (Fed. Cir. 2014); see also *ResQNet.com, Inc. v. Lansa, Inc.*, 594 F.3d 860 (Fed. Cir. 2010); *Uniloc USA, Inc. v. Microsoft Corp.*, 632 F.3d 1292 (Fed. Cir. 2011); *Ericsson, Inc. v. D-Link Sys., Inc.*, 773 F.3d 1201 (Fed. Cir. 2014); *Cornell Univ. v. Hewlett-Packard Co.*, 609 F. Supp. 2d 279 (N.D.N.Y. 2009) (former Judge Rader, sitting by designation in the district court).

[2] *Finjan, Inc. v. Blue Coat Sys., Inc.*, No. 2016-2520 (Fed. Cir. Jan. 10, 2018).

[3] *Id.*, Slip Op. at 17.

[4] *Exmark Mfg. Co. Inc. v. Briggs & Stratton Power Prods. Group, LLC*, No. 2016-2197 (Fed. Cir. Jan. 12, 2018).

[5] *Id.*, Slip Op. at 21-24.

[6] *Finjan*, Slip Op. at 4.

[7] *Id.* at 11, 13, 14.

[8] *Id.* at 21.

[9] *Id.* at 23-24.

[10] *Id.* at 18.

[11] *Lucent*, 580 F.3d at 1310.

[12] *Id.*

[13] “Substantial evidence” means “such relevant evidence as a reasonable mind might accept as adequate to support a conclusion.” *Yorkey v. Diab*, 601 F.3d 1279, 1286 (Fed. Cir. 2010).

[14] *Finjan*, Slip Op. at 17.

[15] *Id.* at 10, 18.

[16] *Id.* at 18.

[17] *Id.*

[18] *Id.*

[19] Id.

[20] Id. at 20-22.

[21] Id. at 3.

[22] Id. at 17.

[23] Id. at 21.

[24] Id. at 21.

[25] Id. at 20.

[26] See Lucent, 580 F.3d at 1324-26 (describing various methodologies, including analytical method, running royalties, and lump-sum); Ericsson, 773 F.3d at 1226 (describing “various ways” that an economist could isolate the value of the patented invention).

[27] 35 U.S.C. § 284.

[28] See Ericsson, 773 F.3d at 1226 (“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.”)

[29] Finjan, Slip Op. at 19.

[30] Id. at 19-20 (citing LaserDynamics and VirnetX).

[31] Id. at 20-22.

[32] Id.

[33] See Ericsson, 773 F.3d at 1226 (describing the value added by the invention).

[34] Id.

[35] Lucent, 580 F.3d at 1327-32; ResQNet.com, 594 F.3d at 869-72 (applying Lucent and inferring a “rule” from its license analysis).

[36] No. 16-1011 (S. Ct. Jan. 12, 2018).

[37] WesternGeco L.L.C. v. ION Geophysical Corp., 791 F.3d 1340 (Fed. Cir. 2015).

[38] Id. at 1343-44, 1347-49.

[39] Id. at 1349.

[40] Id. at 1349-52.

[41] *Id.* at 1361.

[42] No. 16-1011, Brief filed Dec. 6, 2017, at 7-9.

[43] We have suggested a similar framework in prior publications. See A. Fahrenkrog et al., A Guide to Understanding Fed. Circ.’s *VirnetX* Opinion, *Law360*, Oct. 14, 2014 (deconstructing EMVR into evidentiary components, subsequently confirmed in *Ericsson, Inc. v. D-Link Sys.*, 773 F.3d 1201, 1226-27 (Fed. Cir. Dec. 4, 2014)); A. Fahrenkrog, Farewell Entire Market Value Rule, *Law360*, Apr. 16, 2015 (addressing *Ericsson* and the deconstruction of EMVR into basic causation and evidentiary principles); A. Fahrenkrog, Convergence: A Common Framework for Lost Profits and Reasonable Royalty Damages Using the Footprint Approach, *Intellectual Property Today*, May 2015; A. Fahrenkrog et al., A grand unifying theory for determining infringement remedies, *IAM*, Mar.-Apr. 2016.

[44] No. 16-1011, Brief filed Dec. 6, 2017, at 7-8.

[45] See, e.g., *KSR Int’l Co. v. Teleflex, Inc.*, 550 U.S. 398 (2007) (rejecting “teaching-suggestion-motivation” test for obviousness); *Nautilus, Inc. v. Biosig Instruments, Inc.*, 134 S. Ct. 2120 (2014) (rejecting “insolubly ambiguous” test for indefiniteness); *Halo Elecs., Inc. v. Pulse Elecs., Inc.*, 136 S. Ct. 1923 (2016) (rejecting *Seagate* test for willful infringement).

[46] See *VirnetX*, 767 F.3d at 1326; *Ericsson*, 773 F.3d at 1226; *Finjan*, Slip Op. at 17.