If it Ain't Broke...

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High-tech companies are trying to persuade the U.S. Court of Appeals for the Federal Circuit to limit big damages verdicts in patent cases. Currently there is legislation pending in Congress to limit damages in patent cases.[1] Microsoft, Apple Inc., Intel Corp., and Yahoo, among others, have filed briefs in the Federal Circuit arguing that the district court misapplied the "entire market value rule" and that damages should be reduced. Under the entire market value rule a patent owner is allowed to capture the entire value of a larger product that unlawfully incorporates a smaller infringing component, as long as the patent related feature is the basis for the customer demand[2] and the patented and unpatented features are a single functioning unit.[3] For example, if a small component within a product infringes a patent the damages could be calculated by taking into consideration a percentage of sales of the entire product.

Proponents of limiting the entire market value rule argue that this rule allows for excessive damages awards that reward patent holders for the entire invention instead of the specific part that was patented.[4] They also argue that the entire market value rule is now outdated because most innovation these days is incremental and compensating a patent holder for the whole is disproportionate.[5] However, the requirements that the entire market value rule will apply so long as the patent related feature is the basis for customer demand and so long as the patented and non-patented parts function together as part of a single functioning unit, are sensible requirements that when supported by the evidence prevents excessive and disproportionate damages awards and instead gives the patent holder adequate compensation for his/her invention.

Limiting the entire market value rule to reduce damages will undercompensate inventors, like Apple, Intel and Yahoo. What if these companies had a patented feature being used by a competitor that just happened to be the feature in the product that caused demand for that product. Wouldn't Apple, Intel and Yahoo want to be adequately compensated for their inventions? These companies appear to be shooting themselves in the foot by taking a position that in the end could benefit them. It isn't a secret that using a patent portfolio to maximize revenues is a strategic approach employed by high tech companies.[6] It seems large high tech companies are moving away from using their patent portfolios to maximize revenues. There is no need to limit or change the entire market value rule. So long as courts adhere to its requirements and substantial evidence supports its application patent holders will be adequately compensated.

A BRIEF HISTORY OF ENTIRE MARKET VALUE RULE

In the case of *Garretson v. Clark* the United States Supreme Court first articulated a need to apportion damages.[7] In *Garretson* the Court held that if a patent is for the improvement of a machine, as opposed to an entirely new machine, when calculating damages, the patentee needed to show what had been improved and that the patentee "must separate its results directly from those of the other parts, so that the benefits derived from it may be distinctly seen and appreciated."[8] This apportionment rule was followed until about the early 1900s when the Supreme Court articulated an exception to the apportionment rule in the context of an evidentiary burden shifting scheme—if it was impossible to apportion damages, damages should be awarded based on the value of the entire infringing article.[9] In 1979 the Court of Claims affirmed the award of damages to a patent holder based on the entire value of the product at issue, even though only certain components were patented.[10] The court reasoned that the unpatented items did "derive their utility and value from the patented invention."[11] The Federal Circuit held in a later case that the entire market value rule "permits recovery of damages based on the value of the entire apparatus containing several features, where the patent related feature is the basis for customer demand."[12] In 1995, the Federal Circuit held that a patent holder could use the entire market value rule to obtain damages so long as the patented and non-patented parts functioned together as part of single functioning unit.[13] More recently, the entire market value rule was applied to give a patent holder (Lucent) a multimillion dollar judgment against

Microsoft Corp. Microsoft is appealing the judgment.

THE MICROSOFT CASE

In 2007, Microsoft was hit with a $500 million verdict. Microsoft created an appointment feature in the calendar function of its Outlook email product.[14] It was found that this feature infringed one of Lucent's patents. On appeal Microsoft argues that the district court misapplied the entire market value rule because "the narrow functions claimed in the patents here are not essential for use of Microsoft's products, and are not even important to them."[15] However, in affirming the $500 million jury verdict, the district court found that there *was* substantial evidence introduced at trial for the jury to rely on the whole value of the Outlook software when determining damages. "Lucent introduced substantial evidence, such as marketing material, product documentation, and expert testimony, that the accused [appointment] features [found in Outlook] were important to the success of Microsoft's products and were promoted by Microsoft" and that "[t]he jury could have reasonably accepted this evidence and concluded that, without the user interface benefits provided by the patented method, the products would have suffered commercially by not meeting consumer expectations."[16] In other words, substantial evidence was introduced at trial that the calendar and other interface functions were the basis for customer demand.

Filing friendly briefs in support of Microsoft, Apple and Oracle, have also argued that "[t]he district court improperly found the verdict supported despite the absence of meaningful and rigorous proof…that the requested damages have a valid nexus to the value of the patented feature relative to the rest of the product on which the royalty is sought."[17] Robert Merges, a law professor who wrote the *amicus* brief for Yahoo and Intel says that the entire market value rule "has been misapplied…often justif[ying] excessive damages."[18] In at least one case the Federal Circuit seems to have broadly applied the entire market value rule.

JUICY WHIP—CAUSE FOR CONCERN

In *Juicy Whip*, applying the functional unit test, the Federal Circuit held that damages calculations should have included the value of a product, syrup, that was not wholly integrated as a component of the overall product.[19] The Federal Circuit in *Juicy Whip* seems to have broadened the definition of a functional unit to include a non-patented item that is not really integrated into the whole product when sold. The Federal Circuit also completely ignored the customer demand limitation articulated in *Indus., Inc. v. Mor-Flo Indus., Inc*. in its analysis. Had the Federal Circuit in this case stuck to its guns and applied the functional unit test more narrowly and had it also applied the customer demand limitation, the result in *Juicy Whip* might have turned out differently. However, just because it seems that the Federal Circuit has slipped in some instances and has seemingly misapplied the entire market value rule, does it mean that the district court in the *Microsoft* case misapplied the rule, as argued by Microsoft and its entourage? The answer, no. As discussed herein, according to the district court in *Microsoft* there *was substantial* evidence that the patented feature was the basis for customer demand.[20]

IMMONEX—AN EXAMPLE OF THE COURTS CORRECTLY APPLYING THE ENTIRE MARKET VALUE RULE

To the extent that high-tech companies such as Microsoft, Yahoo, Apple, and Intel are implying that the entire market value rule has been grossly misapplied by courts, the case law reviewed does not support their position. The cases on this issue illustrate that the district courts (and the Federal Circuit) are correctly applying the entire market value rule to limit damages when the evidence does not support use of the rule or allow damages under the rule when there is evidentiary support.[21] In *Immonex* the patent was directed to a coin selection mechanism.[22] The patent owner sued end users who sold washing machines that incorporated the coin selection mechanisms.[23] The patent holder wanted to recover damages under the entire market value rule based on the price of the washing machines.[24] During the trial the court properly limited the damages calculations to include individual coin selectors instead of an attempt by the patent holder to calculate damages based on sales of the washing machines which incorporated the coin selectors.[25] The court limited the entire market value rule to cases where the patent-related feature is the "basis for customer demand."[26] The patent holder was not able to introduce evidence at trial that the feature covered by the patent was the basis for customer demand of the whole washing machine.[27] As a result of the trial court applying the limitations of the entire market value rule in *Immonex*, the patent holder's damages were limited to a proper amount. The Federal Circuit affirmed the trial court's decision.[28] In *Immonex* the trial court correctly applied the entire market value rule to limit damages and the Federal Circuit recognized this. While some legal scholars claim that the patent system is broken, the question is whether it in fact is and whether it needs to be changed, at least the damages part of it? Even Chief Judge of the U.S. Court of Appeals for the Federal Circuit, Paul R. Michel probably agrees that the entire market value rule is not being misapplied by the courts nor that the courts are "out of control" in applying it.[29] What needs fixing?

DO WE REALLY NEED TO FIX ANYTHING?

So if the entire market value rule "ain't broke, why fix it?" It seems courts are evaluating the evidence correctly and applying the requirements of the market value rule fairly and consistently. One fact that is glaringly obvious is that those companies who are seeking to limit damages under the entire market value rule are large companies. Could it be because larger companies no longer need patent protection for smaller features? Whatever the answer may be the current case law indicates that the courts are doing the right thing—they are not misapplying the entire market value rule. ▪

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Endnotes

1. *See* S 1145 and H.R. 1908.
2. *Imonex Servs., Inc. v. W.H. Munzprufer Dietmar Trenner GmbH.*, 408 F.3d 1374, 1379 (Fed. Cir. 2005) (citation omitted).
3. *Rite-Hite Corp. v. Kelley Co.*, 56 F.3d 1538, 1550 (Fed. Cir. 1995).
4. *See e.g.,* Amy L. Landers, Let the Games Begin: Incentives to Innovation in the New Economy of Intellectual Property Law, 46 Santa Clara L. Rev. 307 (2007).
5. *Id.*
6. Surviving Intellectual-Property Due Diligence Metropolitan Corporate Counsel, February 2007, Northeast Edition, pg. 23, Vol. 15, No. 2, Steven J. Frank, author. *See, e.g.*, Kevin G. Rivette & David Kline, Rembrandts in the Attic, Unlocking the Hidden Value of Patents 57–63, 119–122 (2000) (discussing patent licensing strategies by Xerox and Cadtrak based on IBM's successful patent licensing model); Gideon Parchomovsky & R. Polk Wagner, Patent Portfolios, 154 U. Pa. L. Rev. 1, 46–49 (2005) (discussing IBM's portfolio-building success); PortfolioIP.com, Patent Mining, http://www.portfolioip.com/s7.htm (last visited Mar. 27, 2006) (describing patent mining services); *see* generally Gary L. Reback, Patently Absurd, Forbes.com, June 24, 2002, http://www.forbes.com/asap/2002/0624/044.html (criticizing IBM's patent licensing strategy).
7. 111 U.S. 120, 121 (1884).
8. *Id.*
9. *Westinghouse Electric & Manufacturing Co. v. Wagner Electric & Manufacturing Co.,* 225 U.S. 604, 620–22 (1921).
10. *Leesona Corp. v. United States*, 599 F.2d 958, 973 (Ct. Cl. 1979).
11. *Id.*
12. *State Indus., Inc. v. Mor-Flo Indus., Inc.,* 883 F.2d 1573, 1580 (Fed. Cir. 1989).
13. *Rite-Hite Corp. v. Kelley Co.*, 56 F.3d 1538, 1550 (Fed. Cir. 1995).
14. *Lucent Techs. Inc. v. Gateway, Inc.*, 2007 U.S. Dist. LEXIS 36232, *15–16 (S.D. Cal. May 16, 2007).
15. Microsoft Appellate Brief, 2008 WL 5229024 (Fed. Cir.).
16. *Lucent Techs., Inc. v. Gateway, Inc.*, 580 F. Supp. 2d 1016; 2008 U.S. Dist. LEXIS 49394, *81 (S.D. Cal. June 19, 2008).
17. The Recorder, December 29, 2008, No. 251, pg. 8.
18. *Id.* at 1.
19. *Juicy Whip, Inc. v. Orange Bang, Inc.*, 382 F.3d 1367, 1372 (Fed. Cir. 2004).
20. *Lucent Techs., Inc.*, 580 F. Supp. 2d 1016; 2008 U.S. Dist. LEXIS 49394 at *81 (S.D. Cal. June 19, 2008).
21. *Funai Elec. Co., LTD. v. Daewoo Elecs. Corp.*, 2009 U.S. Dist. LEXIS 1618, *42 (N.D. Cal. January 5, 2009) (finding that there was substantial evidence in the record that patented features were the basis for customer demand); *Linear Tech. Corp. v. Micrel, Inc.*, 2006 U.S. Dist. LEXIS 96860, *250 (N.D. Cal. June 9, 2006) (based on evidence found that patented feature was integral part of product and feature was basis for product demand); *Izumi Prods. Co. v. Koninklijke Philips Elecs. N.V.*, 315 F. Supp. 2d 589, 614–15 (D. Del. 2004), *aff'd,* 140 F. Appx. 236 (Fed. Cir. 2005), *cert. denied,* 547 U.S. __ (2006) (court rejected entire market value rule where marketing materials from the patentee, which competed with the accused infringer, stressed a variety of other features but did not reference the patented component); *Eaton Corp. v. ZF Meritor LLC*, 2007 U.S. Dist. LEXIS 16347, *15–16 (E.D. Mich. March 8, 2007) (court rejected use of entire market value rule because there was no evidence that there was customer demand for the patented feature).
22. *Immonex Servs., Inc. v. Munzprufer Dietmar Trenner GMBH*, 408 F.3d 1374, 1376, 1379 (Fed. Cir. 2005).
23. *Id.* at 1376.
24. *Id.*
25. *Id.* at 1380–81.
26. *Id.* at 1380.
27. *Id.*
28. *Id.* at 1381.
29. *See* Association of Patent Counsel, Address by Hon. Paul R. Michel, Chief Judge, U.S. Court of Appeals for the Federal Circuit, Monday January 28, 2008, pgs. 7–13.