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Is This License Comparable?

Issues Facing Damages Experts When Determining Reasonable Royalties

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When determining reasonable royalty damages in patent infringement cases, the market approach is a valuation methodology that can potentially be used to determine the value of the patent(s)-in-suit. The valuation methodology typically requires a damages expert to analyze transactions involving the same or comparable patents. Recently, in *LaserDynamics, Inc. v. Quanta Computer, Inc.*, the Federal Circuit noted that: "[a]ctual licenses to the patented technology are highly probative as to what constitutes a reasonable royalty for those patent rights because such actual licenses most clearly reflect the economic value of the patented technology in the market place."[1] This approach is consistent with the *Georgia Pacific* factors 1, 2 and 12, which allow a damages expert to potentially consider certain comparable license agreements for purposes of determining a reasonable royalty in patent litigation.

To use the market approach and address *Georgia Pacific* factors 1, 2 and 12, a damages expert must determine which license agreements in the record, if any, are comparable to the hypothetical negotiation for the patent(s)-in-suit. Therefore, an important question faced by damages experts is: what exactly makes a license agreement comparable?

In the past decade, the Federal Circuit has devoted considerable attention to license comparability. The Court has provided several guideposts that may assist damages experts in navigating this inquiry. Specifically, the Federal Circuit has identified a number of factors that often render a prior license *incomparable* to the hypothetically negotiated licenses, and thus unreliable as evidence of that royalty. No single factor is dispositive; rather, courts take a holistic approach to determine whether a given license is sufficiently comparable.

This paper will address the topic of license comparability by first revisiting the Federal Circuit's rationales for using prior licenses as evidence of a hypothetical reasonable royalty. Secondly, this paper will examine the various factors identified by the Federal Circuit as tending to show a lack of comparability between a prior license and the hypothetically negotiated royalty. Third, this paper will compare two recent cases, *LaserDynamics v. Quanta Computer*,[2] and *ResQNet.com, Inc. v. Lansa, Inc.*,[3] to illustrate the Federal Circuit's holistic approach to license comparability.

Prior Licenses as Evidence of a
<u>Reasonable Royalty – Legal Framework</u>

Courts often consider evidence of prior licenses between the patent owner and third parties to be "the most influential factor" in determining a reasonable royalty.[4] Under the *Georgia-Pacific* framework, courts may consider evidence of "royalties received by the patentee

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[1] *LaserDynamics, Inc. v. Quanta Computer, Inc.*, 694 F.3d 51, 79 (Fed. Cir. 2012).
[2] *Id.*
[3] *ResQNet.com, Inc. v. Lansa, Inc.*, 594 F.3d 860 (Fed. Cir. 2010).
[4] *Procter & Gamble Co. v. Paragon Trade Brands, Inc.*, 989 F. Supp. 547, 607 (D. Del. 1997) ("Courts and commentators alike have recognized that the royalties received by the patentee under prior and existing licenses for patented technology is often the 'most influential factor' in determining a reasonable royalty"); *Mobil Oil Corp. v. Amoco Chems. Corp.*, 915 F. Supp. 1333, 1353 (D. Del. 1994).; 1-20 Chisum on Patents § 20.07 (2012) ("The most influential factor is that of prior and existing licenses negotiated under the patent in suit").

for the licensing of *the patent in suit*,"[5] because these licenses constitute direct and reliable evidence of the fair market value of a license under the patent.[6] *Georgia-Pacific* also invites courts to consider "the rates paid by the licensee for the use of *other patents comparable* to the patent in suit,"[7] under the theory that a willing licensor and a willing licensee, negotiating from positions of uncertainty as to the future profitability of the patented invention, would be guided to some degree by customary practice in the industry.[8]

Yet, the Federal Circuit has simultaneously cautioned that "comparisons to other licenses are inherently suspect because economic and scientific risks [between licenses] vary greatly."[9] Thus, while prior licenses may be considered in a reasonable royalty analysis, the license evidence proponent must prove by a preponderance of the evidence that the license agreements are "sufficiently comparable" and did not arise from divergent circumstances, or cover different technology.[10] Additionally, the damages expert's methodology in comparing licenses "must itself be sound and not speculative [or] far removed from the facts of the case."[11] In *Uniloc USA*, the Federal Circuit summarized the recent jurisprudence in this area:

> "The meaning of [*Lucent Technologies*, *ResQNet*, and *Wortech Systems*] is clear: there must be a basis in fact to associate the royalty rates used in prior licenses to the particular hypothetical negotiation at issue in this case. . . . [E]vidence purporting to apply to these . . . must be tied to the relevant facts and circumstances of the particular case at issue and the hypothetical negotiations that would have taken place in light of those facts and circumstances at the relevant time."[12]

Thus, in general, damages experts may consider the technological and economic circumstances that surrounded the prior license agreement, and also the terms and nature of the license itself. In each of these broad categories, the Federal Circuit has further identified specific aspects that often render prior licenses unreliable and problematic as evidence of a reasonable royalty. These factors are explored in the following section.

Factors That May Render Prior Licenses Incomparable to a Hypothetical Reasonable Royalty

In recent years, the Federal Circuit has highlighted several factors that may render an asserted prior license incomparable to the hypothetical reasonable royalty, and thus unreliable as evidence of that royalty. A prior license may be incomparable to the hypothetical royalty because: (1) the fee-structure, exclusive nature, and other terms of the prior license are

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[5] *Georgia-Pacific Corp. v. United States Plywood*, 318 F. Supp. 1116, 1120 (S.D. N.Y. 1970), *modified and aff'd*, 446 F.2d 295 (2d Cir. 1971), *cert. denied*, 404 U.S. 870 (1971) (Factor 1).
[6] *See Lucent Technologies, Inc. v. Gateway, Inc.*, 580 F.3d 1301, 1329-30 (Fed. Cir. 2009); 1-20 Chisum on Patents § 20.07 (2007).
[7] *Georgia-Pacific*, 318 F. Supp. at 1120 (Factor 2) (emphasis added).
[8] *See Trading Techs. Int'l, Inc. v. eSpeed, Inc.*, 2007 U.S. Dist. LEXIS 396376 (N.D. Ill. 2007) (citing 1-20 Chisum on Patents § 20.07 (2007)).
[9] *Integra Lifescience I, Ltd. v. Merk KgaA*, 331 F.3d 860, 870 (Fed. Cir. 2003).
[10] *Lucent Techs*, 580 F.3d at 1329-30.
[11] *ePlus, Inc. v. Lawson Software, Inc.*, 764 F. Supp. 2d 807, 813 (E.D.Va. 2011) (citing *Lucent*, 580 F.3d at 1329).
[12] *Uniloc USA, Inc. v. Microsoft Corp.*, 632 F.3d 1292, 1317 (Fed. Cir. 2011) (citing *ResQNet*, 594 F.3d at 870).

significantly different; (2) the prior license arose in the context of litigation; (3) the prior license was consummated at a significantly different time, or in a significantly different industry; (4) the technology claimed in the prior license was intended for significantly different use; (5) the parties involved in the prior license had a significantly different relationship; (6) the prior license confers rights beyond those of the patent-in-suit; (7) the prior license does not involve the patent-in-suit; or (8) the prior license involves only third parties.

Depending on the circumstances of each case, the applicability of a given factor, and the weight it is given may vary; however, a damages expert engaged in a license comparability analysis should carefully analyze each.

(1) The Fee Structure, Exclusive Nature, and Other Terms of the Prior License Are Significantly Different

The nature of a prior license may be incomparable due to the fee structure embodied in that agreement. The Federal Circuit has noted that "significant differences" may exist between a running royalty license and a lump-sum license, sufficient to render a prior license of one type incomparable a hypothetical royalty of the other type.[13] In *Lucent Technologies, Inc. v. Gateway, Inc.*, for example, the Federal Circuit rejected four running-royalty license agreements that were asserted as evidence of a hypothetical lump-sum agreement, noting that "the jury had almost no testimony with which to recalculate in a meaningful way the value of any of the running royalty agreements to arrive at the lump-sum damages award."[14]

The Federal Circuit explained that, in a standard running royalty license, the amount of money payable by the licensee is directly tied to future use of the licensed invention. Hence, much of the business risk is placed on the licensor because it does not receive a guaranteed payment, and the licensor may also have less control over the level of sales or usage of the invention than does the licensee.[15]

According to the *Lucent* Court, a lump-sum agreement, on the other hand, "benefits the patentee in that it enables the company to raise a substantial amount of cash quickly."[16] The Court in *Lucent* also discussed the benefits that a lump-sum agreement may provide to the licensee. For example, a licensee benefits from a lump-sum agreement "by capping its liability and giving it the ability, – usually for the remainder of the patent term – to actually use the patented technology in its own products without any further expenditure."[17] A lump-sum agreement may also remove the risks inherent in arms-lengths transactions, such as false or under reporting, and the associated administrative burdens.[18]

That being said, the Court also recognized that the lump-sum structure carries its own risks to the parties because the technology may be significantly more or less successful than

[13] *Lucent Techs*, 580 F.3d at 1326.
[14] *Id.* at 1330.
[15] *Id.* at 1326.
[16] *Id.* (*citing* Richard F. Cauley, *Winning the Patent Damages Case* 47 (2009)).
[17] *Id.* (*citing* Cauley, *supra* note 18, at 47).
[18] *Id.*

expected, creating the potential for one of the parties to obtain a substantial windfall at the other's expense.[19] The Court clarified that these "fundamental differences" did not mean that a prior lump-sum agreement could never be relevant to a hypothetical running royalty, and vice versa; "however, some basis for comparison must exist in the evidence presented to the jury," and here, no such evidence was presented.[20]

Additionally, a court may find a prior license to be incomparable if the exclusive/nonexclusive nature, territory restrictions, or rights granted are different from those determined to be present in the hypothetical royalty negotiation. While some courts have held that a hypothetically negotiated license will always be nonexclusive,[21] the majority of courts instead find that the type of hypothetical license negotiated by the parties is a question of fact, dependent on the circumstances.[22] As one might expect, a non-exclusive license may obtain a lower royalty rate, whereas higher royalty rates are often associated with licenses that confer exclusive rights to the patent.[23] Similarly, a more territorially restricted license may suggest a lower royalty rate than a worldwide license.[24] Any significant differences in these aspects between the hypothetical license and the asserted prior license may be sufficient to render the asserted license incomparable and unreliable.[25]

(2) <u>The Prior License Arose In the Context of Litigation</u>

Prior license agreements that arise from a settlement agreement or a covenant not-to-sue are considered to arise "in the context of litigation," and consequently, courts often deem such agreements "unsuitable to prove a reasonable royalty."[26] Historically, courts categorically excluded such agreements from evidence under the rule set forth in *Rude v. Westcott*:

> "A payment of any sum in settlement of a claim for an alleged infringement cannot be taken as a standard to measure the value of the improvements patented, in determining the damages sustained by the owners of the patent in the other cases of infringement. Many considerations other than the value of the improvements patented may induce the payment in such cases."[27]

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[19] *Id.*
[20] *Id.* at 1330; *Wordtech Sys., Inc. v. Integrated Networks Solutions, Inc.*, 609 F.3d 1308, 1321 (Fed. Cir. 2010) (finding the asserted prior licenses "offered the jury little more than a recitation of royalty numbers," and were thus unreliable evidence of a reasonable royalty because "the two lump-sum licenses provide no basis for comparison with [defendant's] infringing sales. Neither license describes how the parties calculated each lump sum, the licensees' intended products, or how many products each licensee expected to produce").
[21] *W. L. Gore & Assocs., Inc. v. Carlisle Corp.*, 198 USPQ 353, 369 (D. Del. 1978).
[22] *Bose Corp. v. JBL, Inc.*, 112 F. Supp.2d 138, 165 (D. Mass. 2000), *aff'd*, 274 F.3d 1354 (Fed. Cir. 2001), *cert. denied*, 537 U.S. 880 (2002).
[23] *Lucent Techs.*, 580 F.3d at 1335.
[24] *Bose Corp.*, 112 F. Supp.2d at 165.
[25] *See Lucent Techs.*, 580 F.3d at 1335.
[26] *LaserDynamics, Inc. v. Quanta Computer, Inc.*, 694 F.3d 51, 77 (Fed. Cir. 2012).
[27] *Rude v. Westcott*, 130 U.S. 152, 164 (1889).

Yet, despite the "longstanding disapproval of relying on settlement agreements to establish reasonable royalty damages,"[28] the Federal Circuit has permitted consideration of litigation-based agreements in limited circumstances; namely, where the litigation-based license provides the "most reliable license in [the] record."[29] Nonetheless, even where such agreements are adjudged the "most reliable" evidence, the Federal Circuit continues to emphasize that settlement-related agreements are disfavored in the hypothetical license negotiation because "license fees negotiated in the face of a threat of high litigation costs may be strongly influenced by a desire to avoid full litigation."[30]

Such influences may include the parties' desire to avoid legal fees, the uncertainty and risk of litigation, legal positions of each party, the relative financial positions of the parties, jury confusion and the danger of unfair prejudice. For example, a plaintiff may have entered into a settlement agreement for a lower royalty payment if the company was in financial distress and could not afford litigation expenses. Conversely, a defendant may have been willing to accept a high ongoing royalty rate because the company planned to discontinue the relevant product or service and therefore expected to make minimal royalty payments.

Also, because courts presume validity and infringement of the patents-in-suit during the hypothetical negotiation analysis,[31] courts may take account for artificial deflation in royalty rates that arise from settlement agreements where validity and infringement are not presumed. For these reasons, the Federal Circuit considers it a "logical extension of *Georgia–Pacific*" to conclude that: while litigation-based agreements may be permissible in some rare cases, damages experts should exercise caution in asserting these agreements, as they are often "tainted by the coercive environment of patent litigation."[32]

District courts have followed suit, endorsing the consideration of such settlement agreement related licenses, but only with the understanding that "settlement agreements entered into in the context of litigation . . . have minimal probative value respecting the calculation of reasonable royalties."[33]

Often in these circumstances, a proper analysis may require additional discovery from the parties involved in the settlement agreement. Notably, in a recent ruling, the Federal Circuit stated that "settlement negotiations related to reasonable royalties and damages calculations are not protected by a settlement negotiation privilege."[34] However, the Federal Circuit also

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[28] *LaserDynamics, Inc.*, 694 F.3d at 77.
[29] *ResQNet*, 594 F.3d at 872
[30] *Id.* at 872 (citing *Hanson v. Alpine Valley Ski Area, Inc.*, 718 F.2d 1075, 1078–79 (Fed. Cir. 1983)); *LaserDynamics*, 694 F.3d at 77 (noting the possibility of considering such licenses, but cautioning that "the district court [should] consider the license in its proper context within the hypothetical negotiation framework to ensure that the reasonable royalty rate reflects the economic demand for the claimed technology").
[31] *Lucent Techs.*, 580 F.3d at 1325.
[32] *LaserDynamics*, 694 F.3d at 77.
[33] *ePlus*, 764 F. Supp. 2d at 813; *Wordtech*, 609 F.3d at 1230-21; *Hanson*, 718 F.2d 1075, 1078-79 ("offers [that] were made after the infringement had begun and litigation was threatened or probable . . . should not be considered evidence of an established royalty, since license fees negotiated in the face of a threat of high litigation costs may be strongly influenced by a desire to avoid full litigation").
[34] *In re MSTG Inc.*, No. 996, slip op. (Fed. Cir. Apr. 9, 2012).

indicated that it has "not yet decided the extent to which evidence of settlement negotiations would be admissible under Rule 408, Fed. R. Evid."[35] Accordingly, a damages expert should also exercise caution when relying on underlying negotiations surrounding a settlement agreement, as that evidence may not be admissible at trial.

(3) The Prior License Was Consummated at a Significantly Different Time or in a Significantly Different Industry

If the asserted license was negotiated at a different point in time than the hypothetical negotiation, the Federal Circuit may consider changes in the relevant market of the accused product or service over that timespan in its comparability analysis. This may include consideration of price, sales and profitability of the accused product or service, competition, industry standards, regulatory changes and adoption of new technology into the accused product or service.[36]

For example, in *Integra Lifesciences I, Ltd. v. Merck KGaA*, the Federal Circuit concluded that in the biotechnology industry, a license "negotiated in 1994 could be drastically different from one undertaken in 1995" because "factoring in the rapid development of biotechnological arts, a year can make a great difference in economic risks and rewards." Moreover, due to the necessity and costs of product testing in the biotechnology industry, the Court found that an asserted prior license "may have no bearing on the value of a hypothetical . . . license" because testing had not been conducted at the time of the hypothetical negotiation, whereas significant testing was conducted prior to consummation of the asserted license.[37] Similarly, evidence of infringement in the particular industry may be relevant, as the Federal Circuit has "long recognized that a reasonable royalty can be different than a given royalty when, for example, widespread infringement artificially depressed past licenses."[38]

(4) The Prior License Was Intended for Significantly Different Products

A prior license may also be found incomparable where the licensed technology was intended for a significantly different product than that of the patent-in-suit. In *Lucent*, the Federal Circuit explained that:

> "[the parties engaged in a hypothetical negotiation] consider the expected or estimated usage (or, for devices, production) of a given invention . . . because the more frequently

[35] *Id.*
[36] *E.g.*, *Integra Lifesciences I, Ltd. v. Merck KGaA*, 331 F.3d 860, 870 (Fed. Cir. 2003), *reversed on other grounds*, *Merck KGaA v. Integra Lifesciences I, Ltd.*, 545 U.S. 193 (2005) (noting that, in the biotechnology industry, a license "negotiated in 1994 could be drastically different from one undertaken in 1995" because "factoring in the rapid development of biotechnological arts, a year can make a great difference in economic risks and rewards").
[37] *Id.* at 871.
[38] *ResQNet*, 594 F.3d at 872 (citing *Nickson Indus., Inc. v. Rol Mfg. Co.,* 847 F.2d 795, 798 (Fed. Cir. 1988); *Fromson v. W. Litho Plate & Supply Co*., 853 F.2d 1568, 1574 (Fed. Cir. 1988) 1577 n. 15 ("[A] court should not select a diminished royalty rate a patentee may have been forced to accept by the disrepute of his patent and the open defiance of his rights")).

> most inventions are used, the more valuable they generally are and therefore the larger the [royalty]. Conversely, a minimally used feature, with all else being equal, will usually command a lower [royalty] payment."[39]

The Court went on to reject a license agreement that covered patents of "broad, PC-related technologies," in-part because the those technologies presented "a vastly different situation that the hypothetical licensing scenario of the present case involving [a patent] directed to a narrower method of using a graphical user interface tool known as the date-picker."[40] Thus, because "Lucent identifies no documentary evidence or testimony showing the parties' expectations as to usage of the claimed method," "one can only speculate as to how the [asserted prior] agreement could be compared to any licensing agreement involving the [patent-in-suit]."[41]

Therefore, depending on the facts and circumstances of a case, it is possible that a licensee would be willing to pay a somewhat higher royalty if the accused technology enables, for example, the most important feature on a product. The damages expert may need to carefully compare the intended or expected use of the technology claimed in the prior license to that of the patent-in-suit, and present evidence in that regard. The expert may also wish to consider and compare the sales, profits and price of the relevant products or services over the relevant period, the industry and competitive market to the overall business of the licensee. Such evidence may be shown through a business plan and projections for future sales.[42]

(5) The Parties Involved in the Prior License <u>Had a Significantly Different Relationship</u>

Where the prior license was consummated between two parties with significantly different relationships than those engaged in the hypothetical negotiation, the prior -license may be found incomparable. By way of example, in *Lucent*, the Federal Circuit found that a prior license between IBM and Dell was "vastly different" from the circumstances surrounding the hypothetical negotiation between Microsoft and Lucent, in-part because the IBM-Dell license reflected IBM's attempts to "protect[] its one-time dominance in the personal computer market."[43] The Court found this license incomparable and hence irrelevant to the hypothetical negotiation at issue, because the agreement involved two parties in unique circumstances. The Court explained that these parties were distinct from those in-suit because Dell was "the first company to announce copies of [IBM's] year old Personal System/2 computer line," and IBM was "considering raising the royalty it charges . . . to be more aggressive in making sure competitors take out licenses" for personal computers.[44]

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[39] *Lucent Techs.*, 580 F.3d at 1327.
[40] *Id.* at 1328.
[41] *Id.* at 1328.
[42] *Interactive Pictures Corp. v. Infinite Pictures, Inc.*, 274 F.3d 1371, 1384-85 (Fed. Cir. 2001) (accepting as suitable factual evidence of expected use the patentee's "business plan and its projections for future sales" prepared "two months before infringement began").
[43] *Lucent Techs.*, 580 F.3d at 1328.
[44] *Id*.

Likewise, in *Micro Motion, Inc. v. Exac Corp.*, the Northern District of California rejected three asserted prior licenses, because they were of "little probative value" as to a hypothetically negotiated rate.[45] The Court found that:

> "[The defendant] would compete directly with [the patentee] for most of its sales. And for each sale that it lost to [defendant], [patentee] would forego a profit margin of sixty-five percent. Accordingly, [patentee] would have sought a high royalty rate. . . . [The first asserted prior] agreement was not between competitors and covered a device that applied only to a narrow segment of the [relevant] market. . . . [The second and third licenses involved the patentee and two third parties, and] [b]ecause both arrangements were with sister companies doing business outside the United States they, too, are of little probative value."[46]

Thus, it may be important for the damages expert to consider the relative bargaining positions of the licensor and licensee and compare their respective positions to those of the licensor and licensee in the hypothetical negotiation. This analysis may consider the market position and relationship of the parties (*e.g.*, competitors, supplier-customer relationship), anticipated sales volumes, anticipated profitability, anticipated market share, importance of the accused product or service to the overall business of the licensee, and the extent to which royalties were paid or obtained under the potentially comparable license.

Moreover, counsel may consider whether the parties have an on-going business relationship with one another (e.g., whether the patent license agreement part of a larger business venture between the parties). If the license agreement is part of a larger business arrangement between the licensor and licensee, such as a joint development agreement, then the patent license agreement may not represent an "arm's length" transaction, as both sides have a mutual interest in the success of their business venture and the licensor may have been willing to grant the licensee more favorable terms than it otherwise would have but for the larger business arrangement.

(6) The Prior License Confers Rights <u>Beyond the Rights to the Patent-In-Suit</u>

Additionally, the Federal Circuit has opined that a prior license may be incomparable to the hypothetically negotiated license because the prior license confers rights beyond those conferred in the negotiation apropos the patent-in-suit.[47] The Federal Circuit addressed this very issue in *ResQNet.com, Inc. v. Lansa, Inc.*, where the Court vacated the district court's damages award, finding that:

> "[the asserted licenses] furnished finished software products and source code, as well as services such as training, maintenance, marketing, and upgrades, to other software

[45] *Micro Motion, Inc. v. Exac Corp.*, 761 F. Suppl. 1420, 1435 (N.D. Cal. 1991).
[46] *Id.*
[47] *Lucent Techs.,* 580 F.3d at 1328 (holding that two asserted prior license agreements were "vastly different from any agreement [the parties] would have stuck for the [patent-in-suit] at the time of infringement" because the asserted licenses governed the patentee's entire patent portfolio, whereas the hypothetical license covered a single patent).

> companies in exchange for ongoing revenue-based royalties. . . . In simple terms, the [patent-in-suit] deals with a method of communicating between host computers and remote terminals, not training, marketing, and customer support services. The [asserted] licenses simply have no place in this case."

Thus, a damages expert may wish to consider whether a license agreement conveys rights to intellectual property beyond rights to the patent-in-suit, including but not limited to other patents, trademarks, know-how, copyrights, trade-secrets and training.[48] If a damages expert encounters a license agreement that conveys rights to other intellectual property, the Federal Circuit has advised damages experts to apportion the value of the royalty consideration that is attributable to the licensed patents versus the other licensed intellectual property.[49] If a license agreement includes rights to the patents-in-suit and other licensed intellectual property, such as a trademark, depending on the facts and circumstances of the case, the royalty consideration included in that agreement may potentially place an upper bound on the royalty rate for the patent-in-suit in the hypothetical negotiation, as the hypothetical license would not include rights to the licensed trademark. Also, even if a damages expert determines that a license agreement involving rights to intellectual property in excess of a bare patent use license is not instructive to the determination of a specific royalty amount, the expert may determine that it is instructive to the form of royalty that would acceptable to the parties involved in the hypothetical negotiation. For example, it may show a propensity for the plaintiff and/or defendant to enter into license agreements containing royalty consideration in the form of one-time lump-sum payment as opposed to licensing technology based on an ongoing royalty rate.

Additionally, a damages expert may consider if a license agreement includes cross-license provisions, whereby both parties to the agreement are granting licenses to their respective patents. License agreements including cross-license provisions are often not instructive to the determination of a specific reasonable royalty amount, as it may be difficult to determine the value of the intellectual property being cross-licensed and the royalty consideration in the agreement generally represents the estimated net difference in value between the two patent portfolios being licensed by the parties. However, a license agreement including a cross-license provision may be instructive to the form of royalty that is acceptable to the parties involved in the agreement.

(7) <u>The Prior License Does Not Involve the Patent-In-Suit</u>

Under *Georgia-Pacific*, "the rates paid by the licensee for the use of *other patents* comparable to the patent in suit" may be a factor in determining a hypothetical license.[50] Yet, the Federal Circuit "has long required district courts performing reasonable royalty calculations to exercise vigilance when considering past licenses to technologies other than the patent in suit."[51] Thus, as the Federal Circuit noted in *Lucent*, these licenses are only reliable evidence of

[48] *Id.*; *see also Trell v. Marlee Elecs.. Corp.*, 912 F.2d 1443, 1446 (Fed. Cir. 1990) (vacating a royalty rate because the asserted agreement relied upon by the jury "conveyed rights more broad in scope than those covered by Trell's patent").
[49] *ResQNet*, 594 F.3d at 871.
[50] *Georgia-Pacific*, 318 F. Supp. at 1120 (emphasis added).
[51] *ResQNet*, 594 F.3d at 869.

a hypothetical royalty if the party asserting them is able to demonstrate that they are "sufficiently comparable to the hypothetical license at issue in suit."[52] To do so, the damages expert must demonstrate that the technology in the asserted license has "a discernible link to the claimed technology."[53] In *ResQNet.com, Inc. v. Lansa, Inc.*, the Federal Circuit rejected ResQNet's asserted licenses, finding that:

> "[ResQNet's damages expert] used licenses with no relationship to the claimed invention to drive the royalty rate up to unjustified double digits. ResQNet's [asserted prior] licenses are absolutely silent on any relation to the patents in suit. [ResQNet's damages expert] did not even attempt to show that these agreements embody or use the claimed technology or otherwise show demand for the infringed technology. . . . [N]one of these licenses even mentioned the patents in suit or showed any other discernible link to the claimed technology."[54]

In addition to linking the two technologies, a damages expert may need to consider the relative importance of the each technology to its respective product(s) or service(s). This analysis may require the expert to determine the importance of the licensed technology to demand, sales, profits and price of the relevant product or service. Where the licensed technology is related to only one component of the overall relevant product or service, the damages expert would have to apportion these factors accordingly.

As an illustrative example, consider a plaintiff that is suing a manufacturer of smartphones for alleged infringement of one patent that relates to video recording, and the record includes one prior license for the patent-in-suit with a manufacturer of camcorders that includes royalty payments of $0.50 for each camcorder sold. Depending on the facts and circumstances of the case, it could be possible that a manufacturer of camcorders would be willing to pay higher royalties for the patent-in-suit, as video recording relates to the core and primary function of camcorder, whereas a smartphone's primary functions would additionally include the ability to place calls, compose emails, take pictures and navigate the internet as examples. In order to analyze the similarity and relative importance of the various technologies, a damages expert may need to rely on supporting testimony from a technical expert or appropriate company personnel.

(8) <u>The Prior License Involves Only Third Parties</u>

Last, the Federal Circuit has found prior licenses involving only third parties (i.e. parties who are not parties to the litigation) to be relevant evidence of a hypothetical royalty in some instances, because they may demonstrate the customary practice of an industry.[55] Generally, however, third party licenses are of minimal evidentiary value because of the increased possibility that they convey rights to a significantly different invention, or that the parties exploit that invention in significantly different ways as compared to the parties-in-suit.[56] Thus, to the

[52] *Lucent*, 580 F.3d at 1325-26.
[53] *Id.* at 870.
[54] *Id.* at 871.
[55] *Integra Lifescience*, 331 F.3d at 871.
[56] *Id.* at 871 (noting that "comparisons to other licenses are inherently suspect because economic and scientific risks vary greatly"); *H.K. Porter Co., Inc. v. Goodyear Tire & Rubber Co.*, 536 F.2d 1115, 1124 (6th Cir. 1976); *Austin-*

extent neither the licensee nor the licensor in the potentially comparable agreement is a party to the hypothetical license, the courts may apply a higher degree of review to determine if the potentially comparable agreement is relevant to the reasonable royalty determination.

An Illustrative Example: The Federal Circuit's Rulings in ResQNet and LaserDynamics

The Federal Circuit's decisions in *ResQNet.com v. Lansa, Inc.* (February 5, 2010) and *LaserDynamics, Inc. v. Quanta Computer, Inc.* (August 30, 2012), when juxtaposed, present a superb illustration of the holistic nature by which the Federal Circuit determines the comparability of prior licenses to a hypothetical reasonable royalty.

ResQNet.com v. Lansa, Inc. (February 5, 2010):

In its February 2010 decision, the Federal Circuit vacated the district court's award of $506,305 in damages based on ResQNet.com's ("ResQNet") claimed 12.5% reasonable royalty applied to Lansa, Inc.'s ("Lansa") infringing sales.[57] The Federal Circuit vacated the district court's damages award because it "relied on speculative and unreliable evidence divorced from proof of economic harm linked to the claimed invention and is inconsistent with sound damages jurisprudence."[58] The circumstances that lead to the Federal Circuit to this decision are discussed below.

To arrive at his claimed 12.5% reasonable royalty, ResQNet's damages expert relied on seven ResQNet licenses. Two of the licenses were "straight" licenses to the patents-in-suit that arose out of litigation.[59] One of these settlement agreements included consideration in the form of a lump-sum payment of stock, which could not be analogized to a royalty rate, while the other settlement agreement included consideration in the form of an ongoing royalty rate "substantially less than 12.5% of revenues."[60] As noted above, the five remaining agreements that ResQNet's damages expert relied on were "re-bundling licenses," which did not relate to the patents-in-suit and included consideration in excess of a bare patent license (including services, such as training, marketing and maintenance, as well as source code and finished software products).[61] From these five "re-bundling licenses," ResQNet's damages expert calculated an average of the royalty ranges specified in the agreements that was "substantially higher than 12.5%."[62] Based on his review of ResQNet's seven licenses, ResQNet's damages expert concluded that a reasonable royalty for the patents-in-suit would fall "'somewhere in the middle' of the re-bundling licenses and the straight rate-based license on the claimed technology."[63] The midpoint of ResQNet's damages experts range was 12.5%.[64]

Wester Roach Mach. Co. v. Disc Grader & Plow Co., 291 F. 301, 305 (8th Cir. 1923)
[57] *ResQNet.com, Inc. v. Lansa, Inc.*, 594 F.3d 860, 869 (Fed. Cir. 2010).
[58] *Id.*
[59] *Id.* at 870.
[60] *Id.*
[61] *Id.*
[62] *Id.*
[63] *Id.*
[64] *Id.*

As stated above, the Federal Circuit vacated the district court's damages award. Specifically, the Federal Circuit was critical of ResQNet's damages expert's analysis because it did not link the "re-bundling licenses" to the claimed invention, nor did it account for the "technological and economic differences between those licenses and the '075 patent."[65] Given that no link was established between ResQNet's "re-bundling licenses" and the claimed invention, the Federal Circuit observed that in this circumstance, "the most reliable license in [the] record arose out of litigation."[66] Although the Federal Circuit acknowledged that "litigation itself can skew the results of the hypothetical negotiation," it instructed the trial court, on remand, to utilize the settlement agreement for the patents-in-suit to determine a reasonable royalty.[67] The Court cautioned, however, that the district court should ensure that it relies only on licenses "clearly linked to the economic demand for the claimed technology."[68]

LaserDynamics, Inc. v. Quanta Computer, Inc. (August 30, 2012):

In August 2012, the Federal Circuit issued a decision in the *LaserDynamics, Inc. v. Quanta Computer, Inc.* matter that addressed the admissibility of a settlement agreement involving the patent-in-suit, as well as other issues brought forth through appeals made by LaserDynamics, Inc. ("LaserDynamics") and Quanta Computer, Inc. ("Quanta Computer") after two district court trials.[69] In its decision, the Federal Circuit ruled that on remand, a settlement agreement involving the patent-in-suit must be excluded, as it "has very little relation to the demonstrated economic demand for [the] patented technology, and its probative value is greatly outweighed by the risk of unfair prejudice, confusion of the issues, and misleading the jury."[70] However, the Federal Circuit distinguished this ruling from its ruling in the *ResQNet.com v. Lansa, Inc.* matter stating, "[t]his case is […] well outside the limited scope of circumstances under which we deemed the settlement agreement in *ResQNet* admissible and probative."[71] The specific case circumstances that lead the Federal Circuit to preclude the use of a settlement agreement involving the patent-in-suit for the purpose of determining a reasonably royalty are addressed below.

In contrast to the record in *ResQNet.com v. Lansa, Inc.*, "where a lone settlement stood apart from all other licenses in the record as being uniquely relevant and reliable," the record in *LaserDynamics, Inc. v. Quanta Computer, Inc.* included 29 licenses executed by LaserDynamics for the patent-in-suit, and the "vast majority" of these agreements were not settlement agreements.[72] Of the 29 license agreements for the patent-in-suit produced by LaserDynamics, all included consideration of $1 million or less, except for the February 16, 2006 settlement agreement between LaserDynamics and BenQ Corporation (the "BenQ settlement"), which included consideration of $6 million.[73] The Federal Circuit noted that the circumstances

[65] *Id.* at 873.
[66] *Id.* at 872.
[67] *Id.*
[68] *Id.* at 872-73.
[69] *LaserDynamics,* 694 F.3d at 56-57.
[70] *Id.* at 78.
[71] *Id.*
[72] *Id.*
[73] *Id.* at 78-79.

surrounding the BenQ settlement agreement were unique, as the agreement was executed on the eve of a trial in which BenQ had numerous sanctions imposed on it by the district court and given these sanctions BenQ would have been legally and procedurally disadvantaged.[74] Additionally, the Federal Circuit indicated that "in light of the changing technological and financial landscape in the market for ODDs, the BenQ settlement, entered into a full three years after the hypothetical negotiation date, is in many ways not relevant to the hypothetical negotiation analysis."[75]

The Federal Circuit noted, "LaserDynamics executed twenty-nine licenses for the patent-in-suit in total, the vast majority of which are not settlements of active litigation and do not involve the unique coercive circumstances of the BenQ settlement agreement, and which are therefore far more reliable indicators of what willing parties would agree to in a hypothetical negotiation."[76] The Federal Circuit also opined that BenQ's "$6 million lump sum license fee is six times larger than the next highest amount paid for a license to the patent-in-suit and ostensibly reflects not the value of the claimed invention but the strong desire to avoid further litigation under the circumstances."[77] Accordingly, the Federal Circuit determined that "[u]nlike the license in *ResQNet*, the BenQ settlement agreement is far from being the 'most reliable license in [the] record.' Indeed, the BenQ settlement agreement appears to be the least reliable license by a wide margin."[78] Furthermore, the decision indicates that damages experts may need to consider the circumstances surrounding a settlement agreement, as the consideration in the agreement may be more a reflection of a desire to avoid additional litigation rather than the value of the patented invention.

The circumstances and scope of comparable license agreements in the respective records in *ResQNet.com v. Lansa, Inc.* and *LaserDynamics, Inc. v. Quanta Computer, Inc.* differ from one another. In *ResQNet.com v. Lansa, Inc.*, only one agreement in the record, a settlement agreement for the patents-in-suit, was deemed "relevant and reliable,"[79] as the non-litigation induced agreements in the record were broad "re-bundling" agreements that were not linked to the patent-in-suit. Given this unique circumstance, it is not necessarily clear that the Federal Circuit would have come to the same conclusion regarding the reliability and relevance of the settlement agreement for the patents-in-suit had there been non-litigation-induced agreements for the patents-in-suit in the record. Conversely, the record in *LaserDynamics, Inc. v. Quanta Computer, Inc.* included a total of 29 executed license agreements for the patent-in-suit, the "vast majority" of which were not settlement agreements and therefore were "reliable indicators of what willing parties would agree to in a hypothetical negotiation."[80] Again, given these circumstances, it is not necessarily clear that the Federal Circuit would have come to the same conclusion regarding the reliability and relevance of the BenQ settlement had the "coercive

[74] *Id.* at 79.
[75] *Id.* at 78.
[76] *Id.*
[77] *Id.*
[78] *Id.* at 77-78.
[79] *Id.* at 78.
[80] *Id.*

circumstances" surrounding the agreement been different, or if the record had not included several non-litigation-induced agreements for the patents-in-suit.[81]

Conclusion

Damages experts are still presented with a multitude of uncertainties regarding the use of prior license agreements as evidence of a reasonable royalty; but the Federal Circuit has highlighted a variety of factors that may provide assistance in this assessment. In conclusion, the recent Federal Circuit jurisprudence, taken together, provides strong encouragement for damages experts to engage in a holistic analysis of each of these considerations to ultimately determine whether licenses are sufficiently comparable.

[81] *See id*.