



Archetype IPSM

Federal Circuit Friday

www.archetype-ip.com

January 2018

With its decision in *Exmark Mfg. v. Briggs & Stratton Power Products* (January 12),¹ the Federal Circuit confirmed, for the time being, that royalty damages may be determined based on the total revenues of a multicomponent product where the patented technology relates to only one or a subset of the components and does not drive demand for the overall product. Thus, “apportionment,” the requirement that damage awards distinguish between and account for the presence of patented and unpatented features in an accused product, may be implemented through use of a lower royalty rate applied to total product revenues.

This has been a confusing area of the law, perhaps needlessly so. An earlier case, *LaserDynamics v. Quanta Computer*,² strictly limited the use of total revenues for a multi-component product as a royalty base to applications of the “entire market value” rule: “[I]n any case involving multi-component products, patentees may not calculate damages based on sales of the entire product . . . without showing that the demand for the entire product is attributable to the patented feature.”³ *LaserDynamics* also explicitly outlawed the seemingly reasonable practice of using total product revenues as a base but applying a proportionately smaller royalty rate to account for the use of the patented technology in only one of several components or features: “[T]he requirement to prove that the patented feature drives demand for the entire product may not be avoided by the use of a very small royalty rate.”⁴ Per *LaserDynamics*, where the patented feature does not drive demand for the entire product, the royalty base must be the revenues associated with “smallest saleable patent-practicing unit.”⁵

As an example, assume a multicomponent product wherein the infringing feature is embodied in only one of the components and is a “nice to have” but does not drive purchaser demand for the entire product. Further assume that the product sells for \$100 and the component embodying the infringing technology sells separately for \$10. Under the *LaserDynamics*’ rule, it would be acceptable to calculate royalty damages as 10% of \$10 but it would **not** be acceptable to calculate royalty damages as 1% of \$100.

The calculations both apportion between patented and unpatented features and generate the same damages amount (\$1 per unit), so why the distinction? The notion, per *LaserDynamics*, was to reduce jury prejudice resulting from presentation of huge revenue numbers in cases involving patents on relatively small components of products.⁶ Although well-intentioned, *LaserDynamics*’ dogmatic approach was unrealistic because:

- Oftentimes, the infringing component is not sold separately and thus there is no revenue data regarding the “smallest saleable patent-practicing unit.” This forces patent owners to estimate revenue numbers for the component to establish a royalty base. Because such estimates are, by their nature, uncertain, they will always be disputed, vigorously, by the defendant. The case then becomes more complex, potentially prejudicing the patent owner.

¹ No. 2016-2197.

² 694 F.3d 51 (Fed. Cir. 2012).

³ *LaserDynamics*, 694 F.3d at 67.

⁴ *Id.*

⁵ *Id.*

⁶ *E.g.*, “Where small elements of multi-component products are accused of infringement, calculating a royalty on the entire product carries a considerable risk that the patentee will be improperly compensated for non-infringing components of that product” and “disclosure to the jury of the overall product revenues cannot help but skew the damages horizon for the jury, regardless of the contribution of the patented component to this revenue.” *Id.* at 67-68 (internal quotation marks omitted).

Archetype IP

Federal Circuit Friday

January 2018

- In the real world, royalties are typically negotiated as a percentage of (or otherwise based upon) the revenues for the entire multicomponent product that is actually sold, with application of a lower rate to account for the market-value of the patented technology that is used in only one component of the product -- *i.e.*, precisely the approach that *Laserdynamics* said was not permissible.

The Federal Circuit backed away from *Laserdynamics* in subsequent decisions (e.g., *Ericsson v. D-Link*,⁷ characterizing *LaserDynamics* as merely imposing an evidentiary rule where the total revenue number would be likely to mislead the jury). This month's case, *Exmark Mfg.*, makes explicit that, as a matter of substantive damages law, "apportionment can be addressed . . . by adjustment of the royalty rate so as to discount the value of a product's non-patented features" such that "[s]o long as Exmark adequately and reliably apportions between the improved and conventional features of the accused mower, using the accused mower as a royalty base and apportioning through the royalty rate is an acceptable methodology."

As a practical matter, the following points outline current law on damages for multicomponent products where the patented improvement is embodied in only one component of the overall product:

1. If the patented feature drives market demand for the entire product, royalty damages may be determined as a percentage of (or otherwise based upon) the total revenues for the overall product. This is an application of the "entire market value" rule.
2. If the patented feature does not drive market demand for the entire product (e.g., it's one of many features that drive demand), royalty damages may nevertheless be determined as a percentage of (or otherwise based upon) the total revenues for the overall product, provided that the rate is set to apportion the value of the infringing feature.
3. A district court may determine, on the facts of a particular case, that it would be prejudicial for the patent owner to present the total revenues for a product to the jury and on that basis limit the patent owner to presenting evidence of the market value (e.g., actual or estimated revenues) of the smallest saleable infringing unit.
 - Defendants may argue prejudice from presenting total product revenues to the jury and find creative ways to measure a smaller revenue number properly associated with the patented technology (e.g., price to upgrade to add the relevant feature to older models of the product, price increase of product when feature was added, subtracting from product price the prices of unpatented components, marketing analyses and surveys, etc.).
 - Patentees may argue that juries are capable of understanding how a lower royalty rate properly apportions the value of the patented technology when applied to the total product revenues and that defendants are free to show the jury that the patented technology shows up in only one component or feature of a much larger and more complex multi-component or multi-feature product.
4. It is ultimately for the advocates to explain persuasively to the jury why their respective damages calculations provide fair compensation to the patent owner. Each side should also always consider, judo-style, whether acquiescing in their opponent's position would actually help *them* persuade the jury.

⁷ 773 F.3d 1201, 1227 (Fed. Cir. 2014)(describing the *LaserDynamics* rule as "the evidentiary principle demanding 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.").