

Patent Damages & Valuation: What Businesses Need to Know

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Agenda

- Introduction and Course Overview
- Why Patent Damages and Valuation Matter
- Fundamentals of Patent Damages
 - Available remedies
 - Reasonable royalties
 - Multi-component devices
 - Lost profits
 - Enhancements
- Common Methodologies for Patent Valuation
- Key Takeaways and Strategic Considerations

Attorney Biographies



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Manny Caixeiro represents leading and cutting-edge clients in their most challenging and important litigations. His practice focuses on complex commercial and intellectual property disputes in the financial services, software, medical device and entertainment industries. Highly knowledgeable about patent damages, valuation and licensing issues, Manny has extensive experience litigating those issues on behalf of plaintiffs and defendants, and frequently assists clients with understanding the monetary value of patent portfolios. By analyzing the strength and value of a patent portfolio, he helps clients maximize their returns in transactions, obtain more accurate litigation assessments, budget more precisely and avoid undue expenses and inefficiencies.



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Tim, a member of our Intellectual Property and Technology group, is viewed by clients and peers as a go-to patent litigator, and has earned the respect of his peers for his numerous successes litigating patent cases involving cutting-edge technology in such areas as medical devices, green technologies, mobile apps, location-based services, messaging systems, Wi-Fi-enabled thermostats, and content management platforms, as well as trade secret disputes involving defense contractors, defense systems and aerospace products. Representing both leading and emerging technology companies, Tim has secured trial wins and preliminary injunctions, forced adversaries to stipulate to non-infringement, won summary judgment awards, earned substantial attorneys' fee awards and prevailed in claim-construction arguments. Tim routinely leads many joint-defense groups involving some of the largest and most sophisticated companies and law firms in the US. His national, high-stakes practice, impressive win-loss record, aggressive but fair approach, and exceptional advocacy skills have all contributed to the strong rapport he has built with clients and colleagues.

Why Patent Damages and Valuation Matter

Patent Damages Matter to Your Business

- Companies invest substantial resources in their patent portfolios
- Patent damages often define the value of patent portfolios, particularly when monetizing through transactions or litigations
- Patent damages are an important measure of the return on your investment

Applications of Patent Valuation/Damages

- Corporate mergers and acquisitions
 - Over- or under-statement of the portfolio's value
 - Challenging to value through routine due diligence
- Sale and licensing of patents
 - More accurate pricing
 - Assessment of patents' benefits
- Financing
- Budgeting and allocation of resources
 - Excessive or inefficient maintenance fees
 - Reallocating resources among products or technologies
- Legal department revenue generation

Case Study #1

- Company A: Product failures; regulatory scrutiny; little hope for survival
- We assessed portfolio of 1000+ patents, performed infringement reads and created a damages model that revealed a significant revenue opportunity
- Result: \$100m in financing from an Investor

Case Study #2

- Company B is considering acquiring a target company
 - Accounting firm values IP at \$2 million using cost-based approach
 - Accounting firm assumes the IP will not generate income
- We are retained to analyze patent portfolio and assess income-generation potential
 - We discover that certain patents can be read against key competitors
- Result: Board approves acquisition, based in part on understanding of potential unaccounted for value in patent portfolio

Patent Valuation/Damages in Litigation

- Cost-benefit analysis for initiating and maintaining litigation
- Enhancing return on your investment in litigation
 - Damages are too often an afterthought
 - Attorneys fail to develop record for strongest damages case
 - Plaintiffs “win” but fail to recover full value
 - Defendants over-rely on non-infringement and invalidity defenses
- Promotes settlement & enhances leverage

Case Study #3

- Company C is mired in patent litigation against key competitor
 - Both sides have reasonable infringement claims against one another
 - Early focus of case is exclusively on development of liability arguments
- We are retained to assess damages arguments, and determine that the key differentiator in the parties’ damages scenarios is whether the technology drives consumer demand for the product
 - We initiate aggressive campaign to build argument that Company C’s technology is what truly matters to consumers, using survey experts, economists, etc.
- Result: Enhanced leverage leads to favorable settlement

Fundamentals of Patent Damages

Remedies are Governed by Statute

- Injunction (35 U.S.C. § 283)
- Damages (35 U.S.C. § 284)

“Upon finding for the claimant the court shall award the claimant damages adequate to compensate for the infringement, but in *no event less than a reasonable royalty* for the use made of the invention by the infringer, together with interest and costs as fixed by the court.

...[T]he court may *increase the damages up to three times* the amount found or assessed. ...”

- Attorney Fees (35 U.S.C. § 285)

“The court in *exceptional cases* may award reasonable attorney fees to the prevailing party.”

Available Damages

- Reasonable Royalty (statutory minimum)
- Lost Profits
- Enhanced Damages (Up to 3x) for Atypical Cases
- Attorneys' Fees for "Exceptional" Cases
- Interest

Damages Only Available For Infringement During Patent's Term

- Earliest date for damages = date of issuance
 - Exception: if patentee secures provisional rights by publication of application, damages can be recovered as early as publication date (35 U.S.C. § 154(d))
- Ends 20 years after filing of earliest relevant application
 - Subject to PTO adjustments and terminal disclaimers
- Other time Limitations
 - Statute of Limitations (35 U.S.C. § 286): 6 years
 - Notice: If the plaintiff is subject to a marking obligation, damages can only be recovered after defendant is notified of infringement
 - Intervening Rights if patent changed substantially

Overview of Reasonable Royalty

- The statutory minimum amount of damages
- Awarded in approximately 80% of cases
 - Pricewaterhouse Coopers, 2011 Patent Litigation Study: Patent Litigation Trends as the “America Invents Act Becomes Law 14, 15 (2011)

- Core Formula:

$$\text{Royalty} = \text{Royalty Rate (\%)} \times \text{Royalty Base (\$)}$$

- Variation:

$$\text{Royalty} = \text{\$/Unit} \times \text{\# of Units}$$

Established Royalty Rates

- A royalty rate is “established” if the patent holder has a history of licensing the relevant patent at a given rate
- It can be very difficult to overcome an established royalty rate
- Patent holders should be cognizant of the downstream impact of granting a low rate
 - Structure royalties with high rates, even if discounts are achievable

The Hypothetical Negotiation

- What rate would a willing licensor and a willing licensee have agreed to when infringement began?
- Based on comprehensive assessment of circumstances at the time infringement began, including:
 - The parties and their leverage
 - Nature and characteristics of the patent
 - Nature and characteristics of the infringing product
 - Market forces
- A fact-intensive inquiry
 - Fact witnesses
 - Expert witnesses
 - Relevant documents

Comparable Licenses

- In performing a hypothetical negotiation, parties will typically refer to other, prior licenses as being “comparable”
- In litigation, the parties often dispute which licenses are truly “comparable”
 - Is the technology distinguishable?
 - Are there discounts/offsets/caps?
 - What is the effective rate?
 - Are the parties in different bargaining positions?
 - Use restrictions?
 - Time left of patents?
 - Portfolio/family license?

Cost of Design-Around

- Defendants' argument: in a hypothetical negotiation, they would not pay an amount that would exceed the cost of designing around the patent
 - What constitutes a non-infringing design-around?
 - Would the design-around have the same market appeal?
 - Why didn't the defendant implement the design around in the first place?

Calculating the Royalty Base

- Royalty Base is generally the revenue from Net Sales of infringing products
 - Net Sales = Gross Sales – Returns, Allowances & Discounts
- For US patents, presumption that royalty base is limited to US sales
 - Potential exception: if there is a domestic act of infringement (e.g., importing infringing product) and, based on the facts, a jury could determine that a “foreign” sale can be deemed as taking place in whole or in part in US (e.g., if contracts signed in US, or products delivered in US)

- See *Carnegie Mellon University v. Marvell Tech. Grp., Ltd.* (Fed. Cir. 2015)

Including Convoyed Sales in Royalty Base

- Convoyed sales refer to non-patented items that are sold in conjunction with patented items
 - *E.g.*, paper towels and dispenser
- Convoyed sales can be included in damages if:
 1. The patented and non-patented products form a “functional unit”; and
 2. Sale of non-patented item results from sale of patented item
 3. May also raise Entire Market Value Rule issues, in which case the court will further scrutinize relationship between patent and consumer demand
- But note that some courts find convoyed sales are proper subject of lost profits, not reasonable royalty damages

- See *Rite-Hite Corp. v. Kelley Co.*, 56 F. 3d 1538 (Fed. Cir.), cert denied, 516 U.S. 867 (1995)

- See *Sloan Valve Co. v. Zurn Industries, Inc.* (N.D. Ill 2014)

Future Sales

- Assumes no permanent injunction
- In many cases, the Court will award an “ongoing royalty,” in which the rate will continue to be applied to future sales
- In some cases, plaintiffs seeking lump sum were allowed to present jury with evidence of discounted future sales
 - But courts did not expressly sanction inclusion of future sales in royalty calculation

- See *Ericsson v. TCL Commun. Tech. Holdings, Ltd.* (E.D. Tex. 2018)

Multi-Technology Products

- Apportionment: “[A] patent owner must apportion or separate the damages between the patented improvement and the conventional components of a multi-component product.”
- Entire Market Value Rule: Royalty base limited to sales from “smallest saleable patent practicing unit” unless patented technology is the basis for consumer demand of the entire product or creates the value for the other components

Panduit Factors Typically Determine Whether Lost Profits Are Available

1. Demand for patented product
2. Absence of acceptable non-infringing substitutes
3. Manufacturing and marketing capability (capacity) to exploit demand
4. Calculation of amount of profit

- *Panduit Corp. v. Stahl Bros. Fibre Works, Inc.*, 575 F.2d 1152 (6th Cir. 1978)

Current Rule: Enhancement in the Courts' Discretion

- 35 U.S.C. § 284: “[T]he Court may increase the damages up to three times the amount found or assessed”
- *Halo Electronics, Inc. v. Pulse Electronics, Inc.*, 136 S. Ct. 1923 (2016):
 - Courts have discretion to enhance damages based on particular facts of each case
 - No rigid tests
 - Enhancement should only be awarded in atypical cases involving “willful, wanton, malicious, bad-faith, deliberate, consciously wrongful, [or] flagrant” infringement
 - Breyer concurring opinion: lay opinions of non-willfulness should be considered in certain cases

Shifting Attorneys' Fees

- 35 U.S.C. § 285: “The court in **exceptional cases** may award reasonable attorney fees to the prevailing party”
 - No rigid test
- An “exceptional” case is “one that stands out from others with respect to the substantive strength of a party’s litigation position (considering both the law and the facts of the case) or the unreasonable manner in which the case was litigated”

- *Octane Fitness, LLC v. ICON Health & Fitness, Inc.* (S. Ct. 2014)

Common Methodologies for Patent Valuation

Income Approach to Patent Valuation

- Patent value = potential income attributable to patent
- Income =
 - Royalties / licensing fees
 - Patent infringement damages / settlements
- Can be adjusted to reflect:
 - Cost of obtaining income
 - Risk
 - Time value of money

Income Approach (Cont'd)

- Based on damages calculations that are well-accepted by courts
 - Tracks logic of patent as monopoly
- Accounts for wide array of information
 - Much of Cost and Market approaches factor into damages
- Flexible and sensitive to unique aspects of patent/market
- Downsides
 - Limited public information; often requires some degree of estimation
 - Depends on analyses of infringement and revenue generation potential that are, by nature, judgment calls and subject to debate
 - Impossible to quantify all risks and costs
 - Requires skilled professionals to perform valuation

Cost Approach to Patent Valuation

- Patent value =
 - cost patent holder paid to obtain patent +
 - replacement cost of operating without the patent
- Relevant costs can include cost of design around, additional materials, R&D, manufacturing change costs, etc.
- Limited usefulness because:
 - Circular logic -- it's valuable because it was expensive
 - Rarely endorsed by courts
 - Tends to equalize value of strong and weak patents
 - Replacement costs often hypothetical
 - Other methodologies consider costs, but in more balanced ways

Market Approach to Patent Valuation

- Patent value is determined by reference to similar transactions in the marketplace (like real estate)
- Limited usefulness because:
 - Difficult to assess “similarity” of prior transactions and patents
 - Especially for new and emerging technologies
 - Over-reliance on quality of valuation in prior transactions
 - Minimizes distinguishing factors of especially strong or weak patents
- Other methodologies consider market value, but in more balanced ways

Key Takeaways and Strategic Considerations

Final Considerations

- An understanding of patent valuation and monetization can:
 - Give your organization the edge in negotiations, litigations and competition
 - Open new revenue streams
- To fully understand the value of a patent portfolio, you must take into account the assets' income generation potential
 - This requires the assistance of experienced and knowledgeable patent attorneys

Thank you

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