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VIEWS AND TOOLS FROM LEADING EXPERTS ON VALUATION, FORENSIC/FRAUD AND LITIGATION SERVICES

Apportionment of Intellectual Property Damages and the Entire Market Value Rule

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Products often contain multiple features. Some of these product features may be covered by patents. The question of apportionment arises in patent infringement matters where an item is sold that includes a patented element or feature. Should damages be based on only the patented feature, or should damages be based on the value of the entire item that includes the patented element or feature? The answer to this question can have an exponential impact on the amount of the patent infringement damage claim.

Pre-1946 case law allowed for an accounting of the defendant's profits as monetary recovery for patent infringement. However, a patentee was limited to an accounting of the defendant's profits attributable to the invention.[1] Prior to 1946, a patentee had to apportion profits between patented and unpatented features or prove "damages are to be calculated on the whole machine for the reason that the entire value of the whole machine, as a marketable article, is properly and legally attributable to the patented feature."[2] Apportionment of profits was the problem that prompted the 1946 amendments of the patent statute.[3]

The 1946 amendments to the patent statute eliminated the equitable profits remedy[4] and set the floor to infringement damages as a reasonable royalty.[5] Despite the elimination of the equitable profits remedy, the concept of obtaining damages on the basis of the entire market value of a product containing an infringed feature did not disappear. When a patent holder seeks damages on unpatented components sold with a patented apparatus, courts have applied a formulation known as the "entire market value rule" to determine whether such components should be included in the damage computation. This applies whether the patent holder seeks reasonable royalty or lost profits damages.[6]

The Court of Appeals for the Federal Circuit has "held that the entire market value rule permits recovery of damages based on the value of a patentee's entire apparatus containing several features when the patent-related feature is the *'basis for customer demand'*"[7] and/or the substantial value of the product sold.[8] Alternately, damages cannot be based on the revenues of the product incorporating the patented feature when the patented feature does not form the basis for customer demand.[9]

In addition to the patented element or feature being the basis for customer demand, the unpatented and patented components must be part of a single assembly or analogous to a single functioning unit.[10] "[T]he unpatented components must function together with the patented component in some manner so as to produce a desired end product or result." The entire market value rule has not been extended "to include items that have essentially no functional relationship to the patented invention and that may have been sold with an infringing device only as a matter of convenience or business advantage."[12]

Continued on next page

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The applicability of the entire market value rule is almost always an issue of intense debate between the parties in patent infringement cases. Addressing whether the rule is applicable to the facts and circumstances of the case should be addressed early on in the discovery process. Gathering sufficient support to prove or disprove applicability of this rule impacts not only the size of the damage claim, but also the credibility of the damages expert.

Some parties seek to apply an entire market value concept of damages to products containing both patented and unpatented features based on the belief that the claimant can obtain an injunction against the sale of the product. Under this concept, the alternative the infringer faces is paying damages based on the value of the entire product or process or exiting the market and making no sales. This approach ignores several factors. Following the eBay decision, post-verdict injunctions are no longer certain.[13] Also, an injunction cannot impose unnecessary restrictions on lawful activity.[14] If non-infringing alternatives exist for a patented feature or the patented feature does not form the basis for customer demand, then an injunction is unlikely and, (i.e., the product had substantial non-infringing uses), under *Grain Processing*,[15] it is necessary to consider what alternatives the infringer would pursue, short of exiting the market.

The entire market value rule can apply to either lost profit or reasonable royalty damages. However, even when the entire market value rule is not used in calculating a reasonable royalty, the royalty base can be the net selling price of the entire product. This situation arises when the selling price for an individual feature is not available. In these instances, the reasonable royalty rate should be adjusted so that when applied to the broader royalty base the total damage amount reflects only the value of the patented feature.

Obtaining persuasive support in discovery regarding the importance of the patented feature to customer demand is a primary factor in determining the applicability of the entire market value rule. Documents that can be expected to address the importance of patented features are the parties' marketing materials, including not only product web sites, promotional, and print advertisements, but also product packaging; internal business plans and market analyses; analyst and industry reports; articles in trade publications; and SEC filings, such as Form 10-K reports detailing products and competition. Often times it is not one single "smoking gun" document, but the preponderance of evidence that indicates the importance of product features in driving customer demand. Discovery in this area is usually relatively broad.

Patent reform may make damage recovery under the entire market value rule more difficult. Both the House and Senate patent reform bills potentially limit the size of reasonable royalty damage amounts by requiring a deduction for "prior art and other feature improvements" included in an infringing product or process.[16] These bills require the court to conduct an analysis to ensure that a royalty is only applied to the economic value properly attributed to the patent's specific contribution over the prior art.[17] While the entire market value rule is still allowed, both House and Senate bills provide an explicit, definitional standard for the application of the rule by requiring the patentee to show that the "patent's specific contribution over the prior art is the predominant basis for market demand for an infringing product or process."[18] Proving that a patent's specific contribution over the prior art is the predominant basis for market demand is a higher standard to meet than is currently being applied.

The applicability of the entire market value rule is almost always an issue of intense debate between the parties in patent infringement cases. Addressing whether the rule is applicable to the facts and circumstances of the case should be addressed early on in the discovery process. Gathering sufficient support to prove or disprove applicability of this rule impacts not only the size of the damage claim, but also the credibility of the damages expert. ℘

1 *Rite-Hite Corp. v. Kelley Co., Inc.*, 56 F.3d 1538, 1565 (Fed. Cir. 1995).

2 *Garretson v. Clark*, 111 U.S. 120, 4 S.Ct. 291, 28 Led. 371 (1884).

3 *Rite-Hite Corp.*, 1566.

4 The patent holder's ability to recover the infringer's profits that resulted from the sale of infringing items.

5 Terence P. Ross, *Intellectual Property Law, Damages and Remedies* (New York: Law Journal Press, 2006) 3-44 and 35 U.S.C. §284 and notes, see 12 December 2007 *<http://www.law.cornell.edu/uscode/html/uscode35/usc_sec_35_00000284——000-notes.html>*.

6 *Rite-Hite Corp.*, 1549.

7 *Rite-Hite Corp.*, 1549, emphasis added; see also *State Indus., Inc. v. Mor-Flo Indus., Inc.* 883 F.2d 1573, 1580 (Fed. Cir. 1989).

8 *Fonar Corp. v. General Electric Co.*, 107 F.3d 1543, 1549, 1553 (Fed. Cir. 1997).

9 *Lucent Techs., Inc. v. Gateway, Inc.*, 2007 U.S. Dist. LEXIS 57135 (S.D. Cal., August 6, 2007).

10 See e.g., *Velo-Bind, Inc. v. Minnesota Mining & Mfg. Co.*, 647 F.2d 965, 211 USPQ 926 (9th Cir.), cert. denied, 454 U.S. 1093, 102 S.Ct. 658, 70 L.Ed.2d 631 (1981) and Kalman v. Berlyn Corp., 914 F.2d 1473, 1485, 16 USPQ2d 1093, 1102 (Fed. Cir. 1990); *Rite-Hite Corp.*, 1550.

11 *Rite-Hite Corp.*, 1550.

12 *Rite-Hite Corp.*, 1550.

13 *eBay Inc. et al. v. MercExchange, L.L.C.*, 547 U.S. _____ (2006) (slip op.).

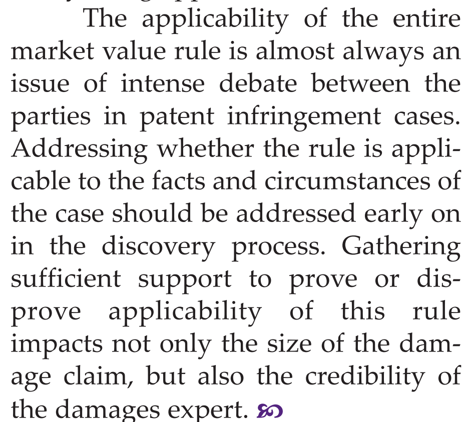
14 *William G. Riles v. Shell Exploration and Production Company*, 298 F.3d 1302, 1311 (Fed. Cir., 2002).

15 *Grain Processing Corp. v. American Maize-Products Co.*, 185 F.3d 1341, 1350 (Fed. Cir. 1999).

16 Michael A. Einhorn, "Patent Reform and Infringement Damages, Some Economic Reasoning," *IPL Newsletter*, Vol. 26, Number 1: Fall 2007, 13.

17 Section 5(b)(2), H.R 1908, 110th Congress (2007) and Section 5(b)(2) S. 1145, 110th Congress (2007).

18 Section 5(b)(3), H.R 1908, 110th Congress (2007) and Section 5(b)(3) S. 1145, 110th, emphasis added



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