

Apple V. Motorola: Implications For Patent Damages

Law360, New York (June 29, 2012, 1:17 PM ET) -- Judge Richard Posner's decision to end the patent infringement case over smartphone technologies between Apple Inc. and Motorola Inc. will have significant implications for patent litigation. Between his Daubert opinion of May 22[1] and his opinion and order of June 22,[2] Posner declared that neither side had proven that it was entitled to any form of relief. Consequently, Posner canceled the hearing on liability, ending the case.

If adopted by courts, Posner's approach — that liability need not be determined when the patent holder fails to provide sufficient evidence proving damages or justifying an injunction — will fundamentally alter the nature of patent litigation in federal courts and at the U.S. International Trade Commission. Importantly, it will elevate the role of patent damages in litigation.

Unfortunately, the level of economic coherence in patent law with respect to damages today is roughly comparable to what existed in antitrust law in 1955. However, Posner's opinions in Apple v. Motorola help clarify legal and economic standards for measuring patent damages.

Distinguishing Between “Disabling Problems” and “Weaknesses” in Patent Damage Testimony

Developments in the case law on patent damages have begun to heighten the standard for measuring patent damages. Several recent cases have raised the bar for using benchmark licenses[3] and the entire market value rule.[4] Uniloc rendered the infamous 25-percent rule of thumb inadmissible.[5] Posner's Daubert and June 22 opinions in Apple v. Motorola excluded damage testimonies of Apple's and Motorola's damage experts.

Although Apple v. Motorola does not identify any particular methodology as inadmissible, it addresses the fundamental question: What is the difference between “disabling problems” and “weaknesses” in patent damage testimony?[6]

Disabling problems render damage testimony inadmissible, whereas weaknesses are tested at trial.[7] Rule 702 of the Federal Rules of Evidence and Daubert require that the methodology and opinions of an expert's testimony be grounded in science to be deemed reliable by federal courts.[8] Apple v. Motorola shows that even seasoned patent damage experts have yet to agree on scientifically rigorous methods for measuring patent damages.

The disabling problems committed by Apple's and Motorola's damage witnesses that Posner identified were:

- (1) relying only on information provided by the party to the dispute, rather than a disinterested third party;[9]
- (2) failing to consider all possible noninfringing substitutes to licensing the patent in suit (that is, all possible methods of inventing around the patent);[10]
- (3) failing to "isolate the value to consumers" of the patented technologies, separate from the value of other technologies in the patented product;[11] and
- (4) arbitrary benchmarking.

Posner's Daubert and June opinions explicitly identified the first three problems. Arbitrary benchmarking is not stated explicitly, but it summarizes multiple disabling problems in the experts' methodologies estimating damages for infringement of Apple's '647 patent and Motorola's '898 patent. [12]

Principles for a Rigorous Approach to Measuring Patent Damages

The disabling problems highlighted in Posner's opinions underscore the need for rigorous, economic standards for measuring patent damages. From Judge Posner's Daubert and June 22 opinions, I outline the parameters for producing reliable expert testimony on patent damages.

First, damage witnesses will need to show more rigorous treatment of hypotheticals, or counterfactuals. A key variable in estimating the counterfactual is identifying and pricing the noninfringing substitute available at the time of first infringement — that is, the method the infringer would have used to invent around the patent. Apple contended in the June hearing that "as long as its expert produces a plausible method of avoiding infringement ... the existence of alternative methods that might be substantially cheaper is an issue to be resolved at trial[.]"[13] Not so, according to Posner. For damage testimony to be admissible, one must consider all potential noninfringing substitutes and "provide reasons for rejecting alternative hypotheses"[14] of substitutes.

Second, damage witnesses will need to disaggregate the harm caused by infringement of the patent in suit using rigorous, economic methods. It is widely accepted that the entire market value rule does not apply when the patent in suit covers only one component in a product containing hundreds or thousands of components. However, seasoned testifying experts are still failing to sufficiently disaggregate damages.

Apple's damage expert attempted to submit into evidence media reports "attesting to what a terrific product the iPhone is." [15] Posner refused to admit those reports into evidence because "the quality of the iPhone ... [has] nothing to do with the handful of patent claims" at issue.[16] In contrast, one would rigorously apportion the value of the patent in suit by estimating the difference in value between the patented product and the next-best noninfringing substitute.

Third, accounting and engineering methods do not constitute expert economic testimony. The profits the patent holder would have made absent infringement, or the royalty upon which the patent holder and the would-be infringer would have agreed in a hypothetical negotiation for the patent, is an economic determination. For example, a rigorous methodology identifies noninfringing substitutes based not only on technological differences among alternatives, but also consumer demand for the patented invention and its substitutes.

Courts, lawyers and experts can take advantage of the highly refined jurisprudence found in antitrust law for analyzing consumer substitutability. Using a demand-based definition of substitution will allow one to calibrate patent damages to the relative contribution of the patented invention to consumer demand for the patented product.

Fourth, damages determined in an expert's testimony should equal a valuation of the patent in suit in a nonlitigation context. This principle is based on the standard in *Kumho* that an expert must "employ[] in the courtroom the same level of intellectual rigor that characterizes the practice of an expert in the relevant field." [17] Posner repeatedly uses this standard to evaluate the reliability of the experts' damage methodologies in his *Daubert* opinion. For example, this standard explains why the damage or royalty estimates of the opposing experts should not differ by orders of magnitude. [18]

Fifth, the expert must exercise due diligence with respect to any facts supplied by the client or the client's technical experts. In this case, it was not sufficient for the experts to consider only the noninfringing substitutes provided by the parties' technical experts. Experts should obtain information from a neutral source. Moreover, "[a] competent damage witness," Posner asserted, "would be one who was involved in the procurement of chips, or who advised as a consultant on the choice of chips[.]" [19] Posner's assertion requires interpretation, because the personnel involved in the procurement of inputs is not likely to have the necessary economic expertise to calculate damages, and the typical damage expert is not likely to have the experience in procuring inputs.

One interpretation is that damage experts must not be spoon-fed conclusions on substitutes from their clients or other expert witnesses. Damage experts must have face-to-face discussions with the personnel involved in the procurement of inputs and exercise reasonable due diligence and skepticism over the reasons given for procurement decisions. This obligation would require experts not only to defend their calculations, but also to exercise the appropriate level of due diligence to ensure the reliability of the inputs underlying their calculations. This principle is complimentary to the first principle, concerning rigorous treatment of hypotheticals.

Conclusion

Apple v. Motorola raises the bar for the admissibility of patent damage testimony, and it increases the importance of having reliable damage testimony for the survival of a patent-infringement case. The fundamental task for judges, practitioners and experts is to identify disabling problems in damages testimony that are grounds for exclusion. From the disabling problems that Posner identified in the testimony of Apple's and Motorola's damage experts, one can articulate five principles defining the proper standard for measuring patent damages. More limiting principles may emerge as courts and litigants digest Posner's important ruling.

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[1] Opinion and Order of May 22, 2012, *Apple Inc. v. Motorola Inc.*, Case No. 1:11-cv-08540, at 2 (May 22, 2012) [hereinafter *Daubert Opinion and Order in Apple v. Motorola*].

[2] Opinion and Order of June 22, 2012, *Apple Inc. v. Motorola Inc.*, Case No. 1:11-cv-08540, at 8 (June 22, 2012) [hereinafter *June 22 Opinion and Order in Apple v. Motorola*].

[3] See *Lucent Tech. Inc. v. Gateway Inc.*, 580 F.3d 1301 (Fed. Cir. 2009); *ResQNet.com Inc. v. Lansa Inc.*, 594 F.3d 860 (Fed.Cir. 2010); *Wordtech Systems Inc. v. Integrated Networks Solutions Inc.*, 609 F.3d 1308 (Fed. Cir. 2010).

[4] *Lucent*, 580 F.3d 1301 (Fed. Cir. 2009); *i4i Ltd. Partnership v. Microsoft Corp.*, 598 F.3d 831 (Fed. Cir. 2010); *Uniloc USA Inc. v. Microsoft Corp.*, 632 F.3d 1292 (Fed. Cir. 2011); *IP Innovation LLC v. Red Hat Inc.*, 705 F. Supp. 2d 687 (E.D. Tex 2010); *Cornell Univ. v. Hewlett-Packard Co.*, 609 F. Supp. 2d 279 (N.D.N.Y. 2009).

[5] *Uniloc*, 632 F.3d at 1315 (Fed. Cir. 2011) (“Evidence relying on the 25 percent rule of thumb is ... inadmissible under *Daubert* and the Federal Rules of Evidence, because it fails to tie a reasonable royalty base to the facts of the case at issue.”).

[6] *Daubert Opinion and Order in Apple v. Motorola*, *supra* note 1, at 2.

[7] *Id.*

[8] Fed. R. Evid. 702; *Daubert v. Merrill Dow Pharmaceuticals Inc.*, 509 U.S. 579, 589-94 (1993).

[9] *Daubert Opinion and Order in Apple v. Motorola*, *supra* note 1, at 6, 12, 16.

[10] *Id.* at 11, 13, 19; *June 22 Opinion and Order in Apple v. Motorola*, *supra* note 2, at 4.

[11] *Daubert Opinion and Order in Apple v. Motorola*, *supra* note 1, at 13.

[12] *Id.* at 18; *June 22 Opinion and Order in Apple v. Motorola*, *supra* note 2, at 8, 16-17.

[13] *Daubert Opinion and Order in Apple v. Motorola*, *supra* note 1, at 13.

[14] *Id.* at 14 (quoting *Clausen v. M/V NEW CARISSA*, 339 F.3d 1049, 1058 (9th Cir. 2003)).

[15] *June 22 Opinion and Order in Apple v. Motorola*, *supra* note 2, at 30.

[16] *Id.*

[17] *Kumho Tire Co. v. Carmichael*, 526 U.S. 137, 152 (1999) (quoted in *Daubert Opinion and Order in Apple v. Motorola*, *supra* note 1, at 3).

[18] *Daubert Opinion and Order in Apple v. Motorola*, *supra* note 1, at 6.

[19] *June 22 Opinion and Order in Apple v. Motorola*, *supra* note 2, at 4.

