

Litigation Alert

Federal Circuit on Entire Market Value Rule: A “Necessary” or “Important” Feature Does Not Demonstrate Demand for the Entire Product

AUGUST 31, 2012

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Summary

On Thursday, August 30, 2012, the Federal Circuit decided *Laser Dynamics v. Quanta Computer, Inc.* clarifying the boundaries of the entire market value rule. The Court affirmed the principle that, in general the royalty base for patent damages must be on the “smallest saleable patent-practicing unit.” (citing *Cornell Univ. v. Hewlett-Packard Co.*, 609 F. Supp. 2d 279, 283, 287-88 (N.D.N.Y. 2009)). The Court held that for a patented feature to be the basis for customer demand as required by the rule, the feature must be the motivating factor for the customer purchase. Merely being a “required” or “important” feature is insufficient.

Background of the Case

LaserDynamics accused laptop manufacturer Quanta Computer, Inc. of infringing a patent on technology that enables computer disc drives to tell whether a disc inserted in a drive is a CD or a DVD. At a trial in front of Judge Ward in the Eastern District of Texas, the jury found Quanta liable and ordered it to pay \$52.1 million in damages, adhering closely to the recommendations LaserDynamics damages expert, Mr. Emmett Murtha. Mr. Murtha opined that the parties would have agreed to a running royalty of 2% of the total sales of laptop computers sold by Quanta. This conclusion was largely based on Mr. Murtha’s understanding that the patented technology provided an “important” and valuable function, and that its presence was “necessary” for success in the marketplace. Quanta filed a post-verdict motion for reduced damages or, in the alternative, a new trial based in part on LaserDynamic’s allegedly flawed reliance on the entire market value rule. In granting a new trial, Judge Ward ruled that LaserDynamics’

expert improperly used sales of the entire computer to estimate damages caused by the accused disc drives. During a second trial on damages, Quanta challenged a slew of issues pertaining the LaserDynamics’ damages theory, including the running royalty rate, the admissibility of various settlement agreements, and the date of the hypothetical negotiation between the parties. Following a second jury verdict of \$8.5 million, LaserDynamics appealed the District Court’s grant of a new trial on damages.

The Entire Market Value Rule

The Federal Circuit panel affirmed the grant of a new trial based on improper reliance on the entire market value rule. Noting that the general rule is that a royalty base for multi-component products like computers should be limited to the “smallest saleable patent-practicing unit,” the panel emphasized that the entire market value rule is a narrow exception to this general rule. The panel stated that “[w]here small elements of multi-component products are accused of infringement, calculating a royalty on the entire product carries a considerable risk that the patentees will be improperly compensated for non-infringing components of that product.” The panel reaffirmed that patentees must show that the demand for the entire product is attributable to the patented feature.

LaserDynamics defended the use of the entire market value rule on the grounds that no laptop would be commercially viable if it could not tell what kind of disc was inserted. The panel rejected this functional approach to demand, stating that “[i]t is not enough to merely show that the disc discrimination method is viewed as valuable, important, or even essential to the use of the laptop computer.” Instead, the laptop discrimination

feature must be what “motivates consumers to buy a laptop computer in the first instance” in order to use the entire value of the computer as a royalty base. The panel noted that there are many potentially patented features in a modern computer, any one of which might be essential in the sense that a computer lacking the feature would not be selected by consumers. However, “proof consumers would not want a laptop computer without such features is not tantamount to a proof that any of those features alone drives the market for laptop computers.” The panel emphasized that the patented feature must be the reason for the purchase of the larger article, not just a important feature when comparing two similar options, stating that “if given a choice between two otherwise equivalent laptop computers, only one of which practices [the patented technology], proof that consumers would choose the laptop computer having [the patented technology] says nothing as to whether the presence of that functionality is what motivates consumers to buy a laptop computer in the first place.” The panel suggested that market studies or consumer surveys might have provided LaserDynamics with the necessary proof that the patented technology is actually what drove customers to purchase a computer with the patented feature rather than being “a useful commodity-type feature that consumers expect will be present in all laptop computers.”

The panel also criticized a suggestion by LaserDynamics that a small royalty rate could avoid the requirement to prove that the patented feature drives demand for the entire product. Citing last year’s *Uniloc* decision, the panel noted that presenting the jury with a royalty analysis using the entire market value without proof that the patented feature drives customer demand “skews the damages horizon for the jury, regardless of contribution of the patented component to this revenue.” See *Uniloc USA, Inc. v. Microsoft Corp.*, 632 F.3d 1292, 1320 (Fed. Cir. 2011).

Implications

LaserDynamics demonstrates that application of the entire market value rule is unlikely where the accused products are complex devices with many components. In order to reach the profits of the completed device, a patentee must show that the patented feature alone impels customers to purchase the overall product, not simply that the feature is a necessary or important condition for market success. Patentees seeking to use the entire market value of a product may need to rely upon customer surveys to establish that the demand for the product in fact flows from the patented feature.

For further information, please contact:

David D. Schumann, Partner, Litigation Group
dschumann@fenwick.com, 415.875.2321

Phillip Haack, Associate, Litigation Group
phaack@fenwick.com, 650.335.7932

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