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Exmark And The Erosion Of The Entire Market Value Rule

By **Matthew Becker**

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In Exmark Manufacturing Company v. Briggs & Stratton Power, the U.S. Court of Appeals for the Federal Circuit approved a reasonable royalty damages theory based on the total value of an accused product, even though the patented invention was only part of a multicomponent product.[1] Exmark is remarkable. The Federal Circuit did not mention the entire market value rule and approved of apportioning the royalty rate, instead of a royalty base, to separate the damages attributable to the patented invention from non-patented features. Exmark continues a trend of the Federal Circuit departing from the vigorous application of the entire market value and seemingly unambiguous statements in its earlier Uniloc[2] and LaserDynamics[3] decisions prohibiting apportionment of the royalty rate.

Origin and Federal Circuit Applications of the Entire Market Value Rule Into This Decade

Basing reasonable royalty damages on the value of an entire product has troubled courts for more than 100 years. In 1853, the U.S. Supreme Courtwarned in Seymour v. McCormick that it would be a "very grave error to instruct a jury that as to the measure of damages the same rule is to govern, whether the patent covers an entire machine or an improvement on a machine."[4] Thirty years later, the Supreme Court reiterated the need to separate or apportion the value of the patented invention from nonpatentable parts when determining damages: "The patentee ... must in every case give evidence tending to separate or apportion ... the patentee's damages between the patented feature and the unpatented features."[5]

The entire market value rule developed out of these concerns, in cases where a patented feature was found in a multicomponent accused product having nonpatented features. Under the entire market value rule, a patentee may assess damages based on the entire market value (e.g. net revenue) of the accused product only where the patented feature creates the "basis for customer demand" or "substantially create[s] the value of the component parts."[6]

The entire market value rule took on increased significance in the early part of this decade as a viable way to limit what many considered runaway patent damages awards. In Uniloc USA v. Microsoft, the Federal Circuit found a jury's damages award of $388 million "tainted by the use of a legally inadequate methodology" that required a new trial on damages.[7] The patent owner's damages expert's reasonable royalty opinion applied a small royalty (2.9 percent) to $19.2 billion in revenue from sales of the accused product.[8] On appeal, the parties raised a number of damages issues, including whether Uniloc's damages theory violated the entire market value rule.[9] Uniloc defended the reasonable royalty opinion, arguing that "the entire market value of the products may appropriately be admitted [in evidence] if the royalty rate is low enough."[10] The Federal Circuit rejected the argument, stating:

> The Supreme Court and this court's precedents do not allow consideration of the entire market value of accused products for minor patent improvements simply by asserting a low enough royalty rate.[11]

The Federal Circuit held that the damages expert's testimony violated the entire market value rule because there was no evidence supporting that the accused products' value derived from the patented features or combination.[12]

The Federal Circuit applied the entire market value the following year in its LaserDynamics v. Quanta decision. The invention was an optical disc drive, an "ODD." LaserDynamics' expert presented a damages opinion based on a 2 percent royalty applied to $2.53 billion in total sales of infringing laptop computers.[13] The jury awarded reasonable royalty damages of $52 million following trial, essentially adopting LaserDynamics' damages calculation.[14] The district court found the jury's damage award violated the entire market value rule and granted a conditional new trial on damages.[15]

LaserDynamics appealed, contending that the district court erred by granting a new trial on damages.[16] The Federal Circuit affirmed, finding that the "royalty was expressly calculated as a percentage of the entire market value of a laptop computer rather than a patent-practicing ODD alone," and that there was no evidence that the patented feature drove consumer demand for the computers.[17] Significantly, the Federal Circuit reiterated, "the 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."[18]

The VirnetX v. Cisco decision vacated a $368 million damages award, finding an expert's damages opinion used flawed methodology because he utilized a total sales royalty base in violation of the entire market rule.[19] The Federal Circuit again emphasized that the entire market value may be used "*only where* the patented feature creates the basis for customer demand or substantially creates the value of the component parts."[20] The Federal Circuit criticized the expert's opinion because he "did not even attempt to subtract other unpatented elements from the [royalty] base, which therefore included various features indisputably not claimed by VirnetX."[21] Thus, VirnetX enforced the entire market value rule and required apportionment of the royalty base.

Thereafter, district courts routinely applied the entire market value rule and cited Uniloc and LaserDynamics to reject damages theories that used total revenues as the royalty base.[22]

Ericsson v. D-Link: A Signal of Softening

In late 2014, however, the Federal Circuit signaled a softening of its stance on the entire market value rule and approved of apportioning a royalty rate in lieu of, or in combination with, apportioning the royalty base.[23] In Ericsson v. D-Link, the patented invention covered the 802.11(n) wireless standard. Ericsson accused as infringing electronic devices incorporating wireless chips complying with the 802.11(n) wireless standard.[24] The jury awarded damages of roughly 15 cents per infringing device.

On appeal, D-Link argued that the damages expert's opinion should have been excluded because it relied on licenses tied to the entire value of the accused products in violation of the entire market value rule.[25] The Federal Circuit disagreed, explaining that the value of patented features could be determined "in various ways," including "by adjustment of the royalty rate so as to discount the value of a product's nonpatented features . . . The essential requirement is that the ultimate reasonable royalty award must be based on the incremental value that the patented invention adds to the end product."[26] The fact Ericsson involved "real world" licenses that used total sales as a revenue base undoubtedly played a significant role in the Federal Circuit's decision.

Ericsson's authorization of apportionment of the royalty rate (rather than the royalty base) nevertheless marked a departure from legal analysis and language used in Uniloc and LaserDynamics. The Federal Circuit attempted to reconcile this apparent contradiction by characterizing Uniloc and LaserDynamics as addressing concerns about misleading the jury by presenting total revenues evidence.[27]

> It is not that an appropriately apportioned royalty award could never be fashioned by starting with the entire market value of a multi-component product—by, for instance, dramatically reducing the royalty rate to be applied in those cases—it is that reliance on the entire market value might mislead the jury, who may be less equipped to understand the extent to which the royalty rate would need to do the work in such instances.[28]

While misleading the jury is certainly a concern whenever billion-dollar numbers are presented to a jury, the entire market value rule stemmed from economic concerns requiring a tie between the value of the patented invention and damages.

Exmark: A Continuing Shift

This brings us to Exmark, where the Federal Circuit backed off from the strong statements in Uniloc and LaserDynamics, and a rigid application of the entire market value rule. Exmark accused high-end commercial lawn mowers of infringing a patent directed to a lawn mower having improved flow control baffles.[29] The patent claimed a lawn mower having conventional features as well as the improved baffles.[30] Despite the claim to whole mowers, the parties agreed that damages needed to be apportioned to the value of the baffles.[31] At trial, Exmark's damages expert provided a damages opinion that used total revenues from lawn mower sales as the royalty base. A jury found that Briggs & Stratton willfully infringed and the jury awarded slightly more than $24 million in reasonable royalty damages, which the court enhanced based on the finding of willful infringement.[32]

Briggs & Stratton appealed the district court's denial of a new trial on damages, alleging that Exmark's damages expert improperly based her opinion on the total sales of lawn mowers and failed to apportion the value of the patented baffle feature from the royalty base.[33] Briggs & Stratton's argument logically followed the statements from Uniloc and LaserDynamics that appeared to reject, as a matter of law, using the entire market value of accused products absent evidence showing that patented features drive demand for the patented combination.

Surprisingly, the Federal Circuit did not mention the entire market value rule or discuss whether the patented invention drove consumer demand for Briggs & Stratton's lawn mowers. Instead, the Federal Circuit jumped straight to the issue of apportionment. The Federal Circuit, after quoting Ericsson, found no error in Exmark's expert's methodology:

> So 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.[34]

The Federal Circuit also found, as in Ericsson, that a prior license to the patent-in-suit using a lawn mower royalty base supported the expert's testimony.[35]

The Federal Circuit ultimately vacated the damages award and remanded for a new trial on damages, because Exmark's damages expert's opinion of a 5 percent royalty rate should have been excluded because it was not sufficiently tied to the facts of the case.[36]

Conclusion: Watch for Developments

The Exmark decision evidences a continued shift in the Federal Circuit's application of the entire market value rule. It provides patent litigants with several ways to calculate reasonable royalty damages. Challenges to a patentee's reasonable royalty theories based on the entire market value rule will undoubtedly continue, but Exmark and Ericsson will certainly be relied on by patent owners to counter those challenges. How courts apply Exmark moving forward will be interesting, and a development worth monitoring.

Matthew P. Becker is a principal shareholder in the Chicago office of Banner & Witcoff Ltd.

[1] Exmark, Mfg. Co. v. Briggs & Stratton Power Prods. Group, LLC, Case No. 16-2197 (Fed. Cir. Jan. 12, 2018).

[2] Uniloc USA, Inc. v. Microsoft Corp., 632 F.3d 1292 (Fed. Cir. 2011).

[3] LaserDynamics, Inc. v. Quanta Computer, Inc., 694 F.3d 51 (Fed. Cir. 2012).

[4] Seymour v. McCormick, 57 U.S. (16 How.) 480, 491, 14 L.Ed. 1024 (1853).

[5] Garretson v. Clark, 111 U.S. 120, 121, 4 S.Ct. 291, 28 L.Ed. 371 (1994) (quotation marks omitted).

[6] Uniloc, 632 F.3d at 1318.

[7] Id. at 1295, 1311.

[8] Id. at 1318.

[9] Id. at 1312.

[10] Id. at 1319.

[11] Id. at 1320.

[12] Id. at 1321.

[13] Laser Dynamics, 694 F.3d at 60-61.

[14] Id. at 63.

[15] Id.at 63-64.

[16] Id. at 66.

[17] Id. at 68.

[18] Id. at 67.

[19] VirnetX, Inc. v. Cisco Sys., Inc., 767 F.3d 1308, 1313, 1328 (Fed. Cir. 2014).

[20] VirnetX, 767 F.3d at 1326 (emphasis in original) quoting Versata Software, Inc. v. SAP Am., Inc., 717 F.3d 1255, 1268 (Fed. Cir. 2013).

[21] Id. at 1328.

[22] See Good Tech. Corp. v. MobileIron, Inc., Case No. 12-cv-05826-PSF, 2015 WL 4090431, *5 (N.D. Cal. July 5, 2015) ("Weinstein's first royalty scenario does not sufficiently apportion the royalty base"); Sonos, Inc. v. D&M Holdings, Inc., Civ. No. 14-1330-WCB, 2017 WL 4969328, *7-9 (D. Del. Nov. 1, 2017).

[23] Ericsson, Inc. v. D-Link Systems, Inc., 773 F. 3d 1201 (Fed. Cir. 2014).

[24] Id. at 1209, 1212

[25] Id. at 1225-26.

[26] Id. at 1226.

[27] Id. at 1227.

[28] Id. at 1227 citing Uniloc and LaserDynamics.

[29] Exmark, at 3.

[30] Id., at 22.

[31] Id., at 21.

[32] Id., at 2.

[33] Id., at 22.

[34] Exmark, at 23.

[35] Id. at 23-24.

[36] Id. at 28.