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## Legal Updates & News

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#### The Patent Reform Act: Reining in the Entire Market Value Rule?

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The calls for patent reform legislation have spawned numerous debates and proposals, culminating in the passage of H.R. 1908 by the House and the pending S. 1145 in the Senate. Our focus here is on one potential change that could have a dramatic effect on patent litigation. We explain the state of existing law on the “entire market value rule” of damages, review the changes in the pending legislation, describe the advocates lobbying on the proposal, and try to predict what will result if the legislation in its current form passes.

#### The “Entire Market Value Rule” and Its Impact

The entire market value rule (“EMV rule”) has been a powerful tool for patentees and a source of fear for alleged infringers. This doctrine “permits recovery of damages based on the value of the entire apparatus containing several features, where the patent related feature is the basis for customer demand . . . .” *Imonex Services v. W.H. Munzprufer Dietmar Trenner*, 408 F.3d 1374, 1379-80 (Fed. Cir. 2005). The question of whether the EMV rule will apply has a significant impact on the accused infringer’s exposure.

In the classic hypothetical, the owner of a windshield wiper patent sues car manufacturers and seeks reasonable royalty damages. A critical issue will be whether the patentee’s damages are calculated using the market value of the windshield wiper as the royalty base or the entire car, whose price is orders of magnitude higher. The answer can considerably affect the value of the case: while the car may have a market value of \$35,000, the windshield wiper will have a price tag that is a fraction of that. This might not matter if there is a corresponding adjustment to the royalty rate that gets applied to the base—*i.e.*, if the rate moves down as the base moves up, the final reasonable royalty number would come out the same. But that does not often occur in practice. Accordingly, even when a patentee’s likelihood of prevailing is low, the threat that the EMV rule will apply and lead to an exorbitant royalty base can play a big role in settlement posture.

The Federal Circuit’s standard on this question seems clear on its face—the EMV rule can apply when the patented feature is “the basis” for customer demand. But does this mean the claimed invention must be the *sole basis* for demand? The *predominant basis* for demand? Is it sufficient if the patented feature is *one of several* features that drive customer demand? Ambiguity abounds.

#### Uneven Application in the Cases

Some district courts have applied the EMV rule strictly, and refused to use the larger product as the royalty base when the patented component was not the sole or predominant driver of product demand. In the recent Alcatel-Lucent/Microsoft case, the judge reversed a \$1.5 billion verdict against Microsoft because he concluded that the jury misapplied the EMV rule. *Lucent Technologies, Inc. v. Gateway, Inc.*, 2007 U.S. Dist. LEXIS 57135 (S.D. Cal. Aug. 6, 2007). The jury based damages on the sales price of PCs, even though the patents only covered particular features of MP3 technology. But there was a “lack of evidence showing that the patented features set forth in the claims . . . were the basis for customer demand.” While Lucent cited evidence suggesting “that MP3 capabilities overall were a commercially important feature,” it cited no evidence that the

claimed features “were critical to MP3,” “established the basis for the customer demand or value of MP3,” or “were critical or provided value to the whole computer.” *Id.* at \*67-\*73.

In *Volovik v. Bayer Corp.*, 2004 U.S. Dist. LEXIS 300 (D. Minn. January 7, 2004), the patent owner sought EMV rule damages for selling blood-testing products, even though the patent only covered a specific kind of pump. The court disagreed, partly because the defendant’s engineer merely “testified that the performance of the pump is ‘one of the things’ that is critical to the functioning of the system. He did not say, however, that a particular pump was critical or that only a pump was critical to the performance.” There was no evidence “that customer demand was driven by the allegedly infringing pumps.” *Id.* at \*31-\*32.

Despite such decisions, uncertainty persists. For one thing, the Federal Circuit has applied the EMV rule broadly. *Bose Corp. v. JBL, Inc.*, 274 F.3d 1354 (Fed. Cir. 2001), where Bose asserted its loudspeaker “porting” patent, is illustrative. “Porting” pertains to a tube inside a loudspeaker that enhances sound quality. At trial, damages were based on the value of the entire loudspeaker, even though the ports were a small component of the system. The Federal Circuit affirmed because the patented feature “inextricably worked with other components of loudspeakers as a single functioning unit to provide the desired audible performance,” it “improved the performance of the loudspeakers and contributed substantially to the increased demand for” them, and Bose “provided testimony on its increase in sales in the year following the introduction of its speakers containing the invention.” Notably, the court did not say the patented feature was “the” basis for demand or a “predominant” factor. See also *Tec Air v. Denso Mfg. Michigan*, 192 F.3d 1353, 1362 (Fed. Cir. 1999) (allowing EMV damages even though no evidence that patented method was “the sole” or “predominant” source of demand for radiator assemblies); *Fonar Corp. v. General Elec. Co.*, 107 F.3d 1543, 1552 (Fed. Cir. 1997) (allowing EMV damages for MRI machines where patented feature was a source of demand).

### Legislation Designed to Curb Perceived EMV Abuse and Uncertainty

There is a perception in some industries that the uncertainty surrounding the standard is plaguing litigation. A common scenario in recent years is litigation against PC or notebook computer makers by plaintiffs whose patents cover a chip carrying out some specialized functionality (e.g., video graphics, audio files, or wireless communications). Such a chip may be one of hundreds of the notebook’s components, and may cost on the order of \$25: a trivial amount compared to the price of the \$1,500 notebook. But if the EMV rule applies, then the royalty base becomes \$1,500, rather than \$25. As long as the uncertainty persists, some argue, patentees have the incentive to insist on trials or exorbitant settlements.

To address this uncertainty and the specter of windfall recoveries, proposed legislation would narrow the circumstances where the doctrine applies. In general, coalition groups of large high-tech, credit card, and financial services companies—such as the Coalition for Patent Fairness (CPF)—support the legislation. The CPF includes Apple, Dell, Microsoft, HP, Cisco, Intel, Oracle, Visa, and MasterCard. Many of their products are priced on the order of \$1,000 and contain components that might implicate thousands of patents. For them, the risk of the EMV rule applied over multiple lawsuits accusing different components is especially acute.

Manufacturing groups, smaller inventors, labor interests, biotechnology groups, and pharmaceutical companies are generally opposed to the legislation. One of the most prominent lobbying groups is the Coalition for 21st Century Patent Reform (“21st Century Coalition”), which includes Abbott, Baxter Healthcare, Beckman Coulter, Bristol-Myers, DuPont, Eli Lilly, Merck, Monsanto, and Pfizer. Biotech and pharmaceutical companies are typically threatened by patents covering their entire product rather than constituent parts. They are accordingly more concerned about obtaining robust awards as plaintiffs than they are fearful of excessive damages on component parts.

The proposals would narrow application of the EMV rule. In H.R. 1908, which the House passed on September 7, 2007, Section 5(b)(3) provides that the EMV rule can apply only if the patent’s “specific contribution over the prior art” is the “predominant basis for market demand” for the infringing product. Otherwise, the court or the jury must: (a) apportion a royalty based on the “economic value properly attributable to the patent’s specific contribution over the prior art” by excluding the economic value attributable to the prior art and other features that are not attributable to the patent; or (b) calculate a royalty based on the terms of nonexclusive marketplace licenses or any other relevant factors. (H.R. 1908, §§ 5(b)(2), 5(b)(4).) The Senate version is similar except that the requirements for invoking marketplace licensing are more onerous. The court would need to find that prior licensing rose to the level of a pattern, and that the infringer’s use is similar to the scope of rights granted by licenses, before determining damages based on the licenses. (S. 1145

Substitute, § 284(c)(1)(B).)

Although there is little commentary on Section 5(b)(3), it seems clear that it would make it harder for patentees to obtain EMV rule damages. A patentee would have to establish what specific contribution its invention made over the prior art, and then establish that this specific contribution is the “predominant” basis of the “market demand” for the allegedly infringing product. The former showing would likely require detailed technical evidence distinguishing the patent from the art at the time of invention, and the latter requirement would probably necessitate economic analysis proving that overall market demand for the infringing product—not anecdotal evidence from a few consumers—is based primarily on that specific contribution. Patentees who cannot make both showings would be confined to royalties based on apportionment or marketplace licensing. This could very well have led to contrary outcomes in *Bose*, *Tec-Air*, and *Fonar*.

### Legislation Stalled in Light of Lobbying

Although the House bill passed in September, the Senate legislation appears stalled, and it looks like the Senate will not take action prior to its holiday recess. One reason for the delay is that lobbying has been intense.

For example, six consumer groups wrote to Senate leaders in support of the legislation and emphasized that “[c]urrent practice has allowed patent holders to recover damages . . . based on the entire value of the infringing product even where the patented technology is a small part of the infringing product. . . . Fear of having to pay excessive damages forces defendants to settle lawsuits and license technologies even where the validity of the patent is doubtful.” Likewise, the CPF has long stated that the “amount of money potentially at stake in the litigation as a result of [the EMV rule] creates huge pressure on the defendants to settle regardless of the strength of the infringement claim.”

In critiquing the legislation, the Commerce Department argued that the *Georgia-Pacific* factors already direct courts “to consider the contribution of other elements of the entire product added by the infringer.” The Communications Workers of America similarly wrote that “courts already follow a multipoint system for the appropriate consideration for damages. This should remain intact rather than constricted so as to limit damage settlements.” The 21st Century Coalition complained that the “prior art subtraction” requirement from the House bill is “untested,” “fundamentally flawed,” and “unworkable.” The House methodology allegedly “heavily favors infringers, as most inventions are not as valuable at the time they are first conceived as they are after the inventor invests time and money to develop, manufacture, and market them.” The AFL-CIO, IEEE, ABA, United Steelworkers, BIO, and others have raised similar concerns.

Further action may not occur until 2008. But if ultimate legislation is anything like the current proposals, the landscape for patent damages will change significantly.