



## Federal Circuit Declares a Common Basis for Estimating Patent Infringement Damages to be “Fundamentally Flawed”

In light of a recent decision by the U.S. Court of Appeals for the Federal Circuit (CAFC), patent owners and accused infringers need to carefully consider the evidence used to support a claim for damages in every patent infringement lawsuit.

In the decision (*Uniloc USA, Inc. et al. v. Microsoft Corp.*, CAFC appeals nos. 2010-1035 and -1055, published on January 4, 2011), the CAFC rejected use of a common analytical tool (“the 25% Rule”) as a basis for calculating damages arising from infringement of a patent.

In patent infringement cases, the patentee has the burden of proving that an accused infringer has, in fact, infringed the patent at issue. A patentee who proves infringement also bears the burden of proving the quantity of damages to which it is entitled on account of the infringement. The patent statutes specify that damages for patent infringement shall be “in no event less than a reasonable royalty for the use made of the invention by the infringer.” Quantification of a “reasonable royalty” can be difficult in many circumstances.

Because there is often no objective evidence of the amount of money that represents a reasonable royalty, patentees must commonly rely on indirect evidence to prove their damages. Such indirect evidence can include expert testimony and use of models to determine a reasonable royalty. The 25% Rule is one such model. The 25% Rule posits that a willing licensee will ordinarily agree to share about a quarter of its profits attributable to a product with the owner of a patent that would be infringed by manufacture, use, or sale of the product. Although relatively common, the 25% Rule is not universally accepted and many commentators have suggested that the 25% Rule is a poor rule of thumb in various factual situations.

In the *Uniloc* decision, a three-judge Panel of the CAFC acknowledged that the 25% Rule has been widely used, even in cases decided by the CAFC. The panel asserted, however, that admissibility of testimony of a damages expert that incorporates the 25% Rule had not previously been squarely addressed by the CAFC.

In the dispute, Microsoft Corporation’s sale of its Word® and Windows® software products was alleged to infringe a patent owned by Uniloc USA, Inc. The Uniloc patent relates to a particular method for preventing unauthorized copying of the product by a user. As a part of its case, Uniloc presented the testimony of an expert who offered opinions that

- i) a Microsoft document indicated that the value of the copy-protection feature of the Word® and Windows® software products was \$10 per product unit;
- ii) application of the 25% Rule to that \$10 figure yielded a “reasonable royalty” value of \$2.50 per product unit; and

iii) multiplying this value by the number of product units sold during the relevant period indicated a total reasonable royalty amount of about \$565 million.

The jury returned an infringement verdict and awarded Uniloc about \$388 million. Microsoft appealed the damage award before the CAFC.

In the *Uniloc* decision, the CAFC Panel noted that prior CAFC decisions had rejected, as insufficiently supported, expert testimony pertaining to reasonable royalty rates when that testimony was based on comparisons with patent license agreements for products considered insufficiently similar to the accused infringing product. The Panel considered whether there was sufficient support for expert testimony applying the 25% Rule in the appealed case.

Before the trial court, Uniloc's expert justified his use of the 25% Rule by testifying that the 25% Rule had been accepted in other patent cases and that he considered the 25% Rule an appropriate basis for estimating a reasonable royalty. The CAFC Panel faulted Uniloc's expert for failing to establish any reasonable basis for applying the 25% Rule to the particular case before the court – i.e., for using the 25% Rule to calculate a reasonable royalty for the copy-protection feature of Microsoft's accused software products.

As with all other types of expert testimony, that relating to proof of infringement damages must meet the criteria set forth by the U.S. Supreme Court in *Daubert v. Merrell Dow Pharmaceuticals*, 509 U.S. 579 (1993) and related cases. According to the *Daubert* criteria, the trial judge must assume a gate-keeping role when the admissibility of expert testimony is challenged, admitting only expert testimony that is reliable and relevant to the dispute at issue in the case.

The *Uniloc* Panel held that the Uniloc expert's testimony regarding the 25% Rule failed to satisfy the *Daubert* criteria because Uniloc had failed to establish that application of the 25% Rule yielded an estimated royalty that was relevant to the specific dispute before the court. The Panel held that the testimony of Uniloc's damages expert (at least the portion pertaining to application of the 25% Rule) should not have been admitted by the trial judge and that the testimony tainted the jury's damage calculation. The Panel awarded Microsoft a new trial on the issue of damages.

As a precedential decision of the CAFC, the *Uniloc* decision is binding on all Federal District courts in patent infringement disputes. Thus, in every patent litigation matter, the trial judge can be called upon by one litigant to exclude another litigant's expert testimony relating to calculation of reasonable royalties and other damages. A well-prepared patent litigant will be prepared to defend the basis underlying its damages expert's opinion and to challenge that of its opponent's.

A copy of the *Uniloc* decision is available at this link.

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The criticality of developing and presenting a relevant and reliable basis for an award of patent infringement damages has long been appreciated by careful patent litigators. Patentees should note that even the most convincing evidence of infringement may be for naught if

adequate proof of damages is not presented to the trial court. Accused infringers can look to the *Uniloc* decision for guidance on excluding speculative “evidence” proposed by patentees for the purpose of inflating purported damages.

Analyzing and developing the adequacy of proof of patent infringement damages is a highly complicated and fact-intensive undertaking. The *Uniloc* decision is but one of many court decisions that must be taken into account. Attorneys with the Dilworth Paxson LLP firm stand ready to assist their clients in navigating the intricacies of these and other patent litigation matters.



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