STONETURN GROUP

SELECTED RECENT DEVELOPMENTS IN INTELLECTUAL ASSET AND IP DAMAGES LITIGATION

Alan Ratliff, CPA-JD
Direct: (713) 353-4662
Cell: (832) 435-3535
Fax: (832) 202-0540
aratliff@stoneturn.com

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INTRODUCTION

The focus of this article is litigation involving intellectual assets and intellectual property (IA/IP), focusing on patent, copyright and trade secret disputes.

Historically, patent litigation is recognized for yielding more frequent and sizeable damage awards when compared to copyright and trade secret litigation (although, there have certainly been some large copyright, trade secret and breach of license damage awards as well).[1] In fact, in 2005, five of the twenty-five largest damage verdicts were IP cases and the two largest of those five (totaling damages of more than $600 million) were not patent infringement cases.[2] Based on prior year NLJ Top 100 reports, several $100+ million copyright, trade secret and breach of license damage awards and settlements have occurred since 2000 and, for the first time since accurate electronic case tracking has been available, there were more copyright litigations filed in federal court last year than any other type of IP litigation.[3] And, as the table below shows, the trend continued into 2005 with copyright filings occurring at nearly double the rate of patent filings, and copyright filings representing the only category with increased filings compared to 2004.[4]

Case Type	2003	2004	2005
COPYRIGHT	2,711	4,304	5,421
PATENT	3,016	3,359	2,761
TRADEMARK	3,838	3,951	3,676

At least in part, this trend is reasonably attributable to the growing use of the statutory damage provisions including, e.g., those under the DMCA that provide for not less than $200 in damages for each act of circumvention of a security measure.[5] While the damage amount is small, when multiplied by thousands of violations (which could easily occur in a single day on a large computer network), the damages can really add up.

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[1] See, e.g., PwC's "Accounting for Damages in IP Litigation," http://www.buildingipvalue.com/05_SF/354_359.htm (2004); "Patent Infringement Lawsuits/Licensing Awards" (InteCap, Inc. 2003); "Significant Awards & Settlements," http://www.fticonsulting.com/ip/presentations/ip_chart_feb/slide0006_files/slide0145.htm (copyright, trade secrets, trademarks), http://www.fticonsulting.com/ip/presentations/ip_chart/slide0001_files/slide0133.htm and http://www.fticonsulting.com/ip/presentations/ip_chart/slide0003_files/slide0135.htm (patents).

[2] National Law Journal, "The Top 100 Verdicts of 2005" (February 20, 2006).

[3] Based on a query of the Public Access to Court Electronic Records (PACER) database, an electronic public access service that allows users to obtain case and docket information from Federal Appellate, District and Bankruptcy courts, and from the U.S. Party/Case Index. The search was for Case Types 820, 830 and 840 (Copyright, Patent and Trademark, respectively) at https://pacer.login.uscourts.gov/cgi-bin/login.pl. Trade secret cases don't have their own code, so no analysis of that trend is reflected here.

[4] *Id.* Based on query as of March 3, 2006, copyright, patent and trademark filings to date are 819, 450 and 622, respectively.

[5] 17 U.S.C. §1201-§1203 (not less than $200 per violation).

That said winning damages, much less significant damages, in IA/IP related copyright and trade secret litigations is by no means a slam dunk. For example, in *Ellison v. AOL*,[6] the court reminded of the need, in more indirect cases of liability (e.g., contributory and vicarious copyright infringement), to "link" the allegedly infringing act to the damages.[7] This includes requiring that the defendant have "direct financial benefit from the infringement" and "the right and ability to supervise the infringing activity," or know or have reason to know "of the infringing activity taking place" such that the defendant "materially contributed to the infringing activity." [8] This view may soften in light of *Grokster* (discussed during another session of this Institute), but the impact of *Grokster* on damages (the Supreme Court's ruling focused on liability) is as of yet unknown.

The remaining focus of this article is on the caveats and difficulties associated with obtaining significant damage awards in IA/IP litigation. This article is not a comprehensive survey of cases, but highlights some important recent cases and trends.

A. Background

University Computing Company v. Lykes-Youngstown Corporation, et al., 504 F.2d 518 (5^{th} Cir. 1974)

While it is a somewhat older precedent, the outline of common law damages for the torts of misappropriation and infringement of intellectual asset rights described in *University Computing*,[9] is consistent with the approach followed in most jurisdictions today. Generally, these remedies derive from federal patent and copyright law, and may include losses to the plaintiff such as lost profits, loss in value or a royalty, or disgorgement of benefits to the defendant based on unjust enrichment such as defendant's profits, avoided costs or other advantages gained (e.g., head start).[10]

Based on this conceptual framework, the cases that follow demonstrate some successes and the many challenges associated with proving these damages in today's complicated transactions and complex marketplace.

[6] No. 0255797, 04 C.D.O.S. 1198 (9^{th} Cir. 2004).
[7] *Id.*
[8] *Id.*
[9] *University Computing Company v. Lykes-Youngstown Corporation*, et al., 504 F.2d 518 (5^{th} Cir. 1974).
[10] *Id.* at 535-38.

B. Recent IA/IP Cases

1. The 3 Letter Words Plaintiff's Hate to Hear: Fit & Gap

Flowing from *Daubert* and its progeny are many federal rule- and case law-based factors used by courts to determine the reliability of expert opinions.[11] Two concepts receiving a lot of play in the more recent cases I've been reading are "fit" and "gap". Fit relates to whether the methodology used "fits the facts of the case," or at least some parties "some evidence" version of them. The gap concept has been around since *Joiner*, and refers to that analytical gap between the facts, data, assumptions and/or analysis performed and the opinions reached. The case that follows illustrates the importance of both if a plaintiff is to successfully prove damages.

Atlas Copco Tools, Inc. v. Air Power Tool & Hoist, Inc., 131 S.W.3d 203 (Tex.App.—Fort Worth 2004, pet. denied)

Appellant Atlas Copco Tools, Inc. manufactured and sold industrial tools throughout the United States, primarily through regional distributors.[12] Beginning in 1994, appellee Air Power Tool & Hoist, Inc. became one of appellant's nonexclusive authorized distributors within parts of Texas and Louisiana. In May 2000, appellant appointed another Texas distributor, Tooling Technologies, L.L.C., by executing a nonexclusive distribution agreement, which included beneficial provisions that appellee's agreement did not contain.[13]

Soon after, appellant began assigning customers between the two distributors. In September of 2000, a new contract was negotiated between appellant and appellee. Appellee felt it was coerced into signing the new agreement, which ceded large, existing customers to Tooling Technologies. During late 2000, appellant began receiving service complaints from its Motor Vehicle Industry ("MVI") customers, which purchased the more complex electrical tools as opposed to basic pneumatic "air powered" tools. As a result, in late 2000 and early 2001, appellant assigned all of appellee's MVI accounts to Tooling Technologies. Appellee felt it was forced to agree to these changes. Appellant notified appellee's "reassigned" customers by email.[14]

Appellee filed suit against appellant and Tooling Technologies for anticompetitive practices under Section 15.05 of the Texas Free Enterprise and Antitrust Act ("TFEAA"), false promise of future performance, business disparagement, tortious interference with prospective relationships, fraud and constructive fraud, misrepresentation of confidential

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[11] See, e.g., Adroguè & Ratliff, "Kicking The Tires After *Kumho*," Vol. 37 HOUSTON LAW REVIEW No. 2, 431-514 (Summer 2000) and "The Independent Expert Evolution," Vol. 34 TEXAS TECH LAW REVIEW No. 4, 843-897 (2003).

[12] *Atlas Copco Tools, Inc. v. Air Power Tool & Hoist, Inc.*, 131 S.W.3d 203, 205 (Tex.App.—Fort Worth 2004, pet. denied).

[13] *Id.*

[14] *Id.*

information, and negligent or intentional misrepresentation. The trial court granted summary judgment for Tooling Technologies on all claims against it.[15]

At trial, the jury found: (1) appellant engaged in “a contract, combination or conspiracy in restraint of trade” and that such action was “willful and flagrant” under the TFEAA; (2) appellant disparaged the business or reputation of appellee; and (3) appellant breached the relationship of trust and confidence that existed between appellant and appellee.[16] Based on the jury's findings, the trial court awarded appellee $700,000, which it trebled pursuant to the finding of willful or flagrant conduct under the TFEAA to $2,100,000, attorney's fees in the amount of $123,761.56, and court costs in the amount of $9,160.60.[17] The court of appeals reversed the judgment because damages were not computed using a proper methodology under Texas law and were otherwise based on speculation.[18]

Under Texas law, a party seeking to recover lost profits must prove the loss through competent evidence with reasonable certainty, and opinions or estimates of lost profits must be based on objective facts, figures, or data from which the amount of lost profits can be ascertained.[19] The court explained that reasonable certainty is not established when the profits claimed to be lost are largely speculative or a mere hope for success, as from an activity dependent on uncertain or changing market conditions, on chancy business opportunities, or on promotion of untested products or entry into unknown or unproven enterprises.[20]

The damages expert testified about lost profits, loss to goodwill and relied on analyses that projected relevant financial data six years into the future.[21] These projections, however, ignored the terms of the agreement, the facts of the case, and Texas law regarding the calculation of lost profits.[22] The court considered the future six year period mere “speculation.”[23] Furthermore, the expert projected a dramatic increase in appellee's sales of appellant's products over the six-year period that bore no relation to established facts and results, and incorrectly calculated profits by measuring lost gross profits, not lost net profits, as Texas law requires.[24] The expert’s testimony was also ineffective because she improperly deducted the incremental costs of selling the tools and failed to deduct other expenses incurred in carrying on the business, as required by Texas law.

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[15] *Id.*
[16] *Id.* at 205-06.
[17] *Id.* at 206.
[18] *Id.* at 209.
[19] *Atlas Copco Tools, Inc.*, 131 S.W.3d at 206.
[20] *Id.*
[21] *Id*.
[22] *Id.*
[23] *Id.*
[24] *Id.* at 209.

Although the court did not use the words "fit" or "gap", clearly the court found that given the absence of objective facts, figures, or data from which the amount of lost profits can be ascertained, the lost profits methodology did not "fit the facts" of this case. Similarly, assumptions about the length of the damages period, sales growth during that period, and failure to account for all expenses created an "analytical gap" between the facts, data and assumptions, and the damages opinions proffered by the expert.

Fluorine On Call v. Fluorogas, 380 F.3d 849 (5th Cir. 2004)

The absence of "fit" and the existence of a "gap" in more dramatic proportions arose later in 2004 when the Fifth Circuit reversed a damage award of more than $120 million because the expert's opinions on damages were considered speculative.[25] In connection with a Memorandum of Understanding (MOU) regarding a license for fluorine generators, the licensor repudiated the handwritten MOU six months after it was signed. The court found that the district court properly concluded that the MOU was an indefinite length contract, that it was terminable at will, and that the jury could read a reasonable term into the contract. The court reversed the multi-million dollar award for lost asset damages because the record contained no evidence of the exclusive license's market value. The court reversed the judgment on the fraud claims and the derivative liability claim, and the court rendered judgments in favor of the licensor and the parent corporation on those claims. The court reversed the attorney fee award and the summary judgment in favor of the competitor, and the court remanded those issues for further proceedings. The court reversed the punitive damages award.[26]

More specifically, concerning economic damages, the court determined that the available remedy was loss in market value of an exclusive license for a new business with no history of profitability that alleged, in effect, that an exclusive supplier became its competitor and usurped its business opportunities. While the expert performed an analysis that was arguably similar to loss in value (plaintiff's argue that he simply didn't use those "magic words"), the result of the expert's analysis was characterized by the expert as a determination future lost profits which the court found to be speculative.[27]

[25] *Fluorine On Call Ltd. v. Fluorogas Ltd.*, 380 F.3d 849, 861 (5th Cir. 2004).
[26] *Id.*
[27] *Id.*

In this case, the damages awarded were based on plaintiff's contract claim. As a result, plaintiff's loss in value (also called lost asset) claim was characterized within the contract damages scheme as a claim for consequential damages.[28] Despite the ultimate finding that the damage computation was speculative, the court's analysis remains very instructive.

According to the court, the loss in value or lost asset measure of damages is the "market value of the asset at the time of breach - not the lost profits that the asset could have produced in the future [citations omitted]."[29] This amount is connected to a "buyer's projections of what income he could derive from the asset in the future [citations omitted]." [30] Further, the court noted that the market value damages were "based on future profits as estimated by potential buyers who form the 'market' and 'reflect the buyer's discount for the fact that the profits would be postponed and . . . uncertain."[31]

Nonetheless, "the market value of an income-producing asset is inherently less speculative than lost profits because it is determined at a single point in time. It represents what a buyer is willing to pay for the chance to earn the speculative profits."[32] Further, the court noted "the same kind of market-value proof is sometimes required to prove general damages to prove 'hybrid' damages for the loss of an income-producing asset. But the two remain analytically distinct."[33]

Reviewing other authorities, the court listed several methods for determining the market value in the absence of a standardized market or exchange, including evidence of sales of comparable assets as well as considering what a hypothetical buyer would pay for the chance to earn future profits, though the best evidence of this value is an actual sale of the asset.[34]

[28] *Id.* at 860.
[29] *Id.*
[30] *Id.*
[31] *Id.*
[32] *Id.*
[33] *Id.*
[34] *Id.*

2. Limits on Flexibility in Proving Unjust Enrichment: Acquisition Price

Alcatel USA , Inc. v. Cisco Sys., Inc., 239 F.Supp.2d 660 (E.D.Tex. 2002)

The lawsuit between plaintiff Alcatel and its competitor Cisco arose from alleged patent and copyright infringement, as well as other tortious acts (including the misappropriation of trade secrets), committed by Cisco and Monterrey Networks, a company Cisco acquired in 1999.[35] Alcatel alleged that Monterrey and Cisco systematically misappropriated and used cutting-edge Alcatel technology to develop and market a product called the Wavelength Router, a telecommunications product allegedly designed to compete directly with Alcatel's products.[36]

Alcatel further contended that Monterrey's ability to get the Wavelength Router ready to market quickly was critically important to Monterey.[37] First, certain major national customer accounts were contingent upon Monterey's ability to quickly develop the Wavelength Router and, second, Monterey's speed to the market increased the likelihood that it would be acquired by Cisco and would increase the price that it would command.[38] Monterrey was able to achieve this accelerated product development by hiring Alcatel employees in 1998 who disclosed Alcatel's trade secrets.[39]

Cisco acquired Monterey for a little more than $500 million in 1999, in two separate transactions.[40] Subsequently, in April of 2001, due to its failure to complete any sale of the Wavelength Router, Cisco cancelled the project.[41]

In connection with summary judgment proceedings, the court questioned Alcatel's $500 million damages claim.[42] Alcatel's expert calculated the damages using a simplistic acquisition price methodology; the expert assumed that Monterrey's entire value rested on the allegedly misappropriated trade secrets and thus reasoned that the value of the trade secrets must have been the entire purchase price paid by Cisco to acquire Monterrey.[43] The court commenced its criticism of the damages experts:

> This Court has long been suspicious of Alcatel's alleged entitlement to an award of over a half [of] a billion dollars. During a hearing in July 2001 on various pending motions in this case, the Court, *sua sponte*, questioned the propriety of Alcatel's prospective damage theory. To help dispel these

[35] *Alcatel USA , Inc. v. Cisco Sys., Inc.*, 239 F.Supp.2d 660, 662 (E.D.Tex. 2002) (mem.).
[36] *Id.*
[37] *Id.* at 664.
[38] *Id.*
[39] *See id.* at 663.
[40] *Id.* at 664.
[41] *Alcatel USA, Inc.*, 239 F.Supp.2d at 665.
[42] *Id.*
[43] *Id.* at 666.

> concerns, the Court ordered the parties to brief the legal viability of Alcatel's damage theory. . . . In its brief, Alcatel argued that it was entitled to recover the value of the trade secrets at the time of the misappropriation. Alcatel further argued that this value could be measured based on a reasonable royalty or unjust enrichment. In response to Alcatel's brief on damages, Cisco filed a motion for summary judgment . . . . In its motion, Cisco argued that Alcatel's damage theory was untenable because Alcatel had not suffered any lost profits as a result of the alleged misappropriation and that, due to its cancellation of the Wavelength Router, Cisco had not profited from sales based on Alcatel's intellectual property. Accordingly, for these and other reasons, Cisco insisted that Alcatel could not recover pursuant to any conceivable damage theory.[44]

In a previous ruling the court identified one damages approach that was conceivably available to Alcatel, the reasonable-royalty method.[45] The court held that such an approach is appropriate, for example, where the trade secret has not been destroyed, where the plaintiff is unable to prove specific injury, and where the defendant has not gained any profits to use in valuing the secrets.[46] The court further acknowledged that, where "damages are uncertain," the uncertainty should not "preclude recovery" and the "plaintiff should be afforded every opportunity to prove damages once the misappropriation is shown."[47]

Despite affording Alcatel every benefit of the doubt, and in spite of the insistence of Alcatel's expert that Monterrey's acquisition price was a reasonable measure of the trade secret's value, the court was not persuaded to abandon well-established trade secret damage law principles. Addressing the basis for the expert's opinion:

> In the Court's opinion, these assumptions and opinions, all of which serve as the foundation for Alcatel's damage theory, are simply too speculative. A break or non-occurrence in any of the above chain of events would eviscerate the foundation of Alcatel's damages, and consequently, Alcatel's damage theory is rendered exceedingly uncertain.[48]

The court continued, addressing the expert's methodology:

> Aside from the speculative assumptions on which Alcatel's damage theory rests, there is substantial uncertainty as to the amount of damages Alcatel allegedly suffered. In the Court's opinion, the value of the alleged trade secrets cannot be reasonably extrapolated from the purchase price of

[44] *Id.* at 665.
[45] *Id.*
[46] *Id.*
[47] *Alcatel USA , Inc.*, 239 F.Supp.2d at 667 (quoting *Univ. Computing Co. v. Lykes-Youngstown Corp.*, 504 F.2d 518, 538-39 (5th Cir. 1974)).
[48] *Id.* at 668.

> Monterey. Because Alcatel is not claiming it suffered lost profits from Monterey's alleged misappropriation or that Monterey or Cisco financially benefited from direct sales, for example, of the allegedly infringing product, Alcatel's damage theory necessarily seeks to recover the value of the alleged secrets to Monterey/Cisco. Furthermore, this measure is to be calculated based on a reasonable royalty to which the parties would have agreed at the time of the alleged misappropriation. While the Court recognizes that some degree of speculation is inherent in calculating a suppositious licensing agreement between two parties that has never occurred, this hypothetical construct, however, must contain some degree of certitude. After all, the method does not permit the recovery of a simple royalty, but only a reasonable one. In this regard, Alcatel's attempt at recovering the value of the alleged trade secrets based largely on the acquisition price of Monterey, contravenes fundamental notions of reasonableness.[49]

The court noted the "[e]stimation of damages . . . should not be based on sheer speculation. If too few facts exist to permit the trier of fact to calculate proper damages, then a reasonable remedy in law is unavailable."[50] Moreover, "evidence by which the jury can value the rights the defendant has obtained," and the value of these rights should not "be based on sheer speculation."[51]

Even assuming that Alcatel's questionable valuation approach was generally accepted, the court criticized the application of the methodology, including: (1) the expert's use of the acquisition date rather than the misappropriation date to value the trade secrets (problematic because it ignores events that may have affected value between those dates and takes into account information, including the acquisition price itself, that could not have been known by the parties at the hypothetical negotiation date);[52] (2) the failure to apportion the acquisition price to the trade secrets;[53] (3) the dearth of case law recognizing the acquisition price of a company as a measure of a reasonable royalty in the absence of actual lost profits;[54] and (4) the inadmissibility of purchase price evidence where the evidence relies on speculative profit projections based on "uncertain or changing market conditions, or on changing business opportunities, or on promotion of untested products, or entry into an unknown or unviable markets, or on the success of a new and unproven enterprise."[55]

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[49] *Id.* at 669.
[50] *Id.* at 670 (quoting *Metallurgical Indus., Inc. v. Fourtek, Inc.,* 790 F.2d 1995, 1208 (5th Cir. 1986).
[51] *Id.* at 668.
[52] *Id.* at 670.
[53] *Alcatel USA , Inc.*, 239 F.Supp.2d at 670.
[54] *Id.* at 672.
[55] *Id.*

Looking, as courts often do, to federal patent law to guide the damages analysis in trade secret cases, the court quoted from a recent federal circuit decision in closing out its critique of the expert's acquisition-price methodology:

> [T]he price received by an infringing defendant for the sale of its business is not sound evidence on which to measure damages in a reasonable royalty case. . . . Reasonable royalty damages for patent infringement arise from the fact of infringement, and the portion of the sales price consisting of intangible goodwill is not the sale of infringing goods. It is partial compensation for the sale of a business. . . . [C]ompensation in excess of tangible assets, is not sales of infringing goods that can form the base for determination of a reasonable royalty.[56]

Based on the three-and-half-years of litigation in which Alcatel had the opportunity to develop a supportable theory of damages and failed to do so, the district court granted summary judgment against Alcatel.[57]

Storage Tech. Corp. v. Cisco Sys. Inc., 395 F.3d 921 (8th Cir. 2005)

In a similar situation also involving Cisco, the Eighth Circuit found that, although restitution damages were available after Cisco Systems allegedly stole employees from rival (renamed) StorageTek, Cicso was unable to prove the $450 million in damages claimed in its corporate raiding lawsuit.[58]

In 1999, the founders of NuSpeed Internet Systems developed a product to link computers at one location to data storage networks at other locations through the Internet or other networks.[59] Within a month of starting their business, they hired Mark Schrandt, an engineer at StorageTek, which was developing data storage networking products. Schrandt told four other StorageTek engineers about his impending move and encouraged them to join him at the new company. Within a year NuSpeed had hired 22 more engineers who were or had been employed at StorageTek, as NuSpeed grew to employ 78 employees. In early 2000, a new open Internet protocol--iSCSI (Internet, Small Computer Systems Interface)--was published and NuSpeed quickly began working on incorporating iSCSI in its product; within months it became one of the first companies to use the technology to transmit data and hoped to be the first company to bring the product to market.[60]

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[56] *Id.* at 672 (relying on and quoting *Transclean Corp. v. Bridgewood Servs., Inc.*, 290 F.3d 1364, 1375-77 (Fed. Cir. 2002)).
[57] *Id.* at 673.
[58] Storage Tech. Corp. v. Cisco Sys. Inc., 395 F.3d 921 (8th Cir. 2005).
[59] *Id.* at 922-24.
[60] *Id.*

Cisco Systems acquired NuSpeed in September 2000 in a stock-for-stock transaction in which NuSpeed's shareholders received $450 million in Cisco stock. Although the technology was indeed the first onto the market, Cisco never made a profit on NuSpeed and instead had operating losses of $50 million. StorageTek alleged claims for interference with contractual relations for hiring away persons with whom StorageTek had employment contracts, inducing breach of contracts, conversion of confidential information, inducing breach of fiduciary duties by former Storage Technology employees, and for misappropriation of trade secrets.[61]

In sum, the Eighth Circuit determined no damages had been established on the basis that the trial court was "well within its discretion in deciding that [the expert's] testimony was so uninformed and baseless that it could not assist the jury in the task of fixing damages."[62] Although the Eighth Circuit ruled that StorageTek was entitled to damages after it proved a Cisco unit had poached 27 employees who had signed confidentiality agreements and employment contracts, it failed to explain how it was specifically hurt by the tortious interference with contracts.[63]

Instead of proving specific damages, StorageTek argued that it was owed restitution in the amount of Cisco's alleged unjust enrichment, which involves determining how Cisco profited from StorageTek's loss of employees.[64] StorageTek asserted the amount of unjust enrichment should the $450 million Cisco spent to buy the unit that originally lured the employees away. "Storage Technology's entire evidentiary basis for a restitutionary remedy consisted of the report of its expert" who argued that Cisco's valuation of NuSpeed was $450 million.[65] That amount, the expert argued, represented a proper valuation of the damages to StorageTek and due to it for the trade secret appropriation, corporate raiding, and breach of contract and fiduciary responsibilities promulgated.[66]

Contributing to the court's conclusion that the acquisition price methodology was not a reasonable basis for determining damages to a reasonable certainty was that the expert "attributed the entire value of the NuSpeed acquisition to employees and trade secrets wrongfully appropriated from StorageTek, even though NuSpeed had other assets and employees."[67] The expert, the Eighth Circuit said, "did not attempt to value the people or the technology supposedly belonging to StorageTek by any means other than by ascertaining what price Cisco paid for NuSpeed."[68] The expert never considered the

[61] *Id.*
[62] *Id.* at 928.
[63] *Id.* at 925-26.
[64] *Id.* at 923.
[65] *Id.* at 926.
[66] *Id.*
[67] *Id.*
[68] *Id.*

value of the misappropriated technology--which ended up not being successful--and even admitted during his testimony that he did not know what the technology was.[69]

The Eighth Circuit compared the expert's testimony to evidence in the aforementioned *Alcatel* case with similarly "dubious and tenuous inferences" that would be required to conclude that certain information was the crucial ingredient on which hung the whole value of the acquired company.[70] "Storage Technology has done no better a job than Alcatel in establishing that the purchase price of the acquired company was due entirely, or at all, to the presence of Storage Technology engineers and knowledge, or in helping the jury apportion the acquisition price between assets attributable to Storage Technology and assets having no relation to Storage Technology."[71]

While these cases demonstrate the difficulty of obtaining damages based on acquisition or purchase price in common misappropriation or similar statutory business tort claims, the result is consistent with long-standing contract law, as discussed in the *Arkoma Basin* decision hereafter.

3. Even the Jury's Determination of a Reasonable Royalty Without Any Error in the Admission of Evidence or the Jury Charge Isn't Safe…And Other Unresolved Patent Damages Issues

In one of the few significant patent damages decisions in 2005, a $61 million jury verdict was reduced to $17.5 million by the trial and appellate courts.[72] Harris accused Ericsson of infringing its '338 patent relating to software program that restores wireless signals upon receipt to their original discrete values when transmitted. Harris won a $61 million jury award based on a reasonable royalty. Plaintiff's damages expert opined that the reasonable royalty should be 1.75% at the proposed date of the hypothetical negotiation and decline to .5% just before the actual damages period (based on the date of notice).[73] Ericsson's damages expert proposed a fractional rate of about .05% and the jury awarded 1.75% on $3.5 billion of accused sales during the actual damages period.[74] On motion after trial, the district court determined that a dual royalty structure absent subsequent events was not allowable and re-computed the royalty using a weighted average yielding a single royalty rate of 1.24%, reducing royalty damages to $43 million.[75] Ericsson sought a further reduction of appeal to $17.5 million based on the .5% rate.

[69] *Id.* at 927.
[70] *Id.* at 928.
[71] *Id.*
[72] *Harris Corporation v. Ericsson Inc.*, No. 03-1625, -26 (Fed. Cir., August 5, 2005).
[73] *Id.* at 6.
[74] *Id.* at 28.
[75] *Id.* at 7.

Despite remanding the infringement findings for further proceedings at the trial court, in anticipation of similar damage issues upon re-trial, the Court reviewed the damages determination as well. In particular, the Court found the trial court abused its discretion for computing damages based on a blended rate given that the rate applicable during the actual damages period was the lower of the two rates.[76] The Court confirmed its long-standing view that the royalty rate should be one that is believed would result from a hypothetical negotiation between the parties at the date of first infringement but without inflexibly excluding relevant evidence of subsequent events.[77] The Court rejected Harris' suggestion that the jury awarded the higher rate (1.75%) in response to Ericsson's "indefensibly low rate" of .05%.[78]

In sum, despite focusing on reversing the trial court's post-trial re-computation of damages, effectively the Court reversed the jury's use of the 1.75% rate as being contrary to the evidence reflecting that the royalty during the damages period should only be .5%. Notwithstanding this bad news for Harris, the Court left intact the jury finding of willfulness and the trial court's award of $1 million in enhanced damages.

Concerning other unresolved issues in patent damages, while no 2005 cases raised these, they remain in play for future determinations by the Federal Circuit, including:

- Is design around or next best alternative a limit on the reasonable royalty? (*Grain Processing* & *Lextron* 2003)
- How do you compute the royalty on offered for sale/used/imported vs. sold? (*Vulcan, Sci-Med*)[79]
- How useful are average royalty rates from the typically not-so-comparable third-party licenses obtained from public sources and databases for purposes of determining the reasonable royalty in a particular case? (*Integra*)
- When does the hypothetical negotiation occur, and as to what subject matter, where there are multiple patents and claims, including re-examinations, with different dates of first infringement (and, thus, hypothetical negotiation dates)? *(Catalina Lighting*)
- What is the royalty base, what collateral or convoyed sales are included, and how is this analysis affected by the entire market value rule? (*Bose, Riles, Interactive Pics*)
- How reliable are sales "projections" and how can they be used in determining the reasonable royalty and lost profits? (*Interactive Pics, Shockley*)
- How can you get known but unquantifiable indirect sales into the royalty or lost profits base? (*Mabuchi, Sci-Med*)

[76] *Id.* at 27.
[77] *Id.*
[78] *Id.*
[79] Also see discussion in Sternstein, "Are Significant Patent Damages Being Overlooked," National Law Journal at S12, 14 (January 23, 2006).

C. Recent Trends in Real World Royalties[80]

In 2001, the Analysis Group performed an analysis of average royalty rates in 15 industries based on the licensing transactions contained in the RoyaltySource database. The first study reflected an upward trend in average royalty rates (6%+) which had long hovered around 5% based on earlier studies performed by various consultants and reported by LES. The 2005 update to this study reflects that average royalty rates continue to increase based on a review of 6,000 transactions over the last 19 years. Average rates increased to 6.7% from 6.6% in 2004 and 6% in 2001.

Table 1: RoyaltySource® Transaction Analysis

Industry	Average	Median	Max	Min	Count
Chemicals	4.7%	4.5%	25.0%	0.1%	86
Internet (includes software)	12.9%	9.3%	50.0%	0.3%	102
Telecom (excluding Media)	4.9%	4.5%	15.5%	0.4%	95
Consumer Goods, Retail & Leisure	5.4%	5.0%	40.0%	0.1%	122
Media & Entertainment	10.9%	7.6%	50.0%	1.0%	34
Food Processing	4.0%	2.9%	30.0%	0.3%	44
Medical\Health Products	5.8%	5.0%	50.0%	0.1%	409
Pharmaceuticals & Biotechnology	7.3%	5.5%	50.0%	0.0%	719
Energy & Environment	5.0%	5.0%	20.0%	0.1%	137
Machines/Tools	5.1%	4.5%	25.0%	0.5%	91
Automotive	4.7%	4.0%	20.0%	0.5%	71
Electrical & Electronics	4.6%	4.3%	30.0%	0.5%	136
Semiconductors	4.5%	3.5%	30.0%	0.0%	84
Computers & Office Equipment	5.3%	4.0%	25.0%	0.2%	80
Software	11.8%	7.5%	77.0%	0.0%	198
Industry Summary	**6.7%**	**5.0%**			**2,408**

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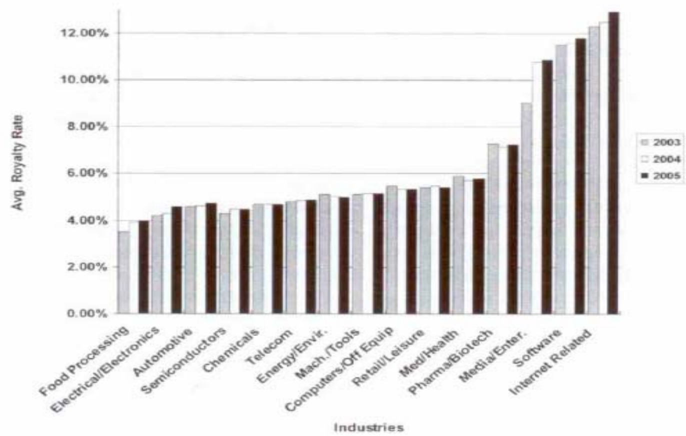
Biotech and pharma represent the most active licensing industries, while the highest rates are in the Internet field. While this study does not track rates awarded in litigation, anecdotal evidence and trends reflected by articles discussing litigation rates published during the first few years of the Analysis Group studies, reflect that rates awarded in litigation have followed the upward trend of real world royalty rates and that litigation rates are typically higher (frequently from 1-3%) than real world rates.[81] The latter observation can be explained where assumptions relating to the hypothetical negotiation differ significantly from realities facing real world negotiators, including the assumptions of validity, infringement and the requirement of a license, as well as converting other real world considerations such as cross-licenses, covenants and supplemental royalties on worldwide sales to account for indirect sales in the U.S. into additions to the reasonable royalty in litigation.

[80] Licensing Economics Review (December 2005).
[81] See., e.g., "Trends in Patent Infringement Damages," IPL Newsletter (Spring 2003).

Figure 1: Average Royalty Rates by Industry (comparing database transactions for years 2003-2005)



D. Recent Non-IA/IP Cases (But Important Nonetheless!)

1. Limits on Flexibility in Proving Unjust Enrichment: Acquisition Price

Arkoma Basin Exploration Co. v. FMF Assocs. 1990-A, Ltd., 118 S.W.3d 445 (Tex. App.—Dallas 2003, no petition)

Although not strictly an intellectual asset or technology litigation, the *Arkoma* case highlights the long-standing view that Courts have not permitted the purchase price to be used as actual value in determining benefit-of-the-bargain damages either. In this case involving oil and gas properties, where certain properties purchased by several partnerships failed to produce the amount of gas predicted, the partnerships sued the sellers for actual and constructive fraud. The trial court determined that Virginia law applied to the case, and the jury awarded damages to the partnerships. The trial court reduced some of the damages and suggested a remittitur. The court of appeals affirmed in part and reversed in part. The partnerships presented sufficient evidence that the sellers were not honest in evaluating the gas reserves. The sellers' manipulation of the data overstated the reserves by two to three times and the life of the wells by several times. Because there was clear and convincing evidence that sellers misrepresented existing fact, assertions that their representations were merely opinions did not shield them from claims of fraud. These opinions, moreover, were supposed to be based on particular data and calculations using that data, and the sellers falsified the results by falsifying the data.[82]

[82] *Arkoma Basin Exploration Co. v. FMF Assocs. 1990-A, Ltd.*, 118 S.W.3d 445 (Tex.App.—Dallas 2003, no pet.).

As to damages, however, the court of appeals held that no "case permits the purchase price to be used as actual value in determining benefit-of-the-bargain damages."[83] In sum, "the partnerships presented no evidence of the actual-value element for the benefit-of-the-bargain damages suffered by HMY, Kahn, Friedman, Greenwald, and Smallwood under Foley's first measure of damages. By presenting no evidence of the actual value of the mineral interests purchased by these five partnerships, these partnerships 'offered no evidence to furnish a range within which a jury could exercise its discretion to award damages in the first place. Without some evidence of the [actual] value . . . [of] the items, the evidence is legally insufficient to support" the jury's damages award.'"[84]

2. However, Some Flexibility Remains in Proving Unjust Enrichment

University of Colorado v. American Cyanamid Company, 342 F.3d 1298 (Fed. Cir. 2003)

In this trade secret misappropriation case relating to confidential information of certain inventors used by a third-party patentee in obtaining a patent on a vitamin supplement, the patentee directly copied tables and significant portions of the inventors' confidential manuscript. The inventors brought a claim of unjust enrichment, and the district court found that the patentee was liable, awarding the inventors the incremental profits the patentee wrongfully made by obtaining the patent, but less than the total profits the patentee made by selling a product incorporating the invention.[85]

Summarizing damages for unjust enrichment and in particular the restitution remedy, the Federal Circuit observed that damages, which are measured by the plaintiff's loss and seek to provide compensation for that loss, are different than restitution because in some cases the defendant gains more than the plaintiff loses, meaning the two remedies may differ in practice as well as in principle.[86] "No wooden formulas exist for determining when restitution of profits realized by a party is permissible."[87]

Further, because it is an equitable remedy, whether profits are awarded to a non-breaching party shall be determined within the discretion of the trial court on a case by case basis.[88] In determining whether restitution of profits or disgorgement in a given case is appropriate, courts must resort to general considerations of fairness, taking into account the nature of the defendant's wrong, the relative extent of his or her contribution, and the feasibility of separating this from the contribution traceable to the plaintiff's interest.[89] Thus, the more culpable the defendant's behavior, and the more direct the connection

[83] *Id.* at 459.
[84] *Id.* at 459.
[85] University of Colorado v. American Cyanamid Company, 342 F.3d 1298 (Fed. Cir. 2003).
[86] *Id.* at 1311.
[87] *Id.*
[88] *Id.* at 1311-12.
[89] *Id.*

between the profits and the wrongdoing, the more likely that plaintiff can recover all of defendant's profits. The trial court must ultimately decide whether the whole circumstances of a case point to the conclusion that the defendant's retention of any profit is unjust.[90]

3. A Lowered Bar for Causation in Proving Indirect Damages, Plus Interest

Bonner v. Dawson, et al., 404 F.3d 290 (4th Circuit 2005)

In this copyright case relating to indirect damages based on defendant’s profits, an architect was hired to select a site for and design a company's new customer service center. The architect recommended a parcel of land owned by defendant landowner. The landowner entered into a lease agreement with the company and hired defendant contractor to perform the construction. The architect's contract did not specify who owned the rights to his design, but each page of the design proposal bore his copyright seal. The company later had the landowner and contractor construct a second building immediately adjacent to the first for use as a computer center. It was similar in style to the first, but was a bit larger and had a distinct interior floor plan. The court held that the architect, by producing evidence of the profits generated by the leasing agreements in the second building which was designed based upon his copyright, had met his burden of establishing the required causal connection under §504(b) as a matter of law. This result despite the fact that defendants had presented evidence that could have led the jury to determine that their profits were attributable to factors other than the copyrighted work.[91]

In sum, once liability has been shown, an initial presumption occurs that the infringer's profits attributable to the infringement are equal to its gross revenue and the burden shifts to the infringer to show that its revenue was attributable to factors other than the copyrighted work.[92] In meeting its initial burden, a copyright holder must show more than the infringer's total gross revenue from all of its profit streams but, rather, revenue reasonably related to the infringement.[93] The copyright owner thus has the burden of demonstrating some causal link (see VW case hereafter for more on the “link” or “nexus”) between the infringement and the particular profit stream.[94]

This result contrasts with the result in another Fourth Circuit case involving the Baltimore Ravens where the trial court granted the team summary judgment excluding some revenue sources from the jury's consideration in determining damages.[95] In sum, the court held summary judgment was properly used to exclude revenue sources which either (1) had no conceivable connection to the infringement, or (2) where, despite the

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[90] *Id.*
[91] *Bonner v. Dawson, et al.*, 404 F.3d 290, 291-293 (4th Circuit 2005).
[92] *Id.* at 294.
[93] *Id.*
[94] *Id.*
[95] *Bouchat v. Baltimore Ravens, et al.*, 346 F.3d 514 (4th Circuit 2003).

existence of a conceivable connection, only speculation was offered to show a causal link between the revenue source and the infringement.[96]

Andreas, et al. v. VW, et al., 210 F. Supp. 2d 1078 (N.D. Iowa 2002), *affirmed in part* and *reversed in part,* 336 F.3d 789 (8th Cir. 2003)

Continuing with the indirect profits theme, but focusing more on the level of causal link or nexus required, the Eighth Circuit reinstated a jury verdict for indirect damages based on defendant's profits upon finding that the plaintiff had demonstrated a nexus between the infringement and the indirect profits.[97] At trial, the jury found that an ad agency used copyrighted material to produce commercials for non-owner manufacturer.[98] The district court held, after the jury returned a verdict for $570,000 of the manufacturer's profits, that there was no evidence to tie the manufacturer's revenues in a non-speculative fashion to the infringement.[99]

The court found that the manufacturer did not sell the copyrighted work or elements of it but, rather, used it in ad copy promoting its sales of automobiles. According to the trial court, the owner failed to present evidence that the revenue received by the manufacturer through the sale of one of its cars was a result of the infringement. However, the trial court agreed that the owner was able to show revenues generated by the sale of the car for the time period of the advertising and infringing use at issue.[100] Thus, despite the fact that there was no direct evidence that meaningfully tied the infringement to the sales of the cars, nor even that the commercial containing the infringing material led to the sale of one car, and no formula inferred a causal relationship between the infringement and sales, the court of appeals concluded that sufficient nexus had been established and that the burden shifted to the infringer to affirmatively demonstrate the absence of nexus as well as any apportionment and other deductions.[101] Further, the court of the appeals affirmed the district court's award of $ 280,000 of the agency's profits attributable to the infringing campaign and the award of pre-judgment interest.

The award of pre-judgment interest is worth special mention since, generally, in copyright cases (unlike patent cases) pre-judgment interest is not customarily awarded. More specifically, the Copyright Act does not provide for prejudgment interest, however, many cases cite decisional law supporting the award of such interest on federal claims even where the governing statute is silent on the issue.[102] Prejudgment interest applies to both royalties and lost profits. Thus, an award of prejudgment interest under federal law

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[96] *Id.*
[97] *Andreas, et al. v. VW, et al.,* 336 F.3d 789 (8th Cir. 2003).
[98] *Andreas, et al. v. VW, et al.,* 210 F. Supp. 2d 1078 (N.D. Iowa 2002).
[99] *Id.* at 1082-83.
[100] *Id.*
[101] 336 F.3d at 797-98.
[102] 210 F. Supp. 2d at 1086-87.

is governed by a two-step analysis. First, the trial court must determine whether an award of prejudgment interest would serve to compensate the injured party.[103] Second, when an award would serve a compensatory function, the court must still determine whether the equities would preclude the award of prejudgment interest.[104] If there is no federal statutory interest rate on prejudgment interest, the rate imposed (e.g., prime rate, the prime rate plus a percentage, the U.S. Treasury rate, state statutory rate, corporate bond rate, or whatever rate the court deems appropriate under the circumstances) will be left to the trial court's discretion, as will whether the interest awarded should be simple or compounded.[105]

Davis v. The Gap, Inc., 246 F.3d 152 (2nd Cir. 2001)

In yet a fourth case on the indirect damages theme, the Second Circuit disallowed indirect damages based on defendant's profits but allowed a reasonable royalty instead.[106] Plaintiff was a designer of eyeglass jewelry and defendant was a major international retailer of clothing and accessories. One of plaintiff's designs appeared prominently on a model in a photographic advertisement for defendant. The plaintiff sued for infringement. The court of appeals affirmed the district court's grant of summary judgment precluding recovery based on defendant's profits because plaintiff's claim (due to an absence of link or nexus) was too speculative, but reversed summary judgment disallowing plaintiff's claim for damages based on defendant's failure to pay the plaintiff a reasonable license fee.[107]

Concerning claims for a royalty in copyright case, the court held that the question is not what the owner would have charged for use of the protected material, but rather what is the fair market value.[108] In order to make out his claim that he has suffered actual damage because of the infringer's failure to pay the fee, the owner must show that the thing taken had a fair market value. But if the plaintiff owner has done so, and the defendant is thus protected against an unrealistically exaggerated claim, there is little reason not to consider the market value of the uncollected license fee as an element of "actual damages" under *17 U.S.C.S. § 504*(b).[109] Furthermore, the fair market value to be determined is not of the highest use for which plaintiff might license but the use the infringer made.[110] In that way, like the result of the hypothetical negotiation in a patent case, the owner's actual damages reflect the reasonable license fee that a willing buyer and a willing seller would have agreed to for use by the infringer.

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[103] *Id.*
[104] *Id.*
[105] *Id.*
[106] *Davis v. The Gap, Inc.*, 246 F.3d 152 (2nd Cir. 2001).
[107] *Id.*
[108] *Id.* at 166-67
[109] *Id.*
[110] *Id.*

4. No Discounts from Retail Price for Infringers

United States v. Slater, 348 F3d 666 (7th Cir. 2003)

In this criminal software piracy case the Seventh Circuit, long-known for its progressive approach to economic damages issues, offers insight into how to determine the value of infringement in connection with a product that is offered for sale at “retail” but always “sold” (under a license) commercially at a much lower price.[111] Obviously, not wanting to give the software pirate the price benefit of being a licensed purchaser, and despite the fact that the pirated usage was non-commercial; the court of appeals held that the district court properly valued the software piracy loss for sentencing purposes by calculating the average retail price per infringing application made available for download.[112] While a court in a civil case could take a different view, typically these issues are looked at more closely in criminal cases due to the added constitutional protections and, having survived such scrutiny, a retail price approach would certainly meet the minimum standard of a reasonable basis based on competent in support of a damages computation.

CONCLUSION

What these cases demonstrate is that plaintiffs can have (and are having) success in non-patent IA/IP litigation using copyright, trade secret, contract and other common law theories. Recent trends reflect an increase in these types of litigations as opposed to patent litigation. At the same time, many complex issues remain unresolved in the field of patent damages leading to uncertainty and, all-to-commonly, reversal.

Although counsel must be careful to develop the damages case using a remedy that fits the facts of the case and is based on an analysis that adequately bridges the gap between the facts, data, assumptions and analyses, and the opinions reached, the plaintiff’s burden is by no means insurmountable. Rather, e.g., while acquisition price-based methodologies are generally considered unreliable for purposes of determining value in connection with damages computations and lost profits are often hard to prove, loss in value analyses that often differ little from lost profit analyses have found favor with courts and presumptions favor parties alleging claims based on indirect damages where at least some showing is made of a causal link or nexus. Lastly, recent decisions support using a reasonable royalty as a proxy for actual damages, awarding pre-judgment interest in copyright cases and using retail price as opposed to average market price for determining infringement damages in cases relating to commercial products.

[111] *United States v. Slater,* 348 F. 3d 666 (7th Cir. 2003).
[112] *Id.*