

# Federal Circuit Provides Guidance on Jury Instructions on Apportionment of Patent Damages

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## I. Introduction

The recent decision by the Federal Circuit in *Ericsson v. D-Link*<sup>1</sup> provided guidance on several issues relevant to the calculation of patent damages. Much attention has been drawn to the fact that this decision was the first from the Federal Circuit to deal with the determination of reasonable and non-discriminatory (“RAND”) royalty rates for standard essential patents (“SEPs”). However, the opinion also provides meaningful guidance on the issues of profit apportionment and the application of the *Georgia-Pacific* factors that can be applied to patent infringement cases not involving SEPs.

This article focuses on the court’s guidance in *Ericsson* on properly instructing the jury on the entire market value rule (“EMVR”) and profit apportionment. We begin by reviewing three notable prior cases in which the courts were faced with this issue. We then describe the Federal Circuit’s ruling in *Ericsson* as it relates to apportionment and its suggestion that parties look to the Supreme Court’s 1884 decision in *Garretson v. Clark*<sup>2</sup> when crafting jury instructions related to apportionment. We then review the relevant language in *Garretson* and conclude by offering practical advice for trial counsel when proposing jury instructions in cases that involve EMVR and/or apportionment issues.

## II. *Seymour v. McCormick* (1854)

More than 150 years ago, the U.S. Supreme Court recognized the need to properly instruct the jury on issues of apportionment when calculating patent damages. In the 1854 case *Seymour v. McCormick*, the patents at issue related to “certain new and useful improvements in the machine for reaping all kinds of small grain” and “certain improvements upon the aforesaid patented reaping machine.”<sup>3</sup> The trial court’s charge (i.e., jury instructions) contained the following direction for calculating damages:

It has been suggested by the counsel for the defendants, that inasmuch as the claims of the plaintiff in question here are simply for improvements upon his old reaping machine and not for an entire machine and every part of it, the damages should be limited in proportion to the value of the improvements thus made, and that therefore a distinction exists, in regard to the rule of damages, between an infringement of an entire machine and an infringement of a mere improvement on a machine. I do not assent to this

distinction. According to my view of the law regulating the measure of damages in cases of this kind, the rule which is to govern is the same whether the patent covers an entire machine or an improvement on a machine. Those who choose to use the old machine have a right to use it without incurring any responsibility; but if they engraft on it the improvement secured to the patentee, and use the machine with that improvement, they have deprived the patentee of the fruits of his invention, the same as if he had invented the entire machine; because it is his improvement that gives value to the machine on account of the public demand for it.<sup>4</sup>

On appeal, the defendant argued that “these rules with regard to damages, as thus laid down by the court, are incorrect, and have produced a verdict for most ruinous damages, far beyond any thing [*sic*] justified by the facts of the case.” The Supreme Court agreed, being “of opinion that the plaintiffs in error have just reason of complaint as regards these instructions and their consequent result.”<sup>5</sup> It explained:

[T]he jury were instructed that the measure of damages for infringing a patented improvement on a machine in public use is the same as if the defendant had pirated the whole machine and every improvement on it previously made, and as a consequence that the plaintiff below had a right to recover as great damages for the infringement of the patent in his second count as if he had proceeded on both counts of his declaration and shown the infringement of all the patents claimed, and that in consequence of these instructions they have been amerced in damages to the enormous sum of \$17,306.66, and with costs to nearly the round sum of \$20,000.<sup>6</sup>

...

We think...that it is 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.”<sup>7</sup>

The Supreme Court thus reversed the trial court’s judgment.<sup>8</sup>

### III. *Lucent v. Gateway* (2009)

In this case, Lucent alleged that Microsoft infringed one of its patents through the sales and use of Microsoft Money, Microsoft Outlook, and Windows Mobile, based on the inclusion of a “date picker” feature in these products.<sup>9</sup> At trial, Lucent’s theory of damages was based on eight percent of sales revenue for the accused software products, and it asked the jury to award \$561.9 million based on Microsoft’s infringing sales.<sup>10</sup> Microsoft countered that a lump-sum payment of \$6.5 million would have been the correct amount for licensing the protected technology.<sup>11</sup> The jury awarded Lucent damages of \$357.7 million.<sup>12</sup> On appeal to the Federal Circuit, Microsoft argued, among other things, that the jury should not have applied the entire market value rule to the value of its three software products.<sup>13</sup>

Amicus briefs were filed by a number of parties, including one by a group of ten technology-based companies that included SAP America, Inc., Bank of America Corporation, Coverity, Inc., Intel Corporation, Micron Technology, Inc., Palm, Inc., Regulatory DataCorp, Inc., Symantec Corp., Trimble Navigation Limited, and Yahoo! Inc.<sup>14</sup> The brief stated:

The Supreme Court has historically policed the law of patent damages carefully to insure that patentees are not overcompensated or undercompensated. That Court has repeatedly admonished trial courts to provide legally coherent guidance to factfinders in cases involving complex patent damages. Amici here now ask this Court to reinvigorate this tradition. In particular, we ask the Court to require trial courts to act as vigorous gatekeepers when it comes to the introduction of damages evidence, and the instruction of juries on damages issues, in patent infringement cases.<sup>15</sup>

The amici made two main arguments: (1) the EMVR has no appropriate place in reasonable royalty calculations, and (2) portfolio licenses covering thousands of patents provide no basis for measuring damages for infringement of a single patent.<sup>16</sup> The brief recommended that juries be guided by the following instruction:

Where a party’s reasonable royalty calculation purports to be based on existing licensing norms that are expressed as a customary percentage times a customary royalty base, the party introducing such evidence must at a minimum show by a preponderance of the evidence that, as compared to the hypothetical license for the patent in suit, the licenses introduced as evidence show (i) a similar royalty base and (ii) a similar royalty percentage that has previously been used in (iii)

a similar license covering (iv) a similar patent.<sup>17</sup>

The amici argued that such an instruction was

essential to help juries make sense of and properly apply the amorphous list of *Georgia-Pacific* factors. Such an instruction would serve two functions. First, it would screen tendered evidence for legal salience, eliminating from jury consideration licenses that bear no reasonable relationship to the hypothetical license at issue in a particular reasonable royalty case. Second, it would help frame the evidence presented, calling the jury’s attention to the importance of comparability, out of the welter of sometimes confusing information permitted under *Georgia-Pacific*.<sup>18</sup>

Although the Federal Circuit called the amicus brief “informative,” it concluded that it “need not address its assertion regarding jury instructions given or not given, for the simple reason that neither party at trial challenged any damages instruction that was given nor proposed an instruction and objected when it was not given.”<sup>19</sup> The court agreed with Microsoft’s argument that substantial evidence did not support the jury’s verdict, finding that to the extent the jury relied on an entire market value calculation to arrive at the damages amount, the award was not supported by substantial evidence and was against the clear weight of the evidence.<sup>20</sup> Accordingly, the court vacated the award and remanded for a new trial on damages.<sup>21</sup>

### IV. *VirnetX v. Cisco* (2014)

In *VirnetX*, the Federal Circuit addressed the proper way to instruct the jury on the entire market value rule. This case involved four patents related to technology for providing security over networks such as the Internet.<sup>22</sup> *VirnetX*’s expert presented damages figures based on the application of several methodologies, including one that involved applying a one percent royalty rate to a royalty base consisting of the lowest sale price of each model of the accused devices containing the accused features.<sup>23</sup> This approach resulted in claimed damages of up to \$708 million.<sup>24</sup> At trial, the jury found that Apple infringed all four of the patents-in-suit and that none of the infringed claims were invalid.<sup>25</sup> It awarded reasonable royalty damages totaling \$368.2 million.<sup>26</sup>

On appeal, Apple argued that the district court’s jury instructions misstated the law on the EMVR. The district court had instructed the jury as follows:

In determining a royalty base, you should not use the value of the entire apparatus or product unless either: (1) the patented feature creates the basis for the custom-

ers' demand for the product, or the patented feature substantially creates the value of the other component parts of the product; or (2) the product in question constitutes the smallest saleable unit containing the patented feature.<sup>27</sup>

The Federal Circuit "agree[d] with Apple that the district court's instruction misstates our law."<sup>28</sup> It explained:

To be sure, we have previously permitted patentees to base royalties on the "smallest salable patent-practicing unit." However, the instruction mistakenly suggests that when the smallest salable unit is used as the royalty base, there is necessarily no further constraint on the selection of the base. That is wrong. For one thing, the fundamental concern about skewing the damages horizon—of using a base that misleadingly suggests an inappropriate range—does not disappear simply because the smallest salable unit is used.

Moreover, the smallest salable unit approach was intended to produce a royalty base much more closely tied to the claimed invention than the entire market value of the accused products. Indeed, that language first arose in the *Cornell* case, where the district court noted that, rather than pursuing a "royalty base claim encompassing a product with significant non-infringing components," the patentee should have based its damages on "the smallest salable infringing unit with close relation to the claimed invention." In other words, the requirement that a patentee identify damages associated with the smallest salable patent-practicing unit is simply a step toward meeting the requirement of apportionment. Where the smallest salable unit is, in fact, a multi-component product containing several non-infringing features with no relation to the patented feature (as VirnetX claims it was here), the patentee must do more to estimate what portion of the value of that product is attributable to the patented technology. To hold otherwise would permit the entire market value exception to swallow the rule of apportionment.<sup>29</sup>

Thus, the court concluded:

[T]he district court's jury instruction regarding the entire market value rule was legally erroneous. Moreover, that error cannot be considered harmless, as

VirnetX's expert relied on the entire value of the iOS devices as the "smallest salable units," without attempting to apportion the value attributable to the VPN On Demand and FaceTime features. Thus, it is clear that the jury's verdict was tainted by the erroneous jury instruction.<sup>30</sup>

For this reason and others, the court vacated the damages award and remanded for further proceedings.<sup>31</sup>

## V. *Ericsson v. D-Link* (2014)

*Ericsson* was a suit for infringement of three of Ericsson's patents generally related to Wi-Fi technology employed by electronic devices for accessing the Internet.<sup>32</sup> Ericsson's damages expert relied on previous Ericsson Wi-Fi licenses to determine a per-unit royalty for each licensed product.<sup>33</sup> The expert then applied his per-unit royalty to the accused products to calculate a reasonable royalty.<sup>34</sup> Before trial, D-Link moved to exclude certain portions of the expert's testimony, arguing that it violated the EMVR.<sup>35</sup> Specifically, D-Link argued that because the damages calculations were based in part on licenses that were themselves tied to the entire value of the licensed products, even though the technology being licensed related to only a component of those products, the testimony was impermissible as a matter of law.<sup>36</sup> In denying that motion, the district court explained that the expert's reference to the prior licenses was not improper because the expert properly apportioned any damages calculations based on those licenses to account for the value of the patents at issue.<sup>37</sup>

D-Link had also proposed the following jury instruction regarding the EMVR:

Under the "entire market value" rule, a patent owner may recover a reasonable royalty based on the value of an entire apparatus or product containing several features, even though only one feature is patented. However, the "entire market value" rule only applies where the patent owner establishes that the patented feature creates the basis for customer demand or substantially creates the value of the component parts.<sup>38</sup>

Ericsson objected to this instruction on the ground that the court had already held that the entire market value rule was not implicated in this case,<sup>39</sup> and the court's final jury instructions did not contain an EMVR instruction.<sup>40</sup>

At trial, the jury found D-Link infringed the asserted claims of the three patents and awarded roughly \$10 million in damages—approximately fifteen cents per infringing device.<sup>41</sup> After post-trial motions, the district court upheld the jury's infringement and validity findings and refused to grant a new trial based on an alleged violation of the EMVR and/or allegedly deficient jury instructions

regarding the standard-setting context and Ericsson's RAND licensing obligations derived from that context.<sup>42</sup>

On appeal, D-Link argued that the district court prejudicially erred by not excluding Ericsson's damages expert's testimony on the challenged licenses.<sup>43</sup> Ericsson responded that the jury award was consistent with comparable Ericsson licenses and that the Federal Circuit had found comparable licenses to be the best evidence of a reasonable royalty rate.<sup>44</sup> Ericsson further argued that the jury award was consistent with "industry norms" and in accord with its damages expert's testimony.<sup>45</sup> According to Ericsson, its expert conducted a rigorous analysis that separated the value of the patents at issue from any other patents covered by the licenses he referenced.<sup>46</sup> Because of this apportionment, Ericsson asserted that neither its damages calculation nor its expert's reference to actual industry licenses was improper under the EMVR or otherwise.<sup>47</sup>

The Federal Circuit concluded that the district court had "properly admitted evidence of the licenses to which D-Link objects,"<sup>48</sup> but it went on to state that

when licenses based on the value of a multi-component product are admitted, or even referenced in expert testimony, the court should give a cautionary instruction regarding the limited purposes for which such testimony is proffered if the accused infringer requests the instruction. The court should also ensure that the instructions fully explain the need to apportion the ultimate royalty award to the incremental value of the patented feature from the overall product.<sup>49</sup>

The court acknowledged that the *Georgia-Pacific* factors, on which the jury was instructed, do include some reference to apportionment. But it observed:

[W]hile the court told the jury about the *Georgia-Pacific* factors—which do take the concepts of apportionment into account to some extent—it did not separately caution the jury about the importance of apportionment.... While factors 9 and 13 of the *Georgia-Pacific* factors allude to apportionment concepts, we believe a separate instruction culled from [*Garretson v. Clark*] would be preferable in future cases.<sup>50</sup>

Elsewhere in the decision, the court referred to *Garretson* as "precedent which covers apportionment of damages in situations" in which the patents "claim only small portions of multicomponent products."<sup>51</sup> It also cited *Garretson* for the proposition that "where multi-component products are involved, the governing rule is that the ultimate combination of royalty base and royalty

rate must reflect the value attributable to the infringing features of the product, and no more"<sup>52</sup> and that "a jury must ultimately 'apportion the defendant's profits and the patentee's damages between the patented feature and the unpatented features' using 'reliable and tangible' evidence."<sup>53</sup>

In *Garretson*, the Supreme Court explained the requirements of apportionment as follows:

When a patent is for an improvement, and not for an entirely new machine or contrivance, the patentee must show in what particulars his improvement has added to the usefulness of the machine or contrivance. He must separate its results distinctly from those of the other parts, so that the benefits derived from it may be distinctly seen and appreciated. The rule on this head is aptly stated by Mr. Justice Blatchford in the court below: "The patentee," he says, "must in every case give evidence tending to separate or apportion the defendant's profits and the patentee's damages between the patented feature and the unpatented features, and such evidence must be reliable and tangible, and not conjectural or speculative; or he must show, by equally reliable and satisfactory evidence, that the profits and damages are to be calculated on the whole machine, for the reason that the entire value of the whole machine, as a marketable article, is properly and legally attributable to the patented feature."<sup>54</sup>

The patent at issue in *Garretson* involved an improvement in the method of moving and securing in place the movable jaw or clamp of a mop-head.<sup>55</sup> The plaintiff had produced no evidence to apportion the profits or damages between the improvement constituting the patented feature and the other features of the mop, instead providing evidence of only the cost of the whole mop and the price at which it was sold.<sup>56</sup> The trial court held that *Garretson* was entitled to only nominal damages, and the Supreme Court affirmed, noting that "of course it could not be pretended that the entire value of the mop-head was attributable to the feature patented."<sup>57</sup>

## VI. Discussion

Reasonable royalty damages cases often involve issues related to the application of the EMVR and apportionment. The Federal Circuit has made it clear that when trying a case where one or both of these issues is implicated, the jury must be provided with proper instructions on these complex topics.

*Ericsson* provides useful guidance for cases in which a patent holder relies on prior license agreements that include a royalty based on a percent of sales of a multi-

component product where the patented technology does not comprise the basis of the demand for the product. In such cases, the alleged infringer should request a cautionary instruction regarding the limited usefulness of these license agreements. *Ericsson* also provides guidance on how to instruct the jury on apportionment, in particular by modeling the instruction after the language the Supreme Court used in *Garretson*.

It can be expected that district courts, taking guidance from the Federal Circuit, will be more inclined to include specific jury instructions on the EMVR and apportionment in the future rather than relying on more generic instructions based on the *Georgia-Pacific* factors. Parties on both sides of cases should keep this in mind throughout the entire litigation process, particularly during the discovery phase. Collecting the evidence necessary to present a detailed case on EMVR and/or apportionment issues may require devoting additional resources to discovery, but it ultimately will help counsel present its damages case in a manner consistent with the charge given to the jury.

## Endnotes

1. *Ericsson, Inc. v. D-Link Systems, Inc.*, 2014 U.S. App. LEXIS 22778, \*51 (Fed. Cir. 2014).
2. *Garretson v. Clark*, 111 U.S. 120, 121 (1884).
3. *Seymour v. McCormick*, 57 U.S. 480, 485 (1854).
4. *Id.* at 486, 487.
5. *Id.* at 488.
6. *Id.*
7. *Id.* at 490-91.
8. *Id.* at 491.
9. *Lucent Technologies, Inc. v. Gateway, Inc.*, 580 F.3d 1301, 1308-09, 1337-38 (Fed. Cir. 2009).
10. *Id.* at 1323 (citing *Lucent Techs.*, 580 F. Supp. 2d at 1042 & n.7).
11. *Id.*
12. *Id.* at 1309.
13. *Id.* at 1323.
14. Brief for Ten Amici Curiae Technology-Based Companies in Support of Appellant Microsoft Corp., 22, *Lucent Technologies, Inc. v. Gateway, Inc.*, 580 F.3d 1301 (Fed. Cir. 2009) (Nos. 2008-1485, -1486, -1487, -1495), 2008 U.S. Fed. Cir. Briefs LEXIS 168, \*1.
15. *Id.* at \*1-2.
16. *Id.* at \*15, \*25.
17. *Id.* at \*3.
18. *Id.* at \*3-4 (citing *Georgia-Pacific Corp. v. U.S. Plywood Corp.*, 318 F. Supp. 1116, 1120 (S.D.N.Y. 1970)).
19. *Lucent Technologies*, 580 F.3d at 1339.
20. *Id.* at 1324.
21. *Id.* at 1340.
22. *VirnetX, Inc. v. Cisco Systems, Inc.*, 767 F.3d 1308, 1314 (Fed. Cir. 2014).
23. *Id.* at 1325.
24. *Id.*
25. *Id.* at 1313.
26. *Id.*
27. *Id.* at 1327.
28. *Id.*
29. *Id.* at 1327, 1328 (citing *LaserDynamics, Inc. v. Quanta Computer, Inc.*, 694 F.3d 51, 67 (Fed. Cir. 2012), and *Cornell Univ. v. Hewlett-Packard Co.*, 609 F. Supp. 2d 279, 287-88 (N.D.N.Y. 2009)).
30. *Id.* at 1328.
31. *Id.* at 1334.
32. *Ericsson*, 2014 U.S. App. LEXIS 22778, \*4.
33. *Ericsson Inc. v. D-Link Corp.*, 2013 U.S. Dist. LEXIS 71564 (E.D. Tex. May 20, 2013).
34. *Id.*
35. *Ericsson*, 2014 U.S. App. LEXIS 22778, \*50-\*51.
36. *Id.* at \*51.
37. *Id.*
38. *Ericsson, Inc. v. D-Link Systems, Inc.*, E.D. Tex., Case 6:10-cv-00473-RWS, Doc. 475-1.
39. *Id.*
40. *Ericsson, Inc. v. D-Link Systems, Inc.*, E.D. Tex., Case 6:10-cv-00473-RWS, Doc. 504.
41. *Ericsson*, 2014 U.S. App. LEXIS 22778, \*4.
42. *Id.*
43. *Id.* at \*51.
44. *Id.* at \*52.
45. *Id.* at \*51.
46. *Id.*
47. *Id.*
48. *Id.* at \*53.
49. *Id.* at \*59.
50. *Id.* at \*59-60.
51. *Id.* at \*70. The court also cited *Uniloc USA, Inc. v. Microsoft Corp.*, 632 F.3d 1292, 1318 (Fed. Cir. 2011), and *Lucent Techs., Inc. v. Gateway, Inc.*, 580 F.3d 1301, 1336 (Fed. Cir. 2009).
52. *Ericsson*, 2014 U.S. App. LEXIS 22778, \*53.
53. *Id.* at \*54.
54. 111 U.S. at 121.
55. *Id.*
56. *Id.*
57. *Id.* at 121-23.

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