

LAW WEEK

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Apportionment In Patent Damages: An Overview

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A REASONABLE ROYALTY in patent litigation has two primary components: the royalty rate and the royalty base to which the rate is applied.

The rate is typically multiplied against the sales revenue for the infringing product to determine total damages. However, the royalty base is often unclear in cases involving patents on discrete features or components of larger products. Courts have struggled to set the bounds of the royalty base where the patented feature is part of a product that includes other, non-patented features, and the product that contains the patented feature is itself a component of a still larger product.

Reasonable royalty damages must reflect “the use made of the invention by the infringer.” In *Uniloc USA, Inc. v. Microsoft Corp.*, the federal circuit interpreted this to require that “royalties be based not on the entire product but instead on the smallest salable patent-practicing unit.” Once the smallest salable unit has been identified, however, damages must be further apportioned to reflect the actual value of what is covered.

A narrow exception to this principle known as the “entire market value rule” applies where it can be shown that the patented feature is the basis for consumer demand for the accused product. If the entire market value rule applies, a reasonable royalty may be calculated based on the value of the complete product, even when the patent does not cover the complete product. To apply the entire market value rule, it is not sufficient to show that the patented feature is valuable, important, or essential, or that consumers would buy a product with the patented feature over one without the patented feature. The patented feature must motivate consumers to purchase the type of product at issue, not merely choose one model over another.

Because the entire market value rule is narrowly applied and thus scarcely available to plaintiffs, in most cases some apportionment of damages will be necessary to determine the relative value of the patented feature in relation to the overall product.



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It may seem natural to simply take the value of the complete product and apply a lower royalty rate to reflect the value of a discrete patented feature. The federal circuit appeared to approve this approach in *Lucent Techs., Inc. v. Gateway, Inc.*, holding that “the base used in a running royalty calculation can always be the value of the entire commercial embodiment, as long as the magnitude of the rate is within an acceptable range (as determined by the evidence).” The federal circuit gave contrary instructions, however, three years later in *LaserDynamics, Inc. v. Quanta Computer, Inc.* There, the court held that the plaintiff had not satisfied the entire market value rule and the presentation of the defendant’s total revenue for sales of the complete accused product created undue jury prejudice.

This apparent conflict may be resolved by considering the difference between the “smallest salable patent-practicing

unit” rule and the entire market value rule. The “entire commercial embodiment” referred to in *Lucent* was the smallest salable patent-practicing unit, whereas the “overall revenues” referred to in *LaserDynamics* included an accused product of which the smallest salable patent-practicing unit was only one component. If the least salable patent-practicing unit is a complete product of which the patented feature is a very small part, then the total value of the complete product may be considered because no other evidence reflecting the value of the patented feature is available. In this scenario, the value of the patented feature can be reflected by a suitably small royalty rate. If the plaintiff seeks to present total revenue for a product that contains a smaller salable unit, however, the entire market value rule must be satisfied.

District courts have struggled with the proper application of apportionment

and the entire market value rule. The *Lucent* and *LaserDynamics* decisions suggest that the least salable patent-practicing unit is the minimum royalty base, but the base can be broadened to include a larger product if the entire market value rule is met as to the larger product.

However, certain courts have held that the “consumer demand” inquiry must be applied even to the smallest salable unit. Other courts have recognized that the entire market value rule is not directly implicated where the smallest salable unit is identified, but have nonetheless applied the principles of the rule to limit damages. Still other courts have allowed royalties to be calculated based on the value of the least salable patent-practicing unit without further apportionment.

Recent federal circuit and district court decisions reveal a general framework for apportionment in patent damages. As an initial matter, if the value of the patented invention can be determined in the abstract, without regard to the sales of an underlying product, then the whole apportionment issue is avoided. A strict per-unit royalty calculated in dollars (or cents) as opposed to a percentage of sales revenue avoids the need to determine the royalty base beyond the raw number of units actually sold.

If this abstract calculation cannot be performed, then the appropriate sales revenue figure (the royalty base) must be identified. If the patented feature is coextensive with the complete product (i.e., the product has no other features material to consumer demand), then no apportionment is necessary. If the patented feature is not coextensive with the complete product, then the smallest salable patent-practicing unit must be identified.

When the smallest salable patent-practicing unit is identified, sales revenue for the smallest salable unit can be used as the royalty base. If the plaintiff can show the patented feature is the basis for consumer demand, then the entire market value rule may apply and apportionment will no longer be necessary. •

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