

## The Federal Circuit's Decision in *Uniloc*: A Death Knell for the 25% Rule of Thumb

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In its recent decision in *Uniloc USA, Inc. v. Microsoft Corporation*,<sup>1</sup> the U.S. Court of Appeals for the Federal Circuit rejected the so-called “25% rule of thumb” as a means for determining damages in a patent infringement case, calling the rule “a fundamentally flawed tool” and declaring evidence relying on the rule inadmissible under the principles of *Daubert*<sup>2</sup> and the Federal Rules of Evidence.

The 25% rule of thumb presupposes that, in a hypothetical negotiation, a licensee will pay a royalty rate of approximately 25% of its expected profits for the accused products. Over the years, the rule has been widely used as a way to arrive at a baseline royalty rate for purposes of patent infringement damage calculations.<sup>3</sup> As a result, many courts, including the Federal Circuit, have passively allowed its use in instances where the applicability of the 25% rule of thumb was not questioned by the parties.<sup>4</sup> The *Uniloc* court noted that “[l]ower courts have invariably admitted evidence based on the 25% rule, largely in reliance on its widespread acceptance or because admissibility was uncontested.” *Uniloc* is the first case in which the Federal Circuit was squarely presented with the issue of whether the rule was an appropriate means by which to calculate damages in a patent case.

The court began its analysis by reiterating the principle espoused in *Daubert* and its progeny: that in order to be admissible, an expert's application of a general theory should be sufficiently tied to the facts of the case.<sup>5</sup> The court then applied this well-founded principle to some of its more recent rulings—including *ResQNet* and *Lucent*<sup>6</sup>—concluding that “there must be a basis in fact to associate the royalty rates used in prior licenses to the hypothetical negotiation at issue in the case. The 25 percent rule of thumb as an abstract and largely theoretical construct fails to satisfy this fundamental requirement.”<sup>7</sup> Where, as in *Uniloc*, there is no evidence that the expert made any effort to tie the application of the

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1. Nos. 2010-1035, 2010-1055, 2011 WL 9738 (Fed. Cir. Jan. 4, 2011).

2. *Daubert v. Merrell Dow Pharm., Inc.*, 509 U.S. 589 (1993).

3. See, e.g., *Bose Corp. v. JBL, Inc.*, 112 F. Supp. 2d 138, 167 (D. Mass. 2000); *GSI Grp., Inc. v. Sukup Mfg. Co.*, 641 F. Supp. 2d 732, 745 (C.D. Ill. 2008).

4. See, e.g., *Fonar Corp. v. General Elec. Co.*, 107 F.3d 1543, 1553 (Fed. Cir. 1997); *Inline Connection Corp. v. AOL Time Warner Inc.*, 470 F. Supp. 2d 424, 432 n.38 (D. Del. 2007).

5. *Uniloc*, Slip Op. at 41–43 (citing *Daubert*, 509 U.S. at 591; *Kumho Tire Co. v. Carmichael*, 526 U.S. 137, 153–54 (1999)).

6. *ResQNet.com, Inc. v. Lansa, Inc.*, 594 F.3d 860 (Fed. Cir. 2010); *Lucent Techs., Inc. v. Gateway, Inc.*, 580 F.3d 1301 (Fed. Cir. 2009).

7. *Id.* at 45.

25% rule of thumb to the facts of the case, the expert’s methodology is considered to be “arbitrary, unreliable, and irrelevant.”

The court also considered the expert’s application of the so-called *Georgia-Pacific* factors,<sup>8</sup> which are universally accepted as a legitimate basis for determining damages in a patent case. However, this methodology was also rejected because the expert applied the *Georgia-Pacific* factors only to adjust up or down from his starting point of 25% (based on the “rule of thumb”). “Beginning from a fundamentally flawed premise and adjusting it based on legitimate considerations specific to the facts of the case nevertheless resulted in a fundamentally flawed conclusion.”

Of further note, the court also considered the Uniloc expert’s use of the entire market value to perform a “check” on his damage calculation based on the 25% rule of thumb. In that regard, the court reiterated its previous cautionary holdings that the entire market value rule should only be applied when the patented component creates the basis for customers’ demand of the product as a whole.

Thus, the implication of the Federal Circuit’s holding in *Uniloc* is that parties, particularly plaintiffs in patent cases, should be careful to ensure that their damages analysis carefully considers the facts surrounding the hypothetical negotiation. Mere application of abstract principles to calculate or even “check” a damages analysis will be met with increased scrutiny.

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8. See *Georgia-Pacific Corp. v. U.S. Plywood Corp.*, 318 F.Supp. 1116 (S.D.N.Y. 1970).

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