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Case Clarifies the Law of Reasonable Royalty Damages

A recent case, *ResQNet.com, Inc. v. Lansa, Inc.*, No. 2008-1365, -1366, 2009-1030 (Fed. Cir. Feb. 5, 2010), has clarified the law of reasonable royalty damages under U.S. Patent Law.

In its September 2009 decision in *Lucent v. Gateway*, the Federal Circuit vacated a \$357 million verdict, signaling to litigants and district court judges that “speculation” and “superficial testimony” were insufficient to support the amount of damages awarded. In *ResQNet.com*, the Federal Circuit delivered a similar message, albeit on a smaller scale—this time vacating a damages award of \$506,305. In doing so, the court provided detailed guidance on the important issue of which prior licenses can be used to set the royalty rate in a patent case.

The claimed invention in *ResQNet.com* involved a method of communicating data between a host computer and a remote terminal. After infringement was found and invalidity defenses were unsuccessful, the district court awarded \$506,305 in reasonable royalty damages, based on a hypothetical royalty rate of 12.5%. The plaintiff’s damages expert had arrived at this number by looking primarily at two things: (1) a group of “re-bundling licenses,” as part of which the plaintiff/patentee had provided “finished software products and source code, as well as services such as training, maintenance, marketing, and upgrades” and (2) a single license limited to just the patented technology. The first group of agreements included top royalty rates of 25% to 40%, while the single-patent license had a much lower royalty rate (apparently in the range of 5%). The plaintiff’s expert arrived at his proposed rate of 12.5% by choosing a number “somewhere in the middle.”

The Federal Circuit rejected this approach for two primary reasons. First, the plaintiff’s expert “offer[ed] little or no evidence of a link between the re-bundling licenses and the claimed invention.” Although he suggested in his testimony that the re-bundling licenses were somehow related to the asserted patent, there was insufficient evidence to establish that any of the products or services provided to the licensees actually embodied the claimed invention. Thus, the court held that “[t]he rebundling licenses simply have no place in this case.” Second, the Federal Circuit criticized the plaintiff’s expert for relying on licenses that clearly covered more than just what was in the patent (for example, training, marketing, and customer support services). The court reasoned that the royalty analysis “must consider licenses that are commensurate with what the defendant has appropriated. If not, a prevailing plaintiff would be free to inflate the reasonable royalty analysis with conveniently selected licenses without an economic or other link to the technology in question.”

The *ResQNet.com* decision is important for litigants evaluating the reasonableness of settlement amounts, as well as a damages award following trial, in view of licenses that may or may not be related to the asserted patents. The decision may provide defendants/licensees with some leverage in settlement negotiations where a plaintiff/licensor has licensed its asserted technology previously, but now seeks a higher royalty rate than in the prior licenses. Finally, the decision may also provide a plaintiff's or defendant's damages expert with guidance as to which licenses to consider in determining a reasonable royalty that would be more likely to be upheld if challenged via post verdict motions or on appeal.

An obviousness determination may be called into question if the Board of Patent Appeals and Interferences (Board) did not appreciate the full scope of a cited prior art reference.

In the case of *In re Andrew P. Chapman and David J. King*, ___ F.3d. ___, No. 2009-1270 (Fed. Cir. February 24, 2010). Chapman's application is directed to an invention of a divalent antibody fragment comprising two antibody heavy chains and at least one polymer molecule attached to the heavy chains in a site-specific manner on each chain for increasing the circulating half-life of the divalent antibody fragment. The patent examiner rejected several claims of Chapman's application under 35 U.S.C. §102(e) as being anticipated by prior art and under 35 U.S.C. §103(a) as obvious over one or more of the cited references. The applicant appealed the examiner's rejection to the Board. The Board affirmed the examiner's obviousness rejections and reversed the anticipation rejection.

The applicant subsequently appealed the Board's decision to the Federal Circuit. Both the applicant and the government agreed that the sole question on appeal was the accuracy of the Board's description and factual findings of the primary reference.

In reviewing the Board's decision, the Federal Circuit stated that the Patent and Trademark Office (PTO) is governed by the Administrative Procedure Act (APA). Thus, PTO decisions are reviewed under the APA standard, as instructed by the U.S. Supreme Court in *Dickinson v. Zurko*, 527 U.S. 150, 152 (1999). Accordingly, the Federal Circuit reviews the Board's legal conclusions without deference, and reviews the Board's findings of fact to determine if they are supported by substantial evidence. Moreover, the judicial review provision of the APA includes a harmless-error rule, which requires the appellant to "not only show the existence of error, but also show that the error was in fact harmful because it affected the decision below."

The Federal Circuit concluded that the Board's opinion included harmful errors because the errors increased the likelihood that the applicant was erroneously denied a patent on grounds of obviousness. The Federal Circuit explained that if the Board based its decision on a misunderstanding of the primary reference, its subsequent conclusions regarding obviousness are called into question. Further, if the Board did not appreciate the full scope of the primary reference, the Federal Circuit could not be confident about its ultimate conclusion. Thus, the Federal Circuit remanded the case back to the Board and directed the Board to reevaluate its conclusion of obviousness in light of the correct understanding of the primary reference. However, the Federal Circuit reminded the Board that it was in no way precluded from finding the claims obvious.

This case serves as a reminder that the Federal Circuit applies the APA standard of review when reviewing PTO decisions.

A copy of the opinion may be found at <http://www.cafc.uscourts.gov/opinions/09-1270.pdf>.

For more information on the issues discussed in this Update, please contact any of the following Morgan Lewis attorneys:

Washington, D.C.

Robert Gaybrick

202.739.5501

rgaybrick@morganlewis.com

Robert Busby

202.739.5970

rbusby@morganlewis.com

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