

Evaluating Reasonable Royalties After ResQNet

Law360, New York (October 14, 2010) -- "The court observes as well that the most reliable license in this record arose out of litigation." [1]

Some have argued that the Federal Circuit's 2010 ResQNet decision reversed age-old jurisprudence that generally made litigation settlements irrelevant in the consideration of reasonable royalties. Nothing could be further from the truth. However, recent district court opinions have varied and brought limited clarity to the situation.

This article provides a discussion on the current case law and some practical advice for advising clients on how to proceed in what have now become unsettled waters.

Background

The 15 factors set out in Georgia-Pacific are frequently cited when determining a reasonable royalty in a patent case, including factor 1 — royalties received by the patentee for the licensing of the patent-in-suit. [2]

In implementing the Georgia-Pacific analysis, the courts have generally disregarded licenses to settle litigations. [3] These decisions have recognized that payments made to settle a lawsuit do not accurately reflect what a willing licensor and licensee would agree to in an arm's length negotiation and do not accurately value the patented technology. [4]

Courts have noted that the parties' avoidance of legal fees, assessments of their claims, financial status, as well as the particular accused technology, risk of treble damages, and uncertainty and risk inherent in litigation are some of the many factors unrelated to the value of the patent that would affect the settlement amount. [5]

This is consistent with Supreme Court case law, as the court explained over a hundred years ago that licenses taken in settlement of litigation are not probative of the amounts that would be considered adequate to compensate, and many considerations other than the value of the patented technology would factor into the settlement amount.

The Federal Circuit's ResQNet Decision Was Not About Admissibility

On Feb. 5, 2010, the Federal Circuit decided ResQNet v. Lansa. At trial, plaintiff ResQNet's damages expert cited seven previous ResQNet licenses, including five "re-branding" licenses that did not include the patents-in-suit or claimed technology and two litigation licenses involving the patents-in-suit. Lansa did not offer a damages expert in response. The court awarded damages and Lansa appealed.

The Federal Circuit vacated the damages award and remanded. It concluded that the district court relied on speculative and unreliable evidence, as the re-branding licenses had "no relationship to the claimed invention."

The Federal Circuit observed that "the most reliable license in this record arose out of litigation" but recognized "[o]n other occasions, this court has acknowledged that the hypothetical reasonable royalty calculation occurs before litigation and that litigation itself can skew the results of the hypothetical negotiation."

The Federal Circuit advised the district judge to "not rely on unrelated licenses to increase the reasonable royalty rates above rates more clearly linked to the economic demand for the claimed technology."

Decisions Since ResQNet

While the ResQNet decision did not purport to alter law on the inadmissibility of litigation settlement agreements for the purposes of determining a reasonable royalty, the statement about litigation settlement agreements has been interpreted as opening the door to new territory.

1) Tyco: Underlying Negotiations Related to Settlements are Discoverable

Less than four weeks after ResQNet, Judge John Ward in the Eastern District of Texas relied on it in granting a motion to compel.[6] In that case, plaintiffs sought discovery of negotiations underlying a litigation license between defendants and a third party.

Citing ResQNet, the court indicated that the Federal Circuit was shifting its approach toward discoverability of settlement negotiations because “a prior related settlement agreement, where it exists, may be central to the fact-finder’s determination of damages using a hypothetical negotiations analysis.”

The court concluded that ResQNet suggests that the “underlying negotiations are relevant to the calculation of a reasonable royalty using the hypothetical negotiation damages model.” Based on this reasoning, the court ordered the production.

2) DataTreasury: Litigation Settlements are Admissible as Support for Nonobviousness and Damages

On the same day as the decision in Tyco, Judge David Folsom, also in the Eastern District of Texas denied a motion in limine seeking to prevent the plaintiff from introducing licenses obtained from litigation settlements in connection with proving nonobviousness and damages.[7]

The court indicated that “In light of ResQNet, litigation-related licenses should not be excluded ... Defendants’ concerns about the reliability of litigation-related licenses are better directed to weight, not admissibility.”

3) Fenner: ResQNet Does Not Mean the Litigation Settlements are Automatically Admissible

In April 2010, Judge John Love in the Eastern District of Texas took issue with the interpretation that ResQNet changed the rules on the admissibility of litigation settlements.[8] In that case, the defendant argued that ResQNet “changed the rules for admissibility of settlement agreements.”

Citing a long line of cases, the court reasoned that “royalties paid to avoid litigation are not a reliable indicator of the value of a patent and therefore should be disregarded when determining reasonable royalty rates.”

The court noted that many of these cases indicate that the license agreements under threat of litigation are of little relevance and that they can confuse and prejudice the jury. The court concluded “the recent ResQNet decision has not altered that admissibility of agreements entered into under the threat of litigation.”

4) Abbott: Plaintiff’s Reliance on Litigation Settlements Could Make Them Admissible

In May, the Northern District of Illinois denied a plaintiff’s motion to preclude the defendant from relying on litigation settlement agreements.[9] The plaintiff previously provided royalty-free licenses to the patents-in-suit to settle litigation, and argued that the court should prevent the defendant from introducing those settlements.

However, the plaintiff’s damages expert had considered the settlements when he conducted the analysis underlying reasonable royalty calculation. Citing Federal Rule of Evidence 705—which imposes upon the defendant the burden of showing on cross-examination the basis for the plaintiff’s expert testimony—and ResQNet, the defendant argued the litigation settlements should be admitted.

The court ruled that “[t]his determination would be easy if the question merely involved whether to admit evidence of license

agreements contained in Abbott's settlements ... It is clear that these license agreements would be inadmissible under Fed. R. Evid. 408."

But "since Abbott's expert had relied on the license agreements at issue separates this case from precedent and supports the admission of the agreements." The court concluded "because the plaintiff's expert specifically relied upon the settlement agreements in his reasonable royalty calculation, the defendant could present those agreements to rebut the expert's testimony."

5) Software Tree: Where Ordinary Course Licenses Exist, Settlement Negotiations Do Not Have to Be Produced

In June, Judge Love decided a motion to compel production of documents regarding negotiations of licenses to the patents-in-suit.[10] The plaintiff had six licenses related to the patented technology, two of which had been executed without filing suit. The defendant sought production of the documents underlying the settlement negotiations.

The court explained that "ResQNet has not upset this district's case law regarding [lack of] discoverability of settlement negotiations." It reiterated that ResQNet case did not reach whether litigation-related licenses were admissible and "[I]ikewise the discoverability of negotiations underlying those licenses was not before the court."

The court denied defendant's motion to compel, indicating that "Continuing to exclude underlying negotiations ... is most appropriate given the chilling effect such discovery would have on settlements ... Continuing to recognize the common law settlement privilege is the most prudent course."

6) Reedhycalog: Litigation Settlements are Admissible When They are Consistent With Ordinary Course Licenses

In the most recent case on the issue, Judge Leonard Davis of the Eastern District of Texas denied the defendant's motion in limine to prevent the plaintiff from relying on litigation settlement agreements.[11] The plaintiff executed 14 licenses related to the patents-in-suit, five of which had resulted from the settlement of litigation. The royalty rates and terms of the litigation settlement agreements were consistent with the nonlitigated licenses.

The court denied the motion to exclude with "the condition that licenses would not be defined or identified as litigation licenses." In its analysis, the court cited ResQNet and noted that "some parties are arguing, and some courts are finding, that settlement licenses are admissible to provide a reasonable royalty."

The court concluded that the admissibility of litigation licenses, like all evidence "must be assessed on a case-by-case basis balancing the potential for unfair prejudice and jury confusion against the potential to be a 'reliable license.'"

The court reasoned that the licenses from the litigation settlements were consistent with the non-litigation settlements and this since the parties had agreed to not distinguish the licenses to the jury, the "probative value of the five licenses ... outweighs the danger of potential prejudice or jury confusion issues."

Where Are We?

In ResQNet, whether the litigation licenses were relevant or admissible was not before the court. Nowhere did the Federal Circuit indicate that past litigation settlements are automatically considered in connection with evaluating reasonable royalties. Nevertheless, language in the court's decision created sufficient uncertainty that district courts have struggled with issues surrounding the relevance or admissibility of litigation settlement agreements.

The rule seems to be that when the admissibility of litigation settlement agreements is challenged for the purposes of determining a reasonable royalty, they should not be admitted. But as recent case law demonstrates, the issue is not bright-line and, as with many issues in litigation, and the specific determination will likely depend on the facts of the case.

What do we tell our clients who are looking for certainty on these issues? Strategically, a plaintiff with substantial litigation

settlements could want to rely on them in determining a reasonable royalty.

The Federal Circuit's decision in ResQNet, according to some, suggests that such agreements may be the "most reliable evidence" of a reasonable royalty and should not therefore be excluded. By the same token, a defendant in a case where the plaintiff has numerous litigation settlements of low royalties could want to base a royalty analysis on those agreements. Again, some would conclude that the ResQNet decision provides the door to getting these agreements into the evidentiary record.

Alternatively, a plaintiff or defendant might not want litigation settlement agreements to be admitted in litigation. Historically, this is the more legally defensible position. But recently, more courts are relying on ResQNet to admit such agreements. Parties that do not want litigation settlement agreements to be admitted should be careful about relying on such agreements lest that reliance provides a basis for admissibility.

The outcome of any of these circumstances seems less clear than ever, although we can be assured that judges will consider situation on a case-by-case basis. Some general rules probably apply:

- 1) Where possible, parties should rely on nonlitigation licenses that are for the patents-in-suit.
- 2) Parties should anticipate that litigation settlements and any documents underlying their negotiation may be admitted.
- 3) Parties should consider preparing analyses comparing the circumstances and terms all relevant license agreements to those that the experts will rely on.

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The opinions expressed are those of the authors and do not necessarily reflect the views of the firm, its clients, or Portfolio Media, publisher of Law360.

[1] ResQNet.Com v. Lansa, 594 F.3d 860 (Fed. Cir. 2010).

[2] Georgia-Pacific v. United States Plywood, 318 F. Supp. 1116 (S.D.N.Y. 1970).

[3] Panduit v. Stahl Bros., 575 F.2d 1152 (6th Cir. 1978); Hanson v. Alpine Valley Ski Area, 718 F.2d 1075 (Fed. Cir. 1983).

[4] See, e.g., Uniloc v. Microsoft, 632 F. Supp. 2d 147 (D.R.I. 2009); Cornell v. Hewlett-Packard, 2008 U.S. Dist. LEXIS 39343 (N.D.N.Y. May 14, 2008).

[5] Rude v. Westcott, 130 U.S. 152 (1889).

[6] Tyco v. E-Z-EM, 2010 U.S. Dist. LEXIS 18253 (E.D. Tex. March 4, 2010).

[7] DataTreasury v. Wells Fargo, 2010 U.S. Dist. LEXIS 25291 (E.D. Tex. March 4, 2010).

[8] Fenner v. Hewlett-Packard, 2010 U.S. Dist. LEXIS 41514 (E.D. Tex. April 28, 2010).

[9] Abbott v. Sandoz, No. 05-5373, slip op. (N.D. Ill. May 24, 2010).

[10] Software Tree v. Red Hat, 2010 U.S. Dist. LEXIS 70542 (E.D. Tex. June 24, 2010).

[11] Reedhycalog v. Diamond Innovations, 2010 U.S. Dist. LEXIS 78138 (E.D. Tex. Aug. 2, 2010).