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Use of Entire Market Value Rule Excluded Where Expert Argued Patented Feature Was a Substantial Basis But Not *The* Basis for Demand

By Kathryn L. Karn

In *Inventio AG v. Otis Elevator Co.*,¹ the District Court for the Southern District of New York ruled that Inventio AG's (Inventio or plaintiff) damages expert's testimony relying on the entire market value rule was inadmissible where the expert argued that the patented feature was a *substantial* basis for customer demand rather than *the* basis for customer demand.² However, the Court allowed the expert's testimony regarding a reasonable royalty rate where the opinion had a basis in the facts of the case. The Court found that it was not an arbitrary starting point analogous to the 25% rule of thumb that had been disallowed under *Uniloc*.

Background

In July 2006, Inventio sued Otis Elevator Co. (Otis or defendant) for infringement of US Patent No. 5,689,094 entitled "Elevator Installation."³ The accused products involved seven elevator installations that included a "seamless entry" destination dispatching system.⁴ In March 2011, Otis filed motions *in limine* requesting, among other things, that the Court preclude Inventio from seeking royalty damages based on the entire market value rule⁵ as well as exclude Inventio's damages expert from testifying on reasonable royalty damages.⁶

Royalty base and entire market value

Plaintiff's damages expert calculated reasonable royalty damages based on the entire market value of the accused elevator installations. He opined that the patented feature was a "substantial basis for demand."⁷ The Court explained that the test for using the entire market value rule, as articulated by Chief Judge Rader, is "whether the patented component was of such paramount importance that it substantially created

¹ *Inventio AG v. Otis Elevator Co.*, Case No. 06 Civ. 5377 (S.D.N.Y. June 23, 2011), Rulings on Motions *in Limine*, DN 269.

² *Ibid.* at 3-4.

³ *Inventio AG v. Otis Elevator Co.*, Case No. 06 Civ. 5377 (S.D.N.Y. July 17, 2006), Complaint, DN 001. The original complaint also named Schindler Elevator Corporation (Schindler) as a plaintiff. However, Schindler was dismissed from the case in December 2010. *Inventio AG v. Otis Elevator Co.*, Case No. 06 Civ. 5377 (S.D.N.Y. December 12, 2010), Stipulation on Consent Concerning Amended Complaint, DN 180.

⁴ Rulings on Motions *in Limine*, DN 269 at 5.

⁵ *Inventio AG v. Otis Elevator Co.*, Case No. 06 Civ. 5377 (S.D.N.Y. March 28, 2011), Defendant Otis Elevator's Motion *In Limine* No. 6 to Preclude Inventio AG from Seeking Royalty Damages Based on the Entire Market Value Rule, DN 221.

⁶ *Inventio AG v. Otis Elevator Co.*, Case No. 06 Civ. 5377 (S.D.N.Y. March 28, 2011), Defendant Otis Elevator's Motion *In Limine* No. 5 to Exclude the Proposed Expert Testimony of [Plaintiff's Damages Expert] on Reasonable Royalty Damages, DN 220.

⁷ Rulings on Motions *in Limine*, DN 269 at 7.

the value of the component parts—thereby making it ‘*the* basis for customer demand.’”⁸ The Court found that by using the wrong standard, the expert’s use of the entire market value rule was flawed and could not be presented to the jury.⁹

The Court considered the evidence of customer demand offered by Inventio in support of its use of the entire market value rule.¹⁰ The Court explained that the evidence must comport with an exacting standard:

It is not enough to present evidence that the patented feature was desirable or that it played some role—even substantial role—in the customer’s decision to purchase a system containing the infringing product. If the patented aspect of a system containing both patented and unpatented elements creates a “substantial basis for demand” that would tend to support the reasonableness of a higher royalty rate. But as long as other features of a product contributed to the customer’s decision, Supreme Court precedent...demands that there be an apportionment of the defendant’s profits and patentee’s damages between the patented feature and the various unpatented features of the “whole machine”...¹¹

The Court determined that the evidence presented by Inventio did not “provide a sound economic connection between the product’s desirability and any contention that [the alleged infringing product] was *the* basis for public demand for an Otis...elevator system.”¹² The Court noted that the evidence did not include statistical or regression analysis, nor did it include customer surveys or interviews asking customers why they selected the accused products.¹³

Royalty rate

However, the Court did not exclude the plaintiff’s expert’s testimony about a reasonable royalty rate which the defendant had argued was based on an arbitrary starting point.

In reaching his damages opinion, Inventio’s damages expert considered an upper and lower boundary for the reasonable royalty that the parties would have agreed to in a hypothetical negotiation.¹⁴ The upper boundary consisted of Otis’s profit margin from offering the patented invention. The expert reasoned that Otis would not be willing to pay more in a hypothetical negotiation than it expected to receive in profits.¹⁵ For the lower boundary, the expert considered a royalty rate at which the technology had once been licensed in an agreement between Inventio and a related company.¹⁶ Inventio’s expert then took the midpoint between these two boundaries as a starting point and applied the 15 *Georgia-Pacific* factors.¹⁷

⁸ *Ibid.* at 7, quoting *IP Innovation v. Red Hat, Inc.*, 705 F. Supp. 2d 687, 689 (E.D. Tex. 2010) (Rader, C.J., sitting by designation). (Emphasis in original.)

⁹ *Ibid.* at 7.

¹⁰ Inventio’s evidence included the fact that customers at the seven accused elevator installations elected to purchase an elevator system with the seamless entry feature; data about projects won and lost compiled by Otis (which the Court found to show “idiosyncratic” demand); evidence of a former Otis employee warning Otis that it needed to offer the accused product based on customer interest; evidence that Otis’s competitors were developing seamless entry systems, putting Otis at a competitive disadvantage; and evidence that Otis added the accused seamless entry to an existing contract after the customer insisted on it. *Ibid.* at 5-6.

¹¹ *Ibid.* at 5.

¹² *Ibid.* at 5. (Emphasis in original.)

¹³ *Ibid.* at 5.

¹⁴ *Inventio AG v. Otis Elevator Co.*, Case No. 06 Civ. 5377 (S.D.N.Y. April 4, 2011), Inventio’s Opposition to Otis’s Motion *In Limine* No. 5 to Exclude the Proposed Expert Testimony of [Plaintiff’s Damages Expert], DN 240.

¹⁵ *Ibid.* at 1.

¹⁶ Rulings on Motions *in Limine*, DN 269 at 3. It appears that a license was entered between Inventio (licensor) and a related company, Shindler Elevator Corporation (licensee). Inventio’s expert argued that if Otis had not been licensed, the only company that would have been able to make the sales was Shindler. Therefore, Inventio would have expected Shindler to make the sales of the patented invention and (presumably) would have expected to derive royalties from Shindler’s sales. Thus, the lower bound was the income Inventio knew it would lose if it were to license Otis. *Inventio AG v. Otis Elevator Co.*, Case No. 06 Civ. 5377 (S.D.N.Y. April 4, 2011), Inventio’s Opposition to Otis’ Motion *In Limine* No. 5 to Exclude the Proposed Expert Testimony of [Plaintiff’s Damages Expert], DN 240, at 2 and footnote 3, p. 3. Note: This pleading has been redacted.

¹⁷ *Ibid.* at 3.

Otis argued that Inventio's expert's royalty opinion began with "an arbitrary anchoring point."¹⁸ Otis argued that under *Uniloc*, the royalty analysis, including any starting point, "must be tied to the relevant facts and circumstances of the particular case at issue."¹⁹

The Court found that the analysis by Inventio's damages expert did not run afoul of *Uniloc*.²⁰ The Court explained:

The 25% rule of thumb that was disallowed in *Uniloc* was, in contrast to the situation at bar, a rule that courts and experts had applied willy-nilly in myriad cases without the slightest regard to the underlying facts—it was, as I understand it, a rule that was deemed to apply regardless of the facts, to all cases. I do not read *Uniloc* to do anything more than get rid of the notion that there is some absolute "rule of thumb" that can be applied to calculate the reasonable royalty without taking into account facts relating to the patent in suit.²¹

The Court reasoned that the expert's starting point was not "untethered from the facts of the case."²² Even so, regarding plaintiff's expert's upper boundary, the Court noted, "The notion that Otis would be willing to pay a royalty that would wipe out its entire profit...is of course worthy of some pointed cross examination."²³ Similarly, the Court stated that the related-company license agreement used as the basis for the expert's lower boundary "goes to the weight or lack of weight that the trier of fact might wish to accord the license data."²⁴ Inventio's expert's application of the *Georgia-Pacific* factors to the midpoint between the upper and lower boundaries "is yet another methodological decision that can be attacked, on cross or through the testimony of Otis' own expert—but it cannot fairly be analogized to what was deemed improper in *Uniloc*."²⁵

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¹⁸ Defendant Otis Elevator's Motion *In Limine* No. 5 to Exclude the Proposed Expert Testimony of [Inventio's Damages Expert] on Reasonable Royalty Damages, DN 220, at 3.

¹⁹ *Ibid.* at 3-4, citing *Uniloc USA, Inc. v. Microsoft Corp.*, 2011 WL 9738, at *22 (Fed. Cir. Jan. 4, 2011).

²⁰ Rulings on Motions *in Limine*, DN 269 at 3.

²¹ *Ibid.* at 3.

²² *Ibid.* at 3.

²³ *Ibid.* at 3.

²⁴ *Ibid.* at 3.

²⁵ *Ibid.* at 3-4.