

# ClientAlert

## Intellectual Property

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### Southern District of New York Clarifies the Evidentiary Test for Damages Based on the Entire Market Value Rule

In *Schindler Elevator Corp. v. Otis Elevator Co.*, 1-06 CV 05377 (S.D.N.Y. June 23, 2011), the Southern District of New York clarified the evidentiary burden plaintiffs face when they seek to use the entire market value rule to calculate damages in patent infringement cases. Under this rule, a patentee calculates damages based on the entire market value of the accused's product on the premise that the product's entire value is attributable to the patented feature. In *Schindler*, Judge McMahon clarified that to benefit from the rule, plaintiffs must put on "competent evidence" that the patented feature of the product is the basis for customer demand for the entire product, and not just a substantial basis for demand. Plaintiffs in *Schindler* fell short of this standard and were barred from using the entire market value rule to calculate damages.

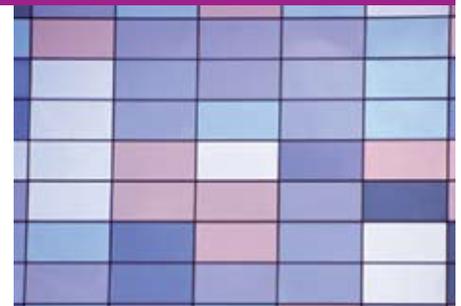
The decision may decrease the potential damages recoverable, as well as the settlement value of certain patent infringement lawsuits. It also continues the trend of requiring plaintiffs to more clearly establish the connection between acts of infringement and damages, as in *Uniloc USA, Inc. v. Microsoft Corp.*, No. 03-CV-0440 (Fed. Cir. Jan. 4, 2011).

#### The Facts

Schindler (licensee) and Inventio (patentee-licensor) sued Otis for the alleged infringement of a patented component of Otis's elevator systems. The plaintiffs sought, among other relief, compensatory damages "in no event less than a reasonable royalty" pursuant to 35 U.S.C. § 284 ("Section 284"). Under Section 284, the court may hear expert testimony to aid in the determination of a "reasonable royalty." The plaintiffs presented expert testimony on reasonable royalty damages and defendants moved to exclude all the testimony or, alternatively, to exclude at least the testimony that used the "entire market value rule" to calculate royalty damages.

#### The Decision

The court granted the defendant's motion to exclude the expert testimony on the entire market value rule because the plaintiff failed to present "*competent evidence*" that the patented feature alone created the basis for customer demand. The court insisted on evidence showing a "sound economic connection" between the customer demand for a product and the patented feature. This competent evidence could include econometric studies, customer surveys, regression analyses or other evidence of marketplace-wide demand sensitivity to the patented feature. It must be clear that the patented feature was *the* basis for customer demand for the product, not just a desirable feature of the product.



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The plaintiffs fell far short of this competent evidence standard. The plaintiffs' evidence was limited to seven customers' statements that they purchased elevators with the patented feature. The court noted that "[n]one of the evidence provided to the court includes any sort of statistical or regression analysis. None of it consists of customer surveys or even interviews asking Otis's seven customers why they selected Otis to provide their elevator installations." The court concluded that customer demand for the elevator systems was "idiosyncratic" and not necessarily because of the patented feature. In fact, some evidence showed that customers made purchasing decisions based on factors completely unrelated to the patented feature.

The plaintiffs compounded their evidentiary problems with an incorrectly stated legal test. The plaintiffs' expert opined that the patented feature was a substantial basis for demand, whereas the proper test for the entire market value rule is "whether the patented component was of such paramount importance that it substantially created the value of the component parts—thereby making it 'the basis for customer demand.'" Here the court approvingly quoted Chief Judge Rader's language in *IP Innovation v. Red Hat, Inc.*, 705 F. Supp. 2d 687, 689 (E.D. Tex. 2010).

## The Significance

*Schindler* is a potentially powerful tool for patent infringement defendants who seek to avoid the entire market value rule. The burden of proof for application of the rule is on the plaintiff; the opinion in *Schindler* may make this burden more difficult to meet. Under *Schindler*, defendants may be able to avoid the rule by presenting evidence that customers purchased the infringing product because of factors wholly independent of the patented feature. A judge could then find that a jury could not reasonably conclude that the patented feature was *the* basis for customer demand for the product and prohibit use of the entire market value rule. As a result, *Schindler* may help defendants avoid the extremely large damage awards or settlements that can result when the rule is applied.

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