



# Recent Developments in the Case Law of Damages

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# Our Panel

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# Learning Objectives

- **Understand why case law is important to damages experts**
- **Learn about recent and noteworthy case law**
  - Establishing and proving damages for newly established businesses
  - Patent Infringement Damages
  - Trade Secrets Damages
- **Insight into how attorneys research experts**

# The importance of case law for damages and accounting experts

## ■ Why it matters

- Understand how damages fit into the broader legal context of the particular case
- Different theories approved by some courts but not others . . . or by some judges, but not others
- Avoid the pitfalls of others
- *Daubert* rulings can be an albatross

# The importance of case law for damages and accounting experts

## ■ What case law should you focus on?

- Start with your jurisdiction (state court vs. federal court)
- Remember the hierarchy:
  - Trial court
  - Court of Appeal
  - Supreme Court
- Mandatory/binding case law versus persuasive rulings
- *Stare decisis* and building blocks

# The importance of case law for damages and accounting experts

## ■ What's the source of damages?

- Common law (created by judges)
- Statutory (created by law, e.g., Lanham Act)
- Regulatory (created by an administrative body)
- Contractual (created by the parties)

# The importance of case law for damages and accounting experts

## ■ How should experts find important case law?

- Lexis/Nexis and Westlaw
- American Bar Ass'n/state bar journals on particular areas of the law (e.g., antitrust, patent)
- Google searches
- Ask the attorneys who've hired you what are the three most relevant damages cases in that arena

# Judges are the “gatekeepers” of expert testimony





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- “It is the jury system itself that requires the common law judge, in his efforts to prevent the jury from being satisfied by matters of slight value, capable of being exaggerated by prejudice and hasty reasoning, to exclude matter which does not rise to a clearly sufficient degree of value.”
- “These comments are especially pertinent to an *array of figures conveying a delusive impression of exactness in an area where a jury’s common sense is less available than usual to protect it.*”

- *Herman Schwabe Inc. v. United Shoe Machinery Corp.* (2d Cir. 1962)

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# Three areas where new case law is impacting your damages theories

- Damages for harm done to newly established businesses
- Patent damages
- Use of reasonable royalty in *trade secrets* cases

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# Recent Case Law Re: Damages for Newly Established Businesses

## ■ Challenges in formulating damages for new or undeveloped businesses

- Most companies lose money first – how long to profitability?
- Assumptions about market development, competition, pricing
- Finding the right comparison

***As a result, many courts won't allow, or severely limit lost-profits damages for new businesses***

# Case Law Re: Damages for Newly Established Businesses

## ■ *Sargon Enters., Inc. v. USC* (Cal. Sup. Ct. 2012)

- Sargon created a revolutionary one-step dental implant that could allow implant to be completed in one day
- USC breached a contract by failing to complete a clinical study
- Trial court rejected Sargon's damages theory, by a forensic accountant, as too speculative; Court of Appeal reversed



# Case Law Re: Damages for Newly Established Businesses

## ■ *Sargon Enters., Inc. v. USC* (Cal. Sup. Ct. 2012)

- Forensic accountant testified that lost profits damages ranged from \$200 million - \$1.18 billion, using a “market share” approach
  - “Given the state of the implant market at the time . . . an innovator such as Sargon would have rapidly commanded a significant market share.”
  - Within ten years, Sargon would have invested and grown into one of the top 6 companies in the world in dental implants
  - Depending on “level of innovation,” different market share could have been achieved (between 3.75% and 20%)
  - Modeled cost structure and profits based on top 6 company

# Case Law Re: Damages for Newly Established Businesses

## ■ *Sargon Enters., Inc. v. USC* (Cal. Sup. Ct. 2012)

- For established businesses, primarily look to past profits and profits of similar businesses operating under similar conditions – don't need mathematical precision.
- For unestablished businesses, a higher bar: “anticipated profits dependent upon future events are allowed where their nature and occurrence can be shown by evidence of reasonable reliability.”
- *But* Court cautioned against an “absolute certainty” requirement – “the lost profit inquiry is always speculative to some degree.”

# Case Law Re: Damages for Newly Established Businesses

## ■ *What went wrong for the expert in Sargon?*

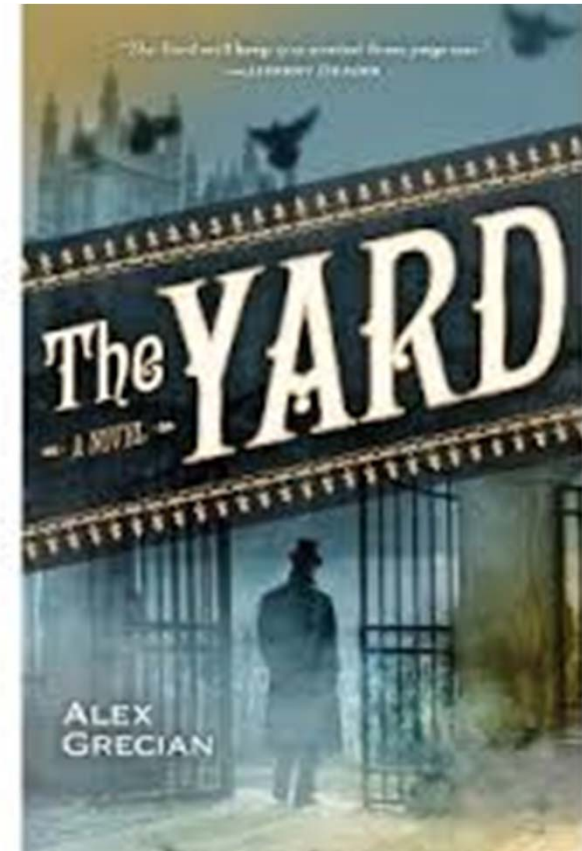
- Picking the wrong comparator
  - Should've used smaller competitors, not the Big Six
- Failure to connect “innovativeness” to market share
- Insufficient hook to existing business (Sargon had only \$101,000 in profits in the base year), prior growth, or equivalent products
- Failed to account for size, history, product line, sales force, access to financing, etc.



# Case Law Re: Damages for Newly Established Businesses - Unsuccessful

## ■ *Levin v. Grecian (N.D. Ill. 2013)*

- Dispute between author of popular novel, *The Yard*, and his agent
- Grecian claimed his agent, Levin, failed to properly promote his earlier works, which had never been acquired by a publisher
- Sought damages based on \$500,000 advance paid for *The Yard*



# Case Law Re: Damages for Newly Established Businesses - Unsuccessful

## ■ *Levin v. Grecian (N.D. Ill. 2013)*

Illinois follows “new business rule” (adopted by some states)

- “A new business generally has no right to recover lost profits [unless] the business was previously established”
- Grecian had not been published before – even though he has had great success since

**Grecian could not show other novels sufficiently comparable**

- Graphic novels versus prose novels
- Quality of novels uncertain
- Analogized to real estate

# Case Law Re: Damages for Newly Established Businesses - Successful

## ■ *Nature's Plus Nordic v. Natural Organics, Inc.* (E.D.N.Y. 2013)

- NOI pulled out of distribution contract for health supplements due to poor performance by the distributor
- NPN (Plaintiff) asserted lost profits of \$13 million, based on expert's comparison of NPN's existing sales of a competing line of supplements
- Holding: Rejected Daubert challenge and summary judgment
  - Even a fledgling business may recover lost profits
  - Comparable sales of a competitor valid measure
  - Debt, pricing, marketing, prior lack of profits, internal managerial issues can all be considered
- More deferential – let the jury sort this out!

# Case Law Re: Damages for Newly Established Businesses - Successful

## ■ *Peterson Group, Inc. v. PLTQ Lotus Group* (Tex. App. 2013)

- Failed shopping center development in the Houston suburbs ends in counter-suits by developer (Peterson) and investor (PLTQ – Dr. Nguyen)
- Developer was skimming off the top, and had signed up tenants who were bankrupt and/or unable to make the rent
- Nguyen alleged Peterson could have done a better job of finding retail tenants – jury awarded \$136,000 in lost tenant rent

# Case Law Re: Damages for Newly Established Businesses - Successful

## ■ *Peterson Group, Inc. v. PLTQ Lotus Group* (Tex. App. 2013)

- Texas standard: “Profits which are largely speculative, as from an activity dependent on uncertain or changing market conditions, or on chancy business opportunities, or on promotion of untested products or entry into unknown or unviable markets, or on the success of a new and unproven enterprise, cannot be recovered. . . .
- ...However, the fact that a business is new does not absolutely preclude recovery of lost profits.”
- Sets up highly fact-specific inquiry

# Case Law Re: Damages for Newly Established Businesses - Successful

## ■ *Peterson Group, Inc. v. PLTQ Lotus Group* (Tex. App. 2013)

- Majority opinion
  - While this particular development was new, relevant market is rental of restaurants and businesses in strip malls
  - The leases developer had signed with struggling businesses provided some sort of benchmark
- Dissenting opinion
  - No evidence to show actual profits from those leases (including account of expenses to be incurred)
  - No data on profitability of comparable projects in the area or comparable projects done by Peterson Group

# Takeaways from Recent Case Law on Damages for Newly Established Businesses

- **Know your jurisdiction**
- **Picking the right comparator, or competitor, is key**
- **Simplify, simplify!**
  - The more degrees of separation from current status, the more likely a *Daubert* challenge will be sustained
- **Groundbreaking products or services are *less likely to see lost-profits damages***
  - Judges don't want juries guessing at how a market might have changed

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# Three areas where new case law is impacting your damages theories

- Damages for harm done to newly established businesses
- Patent damages
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# Patent Damages

- *35 U.S.C. § 284*: damages are the amount “adequate to compensate for the infringement...but in no event less than a reasonable royalty
- Hypothetical licensing negotiation – use the *Georgia-Pacific factors*
  - Comparable licenses
  - Relationship b/w licensor and licensee
  - Profitability of products under patent
  - Uniqueness of patent

# Patent Damages

- Over the years, a number of short-cuts developed that largely sought to inflate the royalties due
  - “25% Rule of Thumb” – in a hypothetical negotiation, 25% of the profits attributable to the infringing technology would go to patentee, 75% to licensee
  - Entire market theory – apply a standard royalty rate to the sales of the entire product incorporating the infringing technology
  - *Georgia-Pacific* factors used to bump those amounts up or down

# Recent Case Law Re: Patent Infringement Damages

## ■ *Uniloc USA, Inc. v. Microsoft Corp.* (Fed. Cir. 2011)

- Rejected the “25 percent rule of thumb”: too crude a measure, untethered to the specific circumstances, industries, products
- Took a feature that Microsoft had said could be worth an extra \$10, said Uniloc gets \$2.50 per license, and multiplied it by 250,000,000 licenses
- Court also cast doubt on entire market value theory (MSFT’s \$19 billion in Office revenues)
  - Need to show driving sale of the product
- Issues of skewing the jury to a huge number

# Recent Case Law Re: Patent Infringement Damages

## ■ *LaserDynamics, Inc. v. Quanta Computer* (Fed. Cir. 2012)

- Further limited the “entire market value” theory
- Not enough to show patented feature is “valuable, important or even essential” to use of overall product
- Entire market theory skews the damages horizon
- *But*, where the patented technology is not itself a commercial product, can rely on the “smallest saleable patent-practicing unit”
  - *And that’s where the terrain shifted*

# Recent Case Law Re: Patent Infringement Damages

## ■ Nash Bargaining Solution

- Named after mathematician John Nash's "The Bargaining Problem" paper
- If certain factual premises are present, mathematically, the solution to a negotiation between equivalent parties is that they split the incremental profits 50/50
- Lower courts have struggled with whether this is a superior mechanism or just another "rule of thumb"



# ***VirnetX v. Cisco Systems, Inc. and Apple Inc.*** **(Fed. Cir. Sept. 16, 2014)**

- VirnetX owns four patents pertaining to the creation of a link for secure video calls
- VirnetX claimed that Apple's FaceTime feature infringed
- Jury found that Apple infringed VirnetX patents and awarded \$368 million in damages



# *VirnetX v. Apple Inc.* (Fed. Cir. 2014)

## ■ Plaintiff's expert offered three damages theories

- 1% royalty on smallest saleable unit (e.g., iPads, iPhones, etc.) = \$708M
- Nash bargaining solution #1 = \$588M
  - Assumed 55/45 split of profits associated with front-facing camera feature
- Nash bargaining solution #2 = \$606M
  - Assumed that FaceTime drives 18% of iOS sales, that \$5.13 in profit per unit is associated with FaceTime, and a 55/45 split of profits

# *VirnetX v. Apple Inc.* (Fed. Cir. 2014)

## ■ Federal Circuit limited use of “smallest saleable unit” exception

- Rejected use of entire market value of multi-component product, even where that is the smallest saleable unit containing the patented feature
- Where the smallest saleable unit is a multi-component product containing several non-infringing features, must exclude all those features (touchscreen, camera, processor, speaker, built-in apps) from the royalty base



## ***VirnetX v. Apple Inc.* (Fed. Cir. 2014)**

“A patentee’s obligation to apportion damages only to the patented feature ***does not end with the identification of the smallest saleable unit*** if that unit still contains significant unpatented features.”

“The law requires patentees to apportion the royalty down to a reasonable estimate of the value of its claimed technology, or else establish that its ***patented technology*** drove demand for the entire product.”

## ***VirnetX v. Apple Inc.* (Fed. Cir. 2014)**

### ■ **Federal Circuit also rejected expert's use of Nash Bargaining Solution**

- Must prove that the particular factual premises in Nash's theory were present
- Deviations from 50/50 must have some basis in fact
- Concerns about skewing jury's perception with high royalty base suggest Nash Bargaining Solution could be further limited

# Patent Damages After *VirnetX*

- Will plaintiffs try to “fit” the Nash factual premises, or just move on to a new theory?
- More reliance on technical experts or creative approaches for apportionment
  - Identify products without the feature
  - Survey data to prove feature driving demand
- More use of lump-sum royalties or other royalty measures
- Expect greater scrutiny – check in with case law over the coming months

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# Recent Case Law Re: Misappropriation of Trade Secrets Damages

## ■ *General Damages Theories*

- “Damages can include both the actual loss caused by misappropriation and the unjust enrichment caused by misappropriation that is not taken into account in computing actual loss.”
- “In lieu of damages measured by any other methods, the damages caused by misappropriation may be measured by imposition of liability for a reasonable royalty for a misappropriator’s unauthorized disclosure or use of a trade secret.”

-UTSA § 3(a) (amended 1985).

# Recent Case Law Re: Misappropriation of Trade Secrets Damages

## ■ *Reasonable Royalties – Differences Among States*

- Majority of States: Reasonable royalties available as stated in UTSA (“in lieu of damages measure by any other method”)
- CA: “If neither damages nor unjust enrichment caused by misappropriation are provable, the court may order payment of a reasonable royalty for no longer than the period of time the use could have been prohibited.” – CUTSA (CA Civil Code § 3426.3)

# Recent Case Law Re: Misappropriation of Trade Secrets Damages

## ■ *Bianco v. Globus Medical, Inc., (E.D. Tex. July 1, 2014).*

- Jury rejected disgorgement of defendant's profits, but awarded reasonable royalty damages of \$4.3M = 5% of net sales earned prior to trial
- Court denied post-trial permanent injunction
- For future damages:
  - Defendant argued that at most, it only received a "head start" and that such "head start" did not extend past trial
  - However, defendant's expert never testified that royalty should terminate at any point
- Court granted ongoing royalty @ 5% of future sales for 8 years (based upon single hypothetical negotiation at time of misappropriation)

# Insights from Attorneys on Panel Re: Experts

## ■ What attorneys do to research experts they may hire or cross examine

- LexisNexis and Westlaw tools
  - Old resumes (both court-filed and non-court filed)
  - Deposition and trial transcripts
  - “Challenge reports” – prior Daubert motions and results
  - Expert reports and declarations
- Subject-Specific Literature Databases
- PACER and Court dockets
- Wayback Machine (historical websites)
- Phone calls to counsel



# Insights from Attorneys on Panel Re: Experts

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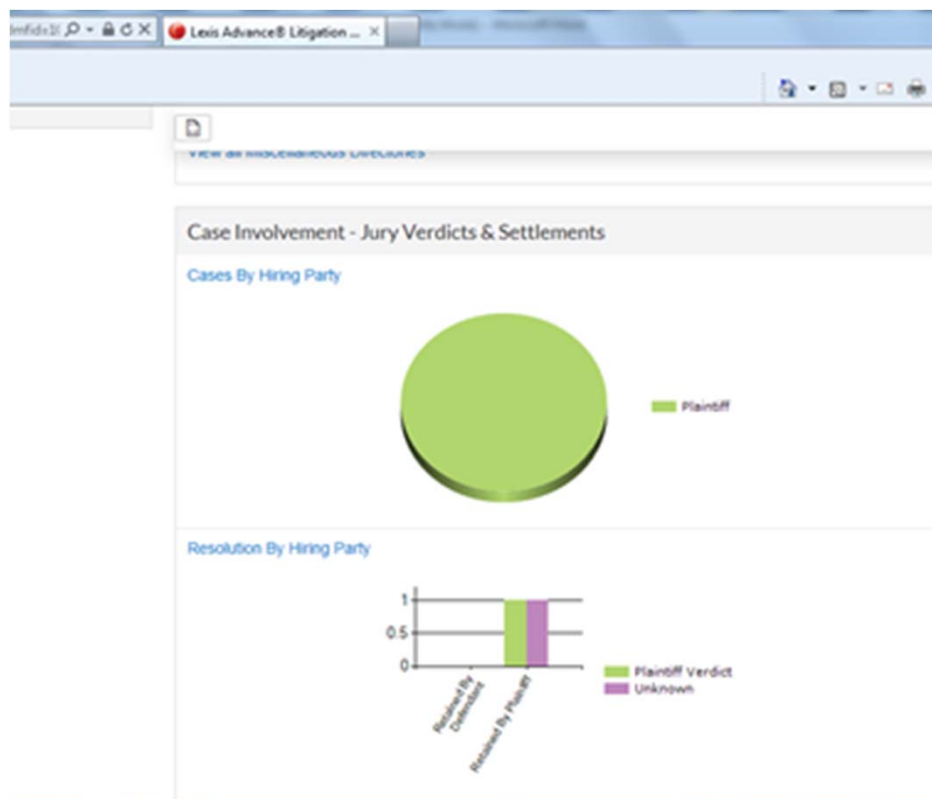
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# Insights from Attorneys on Panel Re: Experts



# Insights from Attorneys on Panel Re: Experts

## ■ Effective and non-effective ways of working between experts and counsel

- Identify case law parameters
- Communicate clearly about scope of work/theories up front, then check in regularly
- Ask – early – for materials that will be needed
- Understand whether communications and drafts will be discoverable