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One Size Does Not Fit All When It Comes to Economic Theories Used to Determine Royalty Rates

Article By:

Michael T. Renaud

James Wodarski

Aarti Shah

Matthew S. Galica

Tiffany Knapp

Calculating royalty rates as part of a patent dispute often becomes a hotly-disputed issue, where opposing economic theories from expert witnesses are pinned against one another. As a litigant, care must be taken when deciding which economic theory to advance—and what facts to rely on—in support of a particular royalty rate. Given the varying and unique nature of disputes, a singular economic approach to determining a royalty rate is impractical and, oftentimes, inappropriate. A recent district court opinion from Delaware reinforces this notion and should serve as a reminder that, when arguing for a particular royalty rate, you must select an appropriate economic theory and buttress it with equally appropriate and relevant facts. Importantly, the case also finds that the "top-down" methodology used to set a royalty rate in the *TCL* case is not appropriate where the patents at issue are not standard-essential.

By way of background, TC Technology LLC ("TC Tech") sued Sprint Corporation and Sprint Spectrum, L.P. (collectively, "Sprint") in the District Court for the District of Delaware for infringing a patent based on implementation of the LTE technology standard. Notably, the patent at issue was not standard-essential as it had not been accepted by a standards setting organization and TC Tech never agreed to license the patent on fair, reasonable, and non-discriminatory (FRAND) terms. To determine what constituted an appropriate royalty rate, the parties submitted expert testimony based on various economic theories. Each party moved to exclude the other's testimony on various grounds, claiming the theories were inappropriate. In particular, Sprint moved to strike three of TC Tech's arguments. As a counter measure, TC Tech moved to strike one of Sprint's arguments. Judge Andrews' order on these motions contains a detailed discussion of the economic theories that were deemed to be appropriate for the specific contours of the parties' dispute.

TC Tech's Arguments:

To start, TC Tech's damages expert calculated a reasonable royalty based upon the cost savings Sprint obtained by implementing the LTE standard versus its predecessor technology, 3G. Sprint argued that these opinions failed to properly apportion damages because they did not exclude (1) the value of LTE as an industry-wide standard and (2) the value of LTE attributable to unpatented technologies. Judge Andrews, referencing the Federal Circuit decision Prism Tech. LLC v Sprint Spectrum L.P., noted that damages can be based on cost savings from a defendant's infringement without any independent analysis of the invention's "footprint." The court also determined that TC Tech's expert had a reasonable basis for finding that Sprint had no non-infringing alternative to implementing LTE. Finally, the court reasoned that TC Tech's damages expert necessarily excluded the value of unpatented technologies by determining the incremental cost savings between LTE and 3G. Accordingly, Judge Andrews found TC Tech's argument to be appropriate and denied this portion of Sprint's motion.

In addition to the first theory, TC Tech's expert argued for a reasonable royalty based upon a previous royalty rate obtained by Sprint against TC Tech. For context, the previous rate was a by-product of prior litigation involving Sprint's Voice over Internet Protocol (VoIP) patents. Sprint argued that TC Tech's reliance on the prior royalty rate as a prior license was inappropriate, as the prior royalty rate was not comparable to the present, hypothetical license. The court agreed with Sprint, and found this theory unreliable and inadmissible because the evidence did not show sufficient comparability between Sprint's prior demand and the hypothetical license at issue, and there was no overlap in fact between the asserted patents and accused services in the prior case. As a result, the court excluded this testimony.

The final reasonable royalty calculation advanced by TC Tech's damages expert utilized "announced" royalty rates from other entities in the same industry, or publicly disclosed royalty rates for standard-essential LTE patents. Sprint argued that these announced rates are equivalent to prior licenses and are therefore insufficiently comparable to the hypothetical license at issue in the matter. While the court agreed that a hypothetical negotiation does not necessarily have to consider announced rates as equivalent to prior licenses, it noted that the information relied upon by the expert specifically stated that the announced rates may differ significantly from actual royalty rates and that a potential licensee should not perceive the listed rates as being guaranteed. In light of this, the court excluded this theory.

Sprint's Arguments:

Sprint's expert submitted an expert report relying upon the "top-down" approach used in the *TCL v. Ericsson* decision. This approach determined a reasonable royalty based on the aggregate royalty for the end-products implementing a standard (*i.e.* LTE devices) and then used this maximum aggregate royalty as a cap for the potential reasonable royalty rates. Sprint's expert report mirrored *TCL's* "top-down" approach to calculating a reasonable royalty, and used the same two public statements that were relied on in *TCL* to determine the reasonable aggregate royalty for the industry-wide set of LTE patents. However, the court noted that, in contrast to the patents at issue in *TCL*, the patent at issue in this dispute is not standard-essential, and TC Tech had never agreed to license the patent on FRAND terms. The Court therefore found that this "top down" analysis was inappropriate in this case and on that basis found the testimony inadmissible.

Conclusion:

The order is useful as it demonstrates how economic theories may—or may not—be appropriate to use

in certain patent disputes and underscores the importance of intelligently crafting, and relying on, economic theories that appropriately relate to the issues in patent disputes as a way of persuasively calculating reasonable royalty rates. Ultimately, plaintiffs and defendants, alike, must take care to sufficiently tie alleged damages theories and royalty calculations to the specific facts and issues of a case. Failure to do so may result in economic arguments and theories being cast aside.

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