UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON
AT SEATTLE

AVOCENT REDMOND CORP.,

Plaintiff,

v.

ROSE ELECTRONICS, *et al.*,

Defendants.

Case No. C06-1711RSL

ORDER GRANTING IN PART BELKIN'S MOTION TO EXCLUDE THE TESTIMONY OF WILLIAM O. KERR

This matter comes before the Court on "Belkin, Inc. and Belkin International, Inc.'s Daubert Motion to Preclude Any Testimony at Trial by William O. Kerr." Dkt. # 733.[1] Belkin argues that Dr. Kerr's opinions regarding reasonable royalty rates and lost profits are so flawed that they must be excluded in their entirety for fear of confusing and misleading the jury. Having reviewed the memoranda, declarations, and exhibits submitted by the parties,[2] the Court finds as follows:

A. Opinions Regarding Secondary Considerations Related to Obviousness

Belkin has not challenged Dr. Kerr's opinions regarding certain objective indicia of non-obviousness. Dr. Kerr may, therefore, provide testimony on that subject.

[1] An unredacted version of this motion is filed under seal at Dkt. # 735.

[2] The Court finds that this matter can be resolved on the papers submitted. Belkin's request for oral argument is DENIED.

B. Opinions Regarding Lost Profits

Section 284 of Title 35 provides for the award of damages upon a finding of patent infringement in an amount "adequate to compensate for the infringement, but in no event less than a reasonable royalty for the use made of the invention by the infringer, together with interest and costs as fixed by the court." The Supreme Court has determined that "damages adequate to compensate" means full compensation for any damages the patent holder suffered as a result of the infringement. Gen. Motors Corp. v. Devex Corp., 461 U.S. 648, 654 (1983). Lost profits are recoverable if the patent holder shows a causal link between the infringement and the loss of profits. BIC Leisure Prods., Inc. v. Windsurfing Int'l, Inc., 1 F.3d 1214, 1218 (Fed. Cir. 1993).

The patent holder has the initial burden of showing a reasonable probability that, "but for" the infringement, it would have made additional sales. Crystal Semiconductor Corp. v. TriTech Microelectronics Int'l, Inc., 246 F.3d 1336, 1353 (Fed. Cir. 2001). The "but for" inquiry requires a reconstruction of the market as it would have developed absent the infringing product.

> Reconstructing the market, by definition a hypothetical enterprise, requires the patentee to project economic results that did not occur. To prevent the hypothetical from lapsing into pure speculation, this court requires sound economic proof of the nature of the market and likely outcomes with infringement factored out of the economic picture. . . . Within this framework, trial courts, with this court's approval, consistently permit patentees to present market reconstruction theories showing all of the ways in which they would have been better off in the "but for world," and accordingly to recover lost profits in a wide variety of forms.

Grain Processing Corp. v. Am. Maize-Prods. Co., 185 F.3d 1341, 1350 (Fed. Cir. 1999) (internal citations omitted).

In order to calculate the profits lost by Avocent as a result of Belkin's infringement, Dr. Kerr analyzed the real world KVM switch market to determine each competitor's market share, determined that there were no acceptable non-infringing substitute products to which Belkin's customers could turn, and apportioned Belkin's market share to its competitors in proportion to their real world market share. Dr. Kerr then determined Avocent's per unit profit margin and calculated its lost profits. The Federal Circuit has found this exact methodology acceptable as a means of proving lost profits in patent litigation. See Crystal Semiconductor Corp. v. TriTech Microelectronics Int'l, Inc., 246 F.3d 1336, 1354-56 (Fed. Cir. 2001); Grain Processing, 185 F.3d at 1350 (citing with approval State Indus., Inc. v. Mor-Flo Indus., Inc., 883 F.2d 1573 (Fed. Cir. 1989)).

Belkin, however, identifies a number of shortcomings in the data Dr. Kerr used to calculate market share and argues that some of his assumptions and estimates artificially inflate Avocent's lost profit claim. In Daubert v. Merrell Dow Pharm., Inc., 509 U.S. 579 (1993), the Supreme Court charged trial judges with the responsibility of acting as gatekeepers to prevent unreliable expert testimony from reaching the jury. The gatekeeping function applies to all expert testimony, not just testimony based on science. Kumho Tire Co. v. Carmichael, 526 U.S. 137 (1999). To be admissible, expert testimony must be both reliable and helpful. The reliability of expert testimony is judged not on the substance of the opinions offered, but on the methods employed in developing those opinions. Daubert, 509 U.S. at 594-95. In general, the expert's opinion must be based on principles, techniques, or theories that are generally accepted in his or her profession and must reflect something more than subjective belief and/or unsupported speculation. Daubert, 509 U.S. at 590. The testimony must also be "helpful," such that a valid connection between the opinion offered and the issues of the case exists. Daubert, 509 U.S. at 591-92.

Belkin's objections do not go to the methods or techniques Dr. Kerr used to calculate lost profits. Rather, Belkin argues that some of the underlying data is so speculative that the resulting calculation represents no more than Dr. Kerr's subjective belief or declaration.

For example, Belkin points out that (a) the market share data on which Dr. Kerr relies comes from unauthenticated third-party analyst reports that cover only five of the nine years at issue and (b) Dr. Kerr fails to utilize the best information available when he calculates Avocent Redmond and Avocent Huntsville's market shares by adjusting revenues rather than simply comparing the number of units sold. Dr. Kerr's data is not unassailable: it would, of course, be preferable to have audited annual sales data in a per unit format from every market participant, minutely adjusted to account for all variations in product and customer base before attempting to calculate real world market share. Neither Daubert nor the relevant patent cases require unassailability, however. As noted above, market reconstruction is an inherently hypothetical undertaking and will require certain assumptions, postulations, and theories to carry us from the real world to the "but for" world. As long as inferences the expert draws are reasonable, something less than perfection will be sufficient. The patent holder must demonstrate only that there is a reasonable probability that, but for the infringement, it would have made additional sales. Mor-Flo Indus., 883 F.2d at 1577. It need not prove lost sales to a certainty or "negate *all* possibilities that a purchaser might have bought a different product or might have foregone the purchase altogether." Paper Converting Machine Co. v. Magna-Graphics Corp., 745 F.2d 11, 21 (Fed. Cir. 1984) (emphasis in original). Belkin may cross-examine Dr. Kerr regarding the myriad shortcomings in his data and the effects alternative assumptions would have had on his lost profit opinions. It has not, however, shown that the lost profits testimony is inadmissible under Daubert.

C. Opinions Regarding Reasonable Royalty Rate

With regards to any Belkin sales that do not result in an award of lost profits, Avocent seeks a "reasonable royalty for the use made of the invention by the infringer." 35 U.S.C. § 284. The reasonable royalty rate is derived from a hypothetical negotiation between the patent holder and the infringer at the time the infringement began. The goal of the exercise is "to discern the value of the patented technology to the parties in the marketplace when infringement began." LaserDynamics, Inc. v. Quanta Computer, Inc., 694 F.3d 51, 76 (Fed. Cir. 2012). "A comprehensive (but unprioritized and often overlapping) list of relevant factors for a reasonable royalty calculation appears in Georgia-Pacific Corp. v. United States Plywood Corp., 318 F. Supp. 1116, 1120 (S.D.N.Y. 1970)." ResQNet.com, Inc. v. Lansa, Inc., 594 F.3d 860, 869 (Fed. Cir. 2010). The factors are:

1. The royalties received by the patentee for the licensing of the patent in suit, proving or tending to prove an established royalty.

2. The rates paid by the licensee for the use of other patents comparable to the patent in suit.

3. The nature and scope of the license, as exclusive or non-exclusive; or as restricted or non-restricted in terms of territory or with respect to whom the manufactured product may be sold.

4. The licensor's established policy and marketing program to maintain his patent monopoly by not licensing others to use the invention or by granting licenses under special conditions designed to preserve that monopoly.

5. The commercial relationship between the licensor and licensee, such as, whether they are competitors in the same territory in the same line of business; or whether they are inventor and promoter.

6. The effect of selling the patented specialty in promoting sales of other products of the licensee; that existing value of the invention to the licensor as a generator of sales of his non-patented items; and the extent of such derivative or convoyed sales.

7. The duration of the patent and the term of the license.

8. The established profitability of the product made under the patent; its commercial success; and its current popularity.

9. The utility and advantages of the patent property over the old modes or devices, if any, that had been used for working out similar results.

10. The nature of the patented invention; the character of the commercial embodiment of it as owned and produced by the licensor; and the benefits to those who have used the invention.

11. The extent to which the infringer has made use of the invention; and any evidence probative of the value of that use.

12. The portion of the profit or of the selling price that may be customary in the particular business or in comparable businesses to allow for the use of the invention or analogous inventions.

13. The portion of the realizable profit that should be credited to the invention as distinguished from non-patented elements, the manufacturing process, business risks, or significant features or improvements added by the infringer.

14. The opinion testimony of qualified experts.

15. The amount that a licensor (such as the patentee) and a licensee (such as the infringer) would have agreed upon (at the time the infringement began) if both had been reasonably and voluntarily trying to reach an agreement; that is, the amount which a prudent licensee- who desired, as a business proposition, to obtain a license to manufacture and sell a particular article embodying the patented invention- would have been willing to pay as a royalty and yet be able to make a reasonable profit and which amount would have been acceptable by a prudent patentee who was willing to grant a license.

Georgia-Pacific, 318 F. Supp. at 1120.

In his report, Dr. Kerr addresses all of the Georgia-Pacific factors. Most of them, however, inform the analysis only insofar as they suggest that an increase or a reduction of the royalty rate would be appropriate: they do not provide a starting point for the calculation. In the absence of any comparable Belkin licenses or information regarding a customary royalty in the business, Dr. Kerr turned to the licensing agreements Avocent entered into with other alleged infringers.[3] The licenses provided information regarding the method of calculation (a percentage of sales of both the patented product and associated peripherals), the nature and scope of the license (nonexclusive and unrestricted, but applying to the entire patent family), and the duration of the licenses. Although two of the licenses address situations that were only marginally relevant to the hypothetical negotiation occurring between Avocent and Belkin in 2001, Dr. Kerr

[3] Dr. Kerr's report is based solely on the contents of the settlement and license agreements which Belkin received during discovery. Belkin's evidentiary objections are therefore overruled without prejudice to the issue being raised again if Avocent attempts to elicit testimony regarding the negotiations that led to the settlement agreements.

adopted the 5% royalty rate used in the more comparable Raritan license as the starting point for his analysis. Dr. Kerr concluded, however, that additional adjustments would have to be made.

Up to this point, Dr. Kerr's analysis easily satisfies Daubert and the relevant patent case law. The licenses Dr. Kerr reviewed are clearly related to the claimed invention and, to the extent Raritan's situation was different than Belkin's, further adjustments and fine-tuning based on other Georgia-Pacific factors (such as the invention's established profitability, Belkin's profits, the promotion of sales of related Belkin products, the expert's opinion, *etc*.) could be made to inform the outcome of the hypothetical negotiation. Instead of performing a nuanced analysis, however, Dr. Kerr mentions some of these factors, then simply multiplies the Raritan royalty rate by three. The theory is that the uncertainty arising from ongoing litigation regarding the validity of the patents-in-suit and infringement depressed the royalty rate Avocent was able to negotiate with Raritan. The multiplier is based on data showing that patent holders lose infringement suits in federal court two-thirds of the time, suggesting that Avocent was facing a significant downside risk to pursuing litigation and therefore agreed to a discounted royalty rate. While the concept of adjusting a settlement-related license agreement to account for litigation risk is not inherently objectionable (see Mondis Tech., Ltd. v. LG Elecs., Inc., 2011 WL 2417367, at *4-6 (E.D. Tex. June 14, 2011)), the adjustment must have some relationship to the patent at issue. In this case, there is no indication that Dr. Kerr's chosen method of adjustment is anything more than an arbitrary multiplier based on factors and statistics having nothing to do with the patents or parties in this case.

The Federal Circuit recently rejected a similar tool used in calculating royalty rates. Uniloc USA, Inc. v. Microsoft Corp., 632 F.3d 1292, 1311-18 (Fed. Cir. 2011). The "25% rule of thumb" had been used for many years as the starting point for royalty calculations, giving the patent holder 25% of profits per unit and allowing the infringer to retain 75% of the profits. The rule was developed based on observations of commercial licenses and had been confirmed by years of licensing and profit data across industries. Nevertheless, the Federal Circuit found that the resulting royalty rate was not sufficiently tied to the facts of the case before it and would therefore be unhelpful to the jury. Uniloc, 632 F.3d at 1315-16. The court noted that the 25 percent rule of thumb was "an abstract and largely theoretical construct" that did "not say anything about a particular technology, industry, or party." Uniloc, 632 F.3d at 1317. Because the 25% rate was not actually tied to the facts and circumstances of the case at hand, it would not assist the jury in determining what value the patented technology would have been assigned by the parties in the marketplace when infringement began.

The same can be said of Dr. Kerr's multiplier. The fact that patent holders are successful in only 33% of cases nationwide tells us nothing about the actual or perceived strength of Avocent's claims as it was negotiating the settlement with Raritan. If, in 2005, Avocent was besieged with infringers and facing millions of dollars in legal fees in order to enforce its patent rights in court, it may have been willing to accept a deeply discounted royalty to avoid litigation expenses and risks. On the other hand, if Avocent were sure of its patents, Raritan was earning significant profits by infringing, and it was Raritan that was seeking to avoid litigation, the 5% royalty rate may be accurate or even inflated. Dr. Kerr's one-size-fits-all multiplier would treat all litigation settlements in the same way, regardless of the underlying facts. The Federal Circuit has found that such shortcuts are "arbitrary, unreliable, and irrelevant" and their use "fails to pass muster under Daubert . . . ." Uniloc, 632 F.3d at 1318. Although Dr. Kerr will be permitted to testify regarding his opinion that licenses negotiated in settlement of litigation are often discounted, he may not present his litigation-success-rate theory as a surrogate for facts and circumstances related to the patents-in-suit.[4]

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[4] The Court has not considered Belkin's argument, raised for the first time in reply, that the claimed invention was not the basis for consumer demand. Dkt. # 780 at 6.

For all of the foregoing reasons, the Court GRANTS in part Belkin's motion to exclude the testimony of Dr. Kerr (Dkt. # 735). Dr. Kerr will not be permitted to provide his opinion, based on his general litigation-success-rate theory, that the royalty rate in the negotiated license should be multiplied by three.

Dated this 11th day of March, 2013.

Robert S. Lasnik
United States District Judge