



Settlement Agreements Support Reasonable Royalty Analysis

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Attorneys often turn to forensic accountants as experts in the determination of intellectual property infringement damages. One measure of damages is a reasonable royalty and a number of recent decisions have addressed the use of licenses arising out of litigation settlements as the basis for establishing a reasonable royalty.

Under the accepted hypothetical negotiation approach, a reasonable royalty is “the royalty upon which the parties would have agreed had they successfully negotiated an agreement just before infringement began.” *Lucent Techs., Inc. v. Gateway, Inc.*, 580 F.3d 1301, 1324 (Fed. Cir. 2009). In other words, the negotiation is assumed to take place prior to any infringement or litigation.

The accepted framework for determining a reasonable royalty is commonly known as the Georgia-Pacific factor. *Georgia-Pac. Corp. v. U.S. Plywood Corp.*, 318 F. Supp. 1116, 1120 (S.D.N.Y. 1970). There are 15 Georgia Pacific factors covering issues including past licensing activity, the commercial relationship between the parties, and the advantages of the invention, among others. However, the very first factor to be considered is “The royalties received by the patentee for the licensing of the patent in suit, proving or tending to prove an established royalty.” *Id.* In fact, the existence of an established royalty often overrides all other factors.

Given the weight afforded to the royalties a patentee has received in the past for licensing the patent-in-suit, the circumstances under which such royalties have been negotiated are critically important to a fair assessment of whether or not those prior agreements provide valuable insight into the royalty upon which the parties would have agreed for the patent-in-suit had they successfully negotiated an agreement just before infringement began.

The Federal Circuit has a history of “longstanding disapproval of relying on settlement agreements to establish reasonable royalty damages.” *LaserDynamics, Inc. v. Quanta Computer, 4 Inc.*, 694 F.3d 51, 77 (Fed. Cir. 2012). In fact, the court has traditionally found that settlement agreements are not necessarily probative because “the hypothetical reasonable royalty calculation occurs before litigation and that litigation itself can skew the results of the hypothetical negotiation.” *ResQNet.com, Inc., v. Lansa, Inc.*, 594 F.3d 7 860, 872 (Fed. Cir. 2010). However, in some recent cases, starting with *ResQNet*, courts have upheld the admissibility of licenses that arose out of litigation where such licenses were deemed to be “the most reliable license in the record.” *Id.*

These issues have become increasingly important due to Judge Rader’s statement from *ResQNet*, in which he wrote that “the most reliable license in this record arose out of litigation.” Since that ruling, some plaintiffs have pointed to this statement as support in arguing the importance of prior settlement agreements

in determining reasonable royalty damages. On the other hand, defendants who suspect that the plaintiff settled prior suits for small amounts push to show those agreements to the jury in an effort to drive the damages down.

In *ReedHycalog UK, Ltd. v. Diamond Innovations Inc.*, Case No. 6:08-CV-325 (Aug 10, 2010, EDTX) the district court allowed five settlement agreements to be admitted at trial along with other license agreements. Here the court held that any risk of confusion or prejudice was outweighed by relevance. Interestingly, the court also required that the settlement agreements not be called out as settlement agreements at trial. In reaching its decision to admit these agreements, the court pointed to the consistency of license structure and financial terms among the five agreements, which in the court’s opinion lent credence to plaintiff’s proposed damages model. The court noted that, in its opinion, *ResQNet* had not created a bright-line rule allowing settlement agreements as proper trial evidence, but that it was a case-specific inquiry, and that in this case any Rule 403 concerns were outweighed by relevance.

Shortly after the decision in *ReedHycalog UK*, Judge Davis from the Eastern District of Texas addressed the related issue of admissibility of



negotiation communications in *Clear Computers, LLC v. Bergdorf Goodman, Inc.*, Case No. 6:09CV481 (LEAD) Consol. With 6:09CV95 (E.D. Tex. Nov. 29, 2010). Here the plaintiff, Clear With Computers LLC (CWC) had previously sued numerous third parties for infringement and had settled with all but one. CWC had produced the licenses it reached via the settlement agreements to the defendants (Bergdorf Goodman and Hyundai) but the defendants also sought production of the communications related to the negotiations of the settlement agreements. Seeking a protective order for those same communications, CWC contended it should not be forced to produce the settlement-related communications because production would be unduly burdensome, the settlement agreements contain merger clauses, and the communications are privileged and inadmissible. Defendants contended that the communications were necessary to determine the settlement agreements' admissibility at trial.

Judge Davis noted that while recognizing the courts in his district were split on

whether litigation induced settlement agreements are admissible at trial, this court takes a case-by-case approach to the issue. Citing *ResQNet.com, Inc.*, he went on to say that whether the settlement agreements are admissible would likely depend on whether they are an accurate reflection of the inventions' value and that in this case, the settlement communications were likely to be key in determining whether the settlement agreements accurately reflect the inventions' value or were strongly influenced by a desire to avoid or end full litigation. Judge Davis also noted that in this case, the settlement agreements were likely to be the only licenses of the patents-in-suit, making an accurate understanding of them more important and, therefore, the settlement negotiations had increased relevance. However, Judge Davis also stated that he expected his finding here allowing discovery would be the exception, not the rule, and in most cases discovery of the negotiations would not be warranted.

On Aug. 30, 2012, the Federal Circuit in *LaserDynamics, Inc. v. Quanta Computer, Inc.*, Case Nos. 2011-1440, -1470 (Fed. Cir.) again addressed the use of settlement agreements as comparable licenses for a reasonable royalty analysis. In this case, the Federal Circuit found that the district court had abused its discretion in allowing a litigation settlement agreement into evidence. While acknowledging it had recently permitted such reliance under certain limited circumstances in *ResQNet*, the court distinguished the present facts from that of *ResQNet.com*, noting that settlement agreements are still generally disfavored for damages analyses, but may nevertheless be the *best* evidence in certain scenarios where there is a lack of other reliable indicia of value. The difference between *ResQNet* and *LaserDynamics* is that unlike the *ResQNet* case where the court found a settlement agreement to be the most reliable license in the record, the settlement agreement at issue in *LaserDynamics* was "far from being the most reliable license in [the] record." *Id.* It was executed shortly before trial by a defendant that was in a very disadvantageous bargaining position because of multiple sanctions and there were 28 other licenses to the patent-in-suit, most of which were entered into outside of litigation.

On Feb. 21, 2013, in *AVM Tech, LLC v. Intel Corp.*, (Case No. 1:10-cv-00610-RGA), Judge Andrews of the District of Delaware concluded that AVM could not present a damages theory that was based on a single Intel settlement agreement from a previous litigation involving a different plaintiff, in part because AVM failed to analyze the underlying litigation

that led to the settlement or to explain why other Intel licenses were not comparable. Additionally, Judge Andrews observed that the agreement was executed five years after the hypothetical negotiation, and that AVM's expert had failed to analyze the litigation that led to the settlement.

Most recently, on Mar. 6, 2014 the District Court for the Eastern District of Texas once again held in *Stragent v. Intel*, (Case No. 6:11-cv-421 E.D. TX.) that a damages expert could employ licenses arising from litigation settlements when such licenses are the most reliable licenses in the record. In this case, Stragent sought to introduce two licenses entered into in settlement of litigation by third-party device manufacturers to establish a reasonable royalty. Intel moved to exclude parts of the expert's testimony relating to these licenses. After the magistrate judge denied Intel's motion, Intel moved for reconsideration.

Federal Circuit Judge Dyk, sitting by designation, acknowledged the Federal Circuit's longstanding disapproval of relying on settlement agreements to establish reasonable royalty damages and noted "...there is good reason to be skeptical about the probative value of licenses that may merely reflect the nuisance value of avoiding litigation..." However, in this case Judge Dyk found that the two licenses at issue were the *only* licenses in the record covering the patents-in-suit. Accordingly, Judge Dyk ruled not only that the court would not exclude expert testimony concerning these licenses, but also that Intel would be allowed to present arguments and evidence at trial that the agreements are not probative of a reasonable royalty rate and Intel may propose instructions that such licenses should be given less weight because they were entered into in the context of a litigation settlement.

The above cases show that many of today's courts are finding that licenses reached in settling litigation may be admissible for demonstrating a reasonable royalty rate if it is the most reliable license in the record. Where there are other more relevant license agreements in the record, damages experts would be well served to place little reliance on litigation settlements. Moreover, if a settlement agreement is to be relied upon, the damages expert should, to the extent possible, analyze the litigation that led to such agreements. Moreover, experts should be prepared to explain why settlement agreements are probative and be able to explain the relative weight that should be afforded such agreements in context of the overall reasonable royalty analysis.

