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District Court Tightens Requirements for Applying Entire Market Value Rule in Cornell's Patent Infringement Damages Case Against Hewlett-Packard

Following a jury verdict in the Northern District of New York awarding to Cornell University patent infringement damages of $184 million, Federal Circuit Judge Rader, sitting by designation as the trial judge, granted Hewlett-Packard's Motion for Judgment as a Matter of Law and reduced Cornell's damages award to $53 million. In support of his ruling, Judge Rader found that Cornell's damages evidence failed to meet the requirements of the Entire Market Value Rule ("EMV Rule"). Specifically, Cornell failed to offer "credible and sufficient economic proof that the patented invention [consisting of processing technology that works within a buffer] drove demand" for the Hewlett-Packard products, namely CPU bricks, that Cornell had identified as the royalty base for its reasonable royalty damages calculation.

The EMV Rule permits a patentee to calculate its infringement damages based on the value of the entire apparatus sold by a defendant where the accused apparatus contains both patented and unpatented features. In order for the EMV Rule to apply, a patentee must show that: i) the features of the apparatus covered by the patent are the basis for customer demand for the entire device, including components not covered by the patent, and ii) the covered and not-covered components are parts of a complete machine or assembly of parts, or are typically sold together as a single functioning unit. The EMV Rule is not applied if the covered and not-covered components are sold together for mere business convenience.

The patent at issue in this case, U.S. Patent No. 4,807,115 (the "'115 Patent"), claims a technology that issues multiple and out-of-order computer processor instructions in a single machine clock cycle, thus enhancing the throughput of processors with multiple functional units. This technology was incorporated by Hewlett-Packard into a component of the instruction reorder buffer (IRB), which is a component of a Hewlett-Packard processor. The Hewlett-Packard processor is part of a CPU module. CPU modules, when combined with a temperature controlling thermal solution, an external cache memory and a power converter, are referred to as CPU bricks. CPU bricks are incorporated into a cell board and the cell board is incorporated in Hewlett-Packard's servers and workstations. Thus, the patented technology was used in only a small component of Hewlett-Packard's servers, or as expressed by Judge Rader: "the claimed invention is a small part of the IRB, which is part of a processor, which is part of a CPU module, which is part of a processor, which is part of a CPU module, which is part of a brick, which is itself only part of a larger server."

Cornell initially sought to apply the EMV Rule to Hewlett-Packard's market for servers and workstations. This was rejected by Judge Rader in a ruling on Hewlett-Packard's Daubert motion heard during the trial. In ruling on that motion, Judge Rader found that Cornell and its damages expert failed to offer credible and economic proof that the patented invention drove demand for Hewlett-Packard's entire server and workstation market. Instead, Judge Rader offered to permit damages evidence that takes into account that the claimed invention is not the entire server but rather only a component of the server.

Following the Court's Daubert ruling, Cornell's expert testified that Cornell's damages should be based on the entire market value of the CPU "bricks" within Hewlett-Packard's servers and workstations. This resulted in a smaller royalty base compared with the entire market value of Hewlett-Packard's servers and workstation market, but nevertheless resulted in the jury's $184 million award. Following the trial, Hewlett-Packard filed a Motion for Judgment as a Matter of Law and/or remittittur seeking to reduce the royalty base on which the jury's verdict rested.

The Court granted Hewlett-Packard's motion because Cornell did not prove it was entitled to base its patent infringement damages claim on the entire market value of Hewlett-Packard's CPU brick products. In essence, Judge Rader found Cornell's evidence insufficient for the same reasons he rejected Cornell's attempt to measure its damages based on the entire market value of Hewlett-Packard's server and workstation market, namely that Cornell failed to offer any evidence to show a connection between consumer demand for Hewlett-Packard's CPU bricks and the patented invention.

A key to understanding Judge Rader's decision can be found in his Daubert ruling. *Cornell Univ. v. Hewlett-Packard Co.*, No. 01-CV-1994, 2008 WL 2222189 (N.D. N.Y. May 27, 2008). The Court began by observing that under 35 U.S.C. § 284, a successful patent infringement plaintiff is entitled to damages "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." With respect to reasonable royalty damages, the Court further observed that the Federal Circuit "requires sound economic proof of the nature of the market and likely outcomes with infringement factored out of the economic picture" in all damages calculations, citing *Grain Processing Corp. v. America Maize-Products Co.*, 185 F.3d 1341, 1350 (Fed. Cir. 1999). While recognizing that "some approximation" may be required in the reasonable royalty context, the Court emphasized that Federal Circuit precedent required "sound economic and factual predicates" for the reasonable royalty damages analysis and that a district court must exercise its gatekeeping discretion to exclude proffered testimony which is unsupported by such predicates.

With this background statement of the law governing damages in patent cases, the Court excluded Cornell's proposed testimony that the entire market value of Hewlett-Packard's servers and workstations market should be the royalty base for the reasonable royalty calculation. The Court did so because of the absence of economic proof linking the proposed entire market value royalty base and consumer demand, i.e., because neither Cornell nor its damages expert had drawn any connections between the market for servers and workstations and the patented invention. On the basis of the same rationale, the Court granted Hewlett-Packard's Motion for Judgment as a Matter of Law after trial because Cornell's evidence at trial failed to draw any connection between the market for Hewlett-Packard's CPU "bricks" and the invention of the '115 Patent.

Another key to understanding the Court's decision can be found in the Court's observation, repeated in similar language at least three times in its opinion, that Hewlett-Packard's processor was "the smallest salable patent-practicing unit." This observation was likely derived from the testimony of Cornell's damages expert, who admitted that "the right way to start the intellectual exercise is to consider the smallest possible measure of sales or any measure for a royalty base, and conceptionally [sic] that would be the processor itself." This, combined with the fact that there was evidence that Hewlett-Packard had sold more than 31,000 processors *à la carte* during the damages period, was more than sufficient to reject Cornell's CPU brick royalty base and to adopt an estimate of Hewlett-Packard's processor sales as an alternative royalty base.

Applying the jury's royalty rate to the estimated total sales of Hewlett-Packard's processors reduced damages to $53 million.

The decision is noteworthy because it was made by Judge Rader, who normally sits on the Court of Appeals for the Federal Circuit. Therefore, the decision may suggest a more limited application of the EMV Rule that may find other allies at the Federal Circuit. The decision is also noteworthy because the result reached by Judge Rader relies heavily on the fact that the invention of the '115 Patent was incorporated into only a small component of a separately salable component, i.e., the processor, of Hewlett-Packard's servers and workstations. Since the facts established that the processor was "the smallest salable patent-practicing unit," and Cornell failed to provide evidence that the invention of the '115 Patent drove customer demand for either Hewlett-Packard's servers and workstations, or, in the alternative, its CPU "bricks," the royalty base for application for the EMV Rule was necessarily limited to estimated revenue from that smallest salable unit which practiced the invention at issue. Therefore, the decision also suggests a more limited application of the EMV Rule in other patent cases in which the invention at issue plays only a small role in the overall accused product, a fact pattern that is often presented in cases involving electronics, software and computer related inventions. If, in such cases, the invention is embedded in a smaller, "salable" or functional unit, this may provide a good opening by which to limit the royalty base for application of the EMV Rule to the smallest salable unit which practices the invention.