

Even the Value of The Smallest Salable Unit Must Be Apportioned

*Finjan, Inc. v.
Blue Coat Sys., Inc.*

By Matthew Siegal

In *Finjan, Inc. v. Blue Coat Sys., Inc.*, 16-2520 (Fed. Cir. Jan. 10, 2018) (<http://bit.ly/2nZxFg4>), the Federal Circuit ruled that basing a reasonable royalty calculation on the “smallest salable unit” does not obviate the need to apportion damages to the patented contribution within that unit.

The Federal Circuit vacated a portion of the damages awarded to Finjan by the jury in its patent infringement case against Blue Coat. Finjan’s ‘844 patent (U.S. Pat. No. 6,154,844 titled System and Method for Attaching a Downloadable Security Profile to a Downloadable) claims, *inter alia*, a method for providing computer security to a local network by attaching a security profile to downloadable content before the content is made available to a user in the local network. For example, the invention can help safeguard a business computer system in the event an employee tries to download content from the Internet that is infected with malware.

The “attachment” of the profile to the downloadable content (the infringing method) is performed by the DRTR (dynamic real-time rating engine)

continued on page 6

Will the Supreme Court Seismically Shift the Patent Damages Landscape In *WesternGeco v. ION*?

By Morgan Chu and Dominik Slusarczyk

The U.S. Supreme Court recently agreed to consider whether a patentee may recover foreign lost profits resulting from infringement of a United States patent.

In *WesternGeco LLC v. ION Geophysical Corp.*, the Federal Circuit vacated the lost profits portion of a damages award because the profits resulted from activity on the high seas, outside the territorial reach of United States patent law. 791 F.3d 1340, 1349 (Fed. Cir. 2015) (<http://bit.ly/2o000CS>) [*WesternGeco I*], *vacated on other grounds*, 136 S. Ct. 2486 (2016). The majority opinion billed the decision as largely dictated by settled precedent, but the Supreme Court granted *certiorari* this January to review the holding.

The specific issue is whether profits earned overseas with a patented invention may be recovered by the patentee if components of that invention were exported from the United States in violation of Section 271(f). The Supreme Court’s agreement to consider the case could signal an impending expansion of the territorial damages in patent cases. A decision is expected by the end of June.

STATUTORY BACKGROUND

Incurring Liability for ‘Overseas’ Infringement

At the center of a typical patent infringement case usually lie allegations of infringement under 35 U.S.C. §271(a), which provides that making, using, offering to sell, or selling a patented invention within the United States is infringement of a patent. To establish infringement under that commonly invoked provision, a patentee must prove unauthorized products or processes in the United States that meet each element of a patent claim — for example, the sale of a device in California that meets each limitation of an apparatus claim or the use of a process in New York that uses each step of a method claim.

continued on page 2

In This Issue

SCOTUS to Hear <i>WesternGeco</i> <i>v. ION</i>	1
Smallest Salable Unit Apportionment . .	1
Takeaways from the Swift End to <i>Waymo v. Uber</i> . . .	3
IP News	5

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STANDARD
U.S. POSTAGE
PAID
LANGHORNE, PA
PERMIT 114

IP News

continued from page 5

hoping to obtain access to certain benefits only available if it performs certain acts identified by, and under terms prescribed by the defendant, Travel Sentry.

The panel identified three specific errors that the district court committed in holding that TSA's actions could not be attributed to defendant Travel Sentry. First, the district court misidentified the relevant third-party actions as "the luggage screening mandated by Congress," which, the district court contended, would have been performed by the TSA regardless of any benefit offered by Travel Sentry. Second, it misapprehended what types of "benefits" can satisfy *Akamai's* first prong. Third, the district court mischaracterized

what is required to establish that one has "conditioned" a third party's participation in an activity or receipt of a benefit on the third party's performance of one or more claim steps.

With respect to the first prong of the *Akamai* test, the panel identified the relevant third-party activity as TSA's screening of luggage that it knows can be opened with the passkeys provided by Travel Sentry. The panel also concluded that a reasonable juror could find that the "benefit" to TSA contemplated in the MOU is the ability to open identifiable luggage using a master key, which would obviate the need to break open the lock. The mere fact that TSA entered into the MOU with Travel Sentry, according to the panel, implied that TSA believed it would receive some benefit from the arrangement, be it

tangible (e.g., a reduction in the number of claims submitted by aggrieved travelers or an improvement in the health of its employees) or intangible (e.g., promotion of the public's perception of the agency).

The panel also decided that a reasonable jury could conclude that Travel Sentry "conditions" TSA's participation in the correctly defined activity or receipt of the correctly identified benefits on TSA's performance of the final two claim steps. The panel noted that the relevant "activity" is coextensive with the final two claim steps, and that whatever benefits flow to TSA can only be realized if TSA performs the final two claim steps.

With respect to the second prong of the *Akamai* test, the panel concluded that a reasonable juror could

continued on page 8

Finjan, Inc.

continued from page 1

portion of Blue Coat's infringing WebPulse product. Finjan's damages expert testified that the DRTR is the smallest salable unit of WebPulse and he based his royalty calculation on the total usage of the DRTR by Blue Coat's customers. However, the DRTR performs both infringing and non-infringing functions. The Federal Circuit vacated the jury's award of damages on the grounds Finjan had failed to properly apportion the value of the infringing features within the DRTR, notwithstanding whether DRTR was the smallest salable unit. In addition, the Federal Circuit vacated a damages award based on a paid-up royalty, on the grounds the rate was "plucked from thin air," and not based on evidence.

BACKGROUND

The infringing product sold by Blue Coat is called WebPulse, a cloud-based system that screens content that is downloadable from the Internet. It can be purchased by an employer to screen the content downloaded by its employees. WebPulse "associates URL's with over eighty different categories, including pornography, gambling, shopping,

social networking and 'suspicious.'" *Id.* at 18. URLs that have not already been categorized, are analyzed by the DRTR portion of WebPulse.

When a user accesses a URL that is not already in the WebPulse database, DRTR analyzes its content, assigns it a category and performs other functions not covered by the '844 patent. DRTR examines the URLs for malware and when suspicious code that may contain malware is identified, DRTR attaches a security profile to the URL. This permits a customer of WebPulse to screen downloadables for malware.

Attaching the security profile to the downloadable content infringes the '844 patent. However, other functions that are unrelated to the malware identification function, while desirable to purchasers of WebPulse, do not infringe the '844 patent.

Finjan's Damages Theory

Patent damages are governed by 35 U.S.C. §284. It directs that patent damages must be "adequate to compensate for the infringement," but in no event, less than a reasonable royalty. The "reasonable royalty" has been held to correspond to the amount a willing licensee and licensor would have agreed to at the time

the infringement began, if the licensee would have been prevented from infringing the patent. *Id.* at 16-17.

The reasonable royalty calculation is typically made by multiplying a royalty base by a royalty rate. The combination of base and rate must reflect the value of the infringing features of the product, but no more. *Id.* at 17. Courts have recognized that if the base is too high, it can skew the royalty calculation even if it is multiplied by a small rate. For example, if the patented feature is an improved automobile headlamp filament, it might be prejudicial to a jury to calculate the royalty based on the price of the entire car, even if a small rate were employed. Consequently, an "entire market value rule" has developed. This rule seeks to identify the smallest salable unit of the infringing product, such as the headlamp bulb, in an effort to calculate a reasonable royalty that is more closely tied to the patented invention, and not unpatented features of an infringing product.

The smallest salable unit principle directs that "in any case involving multicomponent products, patentees may not

continued on page 7

Finjan, Inc.

continued from page 6

calculate damages based on sales of the entire product, as opposed to the smallest salable patent-practicing unit, without showing that the demand for the entire product is attributable to the patented feature.” *LaserDynamics, Inc. v. Quanta Comput., Inc.*, 694 F.3d 51, 67–68 (Fed. Cir. 2012).

Id. at 19.

At trial, in an effort to provide evidence of how much use was made of the infringing method, Finjan submitted evidence regarding the total amount of Web traffic that passed through the DRTR. It argued that because the DRTR was the smallest identifiable technical component, essentially the smallest salable unit of WebPulse, evidence of how much it was used was a base measure of how much use was made of the patented method. However, Finjan did not further apportion DRTR usage between non-infringing uses and infringing uses. Finjan argued that “apportionment to DRTR [as a whole] is adequate because DRTR is the ‘smallest, identifiable technical component’ tied to the footprint of the invention,” *i.e.*, the smallest salable unit. *Finjan*, at 19. Therefore, according to Finjan, the damages award was acceptable, because it was not based on total usage of WebPulse, but only on usage of the smallest salable portion performing the infringing feature.

The court acknowledged that Finjan is correct that basing a royalty on the smallest salable unit is a requirement for situations where the “entire market value rule” is an issue. Thus, it would have been

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improper for Finjan to base damages on total usage of WebPulse. However, the court clarified that identifying the smallest salable unit does not end the analysis. Even if a plaintiff identifies the smallest salable unit, it must still ensure that royalties are tied to the patented invention and not to unpatented portions of that smallest unit: identifying the smallest salable unit “does not insulate [the patentee] from the ‘essential requirement’ that the ‘ultimate reasonable royalty award must be based on the incremental value that the patented invention adds to the end product.’” *Ericsson*, 773 F.3d at 1226.” Moreover, the case did not involve a multi-component product and a patent covering only one of those components. Rather, the patent covered a method and plaintiff attempted to isolate use of a feature as a proxy for use of the claimed invention. Thus, even after the smallest salable unit or smallest identifiable technical component is identified, an apportionment must be made between infringing and non-infringing aspects, when such a situation exists. *Id.* at 19.

Finjan also defended its position on the grounds that the patented function was an important driver of sales and that customers viewed many of the non-infringing functions as unimportant. However, the evidence established that customers considered at least some of the unpatented functions of DRTR to be important. Therefore, Finjan was required to apportion between patented and unpatented functionality: “whether ‘viewed as valuable, important or even essential,’ the patented feature must be separated. *VirnetX*, 767 F. 3d at 1329 (quoting *LaserDynamics*, 694 F. 3d at 68.” *Id.* at 20.

The Federal Circuit also found error in Finjan’s alternate royalty calculation, which was based on an \$8-per-user lump-sum royalty. The court found the \$8-per-user lump-sum royalty to be unsupported by the evidence, regardless of apportionment issues. Finjan’s representative testified that in 2008, it obtained an \$8-per-user royalty against the

defendant (Secure Computing) in an unrelated patent infringement litigation also involving computer security software. He testified that the \$8-per-user rate from the earlier case would be a reasonable “starting point” of the subsequent hypothetical royalty negotiation with Blue Coat. *Id.* at 21. However, the Federal Circuit found his methodology to be unsupported.

The Federal Circuit pointed out that the *Secure Computing* case involved a different patent; that there was no evidence establishing the patents were economically or technologically comparable; and that the fact that both infringing products were in the field of computer security was a mere “surface similarity.” Therefore, the court concluded that the “\$8-per-user rate appeared to have been plucked from thin air.” As such, the court could not consider it to be an acceptable basis for a reasonable royalty calculation. *Id.* at 22.

THE FEDERAL CIRCUIT HOLDING

The Federal Circuit remanded the case to the district court for a new calculation of damages. First, the court noted that in its view, Finjan had “failed to present a damages case that can support the jury’s verdict.” *Id.* at 22. However, it recognized that mere reversal would provide Finjan without any compensation for Blue Coat’s infringement of the ‘844 patent. It explained that Finjan is entitled to no less than a reasonable royalty. Therefore, it remanded the case to the district court “to determine whether Finjan has waived the right to establish reasonable royalty damages under a new theory and whether to order a new trial on damages.”

CONCLUSION

The Federal Circuit emphasized that the goal of a patent infringement reasonable royalty calculation is to base the royalty on the incremental value the patented technology adds to the infringing product. Patentees that ignore apportionment between patented and unpatented features do so at their own risk.

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