BVR
What It's Worth

BUSINESS VALUATION UPDATE

Vol. 18, No. 8, August 2012

TIMELY NEWS, ANALYSIS, AND RESOURCES FOR DEFENSIBLE VALUATIONS

10 Key Patent Damages and Valuation Takeaways From *Google v. Oracle*

By Steven R. Hansen

In the hard-fought litigation between Google and Oracle, two district court opinions were issued in March that address patent reasonable royalty damages methodologies in detail: *Oracle America, Inc. v. Google, Inc.*, 2012 U.S. Dist. LEXIS 33619 (N.D. Cal. 2012)(Oracle I), and *Oracle America, Inc. v. Google Inc.*, 2012 U.S. Dist. LEXIS 35393 (N.D. Cal. 2012)(Oracle II)(both have been digested and are available at *BVLaw)*.

The opinions provide guidance for satisfying the increasing level of scrutiny applied to analyses of reasonable royalty patent damages by the Federal Circuit Court of Appeals. This article offers 10 key takeaways from Oracle I and II.

Background of Oracle I and II. Oracle claims that Google's Android mobile phone operating system infringes certain patents and copyrights directed at several smartphone features. The patents and copyrights are a small subset of Oracle's mobile phone IP portfolio, which it acquired from Sun Microsystems. Prior to trial, Oracle submitted several expert reports on damages issues, which Google challenged as insufficiently reliable under *Daubert*. Oracle's experts relied on a $99 million offer Sun made to Google in 2006 to license an IP bundle, which included copyrights and six patents that Google allegedly infringed. The IP bundle also included a large number of patents and copyrights that were not at issue in the case.

Oracle's expert sought to use the 2006 license offer to arrive at a reasonable royalty for the infringement of the six patents asserted against Google. Prior to issuing Oracle I and II, the court struck two of Oracle's damages reports. Thus, in Oracle I and II, the court considered Oracle's third attempt to offer an admissible expert damage opinion and properly apportion the value of the Sun IP bundle attributable to the patents and copyrights-in-suit.

Oracle's expert relied on two apportionment methodologies: 1) the "group and value approach"; and 2) the "independent significance approach." In the group and value approach, Oracle engineers reviewed 569 smartphone platform patents that would have been included in the Sun IP bundle and categorized them into 22 nonoverlapping technology groups. The engineers then rated the patents in each group on a three-point scale based on their respective contributions to desirable smartphone features such as startup, speed, or footprint.

From there, the Oracle engineers counted the number of patents ranked with a "1" in the "purportedly top-three technology groups," arriving at 22 top patents. Three of the six patents asserted by Oracle were part of this group of 22. Oracle's expert further concluded that the three patents-in-suit identified by the Oracle engineers were the most valuable because Google had "decided to infringe" them. To value the top 22 patents, Oracle relied on studies of third-party patent portfolios to determine what portion of the overall value of the Sun Java mobile patent portfolio in the Sun IP bundle should be attributed to the top 22 patents.

Oracle's expert also offered the independent significance approach as an alternative to the group

Reprinted with permissions from Business Valuation Resources, LLC

BUSINESS VALUATION UPDATE

Executive Editor: Jan Davis
Legal Editor: Sherrye Henry Jr.
CEO, Publisher: David Foster
Managing Editor: Janice Prescott
Graphic & Technical Designer: Monique Nijhout
Customer Service: Jasmine Pearsall
VP of Sales: Lexie Gross
President: Lucretia Lyons

EDITORIAL ADVISORY BOARD

CHRISTINE BAKER
CPA/ABV/CFF
PARENTEBEARD
NEW YORK, NY

NEIL J. BEATON
CPA/ABV, CFA, ASA
ALVAREZ & MARSAL VALUATION SERVICES
SEATTLE, WA

JOHN A. BOGDANSKI, ESQ.
LEWIS & CLARK LAW SCHOOL
PORTLAND, OR

MICHAEL A. CRAIN
CPA/ABV, ASA, CFA, CFE
THE FINANCIAL VALUATION GROUP
FORT LAUDERDALE, FL

NANCY J. FANNON
ASA, CPA/ABV, MCBA
FANNON VALUATION GROUP
PORTLAND, ME

JAY E. FISHMAN
FASA, CBA
FINANCIAL RESEARCH ASSOCIATES
BALA CYNWYD, PA

LYNNE Z. GOLD-BIKIN, ESQ.
WEBER GALLAGHER
NORRISTOWN, PA

LANCE S. HALL, ASA
FMV OPINIONS
IRVINE, CA

THEODORE D. ISRAEL
CPA/ABV/CFF, CVA
ECKHOFF ACCOUNTANCY CORP.
SAN RAFAEL, CA

JARED KAPLAN, ESQ.
MCDERMOTT, WILL & EMERY
CHICAGO, IL

GILBERT E. MATTHEWS CFA
SUTTER SECURITIES INCORPORATED
SAN FRANCISCO, CA

Z. CHRISTOPHER MERCER
ASA, CFA
MERCER CAPITAL
MEMPHIS, TN

JOHN W. PORTER, ESQ.
BAKER & BOTTS
HOUSTON, TX

RONALD L. SEIGNEUR
MBA, ASA, CPA/ABV, CVA, CFF
SEIGNEUR GUSTAFSON
LAKEWOOD, CO

BRUCE SILVERSTEIN, ESQ.
YOUNG, CONAWAY, STARGATT & TAYLOR
WILMINGTON, DE

JEFFREY S. TARBELL
ASA, CFA
HOULIHAN LOKEY
SAN FRANCISCO, CA

GARY R. TRUGMAN
ASA, CPA/ABV, MCBA, MVS
TRUGMAN VALUATION ASSOCIATES
PLANTATION, FL

KEVIN R. YEANOPLOS
CPA/ABV/CFF, ASA
BRUEGGEMAN & JOHNSON YEANOPLOS, P.C.
TUCSON, AZ

Business Valuation Update™ (ISSN 1088-4882) is published monthly by Business Valuation Resources, LLC, 1000 SW Broadway, Suite 1200, Portland, OR, 97205-3035. Periodicals Postage Paid at Portland, OR, and at additional mailing offices. Postmaster: Send address changes to *Business Valuation Update*™, Business Valuation Resources, LLC, 1000 SW Broadway, Suite 1200, Portland, OR, 97205-3035.

The annual subscription price for the *Business Valuation Update*™ is $399. Low-cost site licenses are available for those wishing to distribute the *BVU* to their colleagues at the same address. Contact our sales department for details. Please feel free to contact us via email at customerservice@BVResources.com, via phone at 503-291-7963, via fax at 503-291-7955 or visit our web site at BVResources.com. Editorial and subscription requests may be made via email, mail, fax or phone.

Please note that by submitting material to *BVU,* you are granting permission for the newsletter to republish your material in electronic form.

Although the information in this newsletter has been obtained from sources that BVR believes to be reliable, we do not guarantee its accuracy, and such information may be condensed or incomplete. This newsletter is intended for information purposes only, and it is not intended as financial, investment, legal, or consulting advice.

Copyright 2012, Business Valuation Resources, LLC (BVR). All rights reserved. No part of this newsletter may be reproduced without express written consent from BVR.

and value approach. Oracle's expert opined that "at least" 37.5% of the value of the 2006 offer was attributable to the asserted patent claims and copyrights. To rebut Oracle's damages claims, Google's experts sought to use a forward citation analysis to determine the value of the patents-in-suit and also relied on an internal Oracle accounting department document that valued the IP bundle for financial reporting purposes. The document was prepared after Google's alleged infringement.

10 key takeaways. Litigants are in uncharted territory when they try to satisfy the evolving and increasing levels of rigor required to establish patent infringement damages, especially those based on a reasonable royalty model. Here are some key takeaways from the Oracle opinions:

1. Methodologies are case-specific and general rules are hard to find.

Appropriate methodologies for determining the value of asserted IP are necessarily dependent on the evidence that is available. For example, Oracle based its analysis on Sun's 2006 offer to license the Sun IP bundle to Google. Google based its analysis on an internal Oracle accounting evaluation prepared for financial reporting purposes. The methodologies adopted by each expert necessarily depended on these documents. In any particular case, such documents may not exist, which may necessitate the development of an alternate methodology. Thus, there is no one-size-fits-all approach.

2. The line between credibility and reliability is blurry.

District courts are required to act as a "gatekeeper" and ensure that expert opinions are the product of reliable principles and methods. However, certain critiques of an opinion may really involve credibility issues or factual disputes that should be decided by the jury. The Oracle opinions reveal that it is difficult to draw the line between a reliability issue for the judge and a credibility issue for the jury. For example, Oracle relied heavily on the analyses of its own

Reprinted with permissions from Business Valuation Resources, LLC

engineers to arrive at the patent rankings that its expert relied on. However, this was determined to be a credibility issue for the jury, not a reliability issue for the court. In contrast, the court held that Oracle's expert could not testify concerning his opinion that three of the patents-in-suit were the most valuable of the top 22 identified by the Oracle engineers because the logic behind the opinion was "too thin." The court is likely to dismiss challenges to opinions that are characterized in credibility terms as usurping the role of the jury.

3. Opinions should be vetted for errors of law.

Google's expert sought to opine that any reasonable royalty damages awarded to Oracle should be limited to the revenues that Google would have obtained if it had obtained a license for the IP at issue. The court struck the opinion on the grounds that it was contrary to established case law holding that an infringer is not entitled to make a profit.

4. Opinions should be vetted for internal inconsistencies.

The court struck certain Oracle opinions based on internal inconsistencies. For example, Oracle's expert selected three of the patents-in-suit as the most valuable patents from among the 22 that Oracle's engineers concluded were the most valuable in the Sun IP bundle. The expert reasoned that because Google "chose" to infringe them, these three were the most important patents in the bundle. However, the court struck the opinion, stating that the other three patents-in-suit were not even among the top 22, notwithstanding the fact that Google allegedly "chose" to infringe them as well.

5. Claim-by-claim apportionment may not be required.

Patent infringement is assessed on a claim-by-claim basis. An accused infringer may be found to have infringed certain claims, but not others. In a prior opinion, the court took Oracle to task for not apportioning the value of the Sun IP bundle on a claim-by-claim basis. However, in Oracle I and II, the court reversed course, noting that U.S. Patent & Trademark Office rules presume each patent to be directed to a single invention.

6. Consumer surveys may be used to separate the value of patented and unpatented features.

The court held that consumer surveys "are not inherently unreliable" for separating the value of patented and unpatented components of a product. Oracle's expert asked survey respondents to choose between side-by-side smartphone profiles, each having varied levels of functionality with respect to seven smartphone features. The expert then regressed the data to arrive at an estimate of the feature's contribution to Android's market share.

The court struck Oracle's calculation of the effects of each of the seven smartphone features on market share. In particular, the court noted that Oracle's expert selected fewer than one-quarter of the 39 smartphone features identified as important in his own focus-group research. The court also held that the survey data suggested that survey respondents were indifferent to a $100 increase in price, suggesting the failure to control for all relevant variables. The court allowed the use of a portion of the survey analysis that did not suffer from this defect.

7. Forward citations* may *be used as an indicator of patent value.

Patents with significant disclosures may be expected to be cited frequently in the prosecution of future patents. Such citations are known as "forward citations." Google's expert looked at the forward citations for each of the top 22 patents in the Sun IP bundle to assess their value. The court at least implicitly approved of this technique and struck Google's forward citation analysis with respect to only one patent on the basis that it was a reissue patent and that Google failed to account for the forward citations of the patent's predecessor patent.

Reprinted with permissions from Business Valuation Resources, LLC

8. Post-infringement evidence* may *be considered to establish a reasonable royalty.

The relevant period for a reasonable royalty analysis is before infringement occurs. Nevertheless, the court allowed Google to rely on a document prepared by Oracle's accounting department after the alleged infringement that calculated the fair value of Sun's core technology (including the patents in suit). The court held that the document could be relied upon because it could shed light on the reasonableness of the experts' royalty estimates.

9. The group and value method may be used to establish a reasonable royalty.

As explained previously, one of the valuation techniques used by Oracle's expert is known as the group and value method. Oracle's expert calculated an "upper bound" and a "lower bound" using this approach. The upper bound was stricken because it relied on the assumption that three of the patents-in-suit were among the most valuable of the top 22 identified by Oracle's engineers (see Takeaway 4). However, the expert's opinions based on the group and value method were otherwise allowed.

10. Third-party patent studies may be used to apportion the value of a patent portfolio.

Oracle's expert relied on value distribution curves for third-party patent portfolios. The court allowed this methodology, but offered its own statistical criticism of the variance in the data Oracle relied upon. Nevertheless, Google did not raise this challenge, so the court did not strike Oracle's reliance on the studies.

Conclusion. Litigants continue to strive to satisfy the increased Federal Circuit scrutiny of analyses of reasonable royalty damages. The takeaways in Oracle I and II may provide needed guidance in this evolving area of the law.

Steven R. Hansen *is the owner of Hansen IP Law, a firm devoted exclusively to intellectual property matters located in Birmingham, Mich. Hansen's practice includes worldwide patent preparation, prosecution, counseling, licensing, and opinions. He can be reached at 248-504-4849 and by e-mail at srh@hanseniplaw.com.*

Reprinted with permissions from Business Valuation Resources, LLC