

REASONABLE ROYALTY DETERMINATION: 25 PERCENT RULE “FUNDAMENTALLY FLAWED TOOL”

Uniloc USA, Inc. v. Microsoft Corp

Decided: January 4, 2011

According to 35 U.S.C. § 284, the damages awarded by a court shall not be “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.” In patent infringement litigation, a reasonable royalty is often determined on the basis of a hypothetical negotiation, and the 25 percent rule has been used to approximate the reasonable royalty rate. Under the 25 percent rule, it is assumed that the hypothetical licensee had been paying a royalty rate of 25 percent of its profits for the infringed products since the time that infringement began.

In *Uniloc USA, Inc. v. Microsoft Corp*, the U.S. Court of Appeals for the Federal Circuit (Federal Circuit) disapproved the 25 percent rule for determining baseline royalty in a hypothetical negotiation. In this case, the jury found that Microsoft willfully infringed Uniloc’s patent and awarded Uniloc \$388 million in damages. Following Microsoft’s post-trial motions, the U.S. District Court for the District of Rhode Island (District Court) held that Microsoft’s product did not infringe Uniloc’s patent as a matter of law and ordered a new trial on damages. On appeal, the Federal Circuit found that substantial evidence supported the jury’s infringement verdict. Further, the Federal Circuit affirmed the order of new trial by the District Court, but rejected the 25 percent rule as an appropriate rule to determine the reasonable royalty.

In its opinion, the Federal Circuit held that “as a matter of Federal Circuit law ... the 25 percent rule of thumb is a fundamentally flawed tool for determining a baseline royalty rate in a hypothetical negotiation.” In addition, the Federal Circuit also rejected the application of the rule as a starting point of the *Georgia-Pacific* factors¹ application. The Federal Circuit reasoned that the 25 percent rule of thumb is an abstract theory that is not tied to the specific facts of each case. Here, the Federal Circuit found that the testimony of an expert, Dr. Gemini, did not use the 25 percent rule in relation to the facts of the case, and thus it was “arbitrary, unreliable, and irrelevant.”²

The Federal Circuit also rejected Dr. Gemini’s use of the “entire market value rule” in approximating total revenue of the accused products. The Federal Circuit reiterated that the “entire market value rule” may be used to approximate the total market value of the accused products only where “the patented feature creates the ‘basis for customer demand’ or ‘substantially create[s] the value of the component parts.’” Here, no such evidence was shown.

¹ The *Georgia-Pacific* factors are first set out in *Georgia-Pacific Corp. v. U.S. Plywood Corp.*, 318 F. Supp. 1116 (S.D.N.Y. 1970). The *Georgia-Pacific* factors include fifteen factors that are often endorsed by courts as the appropriate factors to consider in determining the amount of reasonable royalties.

² Dr. Gemini testified that, in four or five non-litigation related negotiations, he had recommended the 25% rule only once.