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Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | [customerservice@law360.com](mailto:customerservice@law360.com)

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## Heightened Standard For The Entire Market Value Rule?

Law360, New York (August 3, 2011) -- A recent decision in *Inventio AG v. Otis Elevator Co.* [1] presents a notably strict application of the most controversial rule in patent damages — the entire market value rule ("EMV rule").

The EMV rule allows patent holders to recover damages in certain circumstances based on the value of an entire product where the patented component is one of many within the product. Critics of the rule have argued that its application leads to damages awards that far exceed the economic value of the technology claimed in the underlying patent.

These critics, courts and even Congress have focused attention in recent years on the EMV rule's requirement that the patented feature constitute "the basis for customer demand." The precise contours of that requirement, however, have remained uncertain. Congress abandoned efforts to enact legislation that would have limited the EMV rule to instances where the patented feature's contribution was the "predominant" basis for customer demand.

The Federal Circuit historically has taken a more liberal approach, suggesting that the "customer demand" requirement could be met where the patented feature was "emphasized" or a "substantial" basis for customer demand.

The *Inventio* court has stepped into this void and set a very high standard for meeting the customer demand requirement. It held that the patented feature must be the only basis for customer demand of the product, to the exclusion of other factors, such as price or vendor reliability. Should other courts follow this lead, it would dramatically limit instances where the EMV rule applies.

### The Entire Market Value Rule

Courts developed the EMV rule to address situations where an accused product contains both infringing and noninfringing elements. The EMV rule only applies where plaintiffs can meet a three-part test:

"(1) The infringing components must be the basis for customer demand for the entire machine including the parts beyond the claimed invention; (2) the individual infringing and non-infringing components must be sold together so that they constitute a functional unit or are parts of a complete machine or single assembly of parts; and (3) the individual infringing and non-infringing components must be analogous to a single functioning unit." [2]

The requirements that the infringing and noninfringing components be sold together and constitute a single functional unit typically are uncontroverted. Therefore, it is the first requirement — whether the infringing component is the basis for customer demand — that

defines the scope of the EMV rule.

In *Fonar Corp. v. General Electric Co.*, the Federal Circuit took a plaintiff-friendly approach to the customer demand requirement.[3] The patent at issue covered a feature that improved the efficiency of magnetic resonance imaging machines.

The court affirmed a jury's award of damages based on revenues from sales of the entire MRI machine because several of the defendant's product brochures "emphasized" the patented feature. The Federal Circuit did not point to any other evidence suggesting that the patented feature was important to customers who purchased the defendant's MRI machines.

Similarly, the Federal Circuit in *Tec Air Inc. v. Denso Manufacturing Michigan Inc.*, held that a jury could have reasonably found that the patented invention was the basis for customer demand.[4] The only evidence the court cited in support of its conclusion was a complaint lodged by a single customer after the defendant modified its infringing product to avoid practicing the patent.

In the years following these decisions, the EMV rule became a target for criticism that patent damages were excessive. Beginning in 2005, Congress considered legislation that would — at least in relation to *Fonar* and *Tec Air* — tighten the customer demand requirement.

One representative bill introduced in 2009 would require "a showing to the satisfaction of the court that the claimed invention's specific contribution over the prior art is the predominant basis for market demand for an infringing product or process." [5] Ultimately, Congress abandoned efforts to address the EMV rule through patent reform legislation. The scope of the EMV rule remains in the courts' hands.

The Federal Circuit's recent applications of the EMV rule left substantial ambiguity in the law. In *Lucent Technologies Inc. v. Gateway Inc.* [6] and *Uniloc USA Inc. v. Microsoft Corp.*, [7] the Federal Circuit struck down damages awards because plaintiffs failed to meet the customer demand requirement. In both cases, however, the court stopped short of requiring proof that the patented feature was the sole or even predominant basis for customer demand.

The court in *Lucent* found a "lack of evidence demonstrating the patented method [was] the basis — or even a substantial basis — of the consumer demand for Outlook." This language left room for plaintiffs to argue — as the plaintiff did unsuccessfully in *Inventio* — that the patented feature need only form a substantial basis for the customer demand.

Similarly, the court in *Uniloc* provided little guidance to courts seeking to determine the contours of the customer demand requirement when it stated that the EMV rule applies "where the patented feature creates the 'basis for customer demand' or 'substantially create[s] the value of the component parts.'"

## **The Inventio Decision**

In *Inventio*, the claimed invention involved a "destination dispatching" feature of an elevator system that "recognizes a user when he or she enters an entry location of a building, then dispatches an elevator to bring the user to a destination floor based on user-specific data."

The plaintiff's expert calculated reasonable royalty damages based on the defendant's revenues from sales of the entire elevator system because, in the expert's opinion, the patented "feature is 'a substantial basis for demand' for the entire elevator installation."

The defendant filed a motion in limine to exclude the expert's use of the EMV rule.

The court granted the defendant's motion. It emphasized that for a reasonable royalty to be based on the entire market value of a product containing the infringing item, the injured party must show that the infringing item was not just a substantial basis for customer demand, but that it was the basis for customer demand of the product.

The court explained that "my role is to see if the patentee has proffered some credible evidence that customer demand for an entire elevator system was based on one aspect of that system ... rather than on other factors, including the vendor's history, reliability, price or ability to get the job done in a timely fashion." Price, product quality and seller reputation are factors in almost every transaction. Attempting to prove that those factors played no role in customers' buying decisions presents a very high burden.

The plaintiff in *Inventio* offered evidence linking destination dispatching to customer demand for the elevator system as a whole that appears to be stronger than the evidence described by the Federal Circuit in *Fonar* and *Tec Air*. For example, the defendant was advised that it "needed" to offer the feature to remain competitive.

One of the defendant's customers with an existing contract for an elevator system without destination dispatching insisted on adding the feature (albeit without paying extra for it) and threatened to withhold future business if the defendant did not agree to the change. Based on this type of evidence, the court found that failing to offer destination dispatching would have placed the defendant at a competitive disadvantage.

Nevertheless, the court determined that the evidence linking the patented feature to customer demand was insufficient to justify use of the EMV rule. It pointed to the absence of any statistical analysis or customer survey supporting the plaintiff's claims, and characterized customer demand for the defendant's elevator systems as "idiosyncratic."

It concluded that "the evidence does not provide a sound economic connection between the product's desirability and any contention that [destination dispatching] was the basis for public demand."

## Future Impact of *Inventio*

The impact of *Inventio* remains unclear. In *ActiveVideo Networks Inc. v. Verizon Communications Inc.*, a case decided after *Inventio*, a district court gave the customer demand requirement more cursory treatment and permitted use of the EMV rule. It simply stated without analysis that the plaintiff submitted substantial evidence that the patented feature is the basis for customer demand. Should other courts follow *Inventio*, however, plaintiffs' use of the EMV rule could be limited significantly.

--By Ted Mathias (pictured), Amy Kokoski and Thara Russell, Axinn Veltrop & Harkrider LLP

*Ted Mathias is a partner, and Amy Kokoski is an associate, in the Hartford, Conn., office of Axinn Veltrop & Harkrider. Thara Russell is a summer associate at the firm and a second-year law student at George Washington University Law School.*

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[1] No. 06-5377 (S.D.N.Y. June 23, 2011).

[2] *Cornell Univ. v. Hewlett-Packard Co.*, 609 F. Supp. 2d 279, 286 (N.D.N.Y. 2009).

[3] 107 F.3d 1543, 1552-53 (Fed. Cir. 1997).

[4] 192 F.3d 1353, 1362 (Fed. Cir. 1999).

[5] S. 515, 111th Cong. § 4 (2009).

[6] 580 F.3d 1301 (Fed. Cir. 2009).

[7] 632 F.3d 1292 (Fed. Cir. 2011).

[8] No. 2:10-00248 (E.D. Va. July 15, 2011).

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