

Saving face

David Elkins and Steven Auvil of Squire Sanders tackle Apple's east Texas patent infringement 'merry-go-round' over its FaceTime software

On 6 November 2012, a jury in the US District Court in Tyler, Texas, rendered its verdict. The trial had lasted five days. The jury's charge was to determine whether the plaintiff – VirnetX – had proven by a preponderance of the evidence that Apple's iPhone 4, iPad 2 and iPod Touch devices infringed one or more claims of each of four asserted patents. The jury was also charged with determining whether California-based Apple had proven, by clear and convincing evidence, that the asserted patent claims were invalid.

The jury found in favour of VirnetX and against Apple on all asserted claims. Filling in the last part of the Verdict Form, the jury indicated that a damages award of \$368.16m represents the amount by which VirnetX had been harmed by Apple's infringement. Still pending is VirnetX's request that the court impose a permanent injunction against the sale or importation of the infringing devices.

That very same day, VirnetX sued Apple in the very same court, asserting infringement of the very patents, this time as to Apple's iPhone 5, iPad 4, iPad Mini, and all computers and hardware that run Apple's Mountain Lion operating system.

These cases are just two of many patent infringement lawsuits involving Apple. The VirnetX verdict is huge, yet dwarfed by Apple's \$1.05bn judgment against Samsung in an August 2012 trial in San Francisco.

Apple's myriad of other cases against Samsung and against Google-owned Motorola Mobility has grabbed the lion's share of news headlines as the mobile phone titans grapple for competitive advantages in the burgeoning smart phone market. Yet the VirnetX case offers a number of interesting takeaways for the casual observer seeking to better understand patent infringement litigation in the US and its use as a business tool – or simply as a business unto itself.

The parties

VirnetX, an internet security technology company based in Nevada, describes itself as “developing and commercialising software and technology solutions for securing real-time communications over the Internet.”¹ The company is not a household name, but is publicly traded on the NYSE.

It was founded by key personnel and with

a patent portfolio from Science Application International Corporation (SAIC), a technology developer for the US government. VirnetX's business is comparable to that of Rambus, the semiconductor memory company that develops and licenses technology but makes no tangible products. Just as Rambus pursues patent infringement litigation as part of its business model – not all users (or alleged users) of its technology willingly licence it – so does VirnetX.

VirnetX pursued a prior case against Microsoft based on the same patented technology, leading to a 2010 settlement in which Microsoft reportedly paid VirnetX \$200m, and VirnetX currently is pursuing parallel cases in the Eastern District of Texas against Cisco Systems., Avaya, and Siemens Enterprise Communications.

Apple technological and design successes over the past decade-plus have transformed the company. Having decided, at the infancy of the PC industry, not to licence its operating system to others, Apple was a tiny also-ran in the business, with IBM-compatible PCs the de facto standard in businesses and homes. Its financial state was so fragile in 1997 that it received an infusion of cash from Microsoft. Fifteen years later, observes *The Economist*, “Apple has become a colossus of capitalism, accounting for 4.3% of the value of the S&P 500 and 1.1% of the global equity market.”²

The case

VirnetX alleged that its patents cover functionality for secure communications over the internet, including technology for creating a virtual private network (VPN) between two devices. It contended that the accused Apple devices' FaceTime functionality infringed the patents' claims. FaceTime allows users of Apple computers, iPhones, iPads and even iPod Touches to videoconference with each other over WiFi (and in some cases over cellular networks). VirnetX asked the jury to award \$708m in damages – perhaps an indication as to why the case did not settle before trial.

Apple had a multi-pronged defence strategy, asserting both that it did not use the patented technology and that the VirnetX patents were in any event invalid because the technology had been earlier developed by others. Apple also argued that even if the patents were not invalid and that it

had unknowingly used VirnetX's patented technology in FaceTime, the technology represented a *de minimis* contribution and did not merit a substantial damages award.

The court

The increasing importance of technology in the global economy has led to ever-increasing numbers of patent applications and issued patents in the US – from just over 100,000 issued patents in 1991 to over 240,000 in 2011.³ The number of patent infringement actions filed in US courts has increased in corresponding fashion, rising from about 1,200 in 1991 to 4,015 in 2011.⁴

The technology involved in patent infringement litigation is often extremely complex. Moreover, the claimed use of patented technology in certain ubiquitous devices can support huge damages claims. These and other reasons tend to make litigating patent infringement expensive, high-stakes battles, referred to by some as “a sport of kings”. Savvy lawyers representing plaintiffs thus look to gain whatever advantages are available by filing cases in federal districts that are deemed favourable (a special venue statute for patent infringement cases essentially allows them to be filed wherever an infringing device can be located). This has led to a few courts achieving particular “popularity” as the venue of choice for patent infringement plaintiffs: Delaware (where most major corporations are incorporated), the Eastern District of Virginia (near Washington, D.C.), the Central District of California (encompassing Los Angeles and Orange County) and the Eastern District of Texas.

The popularity of these venues is fuelled by different reasons. The Eastern District of Texas, however, stands out because it is not a region known for technology – and is not particularly populous. Because it is so geographically large, the district has courthouses in several towns: Beaumont, Lufkin, Marshall, Sherman, Texarkana and Tyler. The demographics of the region, though certainly not homogenous, reflect a healthy respect for the rights of patent holders and a belief in fairly compensating them when their rights are violated. After the District Court there adopted patent-specific local rules to expedite the handling of patent infringement cases, the Marshall and Tyler divisions of the court became popular destinations for patent infringement

plaintiffs. Studies showing that the success rate for plaintiffs there is much higher than the national average (from 1995 to 2011 it was about 56%, compared to the national average rate of 32%⁵) made the district even more popular even while that popularity greatly slowed the court's reputation for speed.

The district is a particularly popular destination for companies whose business is predicated purely on licensing patent portfolios that they have acquired or sometimes developed. Called "non-practicing entities," (NPEs) or "patent assertion entities" (or the pejorative term "patent trolls") Eastern District of Texas decisions involving plaintiffs of this type constituted 37% of decisions in all patent infringement cases, with a plaintiff success rate still at a robust 47%.⁶

The verdict

The \$368m verdict is enormous. Larger awards have been made – on 26 December 2012, a jury in Pittsburgh, Pennsylvania awarded Carnegie Mellon University \$1.17bn in damages against chipmaker Marvell Technology Group, the third-largest ever made. Nevertheless, VirnetX's verdict would land in the top-ten largest.⁷ And while the majority of these mega-awards are later reduced or vacated through legal challenges in the District Court and the Court of Appeals for the Federal Circuit, the prospect that any such award could be affirmed can lead to a large settlement payment.

The verdict had an immediate impact on VirnetX's stock: It rose \$7.32 per share, or 28%, to close at \$33.61, in reaction to news of the damages award. At that closing price, VirnetX had a market capitalisation of \$1.7bn – not bad for a company that reported a mere \$36,000 in licensing revenue for the first half of 2012.⁸

Apple investors, meanwhile, did not blink. After all, Apple will challenge the damages award, and in any event it represents a mere 0.9% of Apple's net *profit* of \$41bn in fiscal 2012.⁹

Takeaways

The *VirnetX* case holds a number of takeaways, particularly for those less familiar with patent infringement litigation in the US.

First, patent infringement litigation remains big business unto itself. Wins in a large case or two can catapult a company from an unknown to a billion-dollar company and perhaps to a market leader in certain industries. Witness Rambus's success in the semiconductor memory arena. Perhaps VirnetX will achieve the same success in internet security. Even for companies that are not NPEs, patent infringement litigation can be a key piece of business strategy.

Apple's patent battles with Samsung represent both a tussle over smartphone device market share (they are the two largest makers and sellers of smartphones) and a war-by-proxy with Google over its Android mobile operating system, which quickly overtook Apple to become the leading smartphone OS by volume in the world.

Because the stakes in damages and market share can be so large, patent infringement litigation is more expensive than other types of civil litigation in the US. The American Intellectual Property Law Association's survey reflects that the median litigation cost is \$2.5m for cases where \$1m-\$25m is considered at risk. For higher claims, the median legal cost is \$5m. Notably, these are just medians. Cases involving multiple patents and multiple accused devices can cost much more.

Second, as with real estate, patent infringement litigation is all about location, location, location. A plaintiff's success in getting a case to stick in a jurisdiction that has a plaintiff-friendly reputation (deserved or not) can often result in tangible benefits through settlements or damages awards. While the existing venue scheme for patent infringement cases has been the target of criticism in the context of recent debates over patent reform, the 2011 America Invents Act did not address the issue. Corporate defendants thus remain subject to being hauled into court in the Eastern District of Texas or the Eastern District of Virginia despite the absence of strong connection to those venues.

Third, because of the vicissitudes of the US jury system and the relative unfamiliarity that most jurors have with the level of technology that often characterises patent cases, damages awards follow no discernible methodology. Most cases feature expert witnesses in the damages arena who present vastly divergent opinions on the amount of damages that should be awarded in the event infringement is determined. That is because damages in most cases are based on what is known as a "reasonable royalty", the amount that the defendant would hypothetically have agreed to pay the plaintiff to licence the patent or patents at issue at the time infringement first commenced. The reasonable royalty calculus is in turn based on what are known as the "Georgia-Pacific factors" (named after a 1970 court decision case in which that company was the plaintiff).

The 13 or so *Georgia-Pacific* factors represent a number of inquiries, such as comparable licences the plaintiff had already obtained for the same or similar patents, the anticipated profitability of the defendant's devices using the patented technology and so on. While the factors represent an effort to apply a dose of objectivity to the inquiry, most

experienced expert witnesses can persuasively make the analysis favour the side that hired her or him.

The standard of review on appeal for jury verdicts is generally favourable to the plaintiff (assuming the jury was properly instructed by the trial judge). When that favourable standard is combined with the unpredictability of damages awards, the tendency of most cases to settle before trial is understandable. But the combination – particularly the possibility of unpredictable "home run" verdicts – also leads critics to contend that the unpredictability creates an unfair advantage for plaintiffs. That purported advantage will continue absent a more formulaic methodology for calculating damages.

Footnotes

1. See <http://virnetx.com/company/>.
2. The Economist, "Survival of the Biggest: Battle of the Internet Giants" (1 December 2012).
3. See PWC 2012 Patent Litigation Study at 4. (available at http://www.pwc.com/en_US/us/forensic-services/publications/assets/2012-patent-litigation-study.pdf).
4. *Id.*
5. *Id.* at 23.
6. *Id.* at 24.
7. *Id.* at 8.
8. See Bloomberg.com, "VirnetX Soars After \$368.2 Million Verdict Against Apple" (Nov. 7, 2012) (available at <http://www.bloomberg.com/news/2012-11-07/apple-told-to-pay-368-2-million-to-virnetx-in-patent-trial-1-.html>).
9. See <http://www.apple.com/pr/library/2012/10/25/Apple-Reports-Fourth-Quarter-Results.html>.

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