

No. 19-832

IN THE
Supreme Court of the United States

APPLE INC.,

Petitioner,

v.

VIRNETX INC., LEIDOS, INC.,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

REPLY BRIEF FOR PETITIONER

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TABLE OF CONTENTS

	Page
TABLE OF AUTHORITIES	ii
I. The Federal Circuit’s Settled Position That Apportionment Of Damages Is Not Required In Prior License Cases Warrants This Court’s Review.....	1
A. The Federal Circuit no longer requires apportionment in prior license cases.....	2
B. This case presents the important question of whether apportionment is required in prior license cases.	8
II. Certiorari Should Also Be Granted On The Impact Of Intervening PTO Invalidations On Pending Infringement Actions	10
CONCLUSION	13

TABLE OF AUTHORITIES

	Page(s)
Cases	
<i>B & B Hardware, Inc. v. Hargis Indus., Inc.</i> , 575 U.S. 138 (2015).....	11
<i>City of Madison, Joint Sch. Dist. No. 8 v. Wis. Emp't Relations Comm'n</i> , 429 U.S. 167 (1976).....	2
<i>Commonwealth Sci. & Indus. Research Org. v. Cisco Sys., Inc.</i> , 809 F.3d 1295 (Fed. Cir. 2015).....	2, 3, 4
<i>Dowagiac Mfg. Co. v. Minn. Moline Plow Co.</i> , 235 U.S. 641 (1915).....	1, 7, 8
<i>Elbit Sys. Land & C4I Ltd. v. Hughes Network Sys., LLC</i> , 927 F.3d 1292 (Fed. Cir. 2019).....	5
<i>Ericsson, Inc. v. D-Link Sys., Inc.</i> , 773 F.3d 1201 (Fed. Cir. 2014).....	6
<i>Garretson v. Clark</i> , 111 U.S. 120 (1884).....	1, 8
<i>Nelson v. Adams USA, Inc.</i> , 529 U.S. 460 (2000).....	9

<i>Nestle USA, Inc. v. Steuben Foods, Inc.</i> , 884 F.3d 1350 (Fed. Cir. 2018).....	11
<i>Ohio Willow Wood Co. v. Alps S., LLC</i> , 735 F.3d 1333 (Fed. Cir. 2013).....	11
<i>Prism Techs. LLC v. Sprint Spectrum L.P.</i> , 849 F.3d 1360 (Fed. Cir. 2017).....	7
<i>Sprint Commc'ns Co. v. Time Warner Cable, Inc.</i> , 760 F. App'x 977 (Fed. Cir. 2019).....	5, 6
<i>VirnetX Inc. v. Apple Inc.</i> , 931 F.3d 1363 (Fed. Cir. 2019).....	11, 12
<i>VirnetX Inc. v. Cisco Sys., Inc.</i> , 776 F. App'x 698 (Fed. Cir. 2019).....	11
<i>XY, LLC v. Trans Ova Genetics, L.C.</i> , 890 F.3d 1282 (Fed. Cir. 2018).....	11, 12
<i>Yee v. City of Escondido</i> , 503 U.S. 519 (1992).....	10
Statutes	
35 U.S.C. § 316(a) (2006)	11

REPLY

I. The Federal Circuit's Settled Position That Apportionment Of Damages Is Not Required In Prior License Cases Warrants This Court's Review.

This Court long ago held that patent damages must reflect the value of the patented invention in “every case.” *Garretson v. Clark*, 111 U.S. 120, 121 (1884). As the petition (at 18-21, 31-34), amicus briefs supporting Apple, and academic articles (Pet.20, 31-32 & n.2) explain, *Garretson* reflects a foundational precept of an economically sound patent system. But over the past five years, the Federal Circuit has created a gaping loophole that facilitates massive damages in patent cases where the damages claims are based on prior licenses, regardless of whether those licenses reflect the invention's contribution to the end-product. Pet.18-31.

The Court has not needed to examine apportionment of patent damages in over one hundred years, *see Dowagiac Mfg. Co. v. Minn. Moline Plow Co.*, 235 U.S. 641 (1915), since, until relatively recently, the lower courts have been faithful to *Garretson's* command. Yet by soliciting the Solicitor General's views in a closely related apportionment case just a few terms ago (Pet.19), the Court has already recognized the importance of reviewing the Federal Circuit's current caselaw in this area. And with the Federal Circuit now using its Rule 36 procedures to reject challenges to its apportionment methodology, parties will soon stop complaining about the practice. Now is

the time for the Court to put a halt to the Federal Circuit's blatant disregard for this Court's patent damages precedent.

Nothing in VirnetX's opposition calls these principles into question. VirnetX is wrong in its reading of current Federal Circuit case law, § I.A, and wrong in its description of what occurred below, § I.B. Certiorari is warranted.

A. The Federal Circuit no longer requires apportionment in prior license cases.

VirnetX points to the Federal Circuit's "repeated confirmation that apportionment is required," Opp.19, as proof that apportionment is alive and well. But this "ignore[s] the ancient wisdom that calling a thing by a name does not make it so." *City of Madison, Joint Sch. Dist. No. 8 v. Wis. Emp't Relations Comm'n*, 429 U.S. 167, 174 (1976). The question here is not whether the Federal Circuit pays lip service to apportionment. It is whether the Federal Circuit's rule that apportionment is automatically satisfied when relying on prior licenses guts this requirement. It does.

1. The Court need look no further than VirnetX's own briefing in the Federal Circuit to see the gaping prior license loophole. VirnetX relied heavily on *Commonwealth Scientific & Industrial Research Organisation v. Cisco Systems, Inc.*, 809 F.3d 1295, 1302 (Fed. Cir. 2015) (*CSIRO*), in arguing that apportionment "principles are relevant only 'where a damages model apportions from a royalty base.'" VirnetX Br.

49, Dkt. 49.¹ VirnetX argued that “[t]hose principles are ‘inapplicable here’ because VirnetX ‘did not apportion from a royalty base at all.’” *Id.* (quoting *CSIRO*, 809 F.3d at 1302). Instead, VirnetX’s damages methodology was based on royalty rates in prior licenses, which it claimed necessarily “captured only the value of its technology.” *Id.* VirnetX argued that its expert’s testimony that the prior licenses were apportioned, though he had no idea how, CA.II 1862-63, satisfied apportionment. That was so because “where, as in the licenses VirnetX relied upon, ‘the parties negotiated over the value of the asserted patent[s],’ the results of that negotiation embody ‘built in apportionment.’” VirnetX Br. 50, Dkt. 49 (quoting *CSIRO*, 809 F.3d at 1303) (alteration in original).

Before this Court, VirnetX adopts the opposite reading of *CSIRO*. It now claims the case does not exempt patentees from complying with apportionment when they rely on prior licenses. Opp.20. VirnetX points to the Federal Circuit’s separate analysis of the “unique considerations that apply to apportionment in the context of a standard-essential patent,” *CSIRO*, 809 F.3d at 1304, arguing this shows *CSIRO* requires further apportionment. But these “unique” considerations are plainly irrelevant when, as here, no standard-essential patents are at issue. As VirnetX argued below, *CSIRO* holds that prior negotiations between the same parties to use the same patent in the same

¹ “Dkt.” Refers to the Court of Appeals docket in the case at issue in this petition. “CA.II” refers to the appendix in that same case.

type of end-product “already buil[d] in apportionment.” *Id.* at 1303.²

That holding—“apportionment” is “built in”—is what the Federal Circuit extended here to apply to licenses involving different parties using different patents in different end-products, without requiring any separate evidence of apportionment. After the panel’s decision, VirnetX further confirmed that is exactly how to read the Federal Circuit’s ruling. In opposing rehearing, VirnetX argued that it was appropriate for the panel to affirm without any evidence of apportionment: “Because licensees do not agree to pay for unpatented features, prior licenses have ‘already built in apportionment.’” Reh’g Resp. 8-9, Dkt. 82 (quoting *CSIRO*, 809 F.3d at 1303). VirnetX also defended the panel’s understanding during oral argument that when you “use comparable licenses” to prove a reasonable royalty, that “doesn’t involve an apportionment question.” *Id.* at 9 (quoting Oral Arg. Recording 21:27-54). VirnetX argued the court’s statements merely “restate[] black-letter law—and economic reality.” *Id.* That is an accurate statement of current Federal Circuit law. But it defies, rather than reflects, this Court’s precedent.

² VirnetX also points to a footnote in *CSIRO* indicating that, since the Federal Circuit was already remanding, the district court “may also wish to consider how other factors ... may have affected the parties’ suggested royalty rates.” *CSIRO*, 809 F.3d at 1305 n.4; Opp.20. This suggestion as to what a district court “may” choose to do on remand based on a separate error proves that the Federal Circuit no longer *requires* apportionment in this context.

2. Along with *CSIRO*, VirnetX also mischaracterizes the reasoning of *Elbit Systems Land & C4I Ltd. v. Hughes Network Systems, LLC*, 927 F.3d 1292 (Fed. Cir. 2019), and *Sprint Communications Co. v. Time Warner Cable, Inc.*, 760 F. App'x 977 (Fed. Cir. 2019). In both cases, the court held that patentees could satisfy apportionment by relying on royalty rates in prior licenses, even for different patented inventions in different end-products. Pet.24-27.

VirnetX argues that *Elbit* required further evidence of apportionment. Opp.21. But the *only* evidence *Elbit* had was the expert's conclusory testimony that apportionment "is essentially embedded in [the] comparable value" from the prior license for a different end-product, and that "the requisite apportionment is implicitly considered within the royalty rate" of the prior license. *Elbit*, 927 F.3d at 1301 (citations and second alteration omitted). *Elbit* reiterates that a prior "negotiation can fulfil the apportionment requirement," even when the prior negotiation was between different parties about a different end-product. *Id.* VirnetX fails to address this reasoning. Opp.21.

Instead, VirnetX points to the Federal Circuit's statement in *Elbit* that the prior license was the expert's "*starting point*." Opp.21 (quoting *Elbit*, 927 F.3d at 1301). But his only adjustment from this "starting point" was to increase the royalty rate by \$3 based on the belief that two-way satellite communications generally provided a 20% increase in value over older technology. *Elbit*, 927 F.3d at 1301. This increase had nothing to do with the patented invention's relative contribution to a different end-product. Pet.26.

VirnetX also argues that *Time Warner*, 760 F. App'x 977, “was not about comparable licenses at all,” Opp.22. The damages methodology there, however, indisputably relied on one prior jury verdict and two prior licenses, all of which the court treated as prior licenses. *Time Warner*, 760 F. App'x at 983. Though the defendant had argued the prior licenses were not apportioned to its products, Appellant's Reply Br., *Time Warner*, 760 F. App'x 977 (No. 2017-2247), 2018 WL 2048279, at *19, the Federal Circuit disagreed. It cited *Ericsson, Inc. v. D-Link Systems, Inc.*, 773 F.3d 1201, 1227-28 (Fed. Cir. 2014), for the proposition that “damages testimony regarding real-world relevant licenses ‘takes into account the very types of apportionment principles contemplated in *Garretson*.’” *Time Warner*, 760 F. App'x at 983-84. Again, VirnetX fails to address this tenet of the opinion. Opp.22.

3. Along with misreading the Federal Circuit's cases, VirnetX reimagines the facts of this case throughout, arguing that apportionment was satisfied here because the evidence showed that the prior licenses were “using the same VirnetX technology, in the same way, to the same end.” Opp.18-19; *see also* Opp.23. VirnetX's cited evidence shows nothing of the sort. The record established that the prior licenses covered far more patents, C.A.II 1848-49, 1863-64, that Apple's accused devices are “far, far more complex” than nearly all the products covered by the prior licenses, C.A.II 1866, and that the patented technology made up a larger portion of the features of these products, C.A.II 10094-96.

VirnetX also argues that the decision in the first appeal in this case “proves the Federal Circuit has not

created a ‘loophole’ that allows patentees to evade apportionment by basing royalties on prior comparable licenses.” Opp.22. But in the first trial VirnetX’s damages methodology had employed the “royalty base” approach, estimating how much of the overall value of an iPhone could be attributed to VirnetX’s patents. Pet.11-12, 21-22. It was not until the second trial that VirnetX used the “prior license” approach at issue here, which relied solely on prior licenses, without determining a royalty base at all. Pet.22. The Federal Circuit’s decision in the first appeal, therefore, does not, and could not, address apportionment in prior license cases.³

* * *

At root, VirnetX seeks to condone the Federal Circuit’s disdain for basic economics. The problem here is not that the Federal Circuit refused to demand “mathematical exactness” in apportionment. Opp.23 (quoting *Dowagiac Mfg. Co.*, 235 U.S. at 647). The problem is that the Federal Circuit requires no proof at all. The dicta from *Dowagiac* that VirnetX quotes does not authorize apportionment by assumption;

³ VirnetX also relies on a group of cases discussing yet another distinct damages methodology not at issue here: established royalties. Opp.19. VirnetX indisputably did not press an established royalty theory. *See Dowagiac*, 235 U.S. at 648 (contrasting established royalties, where a royalty is uniform across a wide range of licenses, with reasonable royalties); *Prism Techs. LLC v. Sprint Spectrum L.P.*, 849 F.3d 1360, 1372 (Fed. Cir. 2017) (same). In any event, the most these cases show is that prior licenses *can* measure the value of patented technology. Opp.19.

Dowagiac says apportionment should be based on reliable testimony from “experts and persons informed by observation and experience.” *Dowagiac*, 235 U.S. at 647. “[S]uch evidence must be reliable and tangible, and not conjectural or speculative.” *Garretson*, 111 U.S. at 121. To promote Progress, the patent damages methodologies must be sound.

B. This case presents the important question of whether apportionment is required in prior license cases.

VirnetX next argues that apportionment—the principal damages question disputed below—was somehow waived. Opp.24-27. But Apple has argued at every stage of this litigation that rote reliance on prior licenses does not satisfy apportionment.

1. Apple raised the apportionment issue before the district court, arguing that VirnetX’s “damages model does not apportion the incremental value that the patented invention adds to the end product.” App. 18a. The district court explicitly decided the issue, agreeing with VirnetX that it “did not need to present” evidence of how prior licenses were “apportioned to the patents-in-suit because the real-world market had already done the apportionment.” App. 22a; *see* App. 25a.

With *de facto* prior license apportionment squarely presented on appeal, Apple disputed it vigorously. Apple showed that the particular complexity and functionality of its products, as well as the licenses’ origins in settlement, undermined the district court’s conclusion that “[t]he licenses upon which

[VirnetX's] analysis was based were already apportioned" for Apple's products. App. 25a; *see* Apple Br. 42, 44-45, Dkt. 41 (differences with licensee products); *id.* at 19, 43, 46-47 (settlement); Reply Br. 14-21, Dkt. 53 (same). VirnetX dedicated a dozen pages of its brief to its response. *See* VirnetX Br. 42-54, Dkt. 49.

Notably, VirnetX did not argue waiver before the Federal Circuit. *Id.* Given the parties' extensive briefing on this issue, apportionment was also a focus of oral argument. *See supra* at 4; Oral Arg. Recording 13:29-25:37; 33:29-37:34; 42:20-43:10.

The waiver doctrine exists to ensure that "the lower court be fairly put on notice as to the substance of the issue." *Nelson v. Adams USA, Inc.*, 529 U.S. 460, 469 (2000). Here, it unquestionably was.

2. In the face of this clear preservation, VirnetX makes two far-fetched waiver arguments.

a. VirnetX first contends the petition presents new theories of apportionment, lamenting that it cannot find what it now dubs "intensity-of-use," "different-use," and "settlement" theories below. Opp.16, 24-26. But those "theories" are simply examples demonstrating the same apportionment problem Apple has consistently identified. *See, e.g.*, CA.II 5141-42 (discussing multiple modes of connection available in VPN-on-Demand, much like alternatives to flash in a camera); CA.II 5145 (discussing the impact of settlement); Apple Br. 43-47, Dkt. 41 (similar); Reply Br. 15-16, Dkt. 53 (similar). At bare minimum, the record proves the "substance of the issue" was fairly presented, preserving the issue for review. *Nelson*, 529

U.S. at 469; *see also Yee v. City of Escondido*, 503 U.S. 519, 534-35 (1992).

b. VirnetX then takes the unusual tack of asserting Apple waived the argument by failing to raise it in a separate proceeding. Opp.24. According to VirnetX, Apple should have raised its apportionment challenge to measuring damages solely by prior license costs in the first trial. But as discussed, *supra* at 7, that trial employed a different damages methodology that VirnetX ultimately “eschewed” in the second trial. VirnetX Br. 46, Dkt. 49. Apple could not have challenged in the first trial a damages methodology that VirnetX had not advanced.

II. Certiorari Should Also Be Granted On The Impact Of Intervening PTO Invalidations On Pending Infringement Actions.

VirnetX does not dispute that whether intervening PTO invalidations apply to “appeals that remain pending at the rehearing or certiorari stage” is “an important question worthy of this Court’s review.” Pet.i, 38. VirnetX also has no comment on the observation that review is “especially urgent today” given the “exponentially greater” instances of PTO invalidations under the new inter partes review system. Pet.38.

Instead, VirnetX makes arguments that turn on irrelevant minutia.

First, VirnetX argues that invalidations have no effect until claims are formally cancelled. Opp.30. But once the court affirms a PTO invalidity ruling, its decision has “immediate” effect “on any pending or co-

pending actions involving the patent.” *XY, LLC v. Trans Ova Genetics, L.C.*, 890 F.3d 1282, 1294 (Fed. Cir. 2018).⁴ Indeed, it makes little sense to wait for the PTO to issue formal cancellations—a purely ministerial act that is statutorily mandated as soon as the “appeal proceeding has terminated.” 35 U.S.C. § 316(a) (2006). There is no question that the invalidation appeals at issue here have terminated. *VirnetX Inc. v. Apple Inc.*, 931 F.3d 1363, 1378-80 (Fed. Cir. 2019) (*VirnetX Reexamination Appeal II*); *VirnetX Inc. v. Cisco Sys., Inc.*, 776 F. App’x 698, 700 (Fed. Cir. 2019).

Second, VirnetX clings to the one FaceTime-related claim that is not yet formally invalidated, but is hanging by a thread. The substance of that claim, claim 5 of the ’504 patent, is also claimed in the ’211 patent. See Apple 2d Pet. Reh’g 7-8, Dkt. 99-2 (comparing the two claims). The PTO has already invalidated that claim of the ’211 patent, and the Federal Circuit has affirmed. Pet.36. As the Federal Circuit has repeatedly explained, a patent claim is invalid when it is not patentably distinct from an already invalidated claim. *Nestle USA, Inc. v. Steuben Foods, Inc.*, 884 F.3d 1350, 1352 (Fed. Cir. 2018); *Ohio Willow Wood Co. v. Alps S., LLC*, 735 F.3d 1333, 1342-43 (Fed. Cir. 2013). In fact, as explained in the petition (at 36), the PTO has already *invalidated claim 5*. To be sure, the Federal Circuit remanded that decision on narrow procedural grounds. *Cisco Sys.*, 776 F.

⁴ In fact, the PTO’s invalidity ruling itself can have a preclusive effect on district court proceedings. See *B & B Hardware, Inc. v. Hargis Indus., Inc.*, 575 U.S. 138, 160 (2015).

App'x at 703-04. But VirnetX's brief provides no reason why the PTO would come out any differently next time.

Rather than explaining how claim 5 could be valid, VirnetX suggests that the PTO invalidations have no impact because of the different legal standards at issue in PTO versus district court proceedings. Opp.31. VirnetX's assertion that "[f]indings made in PTO proceedings ... cannot be given preclusive effect in district-court actions," *id.*, is wrong. *See XY*, 890 F.3d at 1294 (affirmance of PTO invalidity ruling has issue-preclusive effect on proceedings in district court).⁵

Finally, VirnetX tries to minimize Apple's arguments as a "[c]ase-[s]pecific" complaint about "docket management." Opp.33. But VirnetX twists the facts, including its accusations of Apple's "gamesmanship." Opp.15, 33 n.8.⁶ Apple does not take issue with the coordination of proceedings involving validity and infringement of overlapping patents. That coordination

⁵ Nor does a footnote in *VirnetX Reexamination Appeal II* indicate that the Federal Circuit has rejected Apple's arguments. Opp.32. Our argument here is premised on the Federal Circuit's failure to give effect to the invalidations affirmed in that very case.

⁶ Apple has consistently refuted VirnetX's accusations of "gamesmanship." *See* Stay Reply 7-9, Dkt. 37-1 (Apple did not breach any agreements by seeking stay.); Apple Br. 64, Dkt. 41 (Apple's lawful stay requests were spaced over several years.). Likewise, Apple is not at fault for the litigation's duration. Opp.1, 15, 34. VirnetX's improper damage methodologies, App. 105a-125a, and prejudicial statements at the second trial, CA.II 10572, are what led to multiple trials and appeals.

makes sense. What does not make sense is for the consequences of patent invalidations—and the fate of massive damage judgments—to turn on *which* opinion the Federal Circuit issues first. At a minimum, this Court should GVR to correct this error.

CONCLUSION

For the foregoing reasons, this Court should grant the petition for a writ of certiorari.

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February 4, 2020