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Patent Damages Based on Avoided Costs Do Not Invoke the Entire Market Value Rule

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In ruling on a recent motion to strike, a judge in the Eastern District of Texas permitted a damages expert to rely on a damages theory based on defendant's "avoided costs," holding that this theory did not run afoul of the "entire market value rule."

When a product accused of infringement includes both the patented feature and other, non-patented features, the general rule is that royalties must be based not on the entire product, but rather on the "smallest saleable patent-practicing unit." This rule is derived from a concern that calculating a royalty based on the entire product will improperly compensate the patentee for non-infringing components. The entire market value rule provides a limited exception, however, allowing royalties to be based on revenue or profits for the entire product where the patentee proves that the patented feature drives demand for the entire product.

In this particular case, the patented technology concerned wireless telephone technology, and the smallest saleable practicing patent unit was the actual devices that practice the asserted patents. Plaintiff's damages expert, though, did not base his opinion on the revenue from those devices. Instead, Plaintiff argued that the patented technology allows wireless carriers to avoid the purchase and use of additional spectrum and based its damages theory on a variety of large financial figures, including the revenue and costs associated with the FCC auctions and secondary market sales of spectrum, the total value of the defendant's spectrum holdings, and the total spectrum saved due to the asserted patents.

The defendants moved to exclude this portion of the damages expert's opinion, arguing that including the valuation of the defendants' spectrum holdings violates the entire market value rule. Specifically, defendants contend that revealing such large numbers would have a prejudicial effect on the jury, even if the ultimate calculation was appropriately apportioned. In response, the plaintiff clarified that there was no entire market value rule concern because the value of the spectrum portfolio was not being used as a royalty base. Instead, the expert's opinion was directed to the incremental costs savings resulting from the data savings of devices that include the accused features, and therefore the spectrum auction amounts are directly relevant to the calculations of defendants' spectrum portfolio.

The court agreed with the plaintiff, finding that the expert's analysis did not invoke the entire market value rule because the plaintiff had presented a damages theory based on avoided costs. Because defendants' cost savings do not implicate the same concerns as the entire market value rule, the court permitted the expert's testimony.

The defendants additionally argued that the plaintiff's valuation of the spectrum was not reliable. Specifically, the defendants claimed that the prices paid at spectrum auctions were an inappropriate proxy for the total value of the spectrum holdings and that the damages expert inappropriately cherry-picked a single auction on which to base the valuation. According to defendants, auction prices are subject to certain externalities that can inflate prices, making plaintiff's ultimate valuation unreliable. The court, however, explained that any concerns regarding the reliability of plaintiff's valuation would be best addressed through vigorous cross-examination, not through exclusion of plaintiff's valuation figures.

Practice Tip: Damages models based on the entire market value rule are common, but where the evidence allows, other models may provide an approach that does not implicate the restrictions of the entire market value rule. This decision from the Eastern District of Texas highlights that an "avoided costs" model may be a viable approach.

Headwater Research LLC v. Verizon Communications Inc. et al, 2:23-cv-00352, D.I. 321(E.D. Tex. Jun. 16, 2025)

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