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Federal Circuit Patent Bulletin: *Warsaw Orthopedic, Inc. v. NuVasive, Inc.*

March 2, 2015

"[A] patentee may not claim, as its own damages, the lost profits of a related company."

On March 2, 2015, in *Warsaw Orthopedic, Inc. v. NuVasive, Inc.*, the U.S. Court of Appeals for the Federal Circuit (Lourie, Dyk,* Reyna) affirmed-in-part, vacated-in-part, and remanded-in-part, inter alia, the district court's judgment that NuVasive infringed U.S. Patents No. 5,860,973 and No. 6,945,933, which related to oversized spinal implants and methods and devices for retracting tissue to create a working channel for minimally invasive spinal surgery; and that Warsaw and Medtronic Sofamor Danek (MSD) infringed U.S. Patent No. 7,470,236, which related to neuromonitoring during surgery. The Federal Circuit stated:

Although Warsaw owns the '933 and '973 patents, it does not practice the patented technologies. Rather, it (1) licenses the technologies to related companies Medtronic Sofamor Danek Deggendorf, GmBH ("Deggendorf") and Medtronic Puerto Rico Operations Co. ("M Proc"), which manufacture and sell the patented products to MSD and pay royalties to Warsaw on those sales and (2) manufactures "fixations," which it sells to MSD for profit. MSD packages the fixations and the patented products together into medical kits, which it sells to hospitals and surgeons. . . . The jury awarded Warsaw $101,196,000 in total damages. The verdict form indicated that the $101 million award was for "Lost Profit Damages (with royalty remainder)" and provided royalty rates for each patent. It is impossible to determine from the verdict form what portion of the verdict is attributable to lost profits and what portion is attributable to a reasonable royalty, much less how much of the lost profits portion is attributable to each of the three different revenue streams. After trial, the district court denied Warsaw's request for supplemental damages, and it set the ongoing royalty rate for the '973 patent at 13.75% of sales of infringing implants and set the ongoing royalty rate for the '933 patent at 8.25% of sales of infringing retractors. NuVasive challenges the award of lost profits. Warsaw challenges the district court's refusal to award supplemental damages and the ongoing royalty rate. . . .

[A] patentee may not claim, as its own damages, the lost profits of a related company. Indeed, Warsaw admits it is not entitled to the lost profits of Deggendorf, M Proc, or MSD. NuVasive challenges treating decreases in revenue from the sale of fixations (e.g., rods and screws for holding the implant and vertebrae in place) as "lost profits." At trial, Warsaw's damages expert testified that NuVasive's infringement of the patented technologies resulted in Warsaw's making fewer sales of fixations to MSD, because MSD itself lost sales of the patented medical kits as a result of NuVasive's infringement. The expert calculated that Warsaw lost $27.8 million in lost sales, $24.5 million of which was lost profits (the remaining $3.3 million was recouped in cost savings). Such a claim is based on the theory that the sales were convoyed sales.

A convoyed sale is a sale of a product that is not patented, but is sufficiently related to the patented product such that the patentee may recover lost profits for lost sales. To be entitled to lost profits for convoyed sales, the related products (e.g., the fixations) must be functionally related to the patented product and losses must be reasonably foreseeable. Being sold together merely for "convenience or business advantage" is not enough. If the convoyed sale has a use independent of the patented device, that suggests a non-functional relationship. . . . The fixations here are not convoyed sales recoverable as lost profits. Warsaw failed to prove a functional relationship necessary to support a jury verdict awarding lost profits for convoyed sales. . . . Warsaw never presented testimony that the fixations it sold to MSD had no independent function-that is, that they would not work as well in other surgeries not involving the patented technologies. Therefore, the district court erred in denying NuVasive's JMOL motion on this issue.

NuVasive next challenges the inclusion of lost royalty payments from M Proc and Deggendorf in the lost profits award. At trial, Warsaw explained that, under its business model, it would license the patented technologies to related companies such as Deggendorf and M Proc, who would manufacture the patented devices. NuVasive's infringement detrimentally affected those manufacturers' sales, which in turn negatively affected the royalty payments they made to Warsaw. . . . To be entitled to lost profits, [the] lost profits must come from the lost sales of a product or service the patentee itself was selling. "Normally, if the patentee is not selling a product, by definition there can be no lost profits." . . . Here, there is a failure of proof and as a result the revenue stream is not recoverable.

NuVasive's final challenge is to the inclusion of the "true-up" payments from MSD to Warsaw. At trial, Warsaw's accounting witness explained that Warsaw engages in various transactions with related companies throughout the year. But, those initial transactions do not necessarily reflect the fair market value of the product or service exchanged. To comply with relevant tax and accounting laws, a transfer pricing agreement is used to require those related companies to transfer funds back and forth to compensate each other for the fair market value of the property previously exchanged. The "true-up" payments are post hoc transfers to ensure that Warsaw receives fair-market-value. The number is substantial; MSD remits back 95% of the profit it made from the sale of patented technologies, and that accounts for the majority of the total lost profits requested by Warsaw. . . . Warsaw apparently contends that the true-up payments are recoverable because they contain, in part, royalty payments from MSD to Warsaw for sales of the patented products to surgeons and hospitals. But Warsaw makes no effort to distinguish what percentage of the true-ups was attributable to those payments as opposed to payments on unrelated transactions. Indeed, the transfer pricing policies indicate that the true-ups are established on a company-by-company, not a technology-bytechnology or even a product-by-product, basis. . . .

Our rejection of Warsaw's claims for lost profits does not mean that Warsaw is precluded from any recovery. . . . Neither party argues it is possible to parse out and compute a reasonable royalty based on the jury verdict. Although the jury verdict did state a reasonable royalty rate, it is not entirely clear the period for which that reasonable royalty was determined or whether the jury impermissibly relied on evidence not probative of the value of the patented technology. We therefore remand for a new trial to determine a reasonable royalty on the patented technologies.