Bargaining Model Takeaways From Limelight Ruling

By **Jeffrey Klenk** (February 9, 2018)

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A recent decision involving Limelight Networks confirmed an apparent trend in courts' acceptance of bargaining theory (based either on Rubinstein or Nash) to model hypothetical negotiations in intellectual property disputes: Such models are fundamentally admissible but their usage must be grounded in the specific facts of the case at hand.

Referencing VirnetX, the U.S. District Court for the Eastern District of Virginia ruled that an expert's use of a so-called Rubinstein bargaining model, while "potentially admissible" as a general proposition, would be excluded for "impermissibly fail[ing] to tie the model to the facts of the case."[1] This follows a ruling in 2015, which also referenced VirtnetX, finding that an expert's use of a Rubinstein bargaining model was admissible since it was more than a "mere 'rule of thumb'" and was grounded in the facts of that particular case as evidenced by its reliance on defendant-specific evidence.[2] Of course, VirnetX itself concluded that the particular use of a Nash bargaining solution that it was ruling on, since it was "insufficiently tied to the facts of the case," amounted to little more than an "inappropriate 'rule of thumb'" given its baseline assumption that profits would be equally split between the licensor and licensee.[3]

Simply stated, a bargaining model provides a way of apportioning a certain economic surplus or "pie" between two parties. Such models can be either axiomatic (such as Nash) or strategic (such as Rubinstein) in nature.[4] Using a Nash approach involves the modeling of certain premises (or axioms) inherent in the bargaining process while using a Rubinstein approach involves the modeling of two parties making strategic offers to each other.[5] In particular, the Rubinstein bargaining model has embedded into it an explicit assumption that "time is valuable."[6] As a result, the bargaining outcome from such a model generally favors the more "patient" party to the negotiation, which is often modeled according to each party's discount rate.[7]

In the Limelight matter, the plaintiff's expert based the parties' discount rates on their respective weighted average costs of capital or WACC, obtained from Bloomberg, and then used those WACCs to determine how the alleged benefit of infringement should be split.[8] Although the court acknowledges the company-specific factors that go into the calculation of a WACC, it characterizes this particular use of a Rubinstein bargaining model as "simply fancy guesswork."[9] In particular, the court contends that the model used WACCs in a way that "has no relationship to the patents in this case" and, most tellingly, would result in a "split [of] the gains in the same way for a fundamental patent at the core of a company's technology [as] for a piece of technology that the company might consider not valuable at all."[10]

Without being privy to the specifics of the damages model that was proffered, one possible response to the court's critique is that the bargaining range itself over which the parties were hypothetically negotiating reflected case-specific evidence indicative of the patents'

value. Presumably a “fundamental patent” would result in a fairly high bargaining range while a patent of a relatively tangential value would result in a much lower bargaining range. Assuming that the bargaining range was determined in such a manner, a Rubinstein bargaining model might then provide a reasonable approximation for how the parties would split that range based on each party’s willingness to wait for a favorable offer to be made.

As the court rightly notes, though, a party’s willingness to wait in a particular negotiation might differ significantly from its overall willingness to wait at the corporate level as embodied by its WACC.[11] For example, an alleged infringer might have a relatively strong capital structure and thus a low WACC but could be desperate to obtain access to the patented technology in order to, say, exploit a first-mover advantage in the marketplace. In such a circumstance, reliance on a corporate WACC might wrongly ascribe to one of the parties a patience that it would not have exhibited in actuality.

The court’s decision here is thus another iteration, starting with VirnetX, of the proposition that rules of thumb are not admissible as components of damages models in intellectual property disputes and that bargaining models based on such rules of thumb are also not admissible, regardless of how sophisticated they might seem. However, this litany of cases very much holds open the possibility that, as a general matter, bargaining models that accurately reflect the specific facts of the case and accurately represent each party’s negotiating position can be used.

These cases also indicate that when developing a bargaining model based either on a Rubinstein or a Nash approach, an expert should first undertake a fact-intensive inquiry to ensure that the model itself incorporates not just party-specific information but rather information specific to the case at hand. Ideally, the bargaining range, as well as the apportionment of that range, would both reflect as closely as possible the situation that would have prevailed had the parties chosen to negotiate a license before the start of the alleged infringement. That would represent the essence of the hypothetical negotiation envisioned by Georgia-Pacific.[12]

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[1] Limelight Networks, Inc. v. XO Communications, LLC, and Akamai Technologies, Inc., Opinion, No. 3:15-cv-720-JAG (E.D. Va. 2018), p. 4.

[2] Content Guard Holdings, Inc. v. Amazon.com, Inc. and Google, Inc., Memorandum Opinion and Order, No. 2:13-CV-1112-JRG (E.D. Tex. Aug. 6, 2015), p. 17.

[3] VirnetX, Inc., v. Cisco Systems, Inc., 767 F.3d 1308, 1332-1334 (Fed. Cir. 2014).

[4] See, e.g., Richard Higgins and Jeffrey Klenk, An Application of Nash Bargaining to Intellectual Property Negotiations, 25 The Federal Circuit Bar Journal 125, 127-131 (2015).

[5] Id.

[6] Ariel Rubinstein, Perfect Equilibrium in a Bargaining Model, 50 Econometrica 97, 98-99 (Jan. 1982).

[7] Limelight Networks, p. 5.

[8] Id.

[9] Id. at 6.

[10] Id.

[11] Id. at fn. 5.

[12] Georgia-Pacific Corp. v. United States Plywood Corp., 318 F.Supp. 1116, 1120 (S.D.N.Y. 1970).