

06-1020, -1078, -1079, -1098, -1099, -1194, -1195

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IN THE  
UNITED STATES COURT OF APPEALS  
FOR THE FEDERAL CIRCUIT

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Freedom Wireless, Inc.,  
*Plaintiff-Cross Appellant,*

v.

Boston Communications Group, Inc.,  
*Defendant-Appellant,*

and

Western Wireless Corporation (d/b/a Cellular One),  
*Defendant-Appellant,*

and

AT&T Wireless PCS, Cingular Wireless LLC, and CMT Partners  
(d/b/a Cellular One Of San Francisco),  
*Defendants-Appellants,*

and

Nextel Communications, Inc. and Nextel Operations, Inc.  
(now known as Sprint Nextel Corporation)  
*Movants-Appellants,*

v.

Rogers Wireless, Inc. (a/k/a Rogers AT&T Wireless),  
*Defendant-Appellee.*

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Appeal from the United States District Court for the District of Massachusetts  
in Case No. 00-CV-12234, Senior Judge Edward F. Harrington

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**CORRECTED BRIEF FOR CINGULAR WIRELESS LLC,  
AT&T WIRELESS, AND CMT PARTNERS**

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Undersigned counsel certifies the following:

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**Cingular Wireless LLC, AT&T Wireless Services, and CMT Partners.**
2. The real party in interest represented by the undersigned is:  
**Cingular Wireless LLC, AT&T Wireless Services, and CMT Partners.**
3. All parent companies and any publicly held companies that own 10 percent or more of the stock of the party represented by me are:  
**Listed *infra* at ii.**
4. The names of all law firms and the partners or associates that appeared for the party now represented by the undersigned in the trial court or are expected to appear in this court are:  
**Listed *infra* at iii-vi.**

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## STATEMENT OF RELATED CASES

No other appeal in or from this same civil action was previously before this court or any other court of appeals. Further, there is no case known by counsel to be pending in this court that will directly affect or be directly affected by this court's decision in the pending appeal.

The following district court cases potentially will be directly affected by this court's decision in the present appeal, according to appellant Boston Communications Group, Inc. ("BCGI"):

*Freedom Wireless, Inc. v. Boston Communications Group, Inc. and Nextel Communications, Inc.*, No. 05-11061 EFH (D. Mass. filed May 20, 2005); and

*Freedom Wireless, Inc. v. Boston Communications Group, Inc., Alltel Corporation and Does 1-20*, No. 05-11062 EFH (D. Mass. filed May 20, 2005).

## **STATEMENT OF JURISDICTION**

The district court had original jurisdiction under 28 U.S.C. §§ 1331 and 1338(a). Because the judgment is final, this court has appellate jurisdiction under 28 U.S.C. § 1295(a)(1). Cingular Wireless LLC, AT&T Wireless PCS, and CMT Partners (d/b/a Cellular One of San Francisco) (collectively, “Cingular”) timely filed a notice of appeal under 28 U.S.C. § 2107(a) and FED. R. APP. P. 4(a).

## **STATEMENT OF ISSUES**

The following issues arise from the judgment that Cingular and Boston Communications Group, Inc. (“BCGI”) “jointly” infringed two Freedom Wireless, Inc. (“Freedom”) patents:

1. Whether liability for patent infringement may be predicated on a theory of “joint” direct infringement by two independent parties dealing at arm’s length, neither of which performs each step of the patented process.
2. Whether, in light of the undisputed evidence of prior art and the patentees’ disclaimers, any reasonable jury could have concluded that Freedom’s patent claims were valid and infringed by BCGI’s service; alternatively, whether the district court erred in not finding Freedom’s patents unenforceable for inequitable conduct.
3. Whether the district court erroneously and prejudicially excluded a patent application, pending when Freedom’s first application was filed, that provided substantial evidence of prior invention and obviousness.
4. Whether the \$128 million damages award is excessive and unsupported.

## **STATEMENT OF THE CASE**

This case involves Freedom’s claim that BCGI and each of several wireless carriers together “jointly” infringed 32 claims of two patents covering methods for

providing prepaid wireless telephone service. *See* U.S. Patent Nos. 5,722,067 (“the ’067 patent”) and 6,157,823 (“the ’823 patent”). Freedom provides no product or services; its only business is enforcing the patents-in-suit, which it purchased for \$750,000 in 1998. A8635-40, A30089(5), A30523(48), A30541(116-17).

BCGI has provided several services to wireless carriers, including an accounting-related service for prepaid wireless phone service. A30862(35).

The carrier defendants provide prepaid wireless service and in doing so have purchased BCGI’s accounting-related service. Cingular Wireless LLC, which provides a wide range of wireless communications services, now owns the stock of two other wireless carrier defendants, AT&T Wireless PCS and CMT Partners (collectively, “Cingular”). A30056(25), A31040(12), A31075-76(9,13).

The remaining carrier defendant, Western Wireless Corp. (“Western”), is independent.

At trial, a jury awarded Freedom over \$128 million in damages. A206, A213, A220, A223. The sole theory of liability presented to the jury did not require a finding that any defendant had performed each step of any patent claim, the established test for direct infringement. Instead, the jury was permitted to aggregate the conduct of BCGI and each carrier defendant, so that it could find “joint” infringement if one defendant performed some steps of a patented claim and the other defendant performed the rest. A162-70, A200-23. The damages, awarded as a “reasonable” royalty, exceeded BCGI’s entire *revenues* for the accounting-

related service for prepaid wireless phone service at issue here. A31156(90-91).

At a subsequent bench trial, the district court found that the patentees had not committed inequitable conduct in prosecuting their application. A14.

The district court ultimately enjoined infringement by Defendants, and then, in a highly unusual step, extended the injunction to non-party Nextel (whose conduct is the subject of a separate action) and refused to stay the injunction. A6.

Defendants and Nextel sought relief in this court, which stayed the injunction pending appeal, finding “a substantial question whether the theory of liability applied in the district court departs from this court’s precedents on vicarious liability for infringement.” A4096.

## **STATEMENT OF FACTS**

### **A. The Prepaid Wireless Service Market.**

Most users of wireless telephone service do not pay in advance, but are billed every month. A31192(82-83). Prepaid wireless service, a more flexible extension of the pay-telephone model, developed to extend access to customers with poor credit. A30814-15(141-44). By 1993, companies such as Banana Cellular provided prepaid wireless service using a variety of technologies. A30094(25-26), A31494(10-11),A31542(200-01),A31544(207),A31633(113). For example, a system presented to the California Public Utilities Commission in 1991 by Cellular Service, Inc. (“CSI”) provided for prepaid wireless systems and services that identified a caller as prepaid, routed the call to a billing service switch that would

validate the account and its balance, and then directly connected the call to whichever telecommunications provider would complete it. A4330-31,A30832-33(48-52),A30848(109),A30954-55(97-98),A31266(50).<sup>1</sup>

In addition, during the summer and fall of 1993, Cominex LLC was testing a similar system that, among other features, called for the mobile switch to identify and route a prepaid subscriber's calls to a Cominex switch that would query a database about the status and balance of the prepaid subscriber's account and disconnect calls when the balance was exhausted. A30826(21),A30989-90(76-77),A30993-94(90-91). On September 14, 1993, two Cominex principals and a consultant filed a patent application for a "Prepaid Radio Phone System" with those features. A30783(18). The PTO ultimately rejected the application for obviousness and lack of novelty. A8093,A30783(19).

Even trade publications were in on the act. In November 1993, Telephony published an article that revealed the key components for providing prepaid service through a wireless or wired network: identification and routing to permit an account database to be queried, connection of a call upon account validation, and termination when the subscriber's balance was exhausted. A6822-23,A31644-46(155-63).

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<sup>1</sup> The CSI proposal and the Cominex invention, next discussed, are more fully described in BCGI's and Nextel's briefs.

**B. Freedom’s Predecessors Try But Fail To Enter The Prepaid Wireless Market.**

In late 1993 or early 1994, Freedom’s predecessors, Fougnyes and Harned, decided to enter the prepaid wireless market, A30067(69),A31495(14-16). They planned to buy excess minutes from local wireless service providers and resell them to local prepaid customers. A30028(36),A30112(96-97),A30830(37-38). The only documentation of any “inventive process” from this period was a one-page drawing, A30096-97(36-39),A30107(79-80), made shortly after the Telephony magazine article appeared. A6822-24,A30104(66-67),A30106(75-76).

Freedom’s predecessors applied for a patent on their “invention” in December 1994. A30836(64),A31496(20). During prosecution, the PTO did not consider Cominex’s then-pending patent application, A30801(90-92), although that application was not abandoned until September 19, 1995. A8093,A30836(64). Nor did the PTO consider the Telephony magazine article. A6822,A30801(90). Even without having to distinguish the substantial prior art not before the PTO, Freedom’s predecessors had to narrow their claims to avoid other patents that issued while their application was pending. *Infra* at 6-7 (characteristics (3) and (5)).

That Freedom was able to obtain a patent was surprising. Even Freedom’s expert, Dr. Levine, admitted that the fundamental features of Freedom’s claims—identifying a call as prepaid at the switch and routing it to a service provider—would have been obvious to even persons of less than ordinary skill in the art at the

time the Freedom invention was made. A30320 (144-45).

The '067 patent issued in 1998. A6000,A31504(50). The '823 patent, a continuation sharing the same specification, issued in December 2000. A31831(175). Taken together, the claims of the two patents had the following principal characteristics:

(1) Based on identifying data transmitted with their calls, calls from prepaid service subscribers would be rerouted at the mobile telephone switching office (MTSO) to a host computer belonging to the prepaid service provider.

(2) The host computer would compare the caller's identifying information to verify the account and the presence of a positive balance in it.

(3) If there was a positive balance, the prepaid service provider's host computer would directly connect the call to the local exchange carrier ("LEC"), that is, the local *landline* telephone company, for completion. A30812-13(132-38). On this front, Freedom's predecessors distinguished other prepaid systems as requiring "physical access to a central switching station" to overcome the examiner's initial rejection of many of their claims based on the prior art Castro patent. A7370.162; A7370.151-156,A7370.167-.173.

(4) Inbound calls to the prepaid wireless subscriber also would be routed to the prepaid wireless service provider's host computer, which would validate the account and then connect the call to the MTSO for completion to the subscriber. A30849(113).

(5) The patents also described a distinct accounting function. To distinguish systems that used a call duration timer, the patents called for “periodic validation,” under which the host computer would periodically query the account database during a call, causing the subscriber’s account balance to diminish at set intervals in real time. A468(3:5-35) (distinguishing Patent No. 5,353,335 (D’Urso)), A30860(26).<sup>2</sup>

Thus, the methods claimed in the patents assigned the routing, completing, and termination of calls to the control of the host computer of the prepaid service provider rather than the wireless carrier. Interposing the prepaid service provider between the wireless carrier and the terminating LEC reflected the business plan of Freedom’s predecessors and their company, Cellexis. A30495(22). As a prospective reseller of wireless minutes, Cellexis needed to connect directly to an LEC to handle its validated calls because it did not have a network or infrastructure of its own. A31797(42).

Cellexis licensed its technology to three companies at a high royalty rate of 5 cents per minute, A31232(73-74). Before the first patent issued, two of the companies went bankrupt; the third never entered the market. A30545(131-33),A30553(5-6). Freedom never saw a dime in revenue from those licenses.

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<sup>2</sup> Again, the BCGI brief and, to a lesser extent, the Nextel brief provide an extended discussion of the patent claims that is not repeated here.

### **C. BCGI's Accounting-Related Service.**

BCGI began providing roaming and other services to wireless carriers in the 1980s. A30213-14(31-33). In 1994, BCGI began creating a national network to provide an accounting-related service that would let wireless carriers serve prepaid customers. A30207(6-7),A30213-14(32-33),A30215(38-40),A30217(45). Although BCGI invested over \$150 million in its prepaid service bureau, BCGI never sought a patent because the technology was familiar. A30214(33-34),A30320-21(146-47). In 1996, BCGI's service bureau began operating, and Cingular began purchasing BCGI's accounting-related services. A30206-07(4-5),A30411(35),A30682(78-79).

To use BCGI's services, carriers identify prepaid calls. A30261-62(68-72). Then they route their prepaid calls to BCGI's billing platform, along with the caller's number, using well-known technology that has been around for more than twenty years. A30815(144-46).

BCGI's service operated nationwide, using a centralized databank for its accounting service bureau. A30214(33),A30670(30-32),A30711(43-44). Notably, BCGI's service enabled carriers to retain control over call routing because it did *not* directly connect calls to an LEC. A30089-90(7-9), A30172(17),A30873(77-78). Instead, after BCGI performed its accounting functions, it returned the call to the wireless carrier for routing. A30873(78).

The carriers wanted to control their calls because they could regulate their network flow, costs, and services better than a third-party. A30174-76(28-30).

Under Cellexis's technology, a carrier would lose control of each call (and its costs) and become dependent on someone else to manage network congestion and other crucial issues. A30409-11(27-34). High-volume providers like Cingular could not tolerate that situation and thus never would have used Cellexis's service. A30172(18-19),A30175(30).

There were other differences between the services as well, including the BCGI service's lack of the "periodic validation," described above. A30172(19-20), A30176(34-35). Cingular otherwise relies on BCGI's brief for the additional detail it provides about BCGI's technology and the distinctions between it and that claimed in the patents-in-suit.

**D. Freedom Acquires Cellexis's IP Rights.**

Because of financial difficulties, Cellexis sold all of its intellectual property rights to Freedom in 1998 for \$750,000. A30514(11-14). Around the same time, Freedom commissioned a valuation of those IP rights. The report concluded that Freedom might reasonably expect to license its technology to carriers for a royalty of as much as 1% of their prepaid wireless revenues. A30515-16(16-17),A30542(119-20),A30548(145). Based on prepaid wireless revenue evidence in this case, that would have produced a royalty of \$14 million. A6639. Relying on this report as a statement of anticipated royalties, Freedom circulated it to potential investors. A30542(120),A30548(146).

By that time, however, competition had intensified in wireless services

generally and in the prepaid market specifically. Multiple wireless carriers competed for monthly and prepaid customers in each major geographic market. A30470(74).

Moreover, prepaid services presented financial challenges. Prepaid customers generated less revenue because they use their phones much less than postpaid customers. A30470(76). In addition, they change carriers (or forgo service entirely) much more frequently; *i.e.*, their “churn” is greater, with rates as high as 10-15% per month. A30470(76),A30478-79(105-06,108-09),A30546(136-37), A31078(21), A31206(138).

In addition, many alternatives to BCGI’s “network-based” service for prepaid wireless existed in the market. A31155-56(84-88). These included “hotlining” (similar to a prepaid calling card), metered billing (where customers pay in advance and their service is subject to termination after any call exceeding their balance), chip-based handsets (where customers’ phones keep track of their balances). A30884(120),A30724-25(95-100), and other switch- and network-based solutions, A30725(98-100). Freedom ultimately admitted that one solution offered by GTE was functionally “identical” to Freedom’s technology. A30531(78),A31155(84-85),A31617(52),A31694(113).

BCGI’s service never dominated this highly competitive environment; for example, by 2004, only one of the four largest prepaid service providers used BCGI, while a chip-based handset solution, TracFone, had the largest customer

base. A31155-56(87-88),A31215(7),A31230-31(68-69).

The extremely competitive nature of these markets was reflected by steeply falling prices and low profits. For example, BCGI's charges to its carrier customers fell from 6.4¢/minute in 1998 to 1.64¢/minute in 2004; total charges for one minute of wireless service dropped over 80% between 1994 and 2004 (and continue to fall dramatically), resulting in average total prices below 10¢/minute. A7859.05, A30459(30-31),A31187(63). Nor were such price declines a surprise. By 1998, everyone in the industry was expecting them. A30470(73), A30611(98).

Profits could be scarce. For example, Western used BCGI's service from 1996 to 1999 and made no profits. A30376(58). Indeed, BCGI lost more than \$20 million from 1996 through 1998 and did not offset that loss until 2002. A31120(42).

To be sure, by the end of the royalty period in 2004, BCGI had earned a total of \$24 million in prepaid profits after more than eight years of operations. A31120(42),A31183(48). But those profits overstate the success of BCGI's business. To earn that \$24 million, BCGI had to invest \$150 million in a network, A30214(33), a massive capital expenditure that remains an on-going business expense until fully depreciated. Even the primary source relied upon by Freedom's damages experts characterized prepaid wireless service as a domestic "failure" as late as 2003. A30443(88),A30472(83-84).

## **E. The Lawsuit And Trial.**

In March 2000, Freedom sued BCGI and the carrier defendants for infringement of the '067 patent, A30207(5), later amending to allege infringement of the '823 patent. A7862-71,A31612(32),A31831(175). In April 2003, the district court construed the claims. A78-94.

Trial began in March 2005.<sup>3</sup> A30050. During trial, the court granted judgment as a matter of law to Cingular on Freedom's claim of willful infringement. A7882,A8101-06. After the close of evidence, the court granted JMOL to both BCGI and Cingular on Freedom's contributory and inducement of infringement claims. A67,A11002-04.

The trial court then took the unusual step of instructing the jury *before* hearing and ruling upon objections to the instructions, A31349(224-25),A31364-78(56-112), contrary to Federal Rule of Civil Procedure 51(b)(2): "The court ... must give the parties an opportunity to object ... to the proposed instructions ... before the instructions and arguments are delivered." After ruling on those deferred objections, the court reinstructed the jury the next day, and then once more after making errors in its prior re-instruction. A31377(107-08),A31399-404(23-43),A31404-08(44-59).

After receiving this confusing trilogy of instructions, the jury found that each

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<sup>3</sup> One carrier defendant, Rogers Wireless, was dismissed on summary judgment

of four “pairs” of defendants (BCGI, on one hand, and the three Cingular defendants and Western on the other) had “jointly” infringed the asserted patent claims. A200-23,A31424-29(3-23). The jury was not asked to decide whether any single defendant infringed the patents; rather, “joint infringement” was the only liability theory submitted, *id.*, under this instruction:

Under Federal patent law, if separate companies work together to perform all of the steps of a claim of a patent, the companies are jointly responsible, that is, responsible as a group for the infringement of the patent. Even if no single company performs all of the steps of a claim, the companies are jointly responsible.

A31358(31-32),A31400-01(28-29).

Exhorted to ignore the “little guy” and focus on “the big guy ... the one making billions of dollars,” A31339-40(185-86), the jury awarded damages in the staggering sum of \$128,000,000 before interest. A206,A213,A220, A223,A31424-29(3-23).

During trial, Freedom was negotiating a patent license to another company, Convergys. A8372-76,A8791-97,A8814-16. The terms of this license were consistent with the testimony of Defendants’ reasonable-royalty expert, but entirely contradicted the opinion of Freedom’s expert that a reasonable royalty for the 1998-2004 time frame would have been an unchanging 5¢/minute for the life of the patents, despite the rapidly falling prices for wireless services. *Id.*; A30575(91),

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before trial.

A30587-91(4-12),A31159-60(101-04). Freedom did not disclose these negotiations to Defendants, the court, the jury, or even its own expert, whose testimony the jury substantially credited in awarding over \$128 million in damages against BCGI and its customers. A30589-91(12-18).

Accordingly, in addition to renewing their JMOL motions and seeking a new trial based on trial errors, Defendants also moved for a new trial or a substantial remittitur based on the newly discovered evidence of the Convergys license. A8372-81.

The district court summarily denied these motions without hearing or opinion and entered a permanent injunction that it refused to stay. A1.1,A2. Defendants moved this court for a stay of the injunction, while Nextel sought leave to intervene. A8821-41,A8851-76. This court granted those motions. Dkt. 29.

### **SUMMARY OF ARGUMENT**

Two overarching errors produced the patent infringement judgment in this case, a judgment now worth over \$160 million. The premise for liability was a theory of “joint” direct infringement—without a single direct infringer—that has no basis in patent law. And the “reasonable royalty” award ignored the fundamental characteristics of the relevant markets when the alleged infringement began—intense competition from many sources, including one with a royalty-free license to Freedom’s own technology, and steadily plunging per-minute prices for wireless service.

Freedom asserted two patents covering methods for providing prepaid wireless service against BCGI, which provided an accounting-related service for prepaid wireless phone service, and against Cingular and other wireless carriers that purchased BCGI's service.

But Freedom did not prove that any defendant performed each step of any asserted patent claim. Accordingly, under established precedent, no defendant used the patented method, as is required for direct infringement under 35 U.S.C. § 271(a). Freedom also failed to prove that any defendant induced or contributed to infringement. 35 U.S.C. §§ 271(b), (c).

Under the unprecedented theory of divided "joint" direct infringement on which the case was tried, the jury could aggregate the activities of separate businesses operating at arm's length (*i.e.*, BCGI and each of the carrier defendants) to satisfy the limitations of the 32 asserted claims. According to the district court's jury instruction, *both* parties could directly infringe the patents based on their collective conduct merely by "working together" in the contractual relationship by which BCGI provided unpatented services to each carrier. This cannot be the law.

The district court compounded its error by permitting Freedom to recover damages far greater than would have been available even if Freedom had successfully established ordinary direct infringement by *all* individual defendants. Under settled law, that multiple entities infringe at different stages of the stream of commerce does not inflate the "reasonable royalty" simply because many infringers

have greater combined revenues than one. Consequently, the calculation of a reasonable royalty must incorporate numerous factors, in particular the competitive constraints of the market where the infringers and patentee operate.

Here, however, the district court not only failed to require the damages evidence to meet that recognized standard, but also failed to confine Freedom's experts to recognized, reliable methodologies. The court completely abdicated its gatekeeper role, apparently believing that a challenge under *Daubert v. Merrell Dow Pharmaceuticals*, 509 U.S. 579 (1993), goes only to an expert's qualifications rather than the methodologies he employs. The court then upheld a royalty rate so far beyond the bounds of reason that it produced damages exceeding all fees the carrier defendants ever paid for BCGI's service.

And these misconceptions were only the tip of the iceberg. The district court permitted Freedom to assert both literal infringement and infringement based on the doctrine of equivalents against subject matter that had been disclaimed in the patents or during prosecution. Despite unrebutted evidence of prior art that anticipated claim after claim, the court nonetheless sent the case to the jury. And even had an anticipatory reference not been present in the prior art, prior art existed that was so similar as to make Freedom's claims invalid for obviousness.

Finally, the court refused to let the jury consider some of the most compelling evidence regarding the lack of novelty of Freedom's patent claims: that a competitor's patent application prefigured Freedom's claims and had been pending

before the PTO before Freedom's application was ever filed. This evidence not only would have established that Freedom was not the first inventor of what it now claims, but also would have provided substantial evidence of motivation to combine and other factors showing obviousness.

### **STANDARDS OF REVIEW**

A district court's denial of a motion for JMOL on infringement or validity should be reversed "if the jury's factual findings are not supported by substantial evidence or if the legal conclusions implied from the jury's verdict cannot in law be supported by those findings." *Cybor Corp. v. FAS Techs., Inc.*, 138 F.3d 1448, 1454 (Fed. Cir. 1998) (en banc). As part of that inquiry, the court reviews the district court's statutory construction *de novo*. *Merck & Co. v. Kessler*, 80 F.3d 1543, 1549 (Fed. Cir. 1996).

This court reviews evidentiary rulings for abuse of discretion. *Gen. Elec. Co. v. Joiner*, 522 U.S. 136, 141-42 (1997); *Bose Corp. v. JBL, Inc.*, 274 F.3d 1354, 1360 (Fed. Cir. 2001). The district court abuses its discretion by making a clear error of judgment in weighing relevant factors or by relying on an error of law or clearly erroneous finding. *A.C. Auckerman Co. v. R.L. Chaides Constr. Co.*, 960 F.2d 1020, 1039 (Fed. Cir. 1992) (en banc). A district court's failure to consider evidence relevant to a question of law is presumptively an abuse of discretion. *Baker v. Dalkon Shields Claimants Trust*, 156 F.3d 248, 252 (1st Cir. 1998). Its determination that a party is precluded from introducing evidence as a matter of law

is reviewed *de novo*. *Sulzer Textil A.G. v. Picanol N.V.*, 358 F.3d 1356, 1363 (Fed. Cir. 2004).

A district court's damages award is reviewed for an erroneous conclusion of law, clearly erroneous factual findings, or a clear error of judgment amounting to an abuse of discretion, while a jury's damages award is reviewed for substantial evidence. *Rite-Hite Corp. v. Kelley Co.*, 56 F. 3d 1538, 1543 (Fed. Cir. 1995) (en banc); *Smithkline Diagnostics, Inc. v. Helena Labs. Corp.*, 926 F.2d 1161, 1164 n.2 (Fed. Cir. 1991).

## ARGUMENT

### **I. The Jury's Liability Findings Were Based On An Improper Theory Of Divided Direct Infringement.**

It is undisputed that no defendant practices all of the steps of any of Freedom's patent claims. Consequently, Freedom did not prove and the jury did not find that any single defendant infringed any claim. Although that should have ended the infringement inquiry, the district court permitted Freedom to proceed under an unprecedented theory of "joint direct infringement."

Under Freedom's theory, two separate parties, neither of whom independently infringe, nonetheless may be liable as direct infringers if their combined actions meet all the limitations of a claim. This is so, according to Freedom, even though neither party controls or directs the action of the other, nor intends or knows that the consequences of their combined action could meet all

limitations of any patent claim. Under the jury instruction in this case, infringement liability may attach whenever separate entities merely “work together” in some undefined way, if in the aggregate their separate actions perform the steps of a patent claim. A31358(31-32),A31400-01(28-29).

This court stayed the district court’s injunction based on the “substantial question whether the theory of liability [joint infringement] applied in the district court departs from this court’s precedents regarding vicarious liability for infringement.” A4096. Not only is the question substantial, but the answer is clear, for it is a fundamental principle that one whose conduct is not itself unlawful is not liable for the conduct of a legally separate entity absent some basis for imposing vicarious liability. Because the Patent Act imposes vicarious liability only in limited situations not present here, it is presumed to preclude it in others. *Deepsouth Packing Co. v. Laitram Corp.*, 406 U.S. 518 (1972) (holding that, absent statutory authorization, there could be no liability for infringement where defendant practiced fewer than all elements of a combination patent). As further explained below, Freedom’s theory of patent infringement liability conflicts with precedent, the statutory allocation of infringement liability, and sound policy.

**A. Defendants Are Entitled To Judgment Because Divided Direct Infringement Is Inconsistent With The Statute And Precedent.**

Because “[t]he cause of action for patent infringement is created and defined by statute,” Freedom had to satisfy the statutory requirements of § 271(a), (b), or

(c). *N. Am. Philips Corp. v. Am. Vending Sales, Inc.*, 35 F.3d 1576, 1579 (Fed. Cir. 1994). Section 271(a) defines direct infringement, providing in relevant part that “whoever without authority ... uses ... any patented invention ... infringes the patent.” See *NTP, Inc. v. Research In Motion, Ltd.*, 418 F.3d 1282, 1319 (Fed. Cir. 2005) (“infringement of method claims under section 271(a)” is “limited to use”), *cert. denied*, 126 S. Ct. 1174 (2006).

Under the strict “all elements” rule, a party infringes only if it practices each element of an asserted claim. *Canton Bio-Medical, Inc. v. Integrated Liner Techs., Inc.*, 216 F.3d 1367, 1370 (Fed. Cir. 2000). For method patents, this means that only the practice of each and every step of the claimed method constitutes direct infringement. *NTP*, 418 F.3d at 1319 (“A method claim is directly infringed only by one practicing the patented method.” (internal quotation marks omitted)); see also 5 Donald E. Chisum, CHISUM ON PATENTS § 16.02[6] (2004) (direct infringement of process claim requires performance of all steps in process). Because it is undisputed that no defendant in this case by itself performed all elements of any asserted claim, Defendants were entitled to judgment as a matter of law on direct infringement.

This court has not definitively resolved whether, or under what circumstances, the conduct of two defendants can be aggregated to satisfy all claim elements in order to extend liability for *direct* infringement to a defendant that did not individually infringe. But the appellate courts that have directly confronted the

issue have not suggested that two independent actors linked only by a routine vendor-customer relationship might be jointly liable for a single act of infringement where *neither* would be liable individually—the situation here.

This court recently considered divided infringement in a case where an apparatus made by Medtronic met all but one limitation of a claim, and the missing limitation allegedly was satisfied by the actions of Medtronic’s surgeon-customers. This court declined to impose liability because “no reasonable juror could find that the accused infringer *itself* makes or uses the entire claimed apparatus.” *Cross Med. Prods., Inc. v. Medtronic Sofamor Danek, Inc.*, 424 F.3d 1293, 1312 (Fed. Cir. 2005) (emphasis added). The court noted a trial court decision indicating that divided infringement of a method claim may be shown “when a step of the claim is performed at the direction of, but not by, that party.” *Id.* at 1311 (citing *Shields v. Halliburton Co.*, 493 F. Supp. 1376, 1389 (W.D. La. 1980)). But the court did not have to decide whether that theory was sound because (as in the present case) “direction” had not been proven: “[I]f anyone makes the claimed apparatus, it is the surgeons, who are, as far as we can tell, not agents of Medtronic. Because Medtronic does not *itself* make an apparatus with the ‘interface’ portion in contact with bone, Medtronic does not directly infringe.” *Id.* (emphasis added).

That holding accorded with the court’s previous rejection of an effort to impose infringement liability where the elements of a claim for printing plates had been divided between a defendant and its customers: the defendant “cannot be

liable for direct infringement with respect to those plates.” *Fromson v. Advance Offset Plate, Inc.*, 720 F.2d 1565, 1567-68 (Fed. Cir. 1983). In addition, before this court existed, the Ninth Circuit had confronted and rejected a similar argument that two entities, Filtrol and Texaco, “split between them the performance of the four steps of the claim.” *Mobil Oil Corp. v. Filtrol Corp.*, 501 F.2d 282, 291 (9th Cir. 1974). Unsatisfied that one step was performed at all, the Ninth Circuit noted that in any event another step was “not performed by Filtrol but by Texaco in its commercial use of catalysts that Texaco purchased from Filtrol.” *Id.* The court then “question[ed] whether a method claim can be infringed when two separate entities perform different operations and neither has control of the other’s activities.” *Id.* at 291-92.<sup>4</sup>

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<sup>4</sup> A panel of this court recently overturned a joint-infringement verdict, holding that even the aggregated conduct of the defendants did not infringe. *See On Demand Mach. Corp. v. Ingram Indus., Inc.*, No. 05-1074, 2006 WL 827302, at \*11-12 (Fed. Cir. Mar. 31, 2006). The *On Demand* panel did not decide the case based on “[the] substantial question whether the theory of liability . . . [joint infringement] departs from this court’s precedents on vicarious liability for infringement” presented here, nor did it have the benefit of the “thorough briefing” the court has sought in this case to decide that substantial question. A4096. Indeed, the *On Demand* defendants’ narrow arguments about the specific application of joint infringement liability to their case did not contest the general theory offered in the instruction and thus did not bring “this court’s precedents on vicarious liability” or divided infringement to the panel’s attention. *See On Demand*, No. 05-1074, Def.-App. Br. 6, 55-57, 60-64; Reply Br. 3, 28-30. In a passing statement that was unnecessary to the decision and presented without analysis or citation, the *On Demand* panel merely said that it “discern[ed] no flaw” in a jury instruction that (1) characterized multiple entities as “joint infringers” when one defendant “ha[d] another perform one step of the process” and (2) stated that infringement could result from “the participation and

The structure of § 271 undergirds this precedent considering and rejecting efforts to combine the conduct of two entities into a single act of direct infringement. Section 271 creates species of infringement liability that rest in part on the conduct of another entity, but does so in the limited instances of inducement in § 271(b) and contributory infringement in § 271(c) where direct infringement has also been established. In contrast with the strict liability imposed in § 271(a) for “actually performing all the steps of a patented process,” §§ 271(b) and (c) require proof of certain mental states to impose liability on entities that do not perform all steps: “‘specific intent’ to induce infringement, or knowledge that a good is specifically adapted for aiding infringement and has no other use.” Mark A. Lemley et al., *Divided Infringement Claims*, 33 AIPLA Q.J. 255, 258, 261-62 (Summer 2005); see *Hewlett-Packard Co. v. Bausch & Lomb, Inc.*, 909 F.2d 1464, 1469 (Fed. Cir. 1990). Significantly, this “vicarious liability” requires proof of a separate direct infringer. *Dynacore Holdings Corp. v. U.S. Philips Corp.*, 363 F.3d 1263, 1277 (Fed. Cir. 2004). Here, however, there was no proof of separate direct infringement or knowledge or intent. Consequently, the district court correctly granted Defendants JMOL on Freedom’s claims under §§ 271(b) and (c). A67, A11002-04.

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combined action(s) of one or more persons or entity.” *On Demand*, 2006 WL 827302 at \*11.

Recognizing liability for divided infringement claims of *any* type—much less claims based on independent economic entities’ merely “working together” within a market—would undo the careful distinctions between types of infringement in the Patent Act. As Professor Lemley explains:

Construing the patent laws to permit the individual, non-infringing acts of unrelated parties together to add up to infringement would render both § 271(b) and § 271(c) meaningless ... . [O]n a theory of joint infringement, no one need ever sue for inducement. All they need allege is that a party performed one of the many steps of a method, and that someone else performed another step. No intent would be required. The result would be to unreasonably expand liability for indirect infringement by conflating it with direct infringement.

33 AIPLA Q.J. at 261-62.

Moreover, recognizing divided infringement would encourage patent abuse. Patent holders could aggregate the conduct of any number of separate actors in a marketplace to cobble together a theory of *unwitting* or *incidental*—not knowing or intentional—collective infringement.

Sustaining liability here would require this court to abandon its precedents, distort the Patent Act, and undo the “important policy purpose” served by the differing standards imposed by its subsections. *Id.* at 261. This court should not take so drastic a step in order to serve such a counterproductive purpose. Any comprehensive loosening of the standards for infringement liability should be left to Congress.

**B. Defendants Are Entitled To Judgment Even Under A “Direction Or Control” Standard.**

Lacking support in statute, appellate precedent, or principle, Freedom has relied on a handful of district court cases. Not even those cases support the standard imposed in this case: aggregating the conduct of two business entities “working together” in an arm’s-length transaction to prove direct infringement against both. Rather, as this court recognized in *Cross Medical*, those cases rest on the notion that a party that performs some but not all claimed steps may be held liable “when a step of the claim is performed at the direction of, but not by, that party.” 424 F.3d at 1311 (citing *Shields*, 493 F. Supp. at 1389).

As Professor Lemley has explained, *Shields* was decided under a theory “akin to inducement, where one party was responsible for directing others to perform the steps of the patented process.” 33 AIPLA Q.J. at 258. That theory could not apply here, however, where the distinct actors are in an arm’s-length business transaction. *See id.* at 260.

The unpublished trial court opinions on which Freedom has relied also emphasize that one entity must direct or control another entity’s performance of the claimed steps of a patent. *See Marley Mouldings Ltd. v. Mikron Indus., Inc.*, No. 02-C-2855, 2003 WL 1989640, at \*3 (N.D. Ill. Apr. 30, 2003) (addressing whether one party had “control over” the activities of another party); *Union Pac. Resources Co. v. Chesapeake Energy Corp.*, No. 4-96-CV-726-Y, 1998 WL 34359124, at \*3

(N.D. Tex. May 20, 1998) (requiring “performance of each step ... by the alleged infringer, its agent, or a party otherwise within its control”), *aff’d*, 236 F.3d 684 (Fed. Cir. 2001).

Here, however, Freedom failed to prove that any carrier’s actions were under BCGI’s direction and control or *vice versa*. BCGI developed and designed its service bureau independently of the carrier defendants. A30216-17(44-45). Indeed, BCGI had offered to provide prepaid services to the carrier defendants’ main competitors, including Bell Atlantic Mobile. A6074-23,A8497-634,A30216-17(44-45),A30411(35),A30639(69).

Nor was there any evidence that any carrier directed or controlled BCGI in its operation, A30180(49),A30217(45),A30411(34-36),A30415(51), much less that BCGI controlled the *carriers* in any aspect of their provision of prepaid wireless services. As BCGI’s Chief Technology Officer testified:

Q. Did Boston Communications ever control or direct the carriers about how they should receive calls from their subscribers?

A. No.

Q. Or about how they should route the calls in operating their own networks?

A. No.

Q. Or whether or not they should use a particular component in getting that call before they send the signal to you?

A. No.

Q. And what about when the calls are returned, did you direct them as to how they should send the calls?

A. No.

Q. So whether they went directly within their own network or they went to a Local Exchange Carrier, that was the decision of your customers, not your decision?

A. That's correct.

A30180(50).

At most, the evidence showed that BCGI and the carriers communicated frequently in connection with BCGI's provision of services. But any service vendor must communicate with its customers—just as any participant in a product supply chain must communicate with upstream suppliers and downstream customers. Legally independent activities of this kind cannot satisfy any cogent direction-or-control standard of divided infringement.

**C. The Jury Was Improperly Instructed That Liability Could Be Imposed For Merely “Working Together.”**

Over Defendants' objections, the jury was not instructed on any elements that might allow BCGI and its customers to be treated as one entity under the law. Nor was the jury even instructed on the bare minimum of “direction and control” found in all cases that Freedom cites. Rather, the jury was twice instructed that, “if separate companies work together to perform all of the steps of a claim of a patent, the companies are jointly responsible, that is, responsible as a group for the infringement of the patent.” A31358(31-32),A31400-01(28-29).

Merely “working together” is a wholly inadequate predicate for patent infringement liability, much less for strict liability for direct infringement based in part on the actions of another independent party. Even if substantial direction and control might conceivably provide a sufficient reason to treat distinct legal entities as one under traditional principles—a doubtful proposition—a “working together” requirement would be met by virtually any arm’s-length relationship between vendors and their customers who independently practice distinct steps of a method patent. At a minimum, this court should announce standards requiring *both* direction and control *and* the specific intent required for other types of “vicarious liability for infringement” under § 271(b) or (c). A4096.

If this court announces such standards, it should nonetheless reverse and render judgment for Cingular. Freedom advanced no evidence to show direction and control after Cingular put Freedom on notice of the need to do so. A31276(35-36). At a minimum, a new trial under the correct standard should be ordered.

**D. Freedom’s Liability Theory Unfairly Prejudiced Defendants On All Damages Issues.**

The instruction on Freedom’s “joint infringement” theory of liability requires a new trial for an additional reason. The presentation of that theory prejudiced the jury’s reasonable royalty determination by blurring the distinction between (1) liability for infringement and (2) joint-and-several liability for damages once liability is established. Specifically, because Freedom’s theory required the jury to

collapse BCGI and Cingular into one entity for liability purposes, it encouraged the jury to do the same for damages.

And that is exactly what occurred. The court instructed the jury to consider “the amount which a prudent licensee who desired as a business proposition to obtain a license to make and sell the invention would have been willing to pay as a royalty and, yet, be able to make a reasonable profit.” A31362(48).<sup>5</sup> Yet Freedom implored the jury in closing to ignore the “little guy” and focus on “the big guy ... the one making billions of dollars.” A31339-40(185-86). The jury’s damages award exceeded BCGI’s prepaid revenues, confirming that the jury paid no attention to BCGI as an independent business concern.

The confusion engendered by Freedom’s novel liability theory encouraged the jury to improperly assess royalties on the aggregate revenues of both BCGI and the carrier defendants, although precedent limits the patentee to a single royalty for a single infringement. *See infra* IV.A. Consequently, even if this court affirmed the liability judgment, a new trial on damages would be required.

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<sup>5</sup> *See Hanson v. Alpine Valley Ski Area, Inc.*, 718 F.2d 1075, 1081 (Fed. Cir. 1983) (“That a reasonable royalty would leave an infringer with a reasonable profit ... is implicit ... .” (internal quotation marks omitted)).

## **II. Freedom’s Patent Claims Were Neither Invalid Nor Infringed By BCGI’s Service, And Freedom’s Patents Were Unenforceable, In Any Event, Because Of Inequitable Conduct.**

Cingular was held “jointly” liable with BCGI for “joint direct infringement.” Because BCGI thoroughly establishes how its service bureau is different from the asserted claims of Freedom’s patents and why the asserted claims are invalid, Cingular addresses those issues only briefly and otherwise relies on BCGI’s brief.<sup>6</sup>

### **A. BCGI’s Service Does Not Infringe The LEC Claims.**

Seventeen of the nineteen asserted claims that pertain to outbound calls (calls placed by a subscriber) require a direct connection between a host computer and a Local Exchange Carrier (“LEC”).<sup>7</sup> A100-08. BCGI’s service did not provide for calls to be directly connected to a LEC. A30172(18-19). Instead, it returned the calls to the carriers to handle. *Id.*

The jury was asked whether those seventeen claims were infringed by equivalents. That theory was precluded as a matter of law because, to obtain its patents, Freedom expressly disclaimed any connection other than a direct one between the host computer and the LEC. A7370.199. That prosecution history estopped Freedom from arguing that BCGI’s service (which does not have such a

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<sup>6</sup> Cingular also relies on BCGI’s brief with respect to the inequitable conduct issue.

<sup>7</sup> These were claims 10-14, 16, and 18 of the ’067 patent and 29-31, 34, 36, 39, 42, 53, 57, and 59 of the ’823 patent. A6012-13,A6026-31,A7027-838. The other two asserted claims pertaining to outbound calls were claim 15 of the ’067 patent and claim 35 of the ’823 patent. A6003,A6031.

direct connection) is equivalent. *See Canton Bio-Medical*, 216 F.3d at 1370.

**B. BCGI's Service Does Not Infringe The Periodic Validation Claims.**

Twenty-seven claims require a method that periodically validates the balance in the subscriber's account and incrementally reduces or "decrements" that balance while the call is in progress.<sup>8</sup> A124-31. BCGI's service does not do this. A30176(34). Instead, its service uses a computer timer that is "a software routine which is part of the Windows NT operating system developed by Microsoft." A30292(34). As a matter of law, because Freedom's patents relied on the distinction between "periodic validation" and prior-art timers (*see supra* at 7), Freedom should not have been permitted to assert that BCGI's service infringes any of the "periodic validation" claims literally or by equivalents.

**C. Certain Claims Are Invalid In View Of The Prior Art.**

Claim 15 of the '067 patent and claim 35 of the '823 patent do nothing more than identify a call as "prepaid" at the switch and route it to a service provider (A6028,A6031)—one of the three basic ideas reflected in Freedom's claims that its own expert admitted was obvious and not novel. A30320(144-45),A30815-16(144-49). The CSI-reseller-switch proposal and the evidence introduced about Cominex disclose this same idea and anticipate these two patent claims. A30824-25(13-

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<sup>8</sup> These were claims 10-14, 16 and 18 of the '067 patent and claims 2-3, 5, 9, 11-12, 15, 17, 19-20, 29-31, 34, 36, 39, 42, 53, 57 and 59 of the '823 patent, which included claims to both outbound (sent) and inbound (received) calls.

17),A30832(46-48).<sup>9</sup>

### **III. The District Court’s Erroneous Exclusion Of Evidence Of Prior Invention Entitles Defendants To A New Trial.**

#### **A. The Cominex Patent Application Demonstrated That Freedom Was Not The First To Invent What It Now Claims.**

If admitted, the Cominex application for a patent on a “Prepaid Radio Phone System,” A30783(18)—which was pending when Freedom applied for the ’067 patent—would have shown that Freedom was not the first inventor of what its patents claim, rendering the claims invalid. That is apparent from the comparisons between the Cominex application and some of the asserted Freedom claims as shown in Nextel’s and BCGI’s briefs. *See* Nextel Br. II.B; BCGI Br. IV.C.2.b. The district court nonetheless excluded the Cominex application as irrelevant. A8383-491,A8782-83. Here, Cingular focuses on the legal deficiencies of this exclusion and relies on the Nextel and BCGI briefs for their factual exposition.

This exclusion plainly prejudiced Defendants’ central defense of prior invention. Moreover, the district court based its adverse rulings on obviousness and anticipation on the evidentiary voids that the Cominex application would have filled. Exacerbating the harm, the court’s method of excluding the application neutralized Defendants’ *other* evidence that Freedom’s “invention” was not new because the Cominex system was marketed and tested before Freedom’s application

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<sup>9</sup> Cingular relies on but does not repeat BCGI’s argument that the district court

was filed. A31263(77-78). Specifically, after admitting the Cominex application *de bene*, the district court at the end of trial instructed the jury to disregard the application for all purposes. A172-73. That instruction unfairly cast doubt on the credibility of the other Cominex evidence.

**1. *The Cominex patent application was admissible as prior art under § 102(g).***

No one is entitled to a patent if “before such person’s invention thereof, the invention was made in this country by another inventor who had not abandoned, suppressed, or concealed it.” 35 U.S.C. § 102(g)(2). An invention is “made” if it had been conceived and either actually or constructively reduced to practice. *Cooper v. Goldfarb*, 154 F.3d 1321, 1327 (Fed. Cir. 1998).

The Cominex patent application “was a *constructive* reduction to practice” of the invention it disclosed “when it was filed.” *Rexam Indus. Corp. v. Eastman Kodak Co.*, 182 F.3d 1366, 1371 (Fed. Cir. 1999) (emphasis added). Defendants sought to introduce it both on that ground and as documentary evidence of *actual* reduction to practice. A31168.30-.40(30-39). The presumptive invention date of the Cominex invention was September 14, 1993—over a year before Freedom’s first patent application and earliest conception date. A30795(68). If admitted, the Cominex patent application would have established both the date and scope of invention for the Cominex system.

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misconstrued claim 15 of the ’067 patent.

**2. *The Cominex application was not abandoned.***

Erroneously concluding that the Cominex application had been abandoned, the district court excluded it from evidence not only under 35 U.S.C. § 102(g), but for any purpose. But the only relevant inquiry is whether the application was pending when Freedom filed its application.

The sole appellate authority makes the point succinctly: “abandonment [of an application] is irrelevant unless it occurred ‘before the [subsequent] applicant’s invention.’ [Section 102(g)’s] use of the pluperfect tense—‘had not abandoned’—plainly refers to an abandonment which occurred before the applicant’s invention.” *Allen v. W.H. Brady Co.*, 508 F.2d 64, 67 (7th Cir. 1974) (Stevens, J.); *see also Swift Agric. Chems. Corp. v. Farmland Indus., Inc.*, 499 F. Supp. 1295, 1299-300 (D. Kan. 1980), *aff’d*, 674 F.2d 1351 (10th Cir. 1982) (following *Allen*); *Leesona Corp. v. Varta Batteries, Inc.*, 522 F. Supp. 1304, 1338 (S.D.N.Y. 1981) (emphasizing the irrelevance of abandonment after a subsequent applicant filed with the PTO).

Here, the Cominex application was filed 15 months before Freedom’s, A30783(18), but was not abandoned until almost a year after the ’067 examination began. A4516. Accordingly, the Cominex application was a proper § 102(g) prior art reference and its exclusion from evidence was reversible error.

**3. *Freedom’s authority is inapposite.***

Freedom has relied on *In re Costello*, 717 F.2d 1346 (Fed. Cir. 1983), to argue that the Cominex application became inoperative as a constructive reduction

to practice under § 102(g) when it was abandoned. But *Costello* involved a different issue in a different context—whether, in light of 35 U.S.C. § 120’s copendency requirements, a patent *applicant* could use an earlier application *he* had filed but later abandoned in order to *avoid* (not establish) a prior art reference.

*Costello* recognized that an abandoned application is a constructive reduction to practice when it was filed, but held that, by abandoning the application, the *applicant* “abandon[ed] ... the *benefit* of that filing as a constructive reduction to practice.” 717 F.2d at 1350 (emphasis added). As *Costello* repeatedly noted, however, what restricts an inventor’s use of *his own* prior applications is § 120. *Id.* at 1347-48, 1348 n.1, 1350. In other words, § 120, not § 102(g), barred *Costello*’s attempt to antedate a § 102(e) prior art reference by relating his subsequent application back to his first. This distinction makes a difference because Defendants used the Cominex application not to secure their private interest in obtaining a patent, but to prevent Freedom from patenting public domain material. *See Rexam Industries*, 182 F.3d at 1370 (holding that a defendant’s ability to challenge the acquisition of an invalid patent furthers public policy and refusing to apply *Costello* outside of its limited context).

**4. *The Cominex application was admissible as documentary evidence of conception.***

Defendants also sought to admit the Cominex application as documentary evidence of conception, A8359, but the district court refused because the date of

conception was undisputed. A7873. This was error because the Cominex application also was offered to show the scope of what was conceived, A8359-60, a hotly contested issue. A30971-72(4-5),A31136(10-12),A31337(176-77).

**5. *The Cominex application was admissible to corroborate the testimony of the Cominex inventors.***

The Cominex inventors testified that they actually reduced the Cominex invention to practice, and explained the tests they used when they did. A4009-11(184-89),A4055(29-30). The Cominex application should have been admitted to corroborate the inventors' testimony, especially in light of Freedom's attacks on their credibility. A3987-88(19-20),A4053(47-48),A4058-60(76-79),A31025-26(64-65),A31028(4),A31128(74-75),A31129(78), A31136-37(12-13).

The district court misplaced its reliance on *Sandt Technology, Ltd. v. Resco Metal & Plastics Corp.*, 264 F.3d 1344, 1350 (Fed. Cir. 2001). *Sandt* sets forth "the standards by which to judge whether or not an inventor's testimony has been *sufficiently* corroborated," *id.* (emphasis added), not rules restricting the *admissibility* of corroborating evidence. Indeed, *Sandt* held that "[d]ocumentary ... evidence ... made contemporaneously with the inventive process," like the Cominex application, "provides the most reliable proof that the inventor's testimony has been corroborated" because "the risk of litigation-inspired fabrication or exaggeration is eliminated." *Id.* at 1350-51. The district court's refusal to admit the Cominex application for this purpose was error. A8091.

**B. The Cominex Application Was Independently Admissible To Show Obviousness.**

***1. The application evidences the motivation to combine and level of skill in the art.***

Defendants alternatively sought to introduce the Cominex application and its prosecution history for the limited purpose of showing motivation to combine and the level of skill in the art. A8358-59. The court erroneously excluded the Cominex application for this purpose based on a case that addressed a different issue: whether the Patent Act exempted abandoned patent applications from discovery under FOIA. *See Lee Pharmaceuticals v. Kreps*, 577 F.2d 610, 613 (9th Cir. 1978). The language in *Lee Pharmaceuticals* regarding the prior art status of abandoned patent applications is dictum and, in any event, does not address the question here because the Cominex application was offered not as a prior art reference, but instead was offered to reflect the level of skill in the art and the motivation to combine prior art. Evidence offered for those purposes need not be a prior art reference itself. *See Nat'l Steel Car, Ltd. v. Canadian Pac. Ry.*, 357 F.3d 1319, 1337-38 (Fed. Cir. 2004); *Med. Instrumentation & Diagnostics Corp. v. Elekta AB*, 344 F.3d 1205, 1220 (Fed. Cir. 2003); *Package Devices, Inc. v. Sun Ray Drug Co.*, 301 F. Supp. 768, 779 (E.D. Pa. 1969), *aff'd*, 432 F.2d 272 (3d Cir. 1970). For similar reasons, the district court also erred in excluding the Cominex patent's prosecution history, A8087-92, A8383, A8782-83, which was equally probative of the state of the prior art and the motivation to combine it.

**2. *The application demonstrates contemporaneous invention.***

Having concluded that the application was not prior art, the court refused to admit it as evidence of secondary considerations of obviousness, such as contemporaneous invention. But an application's status as prior art is irrelevant to its status as evidence of contemporaneous invention. *Monarch Knitting Mach. Corp. v. Sulzer Morat GmbH*, 139 F.3d 877, 884 (Fed. Cir. 1998). The court's exclusion of the Cominex application for this purpose was erroneous as well.

Because the Cominex application demonstrates that Freedom was not the first to invent what it now claims, the exclusion of the application on the § 102(g) issue was sufficiently prejudicial to warrant a new trial. Compounding that prejudice was the exclusion of the evidence on the § 103 issues of level of skill in the art, A8358-59, motivation to combine, and secondary considerations like simultaneous development. Because Defendants' invalidity arguments reach all asserted claims, the new trial should reach equally far.

**IV. The Damages Award Should Be Vacated And Remanded For A New Trial Or Massively Remitted.**

**A. Freedom Presented No Evidence That Carriers Would Pay A Use-Based Third-Party Royalty For A Vendor's Services.**

Because Freedom never practiced its invention, it disclaimed any damages other than the "reasonable royalty" provided in 35 U.S.C. § 284. A8777. Freedom's royalty witness, Parr, testified that a reasonable royalty for the 1998-2004 period would have been an unchanging 5¢ a minute per prepaid call for the life of the patent,

despite continually and sharply falling wireless service prices. A30574(90),A30587-89(4-12),A30592(22-23),A31174(11),A31183(46). That royalty would have been twice BCGI's revenues—a 200% royalty on BCGI's sales that far exceeded the total carriers paid for BCGI's services. *Infra* IV.B.1.b.

Parr opined that such a high royalty was reasonable because his “guess” was that BCGI could pass along the excess cost to its carrier customers. A30589(10), A30590(14). Parr's speculative theory thus created two royalties: one based on BCGI's business and one paid by the carriers. As Parr conceded, however, he had no idea whether the carriers could be required to fund the steep royalty he proposed. A30575(91).

Parr was right to characterize this as a legal question, *id.*, but the answer destroys his theory. As a matter of law, a patentee seeking a reasonable royalty is only entitled to a single royalty. Even if multiple entities successively infringe his patents, that “royalty is not to be separately calculated against each successive infringer” without evidence that such royalties customarily would be paid in the market. *Stickle v. Heublein, Inc.*, 716 F.2d 1550, 1562-63 (Fed. Cir. 1983) (following *Foster v. Am. Mach. & Foundry Co.*, 492 F.2d 1317, 1320-23 (2d Cir. 1974)).

In *Foster*, the plaintiff invented a welding device whose operation was covered by a method patent, and the defendant made welding systems that included the plaintiff's device as a component. Sixty-nine millers bought welding systems

from the defendant and infringed the patent by using the systems to produce welded tubes and pipes. The plaintiff sought a \$52 million royalty, which exceeded the defendant's associated revenues, claiming this was "reasonable" because it was merely 3% of the \$1.75 billion earned by the millers that infringed his patent. The district court rejected this theory and the Second Circuit affirmed because there was no historical evidence that the mill operators would be "willing[] ... to pay a running, or throughput royalty, based on their production, for rights to the welding process." 492 F.2d at 1321; *see also Tech. Licensing Corp. v. Genum Corp.*, No. 3:01-CV-4204-RS, 2004 WL 1274391, at \*8 (N.D. Cal. Mar. 26, 2004) (excluding expert testimony that considered the profit margins of the defendant's customers because the plaintiff provided no evidence suggesting that it could negotiate with an end-user rather than the defendant).

Here, Freedom presented no evidence that any of BCGI's customers would have paid a use-based "throughput royalty" to a third party to use BCGI's services. Nor is this surprising. Although BCGI provides a useful service, there are competing alternatives, *infra* IV.B.1.b, and BCGI's operations constitute a small component of the multibillion-dollar infrastructure needed to provide nationwide cellular service. Under such competitive conditions, BCGI could not pass along significant IP-related costs. Unrebutted evidence showed that, as a matter of standard industry practice, carriers would never even negotiate—let alone pay—use-based, third-party royalties when contracting for a vendor's service.

A31080(29-30), A31091(75-76),A31101(113-14). Indeed, they required BCGI to indemnify them for IP litigation risks. A8688,A30727(105).

Because a purported expert may not opine—let alone speculate—that a vendor can simply pass along royalties without evidence that a pass-through is feasible, a new trial on damages or substantial remittitur is warranted.

**B. The District Court Erroneously Admitted Evidence That Sought To “Justify” An Unreasonable Royalty By Unreliable Methods.**

A reasonable royalty is one that a reasonable licensor and licensee could agree upon in a hypothetical negotiation before the period of infringement. *See Riles v. Shell Exploration & Prod. Co.*, 298 F.3d 1302, 1311 (Fed. Cir. 2002). One of the relevant *Georgia-Pacific* factors used to determine a reasonable royalty is the opinion testimony of qualified experts. *Georgia-Pacific Corp. v. United States Plywood Corp.*, 318 F. Supp. 1116, 1120 (S.D.N.Y. 1970), *modified & aff’d*, 446 F.2d 295 (2d Cir. 1971). For expert testimony to be admissible, however, it must be both relevant and reliable. *See* FED. R. EVID. 702; *Daubert*, 509 U.S. at 589.

An expert may help a jury understand what royalty could have been agreed upon by the parties in a hypothetical negotiation. But such expert testimony must be based on “sound economic and factual predicates” to be reliable. *Riles*, 298 F.3d at 1311. “To prevent the hypothetical from lapsing into pure speculation, this court requires sound economic proof of the nature of the market and likely outcomes with infringement factored out of the economic picture.” *Grain Processing Corp. v. Am.*

*Maize-Products Co.*, 185 F.3d 1341, 1350 (Fed. Cir. 1999). Consequently, economics-based expert testimony about a reasonable royalty must use reliable economic methodology and reliable underlying data.

The Supreme Court has identified several factors to assess the reliability of methodology: whether the method has been or can be tested; whether it has been published and peer-reviewed; its known or potential rate of error; and the extent to which it is generally accepted by a relevant, identifiable scientific community. *Daubert*, 509 U.S. at 593-94.

The same principles apply to the assessment of the reliability of the underlying data. In addition, courts must consider all other applicable rules of evidence. Thus, if the underlying data is hearsay, it must be ““of a type reasonably relied upon by experts in the particular field in forming opinions or inferences upon the subject.”” *Id.* at 594 (quoting FED. R. EVID. 703). Likewise, because “[e]xpert evidence can be both powerful and quite misleading,” a trial court must “exercise[] *more* control over experts than over lay witnesses” when balancing relevancy and unfair prejudice under Federal Rule of Evidence 403. *Id.* at 595 (internal quotation marks omitted, emphasis added).

Parr’s testimony proposing a royalty of an unchanging 5¢ per minute was inadmissible because it was derived through a methodology that was unreliable on two dimensions and was “justified” by four unreliable calculations and comparisons. The district court thus abused its discretion by denying Defendants’

motion to exclude Parr’s methodology under *Daubert*. A8492-93,A30574(89-90).

Indeed, the abuse of discretion is manifest because the court mistook Defendants’ *Daubert* challenge for merely an attack on Parr’s *qualifications* and would not rule on Defendants’ *methodology* objections before letting Parr testify. The court thus abdicated its gatekeeping responsibility, instead adopting a “wait-and-see” attitude:

MR. SALMON: Your Honor, I just wanted to note for the record we have filed a *Daubert* motion on this witness. Based on the factors in that motion—

THE COURT: I’m going to overrule that. He seems to be an expert.

MR. SALMON: It’s not his expertise; it’s his methodology that he used.

THE COURT: Well, we’ll see.

A30574(90). *See* A30620-21(135-36) (denying Defendants’ later motion to strike).

***1. Freedom derived its proposed royalty using unreliable methodology.***

a. *Failure to consider falling per-minute prices.* Parr agreed that in a hypothetical negotiation in 1998, all parties would know that per-minute charges for wireless services were plummeting. A30611(98). Parr also acknowledged that the economic benefit of an invention should be shared between the licensor and licensees, with the licensor receiving, at most, 25-33% of that benefit. A30588(5-6).

A rational negotiation against a backdrop of falling per-minute prices could not result in a long-term contract based on a fixed per-minute price. A31142-43(36-

37). Such a contract places all of the burden of falling prices on the licensee, but when everyone knows prices will be falling, rational parties would divide the burden. *Id.* Thus, a rational negotiation for a long-term contract would determine price using a metric other than minutes (such as revenues). *Id.* Parr provided no economic basis why rational parties would voluntarily enter a long-term contract with a fixed per-minute price in such a situation. Rather, he simply insisted that Freedom was entitled to be “protected from those decreases ... under [his] fixed flat five cents per minute,” A30611(97), even though “everybody knew prices were coming down,” A30611(98). Indeed, he even speculated that the same 5¢/minute royalty would be “reasonable” whether the hypothetical negotiation took place in February 1998 or nearly three years later in December 2000, although prices continually fell in the interim. A30610(95).

b. *Failure to consider substitutes.* If Parr’s proposed royalty were applied to the minutes of service provided by BCGI during 1998-2004, the resulting royalty would be approximately \$250 million. That royalty is twice BCGI’s prepaid gross revenues. A31156(90-91). Because Parr could not justify that result, he assumed that BCGI could pass along the royalty to its carrier customers. A30589(10). But that assumes, in turn, that BCGI’s ability to charge carriers for its service was insensitive to price competition from other forms of prepaid wireless service.

Such an assumption might be warranted where a product has “market power,” so that demand barely falls when prices rise. But even for patented

products, market power is the exception, not the rule, and cannot be presumed. *Ill. Tool Works Inc. v. Indep. Ink, Inc.*, 126 S. Ct. 1281, 1293 (2006). Here, Freedom presented no evidence that BCGI's service had market power.

To the contrary, undisputed evidence demonstrated that BCGI was highly sensitive to competition. First, BCGI lost business to at least four other forms of competing prepaid wireless service, including metered billing, and handset-, switch-, and network-based solutions. A30724-26(96-100,103-04), A30755(64).

Second, during the relevant time frame, three of the four largest prepaid service providers did not use BCGI. A31174(10). In fact, the largest provider of prepaid wireless service was TracFone; Cingular had a royalty-free license to TracFone's technologies. A31082(38-39),A31155-56(87-88),A31215-19(5-21).

Third, the prices that BCGI charged carriers steadily fell from 6.4¢/minute in 1998 to 1.64¢/minute in 2004. A30459(30-31). Yet under Freedom's unproven theory, BCGI's service was so immune to competition that it could have charged 5¢ *more* per minute throughout this time period while maintaining demand. But if BCGI were underpricing demand so dramatically, its prices would not have fallen as they did.

Fourth, competition already prevented BCGI from passing along IP-related costs to carrier customers like Cingular Wireless. Rather, BCGI had to agree to indemnify them for any IP litigation risks. A8688,A30727(105).

Fifth, defense expert Hausman testified without refutation that a 5¢/minute

increase in BCGI's prices would have led to a 90% decline in demand based on the availability of substitutes. A31156(89-90).

Neither Parr nor the district court appreciated the crucial relevance of alternatives. The court flatly believed they were "not relevant" to damages here, A30726(102), and Parr ignored them for unsound reasons. For one, he presumed that a patent confers market power sufficient to give a patentee "equal bargaining power" in any hypothetical negotiation, A30576(96), which is wrong as a matter of law. *Illinois Tool, supra*. It also is wrong as a matter of fact because the existence of acceptable non-infringing substitutes means that the parties do not have equal bargaining power. Parr ignored the other successful prepaid alternatives, however, because he purportedly was told that none was "equivalent" to BCGI's service. A30597(44). That assumption was wrong because non-infringing substitutes like the leading service, TracFone, had all the functional features of Freedom's technology. A31095(90),A31177-78(24-26). Indeed, as explained below, the GTE system was viewed as *identical* to Freedom's yet not subject to any use-royalty based on Freedom's patents.

More fundamentally, Parr's analysis was wrong as a matter of law because the standard is not whether another product or service is identical, but whether it is an *acceptable* substitute. As this court has observed, "[w]ithout the infringing product, a rational would-be infringer is likely to offer an *acceptable* noninfringing alternative, if available, to compete with the patent owner rather than leave the

market altogether.” *Grain Processing*, 185 F.3d at 1351 (emphasis added). Thus, “only by comparing the patented invention to its *next-best available alternative(s)* ... can the court discern the market value of the patent owner’s exclusive right, and therefore his expected profit or reward ... .” *Id.* (emphasis added); *see also Zygo Corp. v. Wyko Corp.*, 79 F.3d 1563, 1571-72 (Fed. Cir. 1996) (availability of a non-infringing alternative is relevant to the royalty calculation because the defendant “would have been in a stronger position to negotiate for a lower royalty rate knowing it had a competitive noninfringing device ‘in the wings’”).

Indeed, the premise of the concept of “demand elasticity” is that non-identical products can be acceptable substitutes when price is considered. *See Litton Sys. Inc. v. Honeywell, Inc.*, 87 F.3d 1559, 1577 (Fed. Cir. 1996), *vacated on other grounds*, 520 U.S. 1111 (1997). But failure to consider demand elasticity renders expert testimony “speculative.” *Id.*

Parr also ignored the fact that BCGI had to agree to indemnify many of its customers for IP litigation risks in order to get those customers in the first place. A30614(109-10). Because this demonstrated BCGI’s relative inability to pass along IP costs to its customers, it reflected pricing pressure that Parr had to consider for his methodology to be reliable.

Finally, Parr failed to take into account Freedom’s actual expectations at the time of any hypothetical negotiations. Based on the investment report Freedom commissioned right before the March 1998 hypothetical negotiation considered by

the jury, Freedom only expected that carriers might pay a 1% royalty. A30515-16(16-17),A30542(119-20),A30548(145). Such a royalty would have totaled only \$14 million, a far cry from the \$250 million figure envisioned by Parr. A6639.

For these reasons, Parr’s opinion that a reasonable royalty for prepaid wireless service would have been an unchanging 5¢ per minute throughout the 1998-2004 royalty period was unreliable and inadmissible as a matter of law. This was harmful error because Parr’s testimony was the only evidence suggesting more than a \$24 million royalty, A31143(39), and because the “expert” label likely gave it a disproportionate impact on the jury.

**2. *Freedom supported its proposed royalty through unreliable calculations and comparisons.***

Parr tried to hide his methodological flaws by presenting several equations whose results fell in the 3¢-5¢ range. Although superficially supporting Parr’s conclusions, his methods were unreliable because they used irrelevant comparisons, unreliable source data, and inaccurate calculations.

**a. *Improper reliance on past licenses that did not generate actual royalties.***

Parr testified that a 5¢/minute royalty was justified because that was the “same” royalty Freedom’s predecessor Cellexis would have received from some of Cellexis’s licensees—if those licensees had been able to pay it. A30580-81(112-15).

When determining a reasonable royalty, a factfinder may consider past

royalties “actually received” because such royalties can reflect an “established royalty.” *Georgia-Pacific*, 318 F. Supp. at 1120. But while Freedom may have hoped for 5¢/minute royalties, it never “actually received” any. Parr thus had to admit that “there was no established royalty ... for these patents.” A30580(112-13). Given Parr’s concession, his reliance on the unrealized expectations of four companies—including some that went bankrupt—was an unreliable basis for any “expert” economic opinion.

b. *Freedom’s ill-founded cost-savings “rule of thumb.”* Parr testified that a 5¢/minute royalty was justified because prepaid phone service cost 14.5¢/minute less than postpaid phone service (based on calculations by Harris, another Freedom witness, discussed *infra* IV.B.3) and because 33% of those cost-savings would be an appropriate royalty based on a generic “rule of thumb.” Parr then multiplied 33% by 14.5¢/minute to get a royalty of 4.8¢/minute. A30588-89(8-9).

First, the only relevant comparison is between prepaid calls using Freedom’s technology and prepaid calls using other technologies, to isolate any cost advantage potentially attributable to Freedom’s patent. *See Georgia-Pacific*, 318 F. Supp. at 1120 (factor nine: “The utility and advantages of the patent property over the old modes or devices, if any, that had been used for working out similar results.”).

Second, Harris’s determination of prepaid service costs was unreliable because it encompassed all means of providing prepaid service, *infra* IV.B.3.a, rather than targeting the purported cost-advantage of Freedom’s patent. *Cf. Riles*,

298 F.3d at 1312 (rejecting plaintiff’s royalty model where it failed to “associate his proposed royalty with the value of the patented method” but instead associated it with “unrelated cost[s]”).

Finally, Parr’s methodology was unreliable because it relied on Harris’s inaccurate calculations and unreliable foundational data. *Infra* IV.B.3.b.-c.

c. *Freedom’s unreliable profit-margin “rule of thumb.”* Parr further justified a 5¢/minute royalty by applying a generic “rule of thumb” royalty of 33% of profits to the 19.6% profit margin that Harris identified for prepaid phone service. Parr then multiplied 19.6% by 33% by 48¢/minute to get 3.1¢/minute. A30588(6). Setting aside the 61% difference between 3.1¢ and 5¢, Parr’s model was unreliable because Harris derived his prepaid profit margin from unreliable foundational data. *Infra* IV.B.3.b.

Parr’s model was additionally unreliable because Defendants’ average per-minute charge for prepaid phone service during 1998-2004 was far less than 48¢. A30608(85-86). Parr erred by taking a simple average of the carriers’ average charges, rather than taking a weighted average of those averages.

With respect to only Cingular Wireless, this produced an error of nearly \$130 million. Between 2001 and 2004, it earned \$928 million in revenues on 3.75 billion minutes in prepaid calls that BCGI processed. A30432-33(48-49). A 5¢/minute royalty on those minutes would be \$188 million, yet Parr’s underlying “profit margin” formula produces a \$60 million royalty: \$928 million in revenues  $\times$

Harris's 19.6% prepaid profit margin  $\times$  Parr's 33% rule of thumb.

d. *Freedom's proposed "profit differential" gave the licensor the entire economic benefit of any invention.* Parr also justified a 5¢/minute royalty by multiplying an assumed 48¢/minute average charge for prepaid service by the 8.3% by which Harris claims the profit margin for prepaid service exceeded that for postpaid service.

Although this produced a 3.8¢/minute royalty, A30589(9), Parr opined that it justified a 5¢ royalty as the profit attributable to Freedom's invention. This calculation shares several of the flaws noted above: it does not compare prepaid service using Freedom's patent with other prepaid service; it uses a prepaid profit margin that encompasses all methods of providing prepaid service; and it uses a non-weighted average of 48¢/minute.

Finally, by taking the entire profit difference as a royalty, Parr's calculation awards the entire marginal economic benefit of the invention to the licensor, rather than splitting it between the licensor and licensee. But no reasonable licensor would demand a royalty that offers nothing to the licensee: there would be no takers.

In sum, Parr exposed the jury to four unreliable calculations to justify a royalty derived from an unreliable method that ignored acceptable substitutes and falling prices. A30574(90-132),A30587-91(4-18),A30616-20(116-33,135). Each of these six flaws warrants a new trial on damages; together, they demand it.

**3. *Freedom's profit and cost calculations were based on unreliable methods, unreliable data, and miscalculations.***

Rather than use actual audited financial data from the full 1998-2004 period to compute profit margins for BCGI's prepaid services, Harris, a non-economist, A30605(74), calculated a generic profit margin—ostensibly good for any year and any company—by using data from a 2003 non-industry source plus one variable from a 2002 industry source. Harris used this formula:

$$(r - (c + o \times h)) \div r$$

*c* represents monthly customer costs, *r* represents monthly customer revenues, *h* represents churn, and *o* represents startup and fixed costs.<sup>10</sup> A30441-43(81-88).

For prepaid service, Harris used the following values:

$$c = \$11.25 \text{ (costs per customer per month)}$$

$$r = \$25 \text{ (revenues per customer per month)}$$

$$o = \$119 \text{ (startup and fixed costs per customer)}$$

$$h = 7.42\% \text{ (monthly churn)}$$

The first three figures came from a 2003 Morgan Stanley investment report and the fourth from a 2002 Cellular Telephone & Internet Association (CTIA) semi-annual report. A6335-38,A8650,A8655,A30445(95),A30446(101),A30448-49(109-13), A30479(106). For postpaid services, Harris took the following numbers from

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<sup>10</sup> As used here, *o* includes capital expenditures and costs expended in acquiring a new customer.

another investment banking source:

$c = \$29$  (costs per customer per month)

$r = \$56.85$  (revenues per customer per month)

$o = \$718$  (startup and fixed costs per customer)

$h = 2.9\%$  (monthly churn)

A30454(9-10).

Using the stated formula, Harris disregarded industry experience and expert testimony that prepaid was either unprofitable or barely profitable compared to postpaid service, A31060(91-92), A31158(98), and testified that prepaid profit margin was 19.6% and postpaid profit margin was 11.6%.<sup>11</sup>

a. *Unreliable Methodology.* Harris had no basis to conclude that a model based primarily on 2003 figures could generate a representative picture of the ever-changing wireless markets throughout the 1998-2004 period.<sup>12</sup> The Morgan Stanley report itself stated that prepaid had been a failure domestically until 2003, A30472(83-84), undermining any basis to use its numbers to color the past as highly profitable.

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<sup>11</sup> A30454(12). Harris also made an arithmetic error, as the given formula yields a 12.4% postpaid profit margin, not 11.6%, when using Harris's inputs.

<sup>12</sup> *Riles*, 298 F.3d at 1313 (“A reasonable royalty determination for purposes of making a damages evaluation must relate to the time infringement occurred, and not be an after-the-fact assessment.”); *Hanson*, 718 F.2d at 1079 (“The key element in setting a reasonable royalty ... is the necessity for return to the date when the

In addition, as noted above, the relevant inquiry for several of Parr’s analyses was the profitability of BCGI’s prepaid service. Yet Harris’s model did not purport to assess BCGI’s profitability, but lumped together all forms of prepaid wireless services: hotlining, metered billing, handset chips, and other network solutions. For these reasons, Harris’s profit-margin methodology was inherently flawed, and the district court erred in allowing his testimony over objection. A30423-24(9-13),A30445-51(95-121),A30452-57(4-21),A30481-86(114-36).

b. *Unreliable Data.* The accuracy of the Morgan Stanley data was not testable because the report provided neither its sources nor its method for obtaining the data. A30471(78). As Harris conceded, none of the data he used came from any audited financial statements. A30471(79). The Morgan Stanley report also did not state the error rate in its data-collection methods, nor could that rate be otherwise calculated because neither the methods nor the data sources were revealed. A8648-76. Indeed, the report warned that it did not represent that the information in it was accurate or complete. A30471(79).

Nor did Freedom present any evidence that the Morgan Stanley report, its method of data collection, or its underlying data had been peer-reviewed, or that such a report and its unstated methods were generally accepted for purposes of determining financial estimates with any degree of precision. On the contrary, the

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infringement began.”) (internal quotation marks omitted).

evidence indicated that the report was intended to generate investment interest in telecommunications companies for whom Morgan Stanley sold stock, A30472(81), not a scientifically objective purpose.

For these reasons, Harris's reliance on the 2003 Morgan Stanley report was unreliable as a matter of law. *See Daubert*, 509 U.S. at 589-91. An expert's "work product simply does not withstand the basic test of reliability" when he "simply adopt[s] [a secondary source] without reviewing its underpinnings." *Chemipal Ltd. v. Slim-Fast Nutritional Foods Int'l, Inc.*, 350 F. Supp. 2d 582, 589-90 (D. Del. 2004). Moreover, an expert's "lack of familiarity with the methods and the reasons underlying" his data sources "virtually preclude[s]" effective cross-examination; thus, lacking "evidence that other experts in his field would rely on such a study and would adopt it for purposes of forming an opinion" on the same topic, the study and any conclusions based on it should be excluded. *TK-7 Corp. v. Estate of Barbouti*, 993 F.2d 722, 732-33 (10th Cir. 1993). Finally, Harris's own reliance on the Morgan Stanley report is inadequate as a matter of law to demonstrate its reliability. The reliability of information must be established by an "objective standard beyond the opinion of the individual witness." *Id.* (citing 3 J. Weinstein & M. Berger, *WEINSTEIN'S EVIDENCE* ¶ 703[03], at 703-25 (1988)).

Similarly, the figure Harris used for churn was unreliable because the CTIA report did not reveal the method, rate of error, and source for that figure, rendering it untestable. Nor was there any evidence that such a report was generally accepted

for calculating the profitability of a wireless service with any degree of precision. Nor was there any evidence that one number in a 2002 report could fairly represent churn across a multi-year period, especially in the face of unrebutted evidence that prepaid churn rates had been much higher during that period. A30478-79(105-06,108-09),A31078(21-23),A31206(138). Small changes in the churn assumption produce extreme changes in profitability. For example, increasing churn by only 2 percentage points (from 7.42% to 9.42%) reduces the prepaid profit margin in Harris's model nearly 50% (from 19.6% to 10.2%), resulting in a profit margin lower than the postpaid profit margin. For these reasons, Harris's profitability models and conclusions were unreliable as a matter of law.

*c. Inaccurate Cost Calculations.* Harris testified that prepaid service cost carriers 14.5¢/minute less than postpaid service. He reached this result by taking his estimated difference in monthly costs for postpaid and prepaid service (\$18.08)<sup>13</sup> and dividing that by 125, which he estimated to be the average number of minutes used by a prepaid customer based on the Morgan Stanley report. A30455(13). But this calculation overestimates any differences between prepaid and postpaid costs because it does not take into account Harris's own assumption that postpaid customers use 383 minutes per month. *Id.* With that adjustment,

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<sup>13</sup> Harris's prior cost assumptions, *supra* at 52-53, reflect a difference in monthly costs of \$17.75, which he viewed as comparable to the \$18.08 figure here. A30455(13).

Harris's data suggest that prepaid service costs more than postpaid service on a per minute basis, not less.<sup>14</sup>

In sum, Freedom's damages experts presented unreliable expert testimony to make a legally excessive royalty appear reasonable. The trial court thus erred in refusing to exclude or strike their testimony. Without that testimony, the only evidence of a reasonable royalty would have resulted in, at most, a verdict of \$24 million (BCGI's total prepaid profits) rather than the \$128 million actually entered. For these reasons, a new trial or substantial remittitur is necessary.

**C. The District Court Erroneously Excluded Evidence That A Competitor, GTE, Had A Royalty Free License To Use Freedom's Technology.**

During the royalty period, non-defendant carrier GTE had the right to practice Freedom's patents and compete with Cingular and BCGI in the prepaid marketplace without paying a royalty. A24122-23,A31155(85-86). GTE's no-royalty presence necessarily limited what BCGI or its carrier customers could pay as a royalty while remaining competitive. Indeed, even without paying a royalty to Freedom during that time period, BCGI lost carrier business to GTE. A31096(94).

The jury never heard this. Instead, the district court excluded all evidence that a royalty-free license had existed because GTE had obtained it in connection

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<sup>14</sup> Using Harris's prior cost and churn assumptions, *supra* at 52-53, and usage assumptions (in the text above), prepaid service would cost 16.1¢/minute versus 13.0¢/minute for postpaid service based on the following formula:  $(o + c \div h) \div (m$

with a litigation settlement. Dist. Ct. Order (Feb. 17, 2005); A30621(136), A31168.11-.28.

But Defendants did not ask to show that Freedom had granted a license to settle baseless litigation. Instead, Defendants sought to introduce only the fact that one of their competitors, with no royalty obligation, was marketing services “identical” to those in Freedom’s patents. A30531(78),A31168.14-.19(14-19), A31617(52),A31694(113). The existence of that non-infringing alternative was admissible to demonstrate the competitive pricing pressure GTE exerted. *Zygo*, 79 F.3d at 1571-72; FED. R. EVID. 401-403, 408. BCGI could not pass along higher prices to the carriers with a competitor waiting “in the wings,” *Zygo*, 79 F.3d at 1571-72, especially one like GTE that was already taking away business.

Because a jury considering such evidence may have awarded a substantially lower royalty, the exclusion of this evidence was harmful and warrants a new trial on damages.

**D. The Court Improperly Awarded Damages Outside The Royalty Period.**

Although the royalty period ended in 2004, A31174(12), the district court added nearly \$15 million in royalties to the jury’s verdict for the December 31, 2004 through September 1, 2005 period, apparently inferring a 2.5¢ per minute royalty for that period based on the jury’s verdict covering the 1998-2004 time

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÷ *h*), where *m* represents monthly usage in minutes.

period. A1. This was error. The jury made no finding of a reasonable royalty for the post-royalty period, A200-03, and, as explained above, a reasonable royalty on Freedom's patents would reflect the steeply declining prices in this industry.

Moreover, during trial, and unbeknownst to Cingular, BCGI, the court, or the jury, Freedom was negotiating a patent license with another company, Convergys. A8372-76,A8791-97,A8814-16. The terms of these licenses, including the royalty rates, *see id.*, were consistent with the testimony of Defendants' experts, and considerably lower than any rate implicitly determined by the jury or proposed by Freedom's experts. A31159-60(101-04). The court, however, refused to consider this newly-discovered evidence for any purpose, Dist. Ct. Order (Sept. 1, 2005), even though it removed the basis for the court's post-royalty-period additur. In addition, this newly-discovered evidence further confirmed Parr's unreliability. Freedom told the jury that Parr was better than Defendants' expert because Parr considered Freedom's actual licensing practices, A31343(200-01), yet Parr was not privy to what Freedom was doing all through trial.

**E. A New Trial Should Be Ordered On Damages Even If Liability Were Reversed Only On Freedom's Outbound Claims.**

As explained in Parts I-II, there is no basis for imposing liability in this case because the only theory on which such liability rests is not cognizable and because Freedom's patent claims are invalid and not infringed. Therefore, the judgment should be reversed as a matter of law. At a minimum, however, if the court accepts

the arguments in Parts II.A and II.C, the judgment should be reversed as to the outbound patent claims, which are covered by those arguments. *See also supra* at 30-31 nn.6-7 (categorizing the asserted outbound and inbound patent claims).

Such a reversal would support at least a 70% damages reduction because roughly 70% of the minutes BCGI processed were outbound calls. A31068(123). Yet even that relief would understate the extent to which the total damages award is infirm because an inbound-only prepaid service has less inherent value than one covering both inbound and outbound calls.

In addition, a reversal as to the outbound claims would negate any finding of infringement as to the asserted claims of the '067 patent. That would require a new trial on damages because a reasonable royalty based solely on the '823 patent would involve a hypothetical negotiation in December 2000, more than two-and-one-half years after the hypothetical negotiation considered here. *See Applied Med. Resources Corp. v. U.S. Surgical Corp.*, 435 F.3d 1356, 1361-62 (Fed Cir. 2006) (holding that a reasonable royalty determination requires a consideration of the actual time frame in which particular infringements occurred).

For these reasons, a new trial on damages would be required to re-determine a reasonable royalty.

## CONCLUSION

For these reasons, the court should reverse the district court's judgment and enter judgment in Cingular's favor. Alternatively, the court should reverse and

remand the case for a new trial on some or all issues. At a minimum, the court should order a substantial remittitur. Cingular also requests such other and further relief to which it may be entitled.

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Respectfully submitted,

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## **CERTIFICATE OF COMPLIANCE**

I certify that this brief meets the type-volume requirements of Federal Rule of Appellate Procedure 32(a)(7)(B)(i). The length is 13,789 words.

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## CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing **CORRECTED BRIEF FOR CINGULAR WIRELESS LLC, AT&T WIRELESS, AND CMT PARTNERS** was served on May 1, 2006 by email and Federal Express on the counsel of record listed below.

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