IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF TEXAS
AUSTIN DIVISION

NANO-PROPRIETARY, INC.,
Plaintiff,

-vs-

Case No. A-05-CA-258-SS

CANON INC. and CANON U.S.A., INC.,
Defendants.

ORDER

BE IT REMEMBERED on the 30th day of April 2007 the Court reviewed the file in the above-styled cause, specifically Canon's Motion to Preclude the Report and Testimony of Dr. James V. Koch [103] and the response and reply thereto [123, 139]; Nano's Motion to Exclude, in part, the Expert Testimony of Raymond Sims [114] and the response and reply thereto [131, 143]; and Canon's Supplemental Motion to Preclude the Reports and Testimony of Dr. James V. Koch [201] and the response and reply thereto [224, 228]. Each party seeks to exclude its opponent's expert testimony on damages.

Federal Rule of Evidence 702 allows expert opinion testimony when specialized knowledge will assist the fact-finder in understanding the evidence. To be admissible, the expert must be qualified and his opinion must be both relevant to the case and sufficiently reliable. *Kumho Tire Co. v. Carmichael*, 526 U.S. 137, 152 (U.S. 1999). None of the present motions to exclude raises serious challenges to the qualifications of the experts in this case, but both sides challenge the relevance and reliability of the other's experts. For the reasons that follow, all motions to exclude expert testimony are DENIED.

Relevance

Relevant evidence is "evidence having any tendency to make the existence of any fact that is of consequence to the determination of the action more probable or less probable than it would be without the evidence." FED. R. EVID. 401. One of the central "facts of consequence" in this case is the amount of damages to which Nano may be entitled for Canon's impermissible sublicensing activity. As Nano argues, the right to license the patents was a "lost asset," whose value is the value at which the right would have changed hands between a willing buyer and a willing seller at the time of the breach. *Schonfeld v. Hilliard*, 218 F.3d 164, 172 (2d Cir. 2000). To put it plainly, relevant evidence regarding damages in this case is evidence that tends to establish the value at which the right to grant licenses to third parties would have changed hands between Nano and Canon at the time of the breach.

Nano argues that Canon's damages expert, Raymond Sims, has conducted an analysis of Canon and Nano's initial negotiations that is irrelevant because it does not refer to the actual time of the breach. However, Nano asserts Canon began to breach the license around June of 1999, when Canon began joint development of SED technology with Toshiba. Only a few months earlier, in March of 1999, Nano and Canon negotiated for the sale of an IP package that included the right to sublicense Nano's patents. This negotiation, though unsuccessful, is relevant to the issue of what price the parties would have put on the right to sublicense at the time of the breach in June of 1999. Even if, as Nano alternatively contends, the breach occurred as late as 2004 (when SED was incorporated), the original negotiations regarding the right to sublicense are relevant to the value of that right at a later date. The passage of time goes to the weight, not the admissibility, of this opinion.

Canon objects to Nano's damages expert, Dr. James Koch's analysis of the value of the right to license to SED based on a royalty stream calculated from SED's projected future sales of display panels and television sets. Among other challenges to this analysis, Canon contends the projected value of sales of television sets (which inflates the total amount at stake) is irrelevant because there is no evidence SED ever intended to sell television sets or any product other than display panels. However, the numerous press releases entered into the record in this case consistently refer to Canon and Toshiba's joint venture plans to make SED televisions. *See, e.g.* Pl.'s Resp. Ex. A, D. Therefore, the use of the license to make flat panel televisions in the future may be relevant to the value of the right to license.

Though relevant, the value of future sales of flat panel displays and television sets is not the value of the lost asset in this case. The Court cautions Nano that a "lost asset" claim is not simply a "lost profits" claim in different clothing. As the *Schonfeld* court explained, "the market value of an income-producing asset is inherently less speculative than lost profits because it is determined at a single point in time. It represents what a buyer is willing to pay for *the chance to earn* the speculative profits." 218 F.3d at 177. Accordingly, though Koch's expert analysis of "the profit Canon expected to earn on its sales of flat panel displays and flat panel television sets based upon Nano's intellectual property" is admissible as evidence *relevant to* the value of the right to license, it is not admissible as an estimate of the value of the lost asset. The question is not what profit Canon expected to make from licensing the patents, but what Canon and Nano would have agreed on as a fair price for the "chance to earn" these profits. *Id.* It appears, however, that Koch is only offering the profit estimates as relevant information, not as estimates of the actual value of the right to license, and the evidence is therefore admissible.

Reliability

Both motions to exclude assert that the expert testimony is unreliable. To be sufficiently reliable, Rule 702 requires that the expert's testimony (1) be based on sufficient facts or data, (2) be the product of reliable principles and methods, and (3) that the expert has reliably applied those principles and methods in this particular analysis. FED. R. EVID. 702. The Supreme Court has established several nonexclusive factors to consider in evaluating the reliability of expert testimony, *Daubert v. Merrell Dow Pharms.*, 509 U.S. 579 (1993). These factors include 1) whether the expert's underlying theory or technique can be or has been tested; 2) the known or potential rate of error of the technique and the existence of control standards; 3) whether the theory or technique has been subjected to peer review and publication; 4) whether the theory or technique is "generally accepted" in the relevant scientific community; and 5) whether the opinion is based on sufficient facts or data. *Id.*

Nano moves to exclude Canon's damages expert testimony as unreliable on grounds that Sims' calculation of damages based on the factors outlined in *Georgia Pacific Corp v. US Plywood Corp*, 318 F.Supp. 1116 (S.D. N.Y. 1970), is contrary to New York law governing breach of contract claims. Plaintiffs further argue that Sims should have calculated the damages as of 2004, when the breach took place, rather than in 1999, when Canon negotiated its deal with Nano and allegedly concealed its parallel negotiations with Toshiba.

Both of these arguments are without merit. The *Georgia-Pacific* factors are a well-established method of calculating royalty damages, and Plaintiffs' own expert (Dr. James Koch) offers an "estimated royalty stream" as a means of calculating the value of Nano's lost asset, relying in part on those same factors. The timing of Sims' damages analysis is appropriate because,

although Plaintiffs allege the licensing agreement was breached in 2004, they allege it was fraudulently induced in 1999 *and* that Canon immediately began sharing the license with Toshiba through its joint development project. Therefore, the damages (if any) from the fraudulent inducement may be calculated from 1999. Moreover, as discussed above, negotiations that took place between the parties in 1999 seem relevant to establish the value of the right to sublicense at the time of the 2004 breach. The passage of time goes to the weight of this evidence, not its admissibility.

Canon moves to exclude Koch's testimony as unreliable. Koch offers a single estimate of the value of the lost asset in 2004 at the time SED Inc was incorporated as a nominal subsidiary of Canon (the time of breach). This number is based on a "convergence" model, where Koch compares the value of the Nano patents to Nano, to Canon, and to the equity market. He incorporates six estimates of the value of the patents. Estimates one and two calculate the present value of the royalties Nano has lost because of Canon's wrongful conduct (one estimate is based on royalties from sale of displays, one is based on royalties from sale of televisions). Estimates three, four, and five calculate the profit Canon expected to earn on its assets and sales of flat panel displays and television sets because of SED's use of Nano's intellectual property (one estimate is based on the sale of both televisions and panel displays, one is based on the sale of panel displays alone, and one is based on the sale of televisions alone). Finally, estimate six calculates the value placed on Nano's intellectual property by the equity market by measuring fluctuations in Nano stock allegedly caused by public announcements regarding Canon/SED. Koch argues that, by comparing these estimates, which represent the value of the licensed patents to Nano, to Canon, and to the market, one can

arrive at a midpoint at which Nano would have been willing to sell the rights and Canon would have been willing to buy them.

Canon first argues that Koch's overall theory of a buyer-seller convergence model is flawed. However, Koch's theory is drawn from published and generally accepted sources (he relies on the theories of Richard Razgaitis, Gordon V. Smith, and Russell L. Parr). Canon articulates no reason why this theory would be inapplicable to the facts of this particular case.

Canon next attacks Koch's estimates of Nano's lost royalty stream, arguing that there is no evidence SED would have purchased a license with a running royalty from Nano. Since the evidence is that Canon included the right to use the Nano patents in the IP it contributed to SED, however, Canon's argument is without merit. SED actually had a license from Nano— the question is what the value of that license was. To arrive at the royalty amount, Koch relies on evidence that Canon and Toshiba cross-licensed the intellectual property each contributed to SED at a royalty rate of 3-5%. Since the right to use the Nano patents is among the intellectual property Canon to the SED joint venture, this information is relevant to establishing the value of the right to license Nano's patents.

Canon further argues that Koch's estimate of the value of the royalty doesn't take into account all necessary factors. However, this argument can easily be explored both on cross examination of Koch and on direct examination of Sims, who offers a competing royalty analysis. Koch's royalty estimates are admissible.

Canon next argues Koch's estimate of the value of Nano's intellectual property in the equity market is flawed for two reasons. First, Canon argues that market "event studies" are not admissible as a measure of damages outside of securities fraud cases. Canon is correct that a drop in Nano's

stock prices is absolutely not a measure of the lost asset in this case. Koch argues, however, that the market event study is relevant to determining the value of the lost asset. His theory is that the "convergence" point between buyer and seller should be close to the objective value of an asset in the marketplace. Therefore, the fluctuations in the market value of Nano's stock as investors learned of Canon and SED's interactions with Nano is relevant to establishing the value of Nano's intellectual property.

Canon next objects that the event study methodology is flawed, because it covers a longer "event window" than normal in this field and because it fails to take into account other possible causes of fluctuation in Nano's stock price. However, these are issues that can be easily brought to the fact-finder's attention on cross examination, and they go to the weight of Koch's testimony rather than its admissiblity.

Accordingly,

IT IS ORDERED that Canon's Motion to Preclude the Report and Testimony of Dr. James V. Koch [103], Nano's Motion to Exclude, in part, the Expert Testimony of Raymond Sims [114], and Canon's Supplemental Motion to Preclude the Reports and Testimony of Dr. James V. Koch [201] are DENIED.

SIGNED this the 30th day of April 2007.

Sam Sparks

SAM SPARKS
UNITED STATES DISTRICT JUDGE