SCO Grp v. Novell Inc Doc. 658

WORKMAN | NYDEGGER A PROFESSIONAL CORPORATION
Sterling A. Brennan (Utah State Bar No. 10060; E-mail: sbrennan@wnlaw.com)
David R. Wright (Utah State Bar No. 5164: E-mail: dwright@wnlaw.com)
Kirk R. Harris (Utah State Bar No. 10221; E-mail: kharris@wnlaw.com)
Cara J. Baldwin (Utah State Bar No. 11863; E-mail: cbaldwin@wnlaw.com)
1000 Eagle Gate Tower
60 E. South Temple
Salt Lake City, Utah 84111
Telephone: (801) 533-9800
Facsimile: (801) 328-1707

MORRISON & FOERSTER LLP
Michael A. Jacobs (Admitted *Pro Hac Vice;* E-mail: mjacobs@mofo.com)
Eric M. Acker (Admitted *Pro Hac Vice;* E-mail: eacker@mofo.com)
Grant L. Kim (Admitted *Pro Hac Vice*; E-Mail: gkim@mofo.com)
425 Market Street
San Francisco, California 94105-2482
Telephone: (415) 268-7000
Facsimile: (415) 268-7522

Attorneys for Defendant and Counterclaim-Plaintiff Novell, Inc.

IN THE UNITED STATES DISTRICT COURT

DISTRICT OF UTAH, CENTRAL DIVISION

THE SCO GROUP, INC., a Delaware corporation, Plaintiff, vs. NOVELL, INC., a Delaware corporation, Defendant.	Case No. 2:04CV00139 **MEMORANDUM IN SUPPORT OF NOVELL, INC.'S *DAUBERT* MOTION TO DISQUALIFY DR. GARY PISANO** Judge Ted Stewart
AND RELATED COUNTERCLAIMS.	

Dockets.Justia.com

TABLE OF CONTENTS

Page

I. INTRODUCTION AND SUMMARY OF ARGUMENT 1

II. ARGUMENT 3

A. Dr. Pisano Cannot Offer Opinion Testimony Based on a Survey He Knows Nothing About 3

B. The Survey Does Not Measure Demand 4

1. Demand Cannot Be Measured without Reference to Price 5

2. Demand Cannot Be Measured without Reference to Need 6

C. Dr. Pisano's Proxy Hypothesis Is Unfounded 7

D. Dr. Pisano's Opinion as to the Size of the Market Is Inadmissible under Rules 402 and 403 10

III. CONCLUSION 10

TABLE OF AUTHORITIES

Page(s)

Cases

Bogacki v. American Machinary & Foundry Co.,
417 F.2d 400 (3d Cir. 1969) 3

Claar v. Burlington N.R.R.,
29 F.3d 499 (9th Cir. 1994) 9

Coastal Oil & Gas Corp. v. Garza Energy Trust,
268 S.W.3d 1 (Tex. 2008)............ 5

Commissioner of Internal Revenue v. Shattuck,
97 F.2d 790 (7th Cir. 1938) 6

Crystal Semiconductor Corp. v. TriTech Microelec International, Inc.,
246 F.3d 1336 (Fed. Cir. 2001) 5

General Electric Co. v. Joiner,
522 U.S. 136, 118 S. Ct. 512 (1997)............ 3

Loctite Corp. v. National Starch & Chemical Corp,
516 F. Supp. 190 (S.D.N.Y. 1981) 4

Monolithic Power Systems, Inc. v. O2 Micro International Ltd.,
476 F. Supp. 2d 1143 (N.D. Cal. 2007) 6

Porter v. Whitehall Laboratories, Inc.,
791 F. Supp. 1335 (S.D. Ind. 1992)............ 9

Pro-Football v. Harjo,
284 F. Supp. 2d 96 (D.D.C. 2003)............ 4

Sheats v. Bowen,
318 F. Supp. 640 (D. Del. 1970)............ 3

The SCO Group, Inc. v. Novell, Inc.,
578 F.3d 1201 (10th Cir. 2009) 7

United States v. Massey,
594 F.2d 676 (8th Cir. 1979) 3

Statutes/Rules

Federal Rule of Evidence 402............ 10

Federal Rule of Evidence 403............ 10

Federal Rule of Evidence 702............ 3, 10

Federal Rule of Evidence 703............ 10

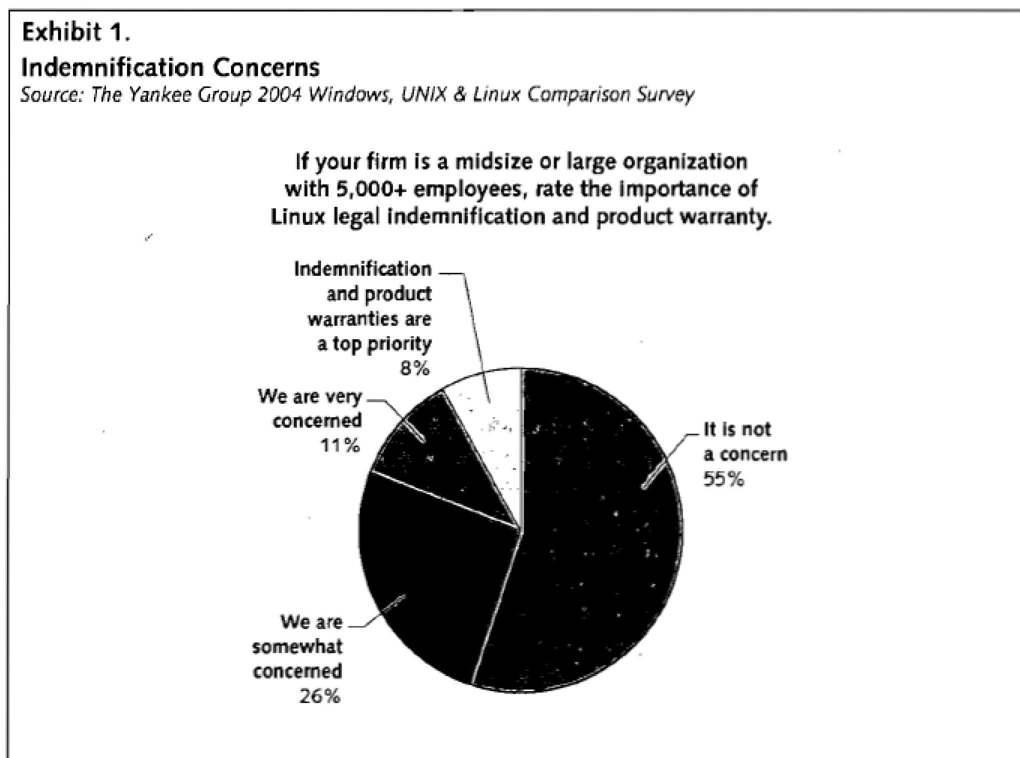
I. INTRODUCTION AND SUMMARY OF ARGUMENT

SCO sued Novell for allegedly interfering with its SCOsource licensing program, by which SCO has been trying to extract money from users of Linux operating systems. According to SCO, it would have made hundreds of millions of dollars from this program if Novell had not made known to those users that SCO does not have clear title to the copyrights on which it was threatening to sue them. SCO hired Dr. Gary Pisano to testify as to the unit volume of lost sales and Novell's supposed causation thereof, as follows:

- "The potential license market … includes approximately 7.4 million Server Operating Environment shipments"; and
- "SCO would have sold its SCOsource license to between 19% and 45% of the Linux Market, but for Novell's statements regarding copyright ownership."

(Expert Report & Decl. of Gary Pisano ["Report," reproduced as Ex. A hereto] at ¶¶ 12(a), (b).)

Dr. Pisano takes his market penetration figures from this chart, which appeared in a November 2004 publication by The Yankee Group (reproduced as Ex. B hereto):



Dr. Pisano arrives at 19% by combining the 8% for whom "[i]ndemnification and product warranties are a top priority" with the 11% who "are very concerned." (Report at ¶¶ 71, 74.) He gets to 45% by adding in the "somewhat concerned" respondents. (*Id.*) To this point, there is nothing very "expert" about Dr. Pisano's opinion; anyone can read numbers off a chart and add them together.

Dr. Pisano then hypothesizes that the importance of indemnification, as measured by the survey, is "an excellent proxy for those who would purchase a SCO RTU [right to use license]." (Ex. C at 65:1-3.) Having posited that proxy relationship, Dr. Pisano concludes that SCO would have sold licenses to all respondents concerned about Linux indemnification, thereby achieving between 19% and 45% penetration of the 7.4 million deployment market, but for Novell's publication of its rival claim to copyright ownership. (*See* Report at ¶12.)

As explained below, Dr. Pisano's opinion regarding market penetration is inadmissible for at least three reasons. First, his reliance on an irrelevant survey that he knows nothing about is impermissible. Second, because the survey is entirely insensitive to price and need, it cannot reliably gauge demand. Third, the proxy relationship he assumes is untenable, and ignores the most obvious alternative explanation for Linux users' decisions not to buy a SCO license—viz., as rational actors they had no incentive to pay SCO for partial indemnification that would have been redundant of full indemnification they were already given for free.

The foregoing is directed to Dr. Pisano's market penetration opinion. Without that opinion, Dr. Pisano's other opinion—viz., "The potential license market … includes approximately 7.4 million Server Operating Environment shipments"—is inadmissible under Federal Rules of Evidence ("Rules") 402 and 403 because the purported size of the market, taken alone, is irrelevant; and its introduction is likely to confuse the issues and mislead the jury regarding damages.

II. ARGUMENT

> If … specialized knowledge will assist the trier of fact … a witness qualified as an expert … may testify thereto in the form of an opinion or otherwise, if (1) the testimony is based upon sufficient facts or data, (2) the testimony is the product of reliable principles and methods, and (3) the witness has applied the principles and methods reliably to the facts of the case.

Rule 702. As set forth below, Dr. Pisano's opinions are inadmissible because they are not based on sufficient facts or data, or the product of any reliable principle or method, but are instead either borrowed from unverified and irrelevant sources or founded on his own ipse dixit. *See General Electric Co. v. Joiner,* 522 U.S. 136, 146, 118 S. Ct. 512 (1997) ("Nothing in either *Daubert* or the Federal Rules of Evidence requires a district court to admit opinion evidence that is connected to existing data only by the *ipse dixit* of the expert. A court may conclude that there is simply too great an analytical gap between the data and the opinion proffered.").

A. Dr. Pisano Cannot Offer Opinion Testimony Based on a Survey He Knows Nothing About

"In order for an expert to base his opinion on a study it is necessary that he be able to testify of his own knowledge as to the nature and extent of the source from which statistics were gathered." *Sheats v. Bowen,* 318 F. Supp. 640, 644 (D. Del. 1970). Dr. Pisano admitted that he has no such knowledge. (Ex. C at 212:8–220:23.) Because Dr. Pisano has no foundational knowledge of the survey on which his proffered opinion testimony is based, that testimony is inadmissible. *See United States v. Massey,* 594 F.2d 676, 680 (8th Cir. 1979) ("Concerning the witness' reference to the Canadian study there can be no doubt that the foundation for such testimony was insufficient. The witness testified that he did not know the nature and extent of the studies conducted from which the statistics were gathered."); *Bogacki v. American Mach. & Foundry Co.,* 417 F.2d 400, 407-08 (3d Cir. 1969) ("Venable was examined exhaustively in respect to the 'Statistical Studies,' and it became apparent that he could not testify of his own knowledge as to the nature and extent of the source from which the statistics were gathered. It

follows … that Venable, lacking the necessary testimonial qualifications, could not be permitted to base his testimony on items of the 'Statistical Studies.'"); Fed. Jud. Ctr., REFERENCE GUIDE ON SURVEY RESEARCH 239 (reproduced as Ex. D hereto) ("The secondary expert who gives an opinion about the … interpretation of a survey not only should have general skills and experience with surveys and be familiar with all of the issues addressed in this reference guide, but also should demonstrate familiarity with the following properties of the survey being discussed: 1. the purpose of the survey; 2. the survey methodology, including a. the target population, b. the sampling design used in conducting the survey, c. the survey instrument (questionnaire or interview schedule), and d. (for interview surveys) interviewer training and instruction; 3. the results, including rates and patterns of missing data; and 4. the statistical analyses used to interpret the results.")

B. The Survey Does Not Measure Demand

The Federal Judicial Center's REFERENCE GUIDE ON SURVEY RESEARCH cautions: "Surveys not conducted specifically in preparation for, or in response to, litigation … frequently ask irrelevant questions." (Ex. D at 237.) As explained below, that is precisely what happened, here. The survey from which Dr. Pisano takes his numbers is irrelevant to lost profits because it is insensitive to price and to whether respondents had an unmet need for indemnification that would have been met by a SCOsource license. *Cf. Pro-Football v. Harjo*, 284 F. Supp. 2d 96, 144 (D.D.C. 2003) ("The survey … says nothing about whether the term 'redskin(s)' when used in connection with Pro-Football's football team disparages Native Americans. … The survey is completely irrelevant to the analysis."); *Loctite Corp. v. Nat'l Starch & Chem. Corp*, 516 F. Supp. 190, 206 (S.D.N.Y. 1981) ("none of these surveys, which were conducted prior to this litigation and for marketing purposes unrelated to this controversy, tested the single issue at hand").

1. Demand Cannot Be Measured without Reference to Price

Apparently, the question asked by the survey from which Dr. Pisano takes his opinion was: "rate the importance of Linux legal indemnification and product warranty." (Ex. B at 3.) Respondents could choose one of four options: (1) "it is not a concern," (2) "we are somewhat concerned," (3) "we are very concerned," or (4) "indemnification and product warranties are a top priority." (*Id.*) Strikingly *absent* from the survey question is any reference to price (or need, as discussed in the next section).

"All markets must respect the law of demand," according to which "consumers will almost always purchase fewer units of a product at a higher price than at a lower price, possibly substituting other products." *Crystal Semiconductor Corp. v. TriTech Microelec. Int'l, Inc.,* 246 F.3d 1336, 1359 (Fed. Cir. 2001); *see also Coastal Oil & Gas Corp. v. Garza Energy Trust,* 268 S.W.3d 1, 41 (Tex. 2008) ("we cannot repeal the law of supply and demand any more than we can repeal the law of gravity"). But the survey Dr. Pisano uses asked respondents to "rate the importance of Linux legal indemnification and product warranty" without even mentioning price. (*See* Ex. B at 3.) Whether or not the result is a valid measure of concern about indemnification, it cannot be a reliable guide to demand because it is entirely insensitive to price.

Crystal Semiconductors, which affirmed remittitur of price erosion damages awarded by a jury for patent infringement, is instructive. To calculate damages, the patentee's expert had simply multiplied the per unit price erosion by the number of units sold, without making allowance for the decrease in demand that would have accompanied a higher price, according to the law of demand. 246 F.3d at 1358. As the Federal Circuit explained, "[t]o show causation with reliable evidence, a patentee must produce credible economic evidence to show the decrease in sales, if any, that would have occurred at the higher hypothetical price." Because "Crystal … presented no evidence of the elasticity of demand" or "make any estimates as to the number of sales it would have lost or kept had it increased its prices," "Crystal did not make a showing of

‘but for’ causation.” *Id.* at 1359. Because the survey Dr. Pisano appropriates for his opinion in this case is entirely insensitive to the inexorable law of demand, it likewise cannot be a reliable measure of demand. *See also Monolithic Power Sys., Inc. v. O2 Micro Int’l Ltd.,* 476 F. Supp. 2d 1143, 1155 (N.D. Cal. 2007) (“Mr. Bratic’s report does not account for the law of supply and demand. Mr. Bratic hypothesizes a royalty that would triple the average selling price for MPS’ accused products, but he makes no allowance for the impact that increased prices would have had on demand.”).

Put another way, to translate Dr. Pisano’s estimate of penetration into damages, it must be multiplied by a price. The survey from which Dr. Pisano takes his estimate might suggest that 1.4 million Linux users would accept indemnification if SCO were giving it away. But that survey cannot support any opinion that those users would pay $699, $100, or any other amount for it. *See Comm’r of Internal Revenue v. Shattuck,* 97 F.2d 790, 792 (7th Cir. 1938) (“It is a matter of common knowledge that the value of any product or commodity, whether it be wheat, hogs or otherwise, is affected by the law of supply and demand.”).

Generic interest in indemnification, as measured by the survey from which Dr. Pisano takes his numbers, is not at issue in this case. The issue is lost profits, which the survey cannot help to measure because it is insensitive to price.

2. Demand Cannot Be Measured without Reference to Need

As Dr. Pisano concedes, a SCOsource license was not the only option available to Linux users who wanted indemnity. (Report at ¶ 83.) Several of the developers and distributors of the software for which SCO is trying to sell licenses indemnify their customers at no additional cost. (*Id.*) Moreover, such protection is superior to a SCOsource license because it reaches *all* intellectual property infringement claims, whereas the only protection afforded by a SCOsource license is from SCO’s copyright infringement claim. (*Id.*)

The survey Dr. Pisano uses apparently did not ask respondents if they already had indemnity. (*See* Ex. B at 3.) For all the survey reveals, the entire 45% for whom indemnification was a top priority or who were very concerned might already have obtained indemnity from some other source. Indeed, their concern might have led them to obtain their Linux from an indemnifying distributor. The survey simply does not say (and Dr. Pisano apparently does not know, *see* Ex. C at 212:8–220:23). Because the survey did not ask respondents if they already had indemnity, it can provide no insight into how many of them would have been willing to pay SCO for a license that would have been redundant of any indemnification they already had.[1]

C. Dr. Pisano's Proxy Hypothesis Is Unfounded

The survey from which Dr. Pisano takes his numbers asked respondents to "rate the importance of Linux legal indemnification and product warranty." (Ex. B at 3.) To justify his equation of the perceived importance of indemnification and warranty, on one side, with but-for purchase of a SCO license, on the other, Dr. Pisano reasons: "Users willing to obtain indemnification were those most concerned with the risks of IP [intellectual property] litigation. This set of users would thus have been the most likely purchasers of SCOsource Right to Use licenses." (Report at ¶ 69.) Or, as he more succinctly phrased this line of reasoning in his deposition, the importance of indemnification as measured by the survey is "an excellent proxy for those who would purchase a SCO RTU." (Ex. C at 65:1-3.) But as explained below, even assuming that the survey measures "[u]sers willing to obtain indemnification," and that those users are motivated by concern "with the risks of IP litigation," there is no reason to think those

[1] Dr. Pisano tries to blame Novell for the existence of indemnity alternatives, as well, theorizing that Novell brought them into being "[b]y creating uncertainty regarding SCO's ownership rights." Novell did not *create* any uncertainty. At worst, Novell brought to the attention of SCO's intended targets the fact that under a reading of the APA and Amendment No. 2 which the Tenth Circuit has ruled is plausible, Novell owns the copyrights SCO was trying to license. *See SCO Group, Inc. v. Novell, Inc.,* 578 F.3d 1201, 1217 (10th Cir. 2009).

users would have been "likely purchasers of SCOsource … licenses." Dr. Pisano's proxy hypothesis is unfounded.

According to Dr. Pisano's survey, "[b]efore SCO's decision to initiate a $1 billion copyright infringement suit against IBM in March 2003," indemnification "was not an issue." (Ex. B at 4.) "Linux indemnification [was] more of an issue late in calendar year 2004," when the report issued, but *not* because of SCO. (*Id.* at 3.) Previously, "Linux and open source users thought little about indemnification …. because Linux and open source products were not widely deployed in enterprise environments." (*Id*. at 4.) But by late 2004, when the report came out, "Linux is no longer a hobbyist's toy; it's becoming a commercial mainstream product and is assuming all of the advantages, risks and liabilities that accompany commercial software." (*Id*. at 9.)

Linux's penetration of the enterprise market meant there was more at stake for individual users, increasing their desire for indemnification. (*See* Report at ¶¶ 59-60.) As the survey recognized, that penetration also increased the risk that *various* opportunists, not just SCO, would try to extract royalties from the growing user base: "forget about SCO. Imagine there is no SCO lawsuit. … Should SCO lose, as many believe it will, there is nothing to preclude other individuals or organizations from filing similar lawsuits." (Ex. B at 6.) "Copyright and patents are big business. With so much royalty money at stake, it's foolish to think that vendors will not enforce their rights if an infringement threatens a significant revenue stream." (*Id*. at 9.) For example, "[i]n August 2004, OSRM [Open Source Risk Management, Inc.] released the results of a commissioned survey that showed Linux infringed on 283 patents. IBM holds approximately one-third of those patents and Microsoft holds 27." (*Id*. at 8.) IBM executives "made no mention of when or if IBM would assert its rights over the GUI [graphical user interface] and LDAP [lightweight directory access protocol] portions of the code – but the possibility and the issue remain open." (*Id*. at 9.)

Everyone expects SCO to lose. The threats against which users might seek indemnity come from elsewhere. But as Dr. Pisano concedes, SCO's license addresses only the (weak) threat posed by SCO. (Report at ¶ 83.) As discussed above, it offers *no* protection against other copyright or *any* patent infringement claims. (*Id.*) Other indemnity providers, such as the developers and distributors of the software for which SCO is trying to sell licenses, offer protection that is superior because it reaches *all* IP infringement claims; and that protection, being free, is cheaper than SCO's $699 license. (*Id.*) Dr. Pisano's theory that 1.4 million users would have paid SCO for partial protection that is redundant of full protection they had already obtained from other sources, for free, but for Novell's assertion of ownership, simply makes no sense.[2] At a minimum, Dr. Pisano's analysis is defective because he has not ruled out the most obvious explanation for the behavior of those customers, viz., they are rational actors. *See Claar v. Burlington N.R.R.,* 29 F.3d 499, 502 (9th Cir. 1994) (upholding exclusion of testimony by experts who had not "made any effort to rule out other possible causes").

Dr. Pisano is the Harry E. Figgie, Jr. Professor of Business Administration at the Harvard Business School. (Report at ¶ 6.) But however prestigious his appointment, "[a]n expert's mere guess or conjecture is properly excluded, because an expert is a conduit of facts and not merely a subjective speculator relying on stature alone." *Porter v. Whitehall Labs., Inc.,* 791 F. Supp. 1335, 1343 (S.D. Ind. 1992). There is no persuasive support for Dr. Pisano's critical proxy hypothesis, or his corresponding theory of causation, other than Dr. Pisano's endorsement; and whatever his stature, that does not suffice.

---

[2] Although not all Linux distributors offer indemnity, neither Dr. Pisano nor the survey disaggregate the customers of Linux distributors that do indemnify from the customers of distributors that do not.

D. Dr. Pisano's Opinion as to the Size of the Market Is Inadmissible under Rules 402 and 403

As explained above, Dr. Pisano's proposed opinion testimony regarding market penetration is inadmissible because it does not meet the requirements of Rules 702 and 703. Without that opinion, his proposed testimony about the size of the market is inadmissible under Rules 402 and 403. First, the size of the market, by itself, is not relevant to anything. Second, absent a proper damages analysis to which the size of the market is relevant, evidence regarding the size of the market is likely to prejudice Novell by confusing the issues and misleading the jury with respect to the calculation of damages.

III. CONCLUSION

Dr. Pisano's opinion regarding market penetration does not satisfy the requirements of Rules 702 and 703; and without that opinion, his opinion regarding the size of the market is inadmissible under Rules 402 and 403. Thus the Court should not permit Dr. Pisano to testify.

DATED: February 8, 2010

Respectfully submitted,

By: /s/ Sterling A. Brennan
WORKMAN NYDEGGER

MORRISON & FOERSTER LLP

Attorneys for Defendant and
Counterclaim-Plaintiff Novell, Inc.