

EXHIBIT 78





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UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
ALEXANDRIA DIVISION

RAI STRATEGIC HOLDINGS, INC. and
R.J. REYNOLDS VAPOR COMPANY,

Plaintiffs and Counterclaim
Defendants,

v.

ALTRIA CLIENT SERVICES LLC; PHILIP
MORRIS USA, INC.; and PHILIP
MORRIS PRODUCTS S.A.,

Defendants and Counterclaim
Plaintiffs.

Case No. 1:20-cv-00393

**REPORT OF
RYAN SULLIVAN, Ph.D.**

A handwritten signature in black ink, appearing to read "R. Sullivan", written over a horizontal line.

Ryan Sullivan, Ph.D.

March 24, 2021

15. Economic Considerations

15.1. Profitability

- (296) The parties at the hypothetical negotiations would have considered the profitability and commercial success of the accused VUSE products. For example, *Georgia-Pacific* factors 8, 12, and 13 relate to the profitability of the product covered by the patented technology. See Section 16.
- (297) The accused VUSE products have been generally successful in the e-cigarette marketplace, as evidenced by their market share. Indeed, a 2015 Reynolds VUSE presentation depicting a graph of “Total US Share of Vapor Performance – Top 5 Brands” from February 2014 to February 2015 shows that VUSE had increased its market share from 1.94% to 22.46% during that year to become the market leader.⁶⁵² By 2018, despite JUUL surpassing VUSE in market share, VUSE maintained the second largest sales volume for both kits and cartridges.⁶⁵³
- (298) However, despite their success in the marketplace, the accused VUSE products have not been significantly profitable. For example, from 2013 to 2020, all VUSE products have generated a gross margin of [REDACTED]⁶⁵⁴ Similarly, VUSE Solo, Reynolds’ highest selling product since its launch in 2013, has generated a gross margin of [REDACTED] over the same time period.⁶⁵⁵ Further, VUSE Alto, Reynolds’ highest selling product in the three year period from 2018 to 2020, has earned [REDACTED]
[REDACTED]⁶⁵⁶
- (299) The parties at the hypothetical negotiations would take into consideration the [REDACTED]
[REDACTED] of the VUSE product line overall in determining the appropriate reasonable royalties for the asserted patents. Specifically, Reynolds would not agree to royalties that

⁶⁵² VUSE Current Situation, 3/24/2015 (RJREDVA_000833225.pptx, at slide 17).

⁶⁵³ February 2019 – Integrated Demand Review, 2/1/2019 (RJREDVA_001616435.pptx, at slides 26–27).

⁶⁵⁴ See Attachment B-1.

Gross margin percentage = gross margin / net sales = [REDACTED]

⁶⁵⁵ See Attachment B-1.
[REDACTED]

⁶⁵⁶ See Attachment B-1.
[REDACTED]

would account for the majority of gross profits earned on their VUSE devices. However, the Meyer Report has perhaps ignored this consideration. For example, the Meyer Report claims that Reynolds would be required to pay a cumulative 6.5% royalty on net sales of VUSE Solo for the '545, '911, and '374 patents starting on September 24, 2019 (the date of the '374 hypothetical negotiation).⁶⁵⁷ As discussed above, VUSE Solo has only earned about [REDACTED] during its commercialization. Moreover, in 2019, VUSE Solo earned [REDACTED].

(300) Comparatively, the cumulative royalty rates resulting from the hypothetical negotiations for the '545, '911, and '374 patents calculated in my report would total 0.91% on net sales of VUSE Solo at the time of the '374 patent hypothetical negotiation.⁶⁵⁹

15.2. Apportionment

(301) The parties at the hypothetical negotiations would also consider apportioning the agreed upon royalties to the specific contributions of the asserted patents. For example, *Georgia-Pacific* factors 12 and 13 relate to the portion of the profit that allow for use of the invention and the profit credited to the invention over non-patented features. See Sections 7 and 16.

(302) I have reasonably taken into consideration the economic contributions of the asserted patents relative to other contributing factors. In particular, apportionment to the direct value of the patents is addressed through my implementation of the market approach and use of the Fontem-RJRV agreement for the '545, '265, '374, and '911 patents. As discussed in Section 12.2.1, the Fontem-RJRV agreement involves the same VUSE products that would be at issue at the hypothetical negotiations. Further, as discussed in Section 13, several of the patents licensed in the Fontem-RJRV agreement are technically comparable to, and likely more valuable than, the patents-in-suit. Thus, I do not further apportion the royalty rates for the

⁶⁵⁷ Meyer Report, 2/24/2021, ¶ 28, Table 2.

The Meyer Report opines that the reasonable royalty rate for the '545 patent would be 3% when taking into account the '545 patent's alleged importance to Reynolds to obtain PMTA authorization from the FDA.

Cumulative royalty rate = '545 rate + '911 rate + '374 rate = 3.0% + 2.0% + 1.5% = 6.5%.

⁶⁵⁸ See Attachment B-1.

⁶⁵⁹ See Attachments G-1, G-4, and G-5.

0.40% + 0.11% + 0.40% = 0.91%.

Attachment B-1

USE Annual Sales and Profitability (2013–2020)

Product	Metric	2013	2014	2015	2016	2017	2018	2019	2020	Total
Solo	Net Sales									
	Cost of Goods Sold									
	Gross margin									
Vibe	Net Sales									
	Cost of Goods Sold									
	Gross margin									
Ciro	Net Sales									
	Cost of Goods Sold									
	Gross margin									
Alto	Net Sales									
	Cost of Goods Sold									
	Gross margin									
Total	Net Sales									
	Cost of Goods Sold									
	Gross margin									

Notes and sources:

13–2019: equal to sum of Amount from Attachment H-2 for each Product and Year shown using the following values for Metric:

Net Sales:	NET SALES
Cost of Goods Sold:	TOTAL COST OF GOODS SOLD
Gross Margin:	GROSS MARGIN

Resulting values multiplied by 1,000. Cost of Goods Sold multiplied by -1,000 to display as a positive number.

20: equal to sum of Amount from Attachment H-1 for each Product shown using the following values for Metric:

Net Sales:	RPNT00000 - NET SALES
Cost of Goods Sold:	RPCO00000 - TOTAL COST OF GOODS SOLD
Gross Margin:	RPGM00000 - GROSS MARGIN