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Beyond ResQNet: Clarifying the Standard for the Use of Patent Settlements

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Beyond ResQNet

Clarifying the Standard for the Use of Patent Settlements_

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In 2010, the Federal Circuit issued *ResQNet.com, Inc. v. Lansa, Inc.*,[1] a landmark decision holding that settlement-related evidence can be compelling proof of damages in subsequent litigation. The effects of *ResQNet* were immediately evident.[2] Some practitioners argued that *ResQNet* granted unlimited permission to use prior patent settlement agreements and related negotiations[3] as evidence of damages for patent infringement. Some courts agreed, while others decided that the Federal Circuit's ruling had no effect on Federal Rule of Evidence 408's prohibition on the use at trial of settlement-related evidence to prove damages. Simply put, *ResQNet* wrought havoc on the standards for the use of patent settlements and settlement negotiations, resulting in a range of divergent rulings nationwide.

Faced with an increasingly fractured landscape, the Federal Circuit has taken steps to calm the confusion caused by *ResQNet*. In two recent decisions, the Federal Circuit attempted to clarify the standards for using patent settlement agreements and negotiations. But several questions remain unanswered. In particular, one of these decisions exacerbated a circuit split over "settlement privilege," and the other left questions regarding the propriety of certain expert testimony unaddressed. Despite the Federal Circuit's recent efforts to clarify the meaning and scope of *ResQNet*, practitioners and courts will continue to wrangle with difficult questions regarding the discovery and admissibility of settlement-related evidence. These lingering issues will require further Federal Circuit attention—or even Supreme Court intervention—before the questions raised by *ResQNet* can finally be settled.

The Decision in ResQNet

In 2010, the Federal Circuit vacated a $506,305 damages award in ResQNet's favor, finding the district court's ruling to be "inconsistent with sound damages jurisprudence" because it "relied on speculative and unreliable evidence divorced from proof of economic harm."[4] In particular, the court was troubled by ResQNet's expert testimony that "used licenses with no relationship to the claimed invention to drive the royalty rate up to unjustified double-digit levels."[5] Because the district court "made no effort to link [these] licenses to the infringed patent," the Federal Circuit remanded with instructions to rely instead on "evidence of licenses on the claimed technology."[6]

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In a key section of the decision, the Federal Circuit indicated that such evidence could include final settlement agreements arising out of previous litigation between ResQNet and outside third parties. The court acknowledged its precedents to the contrary, including its prior rulings emphasizing that "license fees negotiated in the face of a threat of . . . litigation . . . may be strongly influenced by a desire to avoid full litigation."[7] Indeed, these earlier decisions played a central role in Judge Newman's dissent, which criticized the majority's emphasis on "royalties of litigation-induced licenses."[8] Despite this persuasive dissent and decades of precedent—dating back to an 1889 Supreme Court ruling[9]—the panel majority instructed the district court to "not rely on unrelated licenses to increase the reasonable royalty rate," while simultaneously suggesting "that the most reliable license in this record arose out of [other] litigation."[10] The implication was clear: licenses resulting from third-party settlements can be reliable indicia of the appropriate royalty for a related license, and thus are eligible for evidentiary consideration by the examining court.

The World after ResQNet

Patent litigators quickly got the hint. Almost immediately after the *ResQNet* decision was issued, district courts across the country found themselves faced with motions to compel and admit settlement-related documents. But it was not clear how such motions should be adjudicated. On one hand, the district courts had received an apparent directive from the Federal Circuit to consider "reliable" and "related" licenses, even if such licenses arose out of litigation. On the other, however, the district courts also were bound by the Federal Rules of Evidence—including Rule 408, which unambiguously mandates that settlement-related evidence is "not admissible . . . to prove or disprove the validity or amount of a disputed claim."[11]

Faced with this conflicting guidance, district courts unsurprisingly reached vastly different conclusions. Ruling on motions to compel discovery of settlement-related evidence, some courts decided that this evidence was protected by a settlement privilege,[12] others found that no such privilege existed,[13] and still other courts tried to navigate a middle ground.[14] The results were equally muddled with respect to motions to admit settlement-related evidence at trial: some courts found settlement-related evidence to be per se admissible in light of *ResQNet*,[15] and others ruled the evidence inadmissible under Rule 408.[16] In short, *ResQNet* created a mess.[17]

Discovery and In re MSTG

In the wake of the confusion caused by *ResQNet*, the Federal Circuit issued two decisions aimed squarely at settling the questions raised by that 2010 decision. The first of these, *In re MSTG, Inc.*,[18] provides new guidance that settlement-related evidence is generally discoverable under Federal Rule of Civil Procedure 26.[19]

The petitioner in *MSTG* asked the Federal Circuit to "fashion a new privilege . . . [to] prevent discovery of litigation settlement negotiations related to reasonable royalties and damages."[20] Such privileges, however, "are not lightly created,"[21] and require the careful consideration of several factors, including congressional and state pronouncements, prior judicial experience, the list of privileges proposed under the Federal Rules of Evidence, and the public interest.[22] After reviewing these factors,[23] the court expressly held "that settlement negotiations related to reasonable royalties and damage calcula-

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tions are not protected by a settlement negotiation privilege."[24] *MSTG* thus seems to set out a background rule in favor of discoverability: no privilege attaches to settlement negotiations, so the only limits to the discovery of settlement-related evidence are those that typically apply under Federal Rule of Civil Procedure 26's "broad and liberal policy of discovery."[25]

The *MSTG* decision has the obvious benefit of clarifying the standard for the discoverability of patent settlement-related evidence.[26] But this clarity comes at a cost. In deciding *MSTG*, the Federal Circuit took sides in a circuit split over the existence of a settlement privilege.[27] Before the Federal Circuit issued this decision, the Sixth Circuit ruled that "any communications made in furtherance of settlement are privileged,"[28] while other courts, including the Seventh Circuit, had staked out an opposing position.[29] While the clarity provided by *MSTG* has been welcomed by the district courts, only Supreme Court (or congressional) action can now definitively resolve this open question.

Although *MSTG* took some important first steps toward settling the standard for discovery of settlement-related evidence, it explicitly left open the question of admissibility.[30] Moreover, the opinion doubles down on *ResQNet*'s puzzling endorsement of the use at trial of such evidence.[31] Fortunately, the Federal Circuit has since taken definitive steps toward resolving the question of admissibility.

Admissibility and LaserDynamics v. Quanta Computer

In August 2012, the Federal Circuit addressed a district court decision admitting—over Quanta's objection—a prior settlement license between LaserDynamics and third-party BenQ into evidence.[32] Before a damages trial, Quanta filed a motion in limine under Federal Rule of Evidence 403 seeking to exclude the BenQ license, emphasizing that the agreement was reached in the midst of litigation in which BenQ had been repeatedly sanctioned, and that the agreement provided for a lump-sum payment while LaserDynamics wanted to use it to prove a royalty rate. The district court denied the motion and allowed the agreement into evidence.

The Federal Circuit reversed. Importantly, although the issue itself arose under Rule 403, the opinion goes out of its way to note that Rule 408 "specifically prohibits the admission of settlement offers and negotiations offered to prove the amount of damages owed on a claim."[33] This clear restatement of the Federal Rules—together with the opinion's healthy skepticism of the value of settlement-related evidence[34]—recalls earlier Federal Circuit opinions,[35] and accords with academic analysis of *ResQNet*.[36]

Overall, the decision emphasizes the unreliability of settlement-related evidence, while carefully casting *ResQNet* as a unique outlier—a case wherein the *only* relevant evidence in the record was a settlement license, while all other damages-related evidence was unreliable.[37] By contrast, *LaserDynamics* reiterated Rule 408's prohibition on "the admission of settlement offers and negotiations," while emphasizing that such evidence (including the particular evidence in that case) tends not to be a "reliable indicator[] of what willing parties would agree to in a hypothetical negotiation."[38]

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Open Questions

In *MSTG* and *LaserDynamics*, the Federal Circuit took strides to resolve the confusion that boiled over in the wake of *ResQNet*. Nevertheless, some questions regarding the discovery and admissibility of settlement-related evidence remain.

Discovery

Although *MSTG* held that no absolute privilege bars the discovery of settlement-related evidence, the opinion noted that several other courts have "imposed heightened standards for discovery in order to protect confidential settlement discussions," and left for another day the question whether such limits apply under Federal Circuit law.[39]

Patent owners and litigators seeking to keep settlement-related evidence confidential are likely to argue that heightened standards should apply to such evidence. Only time will tell whether the district courts will accept these arguments, and if so, what kinds of rules will apply to the discovery of settlement negotiations and agreements.[40] But if past experience[41] and prior results[42] are any indication, we will see a wide range of rulings[43] on this question. Indeed, some courts have already noted differing approaches,[44] and these are likely to persist—at least until the Federal Circuit intervenes again.

Admissibility

The procedural posture of *LaserDynamics* prevented the Federal Circuit from definitively resolving the applicability of Federal Rule of Evidence 408 to patent settlement-related evidence. Although this decision clarified that settlement-related evidence is generally disfavored under the Federal Rules of Evidence because of its inherent unreliability,[45] the decision nevertheless maintained that *ResQNet* properly directed the district court's attention to the settlement license in that record (even if it acknowledged that the case was unique).[46] This ambiguity in *LaserDynamics*, together with *MSTG*'s own statement that settlement-related evidence is "pertinent to the issue of reasonable royalties,"[47] suggests the Federal Circuit has left open a small window that should have been sealed shut by Rule 408.[48]

But even if the Federal Circuit seems inclined to eventually direct adherence to Rule 408, as *LaserDynamics* suggests, the court will nevertheless have to face the question of how Rule 408 interacts with Article VII of the Federal Rules of Evidence. Because settlement-related evidence is subject to discovery, these documents may be analyzed and discussed at trial as part of an expert opinion—even if they would be otherwise inadmissible.[49] Furthermore, the court may allow the introduction of the actual underlying evidence on cross-examination.[50] That is, Rules 703 and 705 may operate to admit that which Rule 408 attempts to preclude. Perhaps unsurprisingly, courts have not come to a clear consensus on how these rules interact. Some have ruled that Article VII's provisions trump Rule 408's prohibition,[51] while other courts have ruled contrariwise.[52] The answer to this question may also have a substantial impact on the scope of available discovery, especially in light of recently proposed amendments to the discovery rules.[53] The importance of this issue will continue to grow as expert testimony plays an increasingly important role in patent damages determinations,[54] and will eventually require a definitive answer from the Federal Circuit, if not the Supreme Court.

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Conclusion

The decision in *ResQNet* muddled the standards for the discovery and admission of patent settlements and settlement negotiations, and thereby resulted in vastly divergent rulings in district courts across the nation. In the face of this confusion, the Federal Circuit's decisions in *MSTG* and *LaserDynamics* have made progress toward resolving these open questions. Although these rulings do much to clarify the law, they do not solve all the problems raised by *ResQNet*. *LaserDynamics* was brought under Rule 403, rather than Rule 408, and so its commentary on the latter rule is arguably no more than dicta. More importantly, *LaserDynamics* and *MSTG* did not completely back down from *ResQNet*'s confusing directive to consider settlement-related evidence, calling it "appropriately pertinent" to patent damages determinations, and thereby leaving open the possibility that such evidence may be admissible. Furthermore, *MSTG* intimated that a higher standard may be appropriate for settlement-related discovery, but declined to specifically articulate the applicable standard. Although *LaserDynamics* and *MSTG* may have solved some of the problems created by *ResQNet*, the open questions that survive these decisions mean that we are certain to see these issues continue to come before the Federal Circuit in future years. n

Endnotes

1. 594 F.3d 860 (Fed. Cir. 2010).
2. For a more thorough discussion of the *ResQNet* decision, *see* Tejas N. Narechania & Jackson Taylor Kirklin, *An Unsettling Development: The Use of Settlement-Related Evidence for Damages Determinations in Patent Litigation*, 2012 U. ILL. J.L. TECH. & POL'Y 1.*See also* Layne S. Keele, *Res"Q"ing Patent Infringement Damages after* ResQNet*: The Dangers of Litigation Licenses as Evidence of a Reasonable Royalty*, 20 TEX. INTELL. PROP. L.J. 181 (2012); Parker Kuhl, *Rescue Me! The Attack on Settlement Negotiations after* ResQNet v. Lansa, 26 BERKELEY TECH. L.J. 269 (2011).
3. In this article, we use the term "settlement negotiation-related evidence" to refer to offers, proposals, communications, and other preagreement evidence, and we use "final settlement agreement" to refer to the terms of a completed settlement. When referring to both collectively, we use "settlement-related evidence." *See* Narechania & Kirklin, *supra* note 2, at 4 n.11.
4. *ResQNet*, 594 F.3d at 868.
5. *Id.* at 870.
6. *Id.* at 870–72.
7. *Id.* at 872 (quoting Hanson v. Alpine Valley Ski Area, Inc., 718 F.2d 1075, 1078–79 (Fed. Cir. 1983)).
8. *Id.* at 880 (Newman, C.J., concurring in part and dissenting in part).
9. Rude v. Westcott, 130 U.S. 152, 164 (1889).
10. *ResQNet*, 594 F.3d at 872.
11. FED. R. EVID. 408. For a textual analysis of Rule 408, see Narechania & Kirklin, *supra* note 2, at 33–35 & nn.238–39.
12. *See, e.g.*, Software Tree, LLC v. Red Hat, Inc., No. 6:09-CV-097, 2010 WL 2788202, at *3 (E.D. Tex. June 24, 2010).

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13. *See, e.g.*, Tyco Healthcare Grp. LP v. E-Z-EM, Inc., No. 2:07-CV-262 (TJW), 2010 WL 774878, at *1 (E.D. Tex. Mar. 2, 2010); Order Granting Plaintiffs' Motion to Compel, Delphi Auto. Sys., LLC v. Vehicle Occupant Sensing Sys., LLC, No. 10-10886, 2011 U.S. Dist. LEXIS 42236, at *4–5 n.1 (E.D. Mich. Apr. 19, 2011).

14. *See, e.g.*, Clear with Computers, LLC v. Bergdorf Goodman, Inc., 753 F. Supp. 2d 662 (E.D. Tex. 2010).

15. *See, e.g.*, Datatreasury Corp. v. Wells Fargo & Co., No. 2:06-CV-72 DF, 2010 WL 903259, at *1–2 (E.D. Tex. Mar. 4, 2010).

16. *See, e.g.*, Abbott Labs. v. Sandoz, Inc., 743 F. Supp. 2d 762, 767 (N.D. Ill. 2010). As a further complication, some courts analyzed the question under Federal Rule of Evidence 403. There they also reached conflicting resolutions. *Compare* Fenner Invs., Ltd. v. Hewlett-Packard Co., No. 6:08-CV-273, 2010 U.S. Dist. LEXIS 41514, at *3 (E.D. Tex. Apr. 28, 2010) (inadmissible), *with* ReedHycalog UK, Ltd. v. Diamond Innovations Inc., 727 F. Supp. 2d 543, 546 (E.D. Tex. 2010) (admissible).

17. For a more complete discussion of the cases cited in notes 12–16, see Narechania & Kirklin, *supra* note 2, at 18–25.

18. 675 F.3d 1337 (Fed. Cir. 2012).

19. *Id.* at 1346, 1348; *see also* Narechania & Kirklin, *supra* note 2, at 26–31 ("[T]here will frequently be some condition that permits the discovery of settlement-related evidence.").

20. *MSTG*, 675 F.3d at 1342.

21. *Id.* at 1343 (quoting United States v. Nixon, 418 U.S. 683, 710 (1974)).

22. *Id.* at 1346–48 (citing, among others, Jaffee v. Redmond, 518 U.S. 1 (1996)).

23. *Id.*; *see also* Narechania & Kirklin, *supra* note 2, at 26–28 (evaluating privilege factors and reaching similar conclusions).

24. *MSTG*, 675 F.3d at 1348.

25. *Id.* at 1346–48 (internal quotation marks omitted). *But seeinfra* note 40 (noting proposed changes to the Rule 26 standard).

26. In *MSTG*, the Federal Circuit reiterated its position that its law applies to procedural questions implicating patent matters. *MSTG*, 675 F.3d at 1341. *But cf. infra* note 27.

27. *Compare* Goodyear Tire & Rubber Co. v. Chiles Power Supply, Inc., 332 F.3d 976, 977 (6th Cir. 2003), *withIn re* General Motors Corp. Engine Interchange Litig., 594 F.2d 1106, 1124 n.20 (7th Cir. 1979). *See also* Narechania & Kirklin, *supra* note 2, at 7–10.

28. *Goodyear Tire*, 332 F.3d at 983.

29. *General Motors*, 594 F.2d at 1124 n.20; *see also* Matsushita Electric Indus. Co. v. Mediatek, Inc., No. C-05-3148, 2007 WL 963975 (N.D. Cal. Mar. 30, 2007); *In re* Subpoena Issued to Commodity Futures Trading Comm'n, 370 F. Supp. 2d 201 (D.D.C. 2005).

30. *MSTG*, 675 F.3d at 1346 n.4 ("[W]e have not yet decided the extent to which evidence of settlement negotiations would be admissible under [Federal Rule of Evidence] 408.").

31. *Id.* at 1348 ("Our cases appropriately recognize that settlement agreements can be pertinent to the issue of reasonable royalties." (citing ResQNet.com, Inc. v. Lansa, Inc., 594 F.3d 860, 869–73 (Fed. Cir. 2010))).

32. LaserDynamics, Inc. v. Quanta Computer, Inc., 694 F.3d 51, 77 (Fed. Cir. 2012). Confusingly, the Federal Circuit cited to a Fifth Circuit case (the district court decision came from the Eastern District of Texas) for its standard of review over this evidentiary decision, *see id.* at 66 (citing Industrias

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Magromer Cueros y Pieles S.A. v. La. Bayou Furs, 293 F.3d 912, 924 (5th Cir. 2002)), despite earlier intimations that Federal Circuit law might govern such rulings. *See* Sulzer Textil A.G. v. Picanol N.V., 358 F.3d 1356, 1363 (Fed. Cir. 2004); Narechania & Kirklin, *supra* note 2, at 19 n.122, 23 n.150.

33. *LaserDynamics*, 694 F.3d at 77.

34. *See id.* ("The propriety of using prior settlement agreements to prove the amount of a reasonable royalty is questionable.").

35. *Id.* (citing and quoting Hanson v. Alpine Valley Ski Area, Inc., 718 F.2d 1075, 1078–79 (Fed. Cir. 1983); Deere & Co. v. Int'l Harvester Co., 710 F.2d 1551, 1557 (Fed. Cir. 1983); and Panduit Corp. v. Stahlin Bros. Fibre Works, Inc., 575 F.2d 1152, 1164 n.11 (6th Cir. 1978) (Markey, J.)).

36. *See, e.g.*, Narechania & Kirklin, *supra* note 2, at 31–36 (noting settlement-related evidence typically should be excluded under Federal Rules of Evidence 403 and 408).

37. *LaserDynamics*, 694 F.3d at 78 ("[I]n *ResQNet*, . . . a lone settlement agreement stood apart from all other licenses in the record as being uniquely relevant and reliable.").

38. *Id.* at 77–78; *see also* AVM Techs., LLC v. Intel Corp., 927 F. Supp. 2d 139, 144 (D. Del. 2013) (rejecting expert report because "a single settlement agreement on a different patent without any analysis of the settlement context is not a reliable method for calculating damages" even though "multiple settlement agreements might show a pattern").

39. *In re* MSTG, Inc., 675 F.3d 1337, 1347 (Fed. Cir. 2012) ("[W]e reserve for another day the issue of what limits can appropriately be placed on discovery of settlement negotiations.").

40. Indeed, the Judicial Conference Advisory Committee on Bankruptcy and Civil Rules has proposed an amendment to Federal Rule of Civil Procedure 26 that may affect how the "broad and liberal policy of discovery" is applied in patent cases. *MSTG*, 675 F.3d at 1346 (internal citations omitted). The proposed change strikes the condition that discovery be "reasonably calculated to lead to the discovery of admissible evidence," and replaces it with a requirement that the discovery be "proportional to the needs of the case." *See*PRELIMINARY DRAFT OF PROPOSED AMENDMENTS TO THE FEDERAL RULES OF BANKRUPTCY AND CIVIL PROCEDURE 289–90 (Aug. 2013), *available at*www.uscourts.gov/uscourts/rules/preliminary-draft-proposed-amendments.pdf.

41. *See supra* notes 12–16.

42. *MSTG*, 675 F.3d at 1347 (comparing, inter alia, *In re* Teligent, Inc., 640 F.3d 53, 57–58 (2d Cir. 2011) (applying heightened standard), and Eisai Inc. v. Sanofi-Aventis U.S., LLC, No. 08-4168, 2011 WL 5416334, at *8 (D.N.J. Nov. 7, 2011) (requiring a "particularized showing of relevance"), with Vardon Golf Co. v. BBMG Golf Ltd., 156 F.R.D. 641, 650–51 (N.D. Ill. 1994) (rejecting "particularized showing" standard)).

43. *Compare* ABT Sys., LLC v. Emerson Electric Co., No 4:11CV00374, 2012 WL 6594996, at *3 (E.D. Mo. Dec. 18, 2012) (requiring showing of "particularized relevance"), *with* Order Granting Plaintiff's Request to Compel Discovery, Positive Techs., Inc. v. Sony Elecs., Inc., No. 11-cv-2226 SI, 2013 WL 1209338, at *2–3 (N.D. Cal. Mar. 25, 2013) (applying "broad discovery standards"); Order Regarding the Parties' Joint Discovery Letter Dated November 19, 2012, Barnes & Noble, Inc. v. LSI Corp., No. C 11-02709, 2012 WL 6697660, at *2 (N.D. Cal. Dec. 23, 2012) (rejecting the "heightened, more particularized showing of relevance" requirement); Wu v. Pearson Educ. Inc., No. 09 Civ. 6557(KBF)(JCF), 2012 WL 1232958, at *1 (S.D.N.Y. Apr. 12, 2012) (not applying heightened standard).

44. *See, e.g.*, Order Denying Defendants' Motion for Relief from Nondispositive Pretrial Order of Magistrate Judge, Barnes & Noble, Inc. v. LSI Corp., No. C-11-2709 EMC, 2013 WL 841334, at *2 (N.D. Cal. Mar. 6, 2013).

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45. *See* SK Hynix Inc. v. Rambus Inc., No. C-00-20905 RMW, 2013 WL 1915865, at *21 (N.D. Cal. May 8, 2013) (noting that objection under *LaserDynamics* might "have merit if the court were attempting to calculate . . . a *damages* award for patent infringement," but concluding that *LaserDynamics* is not pertinent to calculation of a *sanction*).

46. LaserDynamics, Inc. v. Quanta Computer, Inc., 694 F.3d 51, 78 (Fed. Cir. 2012).

47. *MSTG*, 675 F.3d at 1348.

48. Narechania & Kirklin, *supra* note 2, at 32–36.

49. FED. R. EVID. 703 (providing that data underlying expert opinion need not be admissible).

50. FED. R. EVID. 705.

51. *See, e.g.*, Abbott Labs. v. Sandoz, Inc., 743 F. Supp. 2d 762, 767 (N.D. Ill. 2010); Century Wrecker Corp. v. E.R. Buske Mfg. Co., 898 F. Supp. 1334, 1340–42 (N.D. Iowa 1995).

52. *See, e.g.*, PharmaStem Therapeutics, Inc. v. Viacell Inc., No. C.A. 02-148 GMS, 2003 WL 22387038, at *4 (D. Del. Oct. 7, 2003); *cf.* AVM Techs., LLC v. Intel Corp., 927 F. Supp. 2d 139, 144 (D. Del. 2013) (rejecting expert report because "a single settlement agreement on a different patent without any analysis of the settlement context is not a reliable method for calculating damages" even though a report based on "multiple settlement agreements might show a pattern" and may be admissible).

53. *See supra* note 40.

54. Narechania & Kirklin, *supra* note 2, at 39 & nn.261–62.

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