Chicago Bar Association
Intellectual Property Committee

Assessing Damages in Intellectual Property Cases

Monetary Relief in Patent Cases
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Lost Profits

- **Lost Profits** = Profits the patent owner would have earned from the sale of covered units "***but for***" the infringement

- Lost profits can include:
  - Lost unit sales
  - Lower unit sales prices (price erosion)
  - Higher costs (i.e. increased production and/or marketing costs)
  - Lost sales on ancillary (“convoyed”) products

- When are lost profits available as damages?
  - When plaintiff can demonstrate there was reasonable probability that, ***but for*** the infringement, it would have made the infringer's sales.

- **Panduit Test**
  - Demand existed during the period of infringement
  - Lack of "acceptable non-infringing alternatives"
  - Patent owner possessed sufficient manufacturing and marketing capabilities
  - The amount of profit can be reasonably shown

- **Measuring Revenues**
  - What additional revenues would have been generated ***but for*** the infringement?

- Some questions to consider?
  - What is the appropriate period of damages?
  - Are the lost profits recoverable for the entire apparatus or only the covered feature?
  - Can lost profits be recovered for products and services not covered by the patent?
  - Did the infringer cause an effect on pricing?

- **Damage Period – Start Date**
  - If marked: when the infringing product is made, sold, imported, or offered for sale.
  - If not marked: not until actual notice of infringement is received by the infringer

- **Damage Period – End Date**
  - Damage period ends when the impact of infringement is over.
    - Could be upon injunction, but may reach into the future

- **Price Erosion**
  - –Results when a patent holder is:
    - Forced to decrease prices due to infringing competition
    - Unable to raise prices as much as it would otherwise have been able

- Factors to consider regarding price erosion include:
  - Price elasticity
  - Market analysis
  - Substitutes and new product entrants
  - Power of suppliers and buyers

- **Entire Market Rule** – should lost revenues be based on the selling price of only the covered component or based on the selling price of the entire unit, product, or system of which the component piece was a part?

- **Entire Market Rule** allows for recovery of damages based on the value of the entire apparatus, even when only one feature is covered by the IP in-suit
  - Applies when the patented and non-patented components are physically part of the same machine
  - Can also apply to physically separate non-patented components as long as they are considered part of one complete machine or constitute a functional unit

- **Convoyed or Collateral Sales**
  - Sales of products not covered by the IP in-suit but that are caused by the sale or use of that IP
  - Typically <u>not</u> a physical part of the original device
  - Owner must prove that it would have made the sales but for infringement
  - Cannot merely be sold together for a marketing advantage – needs to be a functional relationship
  - Could include lost services

- **Incremental Costs**
  - Lost Revenues – Incremental Costs = Lost Profits
  - Incremental Costs are the additional costs that would have been incurred had the IP owner made the infringing sales
    - Typically requires analysis of fixed vs. variable costs
    - Some costs are semi-variable

Reasonable Royalty

- Reasonable royalty = **minimum award**
  - A patent holder is entitled to damages adequate to compensate for the infringement, **but in no event less than a reasonable royalty**

- Hypothetical Negotiation
  - What royalty would the owner have obtained in an arm's-length negotiation with the infringer just prior to the infringement?
    - Assumes both parties are willing and able
    - Assumes both parties agree the patent is valid
    - Consider each party's specific circumstances. I.E. financial position, competitive strategies, and market position
    - Analyst may consider information subsequent to infringement date

- **Georgia-Pacific Factors**
  - *Georgia-Pacific Corp. v. U.S. Plywood Corp.* provided a list of 15 factors that the court considers important in determining a reasonable royalty rate.
  - These factors have been widely adopted
  - Not all of the 15 factors will be considered in every case

- The ***Georgia-Pacific Factors*** are **not a formula**!
  - "…there is **no formula** by which these factors can be rated precisely in order of relative importance or by which their economic significance can be automatically transduced into their pecuniary equivalent." (*Georgia-Pacific Corp. v. United States Plywood Corp*., 318 F. Supp. 1116 (S.D.N.Y. 1970), *modified*, 446 F.2nd 295 (Second Cir. 1970), *cert. denied*, 404 U.S. 870 (1971)).

- **Classification of the Georgia-Pacific Factors**
  - 2 broad groups
    - Licensing Activity – including prior and existing licenses, licensing policies and industry customs
    - Value of the Patent – including anticipated profits, benefits of the invention, value of the invention, available non-infringing alternatives, and the duration of the patent

- **Factor 15 sums it up:**
  - "The amount that a licensor and a licensee would have agreed upon if both had reasonably and voluntarily tried to reach an agreement; that is, the amount that a prudent licensee – who desired, as a business proposition, to obtain a license to manufacture and sell a particular article embodying the patented invention – would have been willing to pay as a royalty and yet be able to make a reasonable profit and the amount that would have been acceptable by a prudent patent holder who was willing to grant a license."

- **Other Methods of Measurement**
  - The 25-Percent Rule – No longer accepted!
  - The Analytical Method
    - Royalty calculation based on the infringer's own internal profit projections
      - Takes the profits of the infringer, subtracts the infringer's normal profit, and awards some portion of the remainder to the patent owner.

Recent Decisions re Patent Damages

- ***Uniloc USA, Inc. v. Microsoft Corp***.; 632 F.3rd 1292, 1315 (Fed Cir. 2011)
  - The Federal Circuit issued a bright-line rule regarding the "25% rule", holding it to be inadmissible as a matter of Federal Circuit law.
    - "This court now holds as a matter of Federal Circuit law that the 25 percent rule of thumb is a fundamentally flawed tool for determining a baseline royalty rate in a hypothetical negotiation. Evidence relying on the 25 percent rule of thumb is thus inadmissible under Daubert and the Federal Rules of Evidence, because it fails to tie a reasonable royalty base to the facts of the case at issue."

- Court also addressed the **propriety of using the entire product as a royalty base for minor patent improvements.** The plaintiff argued that using the entire base is always acceptable, so long as the royalty rate is sufficiently low. The Court disagreed, stating: “The Supreme Court and this court’s precedents do not allow consideration of the entire market value of accused products for minor patent improvements simply by asserting a low enough royalty rate.”

- ***Kathrein-Werke KG v. Radiacion Y Microondas SA***, Case No. 07-C-2921 (N. D. Ill., May 19, 2011)
  - The court held, without prejudice, that any decision to change a damages methodology, in light of *Uniloc*, must be decided by the District Judge. The court found that **changes to a damage's methodology is more than a mere "supplementation"** under FRCP 26(e).

- ***Oracle America, Inc., v. Google Inc.***, Case No. C 10-03561 WHA (N.D. CA, Nov. 28, 2011)
  - Ruling addressing a Damages Expert's reliance on foundational facts supplied by others
    - Oracle argued that Google's damages experts had offered improper technical opinions (such as on the viability of non-infringing alternatives), but the Court found that the damages experts were merely relying on underlying technical information from engineers, which Google planned to offer at trial. Oracle also argued that many of the opinions offered were without evidentiary support or "spoon-fed" by Google engineers, but the Court largely disagreed and held that these issues went to credibility – rather than admissibility.

- ***In Re Gabapentin Patent Litigation***, MDL Docket No. 1384 (NJ, Apr. 25, 2011)
  - Can reasonable royalty rate equal to the amount of lost profits?
    - Defendants argued that plaintiff's expert analysis was "improper […] because he failed to undertake a separate analysis to calculate a reasonable royalty than he used to calculate lost profits." Plaintiff's expert concluded that the hypothetical negotiation between Plaintiffs as licensors and Defendants as licensees would have produced no mutually agreed upon price range in which the parties could have negotiated.
      - Judge held that analysis was consistent with the "holdings of several courts[.]" Id. Specifically, the court indicated that the "willing licensor/willing licensee" model is an "inaccurate, and even absurd, characterization when…the patentee does not wish to grant a license." Rite-Hite. V. Kelley Co., 56 F.3d 1538, 1554 (Fed. Cir. 1995).

- ***Lighting Ballast Control, LLC, v. Phillips Electronics North America Corp,*** Case No. 7:07-CV-29 (N.D. Tex., June 10, 2011).
  - Example of when a previous license is not probative of the royalty rate the defendant would be forced to pay in a hypothetical negotiation.
    - First, the royalty rate under the GE License was the highest royalty rate of any license for the patent-in-suit ("the '529 patent") and thus was entered into under the threat of litigation and likely represented considerations other than the value of the patent.
    - Second, the GE License conveyed rights broader than those contemplated by the hypothetical negotiation, because it included another patent ("the '106 patent").