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More Objective Patent Damages Assessments

Law360, New York (October 12, 2009) -- In U.S. patent litigation, the courts will award infringement damages in the form of lost profits and/or a reasonable royalty. Because most patent plaintiffs cannot meet the evidentiary burdens to recover lost profit damages, the form of damages commonly awarded to patent holders is the reasonable royalty.

The amount of the reasonable royalty requires a determination of the royalty rate and the royalty base. The rate times the base provides the damages figure.

With regard to establishing the royalty rate, the U.S. federal courts have been using, and in some cases, struggling with the 15 Georgia-Pacific factors in adjudging patent royalties for decades.

In summary, the Georgia-Pacific factors roughly fall into categories which relate to: a) royalty rates paid for the litigated patent or analogous licensed patents; b) profitability of the product made under the patent; c) the nature of the commercial relationship between the plaintiff and defendant; d) effect of sales of nonpatented components with the patented components; and e) the portion of profit attributable to the invention.

The economic relevance of the Georgia-Pacific factors are typically presented at trial via a patent damages experts, opining on a reasonable royalty.

In most cases, not all 15 factors are pertinent and thus not all are analyzed. In some cases, other economic variables also play a significant role in damages calculations.

Through consideration of the data summarized above, a typical scenario arises where the patentee's damages expert and the defendant's damages expert respectively set a lower boundary and an upper boundary of the royalty rate and damages amount. The jury or court usually determines some number in between these bracketed amounts as the appropriate award.

A survey of U.S. district court and Federal Circuit cases over recent years shows movement toward a more objective — and thus more predictable — determination of patent infringement damages, which align with the categories of the a) analogous licensed rates and b) profitability of the patented article.

Parties and would-be parties to patent litigation suits benefit from the increased number of cases where

damages determinations are outlined by the courts in detailed form.

In industries having historically accepted licensing rates or published indices of these rates, such widely available information allows a rough "back of the envelope" estimate of a likely damages figure.

In at least one instance, the district court allowed the well-established industry tables to set the royalty, when the damages could not be adequately supported by an expert's testimony at trial.

However, use of analogous license rates should be considered with caution.

In most cases where analogous licenses are offered to support a license rate, there is an incentive for each party to point to the differences in the license agreements, such as their term, scope or duration, to devalue their evidentiary weight and worth in damages assessments during litigation.

As a related matter, the relationship of the parties (category c) will help establish the weight accorded to such license rates as an evidentiary matter. For patentees solely seeking royalties, such as nonmanufacturing patent holders, established industry practices may make it more difficult to depart from established historic data.

With regard to category b), two interesting objective measures of a reasonable royalty have emerged in litigation analysis. These are 1) the 25 percent rule and 2) the use of the costs of designing a noninfringing alternative as setting a minimum on the reasonable royalty rate.

The 25 percent rule allocates 25 percent of a patent infringer's operating profit for the infringing article to the patent holder. The 25 percent rule has been applied as a starting point for setting a reasonable royalty, with the other Georgia-Pacific factors being used to increase or decrease this starting figure depending on the facts of the case.

Damages experts also use the 25 percent rule as a checkpoint to corroborate that a royalty rate calculated from an alternative methodology (e.g. analogous licenses or other Georgia Pacific categories) falls within a "reasonable" range.

Regarding the use of the "design around" costs as setting the damages award, several defendants have attempted to establish that these costs define the maximum for a reasonable royalty. Their reasoning is that no infringer would take a license exceeding the amount it would cost to simply "design around" the patent and avoid infringement altogether.

However, courts have flatly rejected this concept that the "design around" costs set a cap on the damages paid. Rather, courts are more likely to construe this as a minimum amount of damages award.

Another economic variable that the courts deny any evidentiary weight as setting the reasonable royalty rate is the manufacturing costs for the infringing item.

When the available data and evidence fall in line with the above categories, it is relatively easier to ascertain

a range of damages that may be assessed for patent infringement. Such information can be used to determine the point to settle a case and inform parties of an appropriate settlement or licensing amount.

At the opposite end of the spectrum, the well-known Georgia-Pacific factors continue to provide flexibility.

The flexibility of application, and unpredictable amounts of damages, are more prevalent when the facts that fall into categories d) the effect of sales of nonpatented components with the patented components; and e) the portion of profit attributable to the invention. Both of these echo considerations that are analyzed when a court applies the "entire market value rule."

This rule allows damages to be recovered on a base of products which include not only the patented invention but also nonpatented components. They often arise in computer and software patents.

The entire market value rule applies when the unpatented and patented components together are considered to be components of a single assembly or parts of a complete machine, or they together constitute a functional unit and when the patent-related feature is the basis for customer demand. It is in these cases where damages calculations remain the most unpredictable.

Patentees take advantage of the entire market value rule where a patent infringer's marketing and business practices tend to show sales of whole functional units including patented and commodity parts.

In addition to computer-based inventions, this is also prevalent in industries when disparate parts of a machine wear at the same rate or need replacement at the same time.

To prevail on the entire market value rule, the patentee must also be able to show some relation between the patented component and the demand for the overall product. This point can be demonstrated by economic survey data, but is often easily demonstrated by reviewing the infringers own marketing literature.

Defendants should be wary when they assemble systems including such mixtures of commodity and leading edge goods, and should ready themselves for a long and contentious fight when their own marketing materials tout the technical benefits of leading edge items. With this flexibility afforded by these Georgia-Pacific factors, there will always be a degree of uncertainty in damages awarded.

Finally, in areas with new business arrangements, the baseline against which a royalty rate can be murky. Here, new business paradigms have led to escalation in royalty payments.

As one example, in the online commerce area, at least one district court has permitted a patentee to recover based on the gross online sales produced through a defendant's website. The court did not require the royalty base to be limited to the defendant's revenue from such sales. Had the court restricted the baseline, this would have decreased the royalty base by at least 50 percent.

As a second example, in the wireless communications area, another court allowed patent infringement

damages to be assessed based on cumulative airtime value in addition to sales of an infringing communications handset. Such new and wide-ranging damages baselines could lead to an escalation damage awards which would warrant a long and hard fight on the part of patent holders.

Patent litigants would be well-advised to consider whether they fall into the first categories where they may be in a better position to assess their costs and downside risk, or whether they fall into the second categories where predictability remains elusive and new business practices and models allow for greater openings to expand the patent damages base.

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