

## Establishing a Cap on Patent Damages

Patent infringement damages in the U.S. are covered by Title 35 of the United States Code, Section 284. This section of the code establishes a reasonable royalty as the floor for patent damages. Specifically, this section states that damages shall be "adequate to compensate for the infringement, but in *no event less than a reasonable royalty* for the use made of the invention by the infringer...."<sup>1</sup>

Monetary damages can be broadly divided into two forms – reasonable royalty damages and lost profit damages. If a reasonable royalty establishes a floor for patent damages, what, if anything, establishes a cap or ceiling on patent damages? While reasonable royalty damage estimates can be very substantial, they are often less – by orders of magnitude – than lost profit damages. Limiting damages to a reasonable royalty (and not lost profits), as well as establishing a cap on patent damages, involves very related analyses.

The evolution of lost profit damages arising from patent infringement can be tracked, in part, through the court opinions of four seminal cases – *Panduit*,<sup>2</sup> *State Industries*,<sup>3</sup> *BIC Leisure Products Inc.*,<sup>4</sup> and *Grain Processing*.<sup>5</sup> *Panduit* established the basic framework to evaluate whether lost profit damages were appropriate. The other three cases opened the way for more comprehensive analysis of lost profit damages criteria.

### PANDUIT FACTORS

*Panduit*, decided in 1978, lays out the basic framework for evaluating whether lost profits is the appropriate measure of damages. While this basic framework has been refined, the four *Panduit* factors still form the basis for an analysis of the appropriateness of lost profits damages. To be awarded lost profits due to lost sales, the plaintiff must prove the following:

- "demand for the patented product,

- absence of acceptable noninfringing substitutes,
- [the patent holder's] manufacturing and marketing capability to exploit the demand; and
- the amount of profit [the patent holder] would have made."<sup>6</sup>

The second *Panduit* factor requires the patent owner to demonstrate that no acceptable, non-infringing substitutes existed in the market during the period of infringement. This generally requires showing that the basis for consumer demand for the infringing product is the specific patented attribute(s) and that there is no alternative means of providing that attribute(s) in a product that does not infringe. If the defendant can show there are non-infringing alternatives available, then the plaintiff may be entitled to only a reasonable royalty and not lost profits. Analysis of this second *Panduit* factor focuses on interpreting (or defining) the relevant market and the importance of the patented attribute in forming consumer demand. In the absence of non-infringing substitutes in a two-supplier market, where the products are relatively identical and the customer base is the same, it is reasonable to assume that, "but for" infringement, the patent holder would have made all the sales made by the infringer.

Analysis of lost sales is more complicated when more than two suppliers are in the market (or when products are differentiated, when geographic markets are different, etc.). In 1990, with *State Industries*, the court allowed an apportionment of infringing sales between the patent holder and others in the market based on the companies' historic market shares.<sup>7</sup> Under *State Industries*, there could be non-infringing substitutes in the market and the patent holder could still be awarded lost profits damages on a portion of its lost sales.

The court recognized an even



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more sophisticated analysis of the market and competition in 1993 with *BIC Leisure Products, Inc.* In its decision in *BIC Leisure Products, Inc.*, the court found that "Windsurfing did not show that BIC's customers would have purchased sailboards from Windsurfing and other manufacturers in proportion to their market shares."<sup>8</sup> BIC sold its products in a lower-end segment of the market. The court found that "[t]o be acceptable to the infringer's customers in an elastic market, the alleged alternative 'must not have a disparately higher price than or possess characteristics significantly different from the patented product.'"<sup>9</sup> While *State Industries* broadens the applicability of lost profit damages, *BIC Leisure* had the opposite effect. *BIC Leisure* highlighted the

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## expert TIP

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importance of market segmentation within broader markets.

### GRAIN PROCESSING

Prior to *Grain Processing*, the standard for an acceptable, non-infringing substitute was quite high. Generally, the non-infringing substitute had to be commercially available and sold in commercial quantities.<sup>10</sup> For example, in *3M v. Johnson & Johnson Orthopedics (JJO)*, the court rejected JJO's argument that a non-infringing substitute existed to 3M's synthetic casting tape, even though JJO had imported and sold small quantities of an alternative, non-infringing product.<sup>11</sup> The court's position was that Bayer (JJO's proposed supplier) did not supply JJO with commercially acceptable casting tape until several weeks before the trial, and this was done only for purposes of this litigation. There was no evidence in the record to suggest that JJO could have actually purchased a competitive casting tape from Bayer during the infringement period and, therefore, there was no viable, non-infringing substitute.

*Grain Processing* answered the question of whether a non-infringing substitute had to be in the marketplace or merely available. In *Grain Processing*, the court framed the "but for" analysis – what the alleged infringer would have done when confronted with the allegations of infringement (assuming the patent was not invalid and was infringed). The court held that while the non-infringing process was not being used commercially at the time of infringement, all the know-how was available and the infringer could have produced a non-infringing product.<sup>12</sup> The court, by allowing infringers to reconstruct the market as it would have developed absent the infringing product,<sup>13</sup> increased the hurdle for proving lost profits damages.

The ability to reconstruct the market as it would have developed absent the infringing product brings more realism into framing the hypo-


thetical negotiation<sup>14</sup> between the parties and into establishing a reasonable royalty. Allowing the infringer greater opportunity to offer non-infringing alternatives also increases the likelihood of reasonable royalty damages over lost profit damages. If the infringer had viable alternatives available to the infringing technology, it reasonably would substitute those for the infringing technology rather than simply exiting the market or paying an exorbitantly high royalty. Logically, the infringer would not pay more as a royalty than it would cost to design around the patented technology.

### RECONSTRUCTING THE MARKET

This ability to reconstruct the market can lead to open speculation as to what the infringer "could have, would have, should have" done to avoid infringement and protect its market share. Focused discovery is necessary to support the viability and plausibility of non-infringing substitutes. In order to show that non-infringing alternatives would have been available, the technological feasibility,

the cost, and the lead time to develop and implement these technologies must be supported in the record. This support ideally should consist of contemporaneous technical and market-related documentation, as well as engineering and business fact witnesses to support cost and development assumptions.

### CASE LAW

Case law has evolved allowing for the recovery of lost profits damages in markets where non-infringing alternatives were available. Current case law has also made it easier to restrict exposure to lost profits claims through the allowance of evidence of non-infringing alternatives that may not have actually been in the marketplace at the time of first infringement, but were technologically and economically feasible. If the infringer can prove the technological and economic feasibility of a non-infringing alternative, not only can lost profits be eliminated as a measure of damages, but the cost of such an alternative can also serve as a cap on reasonable royalty damages. 

<sup>1</sup> Title 35 of the United States Code, Section 284. Emphasis added.

<sup>2</sup> *Panduit Corp. v. Stahl Bros. Fibre Works*, 575 F.2d 1152 (6<sup>th</sup> Cir. 1978).

<sup>3</sup> *State Industries v. Mor-Flo Industries*, 883 F.2d 1573 (Fed. Cir. 1989), cert. denied, 493 U.S. 1022 (1990).

<sup>4</sup> *BIC Leisure Products Inc. v. Windsurfing International, Inc.*, F.3d 1214 (Fed. Cir. 1993).

<sup>5</sup> *Grain Processing Corp. v. American Maize-Products Company*, 185 F.3d 1341, (Fed. Cir. 1999).

<sup>6</sup> *Panduit Corp. v. Stahl Bros. Fibre Works*, 575 F.2d 1152, 1156 (6<sup>th</sup> Cir. 1978).

<sup>7</sup> *State Industries v. Mor-Flo Industries*, 883 F.2d 1573, 1576-1580 (Fed. Cir. 1989), cert. denied, 493 U.S. 1022 (1990).

<sup>8</sup> *BIC Leisure Products Inc. v. Windsurfing International, Inc.*, F.3d 1214, 1216 (Fed. Cir. 1993).

<sup>9</sup> *BIC Leisure Products Inc. v. Windsurfing International, Inc.*, F.3d 1214, 1219 (Fed. Cir. 1993), citing *Kaufman Co. v. Lantech, Inc.*, 926 F.2d 1136, 1142, 17 USPQ2d 1828, 1832 (Fed. Cir. 1991) (citing *Gyromat*, 735 F.2d at 553).

<sup>10</sup> See, e.g., *Kaufman Co. v. Lantech, Inc.*, 926 F.2d 1136 (Fed. Cir. 1991).

<sup>11</sup> *Minnesota Mining and Manufacturing Co. v. Johnson & Johnson Orthopedics, Inc.*, 976 F.2d 1559, 1578 (Fed. Cir. 1992).

<sup>12</sup> "[A] substitute need not be openly on sale to exert this influence. Thus, with proper economic proof of availability, as American Maize provided the district court in this case, an acceptable substitute not on the market during the infringement may nonetheless become part of the lost profits calculus and therefore limit or preclude those damages." *Grain Processing Corp. v. American Maize-Products Company*, 185 F.3d 1341, 1356 (Fed. Cir. 1999).

<sup>13</sup> *Grain Processing Corp. v. American Maize-Products Company*, 185 F.3d 1341, 1350-1351 (Fed. Cir. 1999).

<sup>14</sup> See Factor 15 in *Georgia-Pacific Corp. v. U.S. Plywood Corp.*, 318 F. Supp. 1116, 1120 (1970).