

Reasonable Royalty Damages: What Are We Proving And How?

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By statute, a patentee is entitled to no less than a reasonable royalty as damages for infringement. The object of the reasonable royalty damages portion of a patent infringement trial is to present a reliable method of determining that the ultimate royalty awarded is a fair, if not perfect, representation of the contribution the invention made to the revenue generated by the product in which it is embodied. The method most commonly used is a calculation first of the appropriate revenue base and then the application of a royalty rate to that base. (Other approaches include the analytical method and the rare “established royalty” analysis.)

The Problem

Theoretically, it should not be necessary to apportion the base to as close to the patent’s inventive feature as possible, so long as the result is a reasonable royalty that fairly relates the invention to the revenue. Thus, one could use as the revenue base the price of a consumer product, which has many features other than the invention, and account for the invention’s contribution to the product’s revenue by applying a very small rate to the very large base.

Indeed, this was how reasonable royalties were determined before the Federal Circuit decided that it was inappropriate. The reason the court rejected that approach was not because it was illogical, but because it permitted the patentee to get a very large gross revenue number in front of the jury, which could unfairly anchor the jury to render a larger damages award than was warranted. That was a fair concern.

The solution, however, has led to analyses that have become untethered to the original concern, has divided the district courts about how to properly present the relevant revenue base, and has left the law in a confused state.

Courts Are Divided Over Revenue Base Apportionment

The courts have addressed the potential unfairness in permitting a patentee to anchor a jury to a large revenue number by prohibiting the use of the entire market value of the accused product unless the patentee can prove that the invention drives the demand for the entire product. In the absence of such



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proof, the courts require an apportionment of the revenue base, so that the base number the jury is told is much less than the revenue of the product. The courts are divided, however, on what that apportionment should be. Is it to the smallest salable patent practicing unit? Is it the description in the patent claims, even if there is no salable unit small enough to reflect those claims? Or is it, even further, to the inventive feature in the patent claims?

Confusion Arises From a Failure to Remember the Original Problem to be Solved

The principal argument for requiring apportionment of the base to the inventive feature, rather than to the patent claims or smallest salable patent practicing unit, is that otherwise patent drafters can include in the claims broad non-inventive limitations, and thereby enlarge the base beyond the real effect of the invention. This argument, in my view, has resulted from a failure to remember the problem that gave rise to the apportionment requirement.

There is no principled reason why, in the absence of prejudicing the jury by use of a very large revenue number, a patentee should not be able to use the smallest salable patent practicing unit as the base, and use the rate to reflect the importance of the contribution of the invention to the product. Indeed, that is the most important purpose of the rate calculation.

In most cases, the use of the smallest salable patent practicing unit as the base will not result in the jury being anchored to an unreasonably large number and, therefore, there should be no rigid rule that requires apportionment of the base to the inventive feature in every case. Moreover, there are important practical reasons not to have such a rule.

If the required apportionment leads to something that is other than a salable unit — a product actually sold, or where there is a method that provides reasonable confidence in its estimation — there is no available market price to use. In that case, the patentee is left to ask an expert witness to assess a theoretical price. This type of evidence only increases uncertainty in an already very uncertain business.

Moreover, notwithstanding that former Chief Judge Randall Rader repeatedly has stated that he wants damages proofs to try to replicate the real commercial world, the requirement to apportion the base to below the smallest salable patent practicing unit, indeed solely to the inventive feature, does precisely the opposite. In real industry negotiations, there almost never is such an apportionment.

Thus, not only is the requirement of such apportionment not a replication of the real economic world, there rarely will be any comparable licenses to use. Since “rules of thumb” such as the 25 percent rule, are outlawed, and it will be difficult, if not impossible, to find comparable licenses, how will damages be proven? If this dilemma is solved by permitting the patentee to use the real industry licenses, but to adjust the rate for the importance of the invention, the adjustment would have to be very large since the base already has been apportioned down to solely, or largely, the inventive feature. To use the lower rates found in the licenses for products much larger than the inventive feature would be to apportion for the invention both in the base and the rate, which is a “double-discounting” demonstrably unfair to the patentee.

With Proper Focus, Applying the EMVR Is Unnecessary

The courts have added to the above confusion by applying the analysis that led to the adoption of the Entire Market Value Rule (“EMVR”) to this problem as well. If the courts simply focus on the proper determination of the base and rate in reasonable royalty cases, keeping in mind the problem that

apportionment is intended to solve, balanced by the need to enable patentees to have some reasonable method to prove damages, applying the EMVR usually will be unnecessary.

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