



UNITED NATIONS  
ECONOMIC COMMISSION  
FOR EUROPE



# Damages in IP Litigation: Methods & Sources of Evidence

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# Damages for IP Infringement

- 1st step: ruling on infringement
- **2<sup>nd</sup> step: assessing damages**
- Lost profits
- Infringer's profits
- Reasonable royalties
- (Other economic costs)
- (punitive damages)
- (statutory damages)





# Damages for IP Infringement

- Primary goal is to make the injured party whole again
- Compensate for actual economic loss
- Burden of proof is on the claimant
- May depend on whether infringement was willful or negligent





# Actual Economic Loss

- Difference between net profits that would have been earned if the infringement had not taken place and profits that were earned in actuality
- Necessary to make hypothetical “counterfactual” comparisons
- Profits of infringer may be awarded alternatively/ in addition to plaintiff’s lost profits
- Necessary to show clearly that (lost) profits due to infringement





# Lost Profits

- In the US 4-part test:
  - Demand for the patented product
  - Absence of non-infringing alternatives
  - Sufficient manufacturing & marketing capacity of claimant
  - Ability to quantify lost profits





# Entire Market Value vs Profit Apportionment

- Generally, the claimant must attempt in giving his evidence to separate his damages and the defendants profits between the parts attributable to the infringing feature and those attributable to other features not covered by the IP in dispute.
- Damages or reasonable royalties can be based on the entire market value of the infringing product only if the infringing feature creates the basis for customer demand or substantially creates the value of the component parts.





# Example: Calculating lost & infringer's profits\*

- Claimant & infringer were suppliers of machinery spare parts
- Infringing IP was a parts numbering system used in processing orders
- Infringer had used the claimant's numbering system for orders from some customers, but had also used a different system with other customers
- Claimant & infringer were direct competitors in some spare parts, but not in others
- Claimant had 15% of market, infringer 7%, 3rd parties 78%

\*Example adapted from D.Martin, IPmetrics, Case study economic damages and profit apportionment in trademark litigation; <http://www.jdsupra.com/legalnews/case-study-economic-damages-and-profit-17172/>





# Example: Calculating lost & infringer's profits

- Total sales & gross profits of infringer during the infringing period

Year	2006	2007	2008	2009	2010	total
Total Sales, \$ ,000	3,968	16,196	22,520	27,926	30,596	101,206
Gross profit margin %	42.3	39.0	36.0	37.7	40.8	38.7
Gross profits	1,680	6,324	8,106	10,538	12,498	<b>39,146</b>

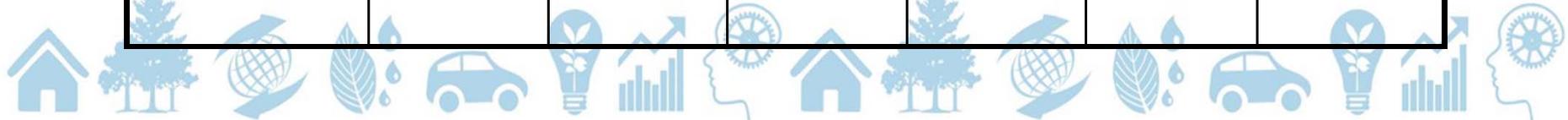




# Example: Calculating lost & infringer's profits

- But: *infringing sales?*

Year	2006	2007	2008	2009	2010	total
Sales, \$ ,000	3,968	16,196	22,520	27,926	30,596	101,206
Infringing sales, \$ ,000	1,640	7,740	12,292	13,418	18,052	53,142
Gross profit	694	3,022	4,424	5,063	7,374	<b><u>20,555</u></b>





# Example: Calculating lost & infringer's profits

- But: *net* profits?

Year	2006	2007	2008	2009	2010	total
Gross profit on infringing sales, \$ ,000	694	3,022	4,424	5,063	7,374	20,555
Eligible operating expenses	254	1,054	1,260	1,278	2,333	6,176
Net profit	440	1,968	3,164	3,785	5,041	<b><u>14,379</u></b>





# Example: Calculating lost & infringer's profits

- But: *apportionment* of profits?
- What part of the infringer's revenue (& hence profits) from the infringing sales were **due to the use of the infringing IP?**
- Infringer's ability to sell was *aided* by use of the numbering system, but many other assets contributed as well (product's quality, sales force, customer relationships, pricing strategy, ...)
- Court found that no more than 10 percent of infringer's profit could be attributed to the IP infringement => **\$ 1.4 mln** in damages





# Example: Calculating lost & infringer's profits

- Lost profits calculation:
- If claimant wanted to claim lost profits, could it base its calculation on the full \$ 53 mln of infringing sales revenue?
- => market share analysis: claimant had market share of 15 % , so 15 % of infringing sales a better basis for lost sales & profits
- Hence profits on \$7.9 mln of lost sales, which if the claimant's cost structure was the same as the infringer's, would have amounted to **\$2.1 mln**





# Example: Calculating lost & infringer's profits

- Lost profits calculation:
  - => capacity analysis: claimant was operating near full capacity; infringing sales = 45% of claimant's
  - Hence claimant would have had to make significant investments in additional capacity to be able to make the sales it claimed to have lost due to infringement
  - => lost sales based on market share analysis may be upper bound of what should be assessed
  - BUT: possibility of sub-contracting?





# Resources to establish counterfactual profits

- Industry/trade publications which analyze the relevant market, its trends & prospects and the competitive environment, chambers of commerce etc.
- [firstresearch.com](http://firstresearch.com)





# Reasonable royalties

- What willing licensor and willing licensee would have negotiated to avoid infringement
- Must be based on ex ante information, not hindsight, i.e. commercial results parties could have expected before the infringement occurred, not results actually achieved!
- But post-infringement evidence can be used as probative in certain circumstances





# Reasonable royalties

- In this example, claimant had recently licensed its numbering system to another company for an annual fee of \$20,000
- Hence straightforward to assess reasonable royalties over 5 years of infringement: \$100,000 only!
- But in other cases, things can be more complicated





# Factors Determining the Value of Licenses

- Significance of licensed IP for the commercial success of the product:
- Is IP fundamental or does it only cover a small unimportant feature?
- Likely value of the product in the market relative to alternatives not using the licensed IP





# Factors Determining the Value of Licenses

- The degree of exclusivity granted by the license:
- Exclusive licenses, where the licensee will be the only one with access to the technology/trademark, are the most valuable
- Sole licenses, where there is only one licensee but the licensor may also use the technology/trademark, are second
- Non-exclusive (ordinary) licenses, where the licensee is one among several/many, are the least valuable





# Factors Determining the Value of Licenses

- The geographical reach of the license:
- Global licenses are more valuable than regional or national licenses





# Factors Determining the Value of Licenses

- The cost and risk of commercialization:
- How much additional R&D was needed to create a market-ready product?
- How high was the risk that no market-ready product can be developed or that the product will not be commercially successful?
- Does the licensee need additional licenses from other parties to develop a product? If so, how expensive are these, and how high is the risk that the licensee might not obtain these additional licenses?
- How high was the risk that the validity of the licensed IP could be successfully challenged and invalidated?
- How high was the risk that the underlying technology will become obsolete b/o competitors' innovations?





# Factors Determining the Value of Licenses

- The quality of the potential licensee:
- Does the potential licensee have the technological capabilities to further develop the technology?
- Does the potential licensee have the financial resources to invest in further R&D and/or to maintain and enforce the underlying IP?
- Does the potential licensee have sufficient knowledge of the target market(s) to successfully commercialize a product?





# Factors Determining the Value of Licenses

- The alternatives available to the potential licensee:
- Could the potential licensee have used an alternative existing technology to put his product on the market? If so, at what cost?
- Could the potential licensee have developed an alternative technology of its own (work-around solution)? If so, at what cost?
- Could the potential licensee have challenged the validity of the underlying IP in court in order to be able to use the technology for free? If so, at what cost and probability of success?





# Factors Determining the Value of Licenses

- Value of comparable IP in the market  
Have there been comparable deals in the recent past?
- Due to the often unique character of innovative technologies, it may be difficult to obtain reliable and sufficient information
- Intensity of competition in the market for the final product
- If there are competing products which are close substitutes for the products of the infringer, the expected profits would be low and the license would not be very valuable





# Financial terms in License Agreements

- Most common types of financial compensation for injured party:
- running royalties, usually either a fixed amount per unit sold or a percentage of sales revenue
- fully paid-up license through one lump sum payment





# Financial terms in License Agreements

- Running royalties: licensor participates in ex ante upside and downside risk of commercialization; monitoring of sales and of commercialization efforts of licensee is needed
- lump sum payment: licensor gets a guaranteed sum ex ante, is unaffected by commercialization success or failure; no monitoring required





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# Example: Alcatel-Lucent vs Gateway, MS et al

- Case originally brought by Lucent in 2002, resolved in 2012
- At issue: a patent owned by Lucent on software enabling the entering of data into a field without using a keyboard (implemented by using the cursor of the mouse or a tactile pen or a touchscreen)
- District court ruled that Microsoft had infringed by including this software in its Outlook program as a way to enter dates in the Outlook calendar
- Alcatel-Lucent originally asked for *running* royalties in the amount of \$ 560 mln





# Lucent vs MS

- District court originally awarded a *lump sum* royalty of \$ 360 mln
- The Appeals Court cancelled the damage award and remanded back to district court arguing that the evidence presented suggested that \$ 360 mln, which amounted to 8 percent of total sales revenues of the infringing product, was *far higher than what a willing licensor and willing licensee would have agreed on if they had negotiated a lump sum royalty*





# Lucent vs MS

- Claimant had asked for *running* royalties, but DC awarded *lump sum*. Because of lower risk and b/o upfront payment, lump sum should generally be lower than sum of running royalties
- Reasonable royalties award needs to be based on information available to parties *prior to infringement*; this would include projections of future sales; DC did not ask for & did not receive any such projections, hence no basis for awarding reasonable royalties





# Lucent vs MS

- Lucent had originally based its claim on *1 pct of sales revenues from every PC with MS Outlook*; when DC rejected that *base*, Lucent claimed only based on sales of Outlook itself, but raised *rate* to 8 pct in order to arrive at the same amount
- MS had never paid 8 pct royalties before, hence no evidence that they would have agreed to this





# Lucent vs MS

- Damages/royalties to be awarded based on *actual infringement*; in this case: DC had no evidence that infringing feature had actually been used by customers
- Outlook calendar includes possibility of entering dates by keyboard, too, hence infringing feature not essential
- *Profit apportionment*: Outlook calendar has many other features in addition to date entry, and Outlook has many other features in addition to calendar, hence implausible that infringing feature would account for 8 pct of Outlook's retail value





# Lucent vs MS

- On remand, Lucent and MS conducted customer surveys to document actual use of infringing feature
- Damage award was reduced to \$70 and then \$23 mln, upon which the two parties settled for an undisclosed amount





# Resources to establish benchmarks for reasonable royalties

- There are many commercial providers of searchable databases collecting information on licensing deals, including royalty rates and other financial information, that can be used as benchmarks when assessing damages based on reasonable royalties
- Some of these are general, some focus on specific industries, such as pharma or biotech
- <http://valuationresources.com/EconomicData/Royalty.htm> contains a free guide to some of these databases
- Examples: [ktmine.com](http://ktmine.com) database, [IP Valuation & Infringement Damages 2012](#) book





Thank you for your attention

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