I. Introduction

In this era of high technology and e-commerce, corporate intellectual property (IP) portfolios comprise a potential source for tremendous value. With damage awards exceeding $100 million or more, patent enforcement litigation can be an effective tool for unlocking value in a corporate IP portfolio. However, the potential for such high recovery should not lead patent owners to rush to the courthouse without weighing the risks involved.

II. Potential Recovery

Upon a finding of infringement, a patent owner may be entitled to both compensatory damages and injunctive relief. Compensatory or money damages remedy past infringement, whereas injunctive relief prevents future acts of infringement.

A. Damages

The Patent Act allows for the recovery of monetary damages upon a finding of infringement. Section 284 of the Act provides, in part, that “the court shall award the claimant damages 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.”\(^1\) Causation may not be speculative, but must be proven with reasonable approximation.

The appropriate remedy of damages may be lost profits or a reasonable royalty depending on the circumstances of the case. A patent owner may recover a mixed award of lost profits on some sales, and a reasonable royalty on other sales. Further, recovery can include a combination of injunctive relief and lost profits or reasonably royalty.

1. Lost profits

Lost profits are the profits that the patent owner would have made “but for” the infringing activities. The seminal case and the most widely used test from determining lost profits is Panduit Corp. v. Stahlin Bros. Fibre Works, Inc.\(^2\) Under the Panduit factors, subsequently adopted by the Federal Circuit, a patent owner may recover lost profits if the patent owner proves:

1. Demand for the patented product;
2. Absence of acceptable noninfringing substitutes;
3. Capacity to exploit the demand; and
4. Profits lost due to the infringement.\(^3\)

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\(^1\) 35 U.S.C. § 284.

\(^2\) 575 F.2d 1152 (6th Cir.), cert. denied, 439 U.S. 856 (1978).

\(^3\) Id. at 1156.
The determinative question is “had the Infringer not infringed, what would the Patent Holder-Licensee have made.”

Damage outcomes typically hinge upon the ability of the patent owner to prove the absence of acceptable noninfringing substitutes factor.

Furthermore, the Panduit factors assume that the patentee and the infringer compete in the same market segment with competing products that are of a similar price. If patentee and infringer’s products are not substitutes in a competitive market, the patentee must show that customers would have transferred demand to its product in absence of the infringer’s product.

a. Two-Supplier Market

In a two-supplier market, evidence of causation and demand for the patented product can be inferred, in absence of any non-infringing alternatives. Therefore, in a two-supplier market, demand for the patented product would simply equal the sum of the patent owner’s sales and the infringer’s sales. The lost profit damages would be determined by a straight-forward calculation of multiplying the volume of the infringing sales by the patent owner’s incremental profit margin.

b. Multiple Competitors – Market Share Approach

In a situation where multiple competitors exist, the patent owner’s market share prior to infringement may be used to prove that the patent owner would have made some of the infringer’s sales. Evidence of market share allows the patent owner to recover lost profits in the ratio or percentage of the patent owner’s original market share. The patent owner is additionally entitled to a reasonable royalty for the remainder of the infringer’s sales.

Under the market share approach, the patent owner is entitled to lost profits, even though acceptable noninfringing alternatives are available in the market at the time of infringement. For example, if three companies compete in a market, each having a one-third share, the patent owner and the company with the noninfringing alternative would have generated 50% of the infringer’s sales. The damages would be lost profits on half of the infringer’s sales and a reasonable royalty on the remaining half.

c. Price Erosion

Typically when an additional supplier enters the market, the potential for price competition increases and results in price erosion. Lost profit damages due to price reductions that the patent owner had to make due to the existence of the infringer are also recoverable.

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7 Id.
Essentially, the patent owner could have held or raised prices “but-for” the infringer’s presence. Such damages are determined by comparing relative sale price of patented product before and after infringement.

d. Entire Market Rule

In *Rite-Hite Corp. v. Kelley Co., Inc.*, the Federal Circuit expanded its interpretation of damages and allowed greater opportunity for patent owners to recover all lost profits reasonably foreseeable by the infringing competitor under the Entire Market rule. According to this doctrine, lost profits may include recovery on non-patented products under the “reasonable objective foreseeability” standard. Furthermore, recovery is also allowed on components that have a functional relationship with the patented invention. Damages on functionally related (though unpatented) components are available *only* if the patented and unpatented components together are “analogous to components of a single assembly . . . parts of a complete machine or constitute a functional unit”, *but not* where the unpatented components “have essentially no functional relationship to the patented invention and . . . may have been sold with an infringing device only as a matter of convenience or business advantage.” This compensates the patent owner for unpatented items that are sold in conjunction with or as a result of the sale of the patented product.

2. Reasonable Royalty

When lost profits cannot be proven, the patent owner is entitled to a reasonable royalty. According to the patent statute, the reasonable royalty is not the only measure of damages, but merely is the “floor below which damages shall not fall”, in other words, the minimum recovery available to the patent owner.

Reasonable royalty is defined as “an amount which a person desiring to manufacture and sell a patented article, as a business proposition, would be willing to pay as a royalty and yet be able to make and sell the patented article in the market at a reasonable profit.” Determination of a reasonable royalty is based on a hypothetical negotiation between patentee and would-be licensor prior to infringement. Consideration is also given to any established royalty from prior licenses to others.

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9 *Id.* at 1549.
10 *Id.* at 1550.
11 35 U.S.C. § 284
12 *Rite-Hite*, 56 F.3d at 1544.
13 *Panduit*, 575 F.2d at 1157-8.
3. Limitations on Damages

a. Available Substitutes

In determining lost profits, the trial court must take into account alternatives reasonably available to the infringer. An infringer can limit the size of a damage award by showing that there was a noninfringing substitute available for use during the period of infringement. With proper proof of availability, an acceptable substitute not on the market may limit or preclude lost profit damages. However, speculative alternatives are unlikely to be sufficient to avoid lost profits.

Reasonable royalty determinations must also consider any reasonable design-around alternative available to the infringer. The cost difference between the infringing and non-infringing device or process may effectively cap the reasonable royalty award.

b. Failure to Mark

The Patent Act provides that a patentee may mark patented products with the applicable patent number(s). While marking is optional, failure to mark products covered by a patent (or failure to require licensees to do the same) could preclude any recovery of damages from an infringer prior to that infringer being given actual notice of the patent. This marking requirement for damages only applies to patents that include apparatus claims – i.e., claims directed to a product rather than a method – and to patentees making, selling or offering to sell products covered by the patent. If a patent contains only method claims, or if the patentee’s products are not covered by the patent, past damages may be recovered from an infringer even absent notice of the patent.

3. Collateral Damages

In addition to damages, a patent owner may, in certain instances, obtain collateral damage assessments of prejudgment interest, enhanced or treble damages (up to three times actual damages upon a finding of willful infringement), and reasonable attorneys fees (in exceptional cases). However, enhanced damages and attorney fees are extraordinary remedies that are discretionary with the court.

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14 Grain Processing, 185 F.3d at 1353.
15 Id.
16 Grain Processing, 185 F.3d at 1353-1354.
17 35 U.S.C. § 287
18 Id.
B. Injunctions

Both preliminary and permanent injunctions are expressly provided for under the Patent Act.\textsuperscript{21} An injunction is an equitable remedy, whose issuance ultimately lies at the court’s discretion guided under the traditional factors: 1) irreparable injury; 2) monetary damages are inadequate; 3) balance of the hardships; and 4) public interest is not disserved by granting the injunction.\textsuperscript{22}

III. Trends in Damages

Over the past few years, patent owners have recovered huge damages or settlements for infringing activities that at least partially occurred over seas. Software companies have been taking increasing advantage of the provision in the Patent Act, which provides recovery for certain extraterritorial activities.\textsuperscript{23} For example, in \textit{Eolas Techs., Inc. v. Microsoft Corp} \textsuperscript{24} and \textit{AT&T Corp. v. Microsoft Corp.} \textsuperscript{25}, the Federal Circuit agreed that the transmittal of computer code over seas could create liability under Section 271(f) for a component of a patented invention “supplied” from the United States. However, the Supreme Court is currently looking at this issue in the \textit{AT&T v. Microsoft} case.

Another increasing trend is patent owners seeking damages based on the value of the entire apparatus or system as a whole, when the invention is a small component of the larger system. For example, royalty awards based on the cost of the entire computer or the entire software package when the inventive feature is limited to some minor improvement on some piece of the product involved. This often leads to unduly inflated verdicts or settlement demands, in which the damages are calculated based on the cumulative value of all features included within the larger system, rather than the proportional value of a patented invention alone. However, the “market value rule” permits recovery based on the value of the entire system containing several features even though only one feature is patented. Such recovery is allowable when the patented feature is the basis for the customer demand for the larger system.\textsuperscript{26}

One way to support an argument for a larger damages basis is claiming an entire device or system as the invention in the patent. For example, where the alleged invention is an improved lug nut for a car, the patent applicant may draft claims that are directed to the entire car with the improved lug nut.

\textsuperscript{21} 35 U.S.C. § 283.
\textsuperscript{22} \textit{eBay Inc. v. MercExchange LLC}, 126 S. Ct. 1837, 1838 (2005).
\textsuperscript{23} 35 U.S.C. § 271(f)(1) provides for liability for causing components of a patented invention to be supplied for assembly abroad.
\textsuperscript{24} 399 F.3d 1325 (Fed. Cir.), \textit{cert. denied}, 126 S. Ct. 568 (2005) (holding that although no physical component of the patented invention had shipped from the U.S, Microsoft's shipment of information on a "golden master" disk created a sufficient nexus with the U.S.).
\textsuperscript{25} 414 F.3d 1366 (Fed, Cir. 2005), \textit{cert. granted}, 127 S. Ct. 467 (2006).
\textsuperscript{26} \textit{Rite-Hite}, 56 F.3d at 1549.
Yet another increasing trend in the area of damages are patent owners seeking per-use royalties based on the output of a patented device, rather than the actual sales of the device. For example, someone having a patent on a new machine to manufacture widgets may assert a claim of damages based on the number of widgets produced by the infringing machine, rather than based on the sales of the machine itself.

IV. Trends in Injunctions

Until recently, permanent injunctions in patent actions issued almost as a matter of course upon a finding of infringement. However, the Supreme Court’s decision in eBay Inc. v. MercExchange LLC\(^{27}\) has added several uncertainties for patent owners seeking injunctive relief. In eBay, the Supreme Court rejected the Federal Circuit’s “general rule” that district courts should issue a permanent injunction in patent cases absent exceptional and rare circumstances. Thus a patent owner, like any other plaintiff, must demonstrate the traditional factors of: irreparable harm, inadequate remedies at law, balance of hardships, and the public interest would not be disserved by granting the injunction.

Additionally, the Supreme Court denounced the use of broad classifications in applying these factors, stressing that each case must be evaluated on its own merits. Therefore, obtaining a permanent injunction is no longer assured and has become very fact intensive. However, in light of the aftermath of eBay, permanent injunctions ought to still be readily available where the patent owner is a direct competitor of the infringer.

Conversely, patent owners who do not practice their patents will have a more difficult argument seeking a permanent injunction. Further, it will also be more difficult to obtain an injunction if the patent is a small component of larger product or is a business method patent. District courts have since denied injunctive relief under these circumstances, latching onto the Justice Kennedy concurring opinion in eBay expressing concern over these areas.\(^{28}\)

Moreover, there remains some uncertainty as to the weight district courts will give to the public interest factor in instances of the public’s strong dependence on the patented technology. Obviously, injunctions are not proper in cases where the infringing product is necessary for public health or medical purposes, particular in instances of a non-practicing patent owner.\(^{29}\) However, will district courts exercise their discretion in less pressing areas of consumer products? Would Research in Motion, Ltd (RIM) be enjoined if NTP, Inc. v. Research in Motion, Ltd. (the well-known “BlackBerry case”) was tried now?

\(^{27}\) 126 S. Ct. 1837 (2006).

\(^{28}\) Id. at 1842.

\(^{29}\) See, e.g., Hybritech, Inc. v. Abbott Lab., 4 U.S.P.Q.2D 1001 (C.D. Cal. 1987) (public interest required that injunction not stop supply of medical test kits that the patentee itself was not marketing), aff'd, 849 F.2d 1446 (Fed. Cir. 1988); Datascope Corp. v. Kontron, Inc., 786 F.2d 398, 401 (Fed. Cir. 1986) (public interest warranted refusal of injunction for catheter used for treatment of heart patients).
Perhaps for now, the case law must still further develop in order to accurately predict when to expect a permanent injunction. Until then, this is yet another layer of uncertainty that a patent owner must consider in deciding to bring suit.

V. Assessing the Risks of Litigation

The treasure trove resulting from successful patent enforcement litigation can be enormous. The potential for an injunction, lost profits and/or treble damages are obvious brass rings. A successful litigation may also give rise to several other long-term benefits, such as: providing a deterrent effect on other potential infringers; increased likelihood of future settlements; and increased leverage in future licensing negotiations. The far-reaching effects of the litigation may be immeasurable.

However, these potential rewards must be tempered by several risks and costs associated with bringing suit. The most obvious is litigation costs. The complex nature of patent litigation results in great expense of outside counsel, expert witness, and discovery costs. According to the AIPLA’s 2005 economic survey, litigating a complex technology patent costs, on average, $4.5 million.30

Additionally, the discovery process in patent cases can be disruptive and may adversely impact normal business operations. In complying with discovery requests, a party may be required to disclose company secrets and highly sensitive information to the opposing party and potentially to the public. This information often includes product development, manufacturing, marketing and sales information. Typically, a well-crafted protective order will minimize or limit the disclosure of confidential information. However, a party should be aware of the risks and remain proactive to prevent any accidental disclosures of sensitive information.

Another risk of patent litigation is the general uncertainty of a jury trial and appeal, which is inherent in any litigation. The high percentages of appeals and subsequent high appellate rate of overturning trial court decisions in patent cases should not be considered lightly. This uncertainty is compounded by the fact that every patent enforcement litigation places the patent at risk of being found invalid or unenforceable. These accusations are almost inevitably asserted in all patent infringement actions. A successful attack on the patent would not only be fatal in obtaining damages in the instant case, but would have far-reaching effects of losing the proprietary rights entirely.

Additionally, competing businesses may have their own arsenal of patents. Potential litigants should be wary of the potential repercussions of filing suit against a direct competitor, where it is likely that the other side will counter sue on its patents. In some instances, it could be a triggering event to World War III. The ensuing litigation could easily escalate to other jurisdictions and countries. Accordingly, potential plaintiffs should carefully scrutinize the strength of their own patent, as well as the patent portfolio of any possible adversary.

30 See AIPLA Report of the Economic Survey 2005 at 22 (AIPLA, Arlington, Va.) (analyzing average patent litigation expenses; range of $ 350,000 in fees for a simple patent case to over $ 3,000,000 for a more complex case, with a total cost ranging from $ 650,000 to $ 4,500,000).
Finally, litigation may potentially have an adverse impact on customer relations. Industry competitors are often closely intertwined with third-party relationships and cross-licenses at various levels. The company that you are considering suing now may be a company that you are seeking a license from in the future. Businesses and consumers may be hesitant to deal with an overly aggressive patent owner if there are alternative sources for the product or services. The risks and expenses of litigation may also dissuade lenders or investors. Lack of shareholder confidence in the outcome of the litigation could lead to undesired volatility for publicly traded companies.

VI. Practical considerations

Patent owners considering litigation should undoubtedly understand the chance of success and related costs. Additionally, based on the discussion above, the following considerations are recommended:

• Carefully scrutinize the strength of the patent – thorough due diligence by outside counsel prior to filing suit
• Evaluate the amount of potential recovery
• Consider alternative technology that may limit monetary recovery
• Balance litigation costs versus potential recovery
• Analyze the likelihood of obtaining permanent injunction
• Evaluate potential exposure to counter infringement suits in U.S. and abroad
• Consider any potential harm to business relationships
• Establish a uniform, company-wide document retention/destruction policy

Complex patent litigation often takes several years until final resolution. In some instances litigation may be unavoidable. In any event, proper pre-planning and preparation is vital to success. Therefore, patent owners should seriously consider all of the effect of legal action before racing to the courthouse and unlocking value through patent enforcement litigation.