Intellectual Property Insights

Intellectual Property Infringement Remedies

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The creation and development of commercial intellectual property (IP) is a costly process. In order to generate a fair rate of return on the IP creation investment, the legal boundaries around the subject IP have to be drawn. If those IP legal boundaries are breached, then legal protections are available to the IP inventor, owner, and operator. This discussion describes the available legal remedies when an IP suffers from infringement.

Introduction

Many issues may be litigated between an intellectual property owner and an alleged infringer. In such litigation claims, typically, the intellectual property owner is the plaintiff and the infringing party is the defendant. In pursuing the infringement claim, the intellectual property owner/plaintiff has several burdens of proof.

First, the plaintiff has to establish that it has intellectual property ownership rights. Second, the plaintiff has to prove that those ownership rights have been infringed upon by the defendant. Third, and finally, a remedy is required to cure the infringement.

The infringer may be able to remedy the litigation by ceasing the alleged misbehavior. When that does not remedy the litigation, then the remedy requested by the intellectual property owner may include either:

1. an injunction against further use by the infringer and/or
2. the payment of the amount of economic damages suffered by the plaintiff.

Injunctive Relief

The typical judicial practice has been to grant a permanent injunction after the plaintiff proves that its rights to the intellectual property are valid and those rights have been infringed. This injunction is based on the legal theory:

1. that the essence of the concept of property is the right to exclude and
2. that property owners may use reasonable force to protect their property from trespassers.

An intellectual property owner plaintiff seeking an injunction needs to successfully demonstrate that:

1. it has suffered an irreparable injury,
2. remedies available at law (e.g., money) provide inadequate compensation for the injury,
3. a remedy in equity is warranted, and
4. the public interest would not be disserved by a permanent injunction.

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In order to prove these factors, expert witness testimony may be required. For example, with respect to the third issue, an expert may be required to address whether:

1. the infringer has the ability to pay an award and
2. the extent to which the infringement is impairing the value of the subject intellectual property.

Recently, courts have exercised judicial discretion and applied fairness principles when deciding whether to grant an injunction in intellectual property infringement cases. For example, in the 2006 *eBay* case,[1] the U.S. Supreme Court held that courts can enforce less drastic measures than an injunction. Such measures include the imposition of a royalty while permitting the defendant's continued use of the subject intellectual property.

Economic Damages

It is generally the plaintiff's burden to establish that the defendant's misbehavior caused damages. The measure of economic damages should be the amount that is directly related to the cause of the economic damages—that is, the alleged infringement. Variations in the facts and circumstances of each individual case can change the way that economic damages measurements are applied.

Technology, accounting, and economics experts are often called upon when the litigants dispute the amount of economic damages suffered by the plaintiff. Typically, the economics expert's assignment is to measure the financial position the plaintiff would have occupied had the alleged infringement not occurred (and compare that to the financial position that the plaintiff otherwise occupies).

Damages are usually compensatory (not punitive) in nature. However, there are statutory provisions for increasing or enhancing the damages award in cases where the infringer is found to have willfully or maliciously misbehaved.

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The measures of plaintiff economic damages that are typically considered in intellectual property infringement litigation include the following:

1. lost profits (from the lost sales and/or the increased costs from the actual sales)
2. price erosion
3. reasonable royalty

In some situations, consideration of indirect damages or an enhancement to the direct damages is appropriate. Another potential element of the remedy for intellectual property infringement is prejudgment interest.

Lost Profits

The lost profits remedy is appropriate when it can be demonstrated that 'but for' the infringement, the intellectual property owner would be in a better economic position (i.e., have more money).

Typically, there are two elements of a lost profits analysis that are subject to challenge:

1. the quantity (measured in units, but ultimately measured in terms of money) that the intellectual property owner would have sold
2. the incremental profit that the intellectual property owner would have earned if those sales had been made

Claims for future lost profits damages (i.e., after the date of the trial) are somewhat rare. This is because, when the intellectual property owner is successful in the litigation, an injunction against future infringement is an available remedy.

The kind of evidence needed to measure the future financial position the plaintiff would have occupied had the alleged infringement not occurred (and to compare that "but for" financial position to the actual financial position that the plaintiff otherwise occupies) may contain some speculative elements.

This means that the damages expert should consider all information available up to the date of the trial. Evidence for the existence and the amount of damages unfolds from the date of the alleged misbehavior.

This intellectual property economic damages procedure is in contrast with the procedures typically performed in an intellectual property valuation analysis. In intellectual property valuation assignments, the analysis usually excludes consideration of any information that was not known or knowable as of the valuation date.

Claims for past damages (i.e., prior to the date of the trial) are analyzed beginning with historical evidence regarding (1) the performance of the competitors and (2) the actions of customers in the relevant market. These factors are considered in the damages analysis even if that information was not known or knowable on the date that the alleged misbehavior began.

Quantifying lost profits from lost sales may not be controversial if the following statements are true:

1. the intellectual property owner's 'but for' price per unit to the infringer's customers would have been the same as the price charged by the infringer
2. the performance and features of the product produced by the intellectual property owner and the infringer are the same
3. the intellectual property owner's per unit historical costs to produce and sell best represents the costs that the intellectual property owner would have incurred to produce the "but for" units

Departure from these three conditions makes the measure of economic damages more complicated. For example, using either a higher or lower "but for" price per unit than that which actually occurred may require an analysis of whether less (or more) units would have sold at the higher (or lower) price.

The information that is required for analyzing a lost profits claim begins with the historical financial statements of:

1. the intellectual property owner and
2. the intellectual property infringer.

The historical financial statements may need to be adjusted if the product that is subject to the infringement claim represents only a portion of the intellectual property owner's—or the intellectual property infringer's—business.

Spare parts, replacement parts, tools, and other products that have a functional relationship with and are sold in tandem with the subject product are called "convoyed products." In some cases, revenue from convoyed products that were sold or would have been sold along with the infringed product is included in the measurement of lost sales.

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With respect to the cost that the intellectual property owner would have incurred to produce those lost sales, again the analysis typically begins with historical financial statements. However, financial statements prepared for financial reporting purposes will include more costs than just those necessary for production of the subject product. For example, costs for the plant and equipment, distribution, currency trading, income taxes, and employee options are reported in the financial statements for all of the products that were produced.

Typically, only incremental costs should be subtracted from the lost sales in order to arrive at lost profits. An incremental cost is a cost associated with producing the additional number of units at the "but for" volume level. In this way, incremental costs are not the same as variable costs.

Usually, from the historical records, a pro forma financial statement is developed that addresses the questions relevant to the measurement of lost profits that are directly attributable to the alleged misbehavior.

Price Erosion

If the intellectual property owner would have sold its units at prices higher than the actual historical prices "but for" the infringer's competition, then the intellectual property owner has suffered damages from price erosion. This is a common remedy request in intellectual property infringement litigation. This is because the very nature of intellectual property includes (1) the lawful ability to exclude competition and (2) the lawful ability to control product pricing.

In many ways, the price erosion analysis is similar to the lost profits analysis: measure the difference in the intellectual property owner's revenue (and consequential profit) that is attributable to the infringement.

In this price erosion analysis, adjustments should be considered for "price elasticity," the effect that the different price would have on the volume of sales. Similarly, the effect that the price and quantity of units sold would have on the incremental costs should be measured.

The intellectual property infringer would attempt to demonstrate that, instead of the infringer's competition, it was market forces (such as customer bargaining power and noninfringing alternative products) that prevented the intellectual property owner from enjoying the higher product price alleged by the plaintiff.

The intellectual property owner's records and intellectual property infringer's records (e.g., pricing strategy, marketing presentations, and customer proposals) may provide the necessary causation and economic evidence.

A Reasonable Royalty

When an intellectual property owner's rights have been infringed, economic damages in an amount no less than a reasonable royalty is a typical remedy. As a result, this remedy is commonly put forward whether or not a separate lost profits or price erosion analysis is offered. For example, this is the most common remedy claimed in patent infringement cases.

It may be appropriate to award a reasonable royalty greater than or at the high end of the range of rates and terms that the parties would have negotiated had they met in the normal course of business. If the rate is simply equal to what the parties would have negotiated, then the infringer would be in a "heads-I-win, tails-you-lose"[2] position.

Just as do royalty-based intellectual property license agreements, a reasonable royalty award could take many forms:

- a percentage of the infringer's sales
- a dollar amount per unit sold by the infringer

- a percentage (up to 100 percent) of the cost savings or other economic benefits enjoyed by the infringer
- a lump sum payment

The reasonable royalty award is normally based on royalty rates in existence in the relevant commercial marketplace just prior to the start of infringement.

The recent *Qualcomm Inc.* ruling[3] is an example of a relatively rich remedy. There, the court awarded a 13-month royalty payment plan against rival Broadcom Corp. plus a generous royalty rate of 6 percent.

Courts have also been known to combine royalty awards. In 2007, the court found the VoIP company, Vonage, guilty of patent infringement.[4] The court awarded a lump-sum payment of $58 million in addition to a royalty rate of 5.5 percent of every Vonage sale. Moreover, sticking to the trend begun by the *eBay* case, a federal appeals court granted a temporary stay of a previous lower court ruling for an injunction.

Unjust Enrichment

The benefit that the intellectual property infringer enjoyed is sometimes an acceptable measure of the value lost by the intellectual property owner. Disgorgement of an infringer's profit may be the appropriate remedy in other cases. This may be appropriate, for example, when the intellectual property infringer is found to have willfully or maliciously misbehaved.

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Whenever the infringer's profits are a meaningful measurement of economic damages, the burden to establish the amount of the defendant's revenue that is attributable to the subject intellectual property infringement may be on the plaintiff.

Many of the difficulties with measuring lost profits described earlier are encountered when measuring the infringer's profits. For example, it is difficult for the plaintiff to isolate the appropriate revenue of the defendant when the infringing product:

1. is bundled and sold in combination with other products or
2. aggregated in the defendant's financial records.

Prejudgment Interest

To compensate the intellectual property owner for the time value of the lost funds between the time the damages occurred and the date of the judgment, prejudgment interest is frequently added.

A variety of interest rates (e.g., statutory, risk-free, commercial paper, prime, cost of capital) have been used and accepted by courts. Usually compound interest is applicable, although sometimes the courts award only simple interest.

Summary and Conclusion

There are a variety of remedies used to resolve disputes over intellectual property infringement. When voluntarily ceasing the allegedly infringing activity does not remedy the situation, the intellectual property owner may pursue litigation.

The remedy typically sought in intellectual property infringement litigation is an involuntary end to the infringing activity (i.e., injunction) and/or economic damages. Expert witness testimony may be required for either of these potential remedies.

The economic damage remedy sought by the intellectual property owner may be lost profits, price erosion, or a reasonable royalty that is a direct result of the subject infringement.

The intellectual property owner's remedy may be more than the direct economic damages. The intellectual property owner may be entitled to recover the profits that the intellectual property infringer enjoyed as a result of the infringing activity.

Finally, depending on how the economic damages are measured, the remedy for intellectual property owner may include interest on the economic damages between (1) the date the damages were measured and (2) the date the award is paid.

Notes:

1. *eBay Inc.* v. *MercExchange, L.LC.*, 547 U.S. 388 (U.S. 2006).
2. As discussed in *Panduit Corp*. v *Stahlin Bros. Fibre Works, Inc.*, 575 F.2d 1152, 1158, 197 U.S.P.Q. (BNA) 726 (6th Cir. 1978).
3. *Broadcom Corp.* v. *Qualcomm Inc.*, 501 F.3d 297 (3d Cir. 2007).
4. *Verizon Servs. Corp.* v. *Vonage Holdings Corp.*, 503 F.3d 1295 (Fed. Cir. 2007).

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