

Proving Lost Profits in Patent Infringement Cases

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As is the case with most complex commercial litigation matters, patent holders must first prove causality before economic damages are considered. However, patent infringement cases are unique when compared with other commercial damages cases because there are legal thresholds to be met in order to prove lost profits. Whether you are the Plaintiff's attorney or representing the Defendant in a lost profits damage case, these thresholds are imperative because, in most situations, economic damages determined by computing lost profits will be significantly greater than that computed by ascertaining a reasonable royalty. This article is not a primer on how to compute economic damages in a patent infringement matter, but instead is intended to make the reader aware of the importance of the economic factors required in proving lost profit damages. Careful consideration and understanding of these factors are integral to determining a legal strategy for a patent infringement case.

There are four factors required to prove lost profits in a patent litigation ("Panduit Factors"), which results from *Panduit Corp v. Stahl Brothers Fiber Works, Inc.*, 575 F.2d 1152, 197 USPQ 726 (6th Cir. 1978). The patent holder must show that (1) market demand existed for the infringed product; (2) acceptable noninfringing substitutes were not available to satisfy demand; (3) the patent holder must possess the ability to produce and market the product to exploit demand; and (4) lost profits can be reasonably estimated and quantified. Because the Panduit requirements to prove damages are not simply a mathematical exercise in computing lost profits, it requires careful analysis and scrutiny of the operations, industry, regulatory environment, and broader markets by the damages expert. Should the damages expert be unable to prove the top three Panduit factors, it does not matter if lost profits are ascertainable. The patent holder will not be able to prove lost profit damages and will only be entitled to damages in the form of a reasonable royalty.

Thoughtful economic analysis is critical in order to prove that lost profits are recoverable. If the alleged infringer can demonstrate that there is no demand for the patented feature; the patent holder may fail the first requirement of the Panduit Factors. For example, consumers who purchased the patented product may have been unaware, or placed no value on the patented feature which would fail the first requirement.

The second requirement of the Panduit Factors is up to interpretation in terms of defining "acceptable", "noninfringing", and "substitutes." As such, it

requires an understanding of any technical advantages provided for by the patent, an understanding of the competitive products in the marketplace, and an understanding as to why consumers are buying that particular product. Product, consumer behavior, and other economic analysis are critical to demonstrate that the alternative products in the marketplace are inferior and that they do not have the same benefits as the patented feature. Consequently, the buyer would not have purchased the product, but for the infringing features and product benefits. Alternative products may also be unreliable, cost more, or have higher maintenance costs than the patented product. As such, it underscores the need for the damages expert to do a thorough market analysis to address the degree of substitutability of the patented product.

For the third requirement, the Plaintiff must also show its ability and capacity to manufacture and market the product in order to prove that it could have made the sale but for the infringement. For example, if the patent holder needs to increase production capacity, obtain different distribution channels, or secure additional key raw materials in order to produce and effectively market the additional units, it would fail Panduit's third requirement.

If one passes the top three requirements of the Panduit Factors, then the damages expert's computation of lost profits needs to be reasonably estimated and not involve speculation.

As noted in this article, rigorous economic analysis is critical in proving lost profits in a patent litigation. Simply computing reasonable and non-speculative lost profits is insufficient to satisfy the aforementioned Panduit Factors. Of course, patent law entitles the patent holder to receive damages adequate to compensate for the infringement, but in no case less than a reasonable royalty. However, as noted above, damages awarded for a reasonable royalty may very well be less than damages awarded based on lost profits. As such, general counsel and external counsel need to understand how Panduit Factors affect the damage theory applied for patent litigation and how that affects litigation strategy. Counsel would be well-advised to seek pre-litigation consulting services from an economic damages expert experienced in Panduit to determine the applicable damage theory instead of possibly being surprised at trial. Further, a Plaintiff's attorney who is retained on a contingency basis is most likely advantaged with a lost profits damage award vis-a-vis a reasonable royalty damage award. If lost profits cannot be proven due to failure of one or more of the Panduit Factors, then taking on that matter could be a costly endeavor for the law firm.

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