

# Determining Reasonable **Royalty Damages: Fundamentals, Methodologies, and Key Issues Explored**



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## “Calculating Reasonable Royalty Without Guideline License Agreements”

# Program Agenda

- Calculating reasonable royalty without guideline license agreements is more difficult but possible
- Comparable profit margin method (analytical method)
- Differential income method (with and without the infringing patent(s)-in-suit)
- Profit split methods
- Reasonable royalty based on research and development expenditures and cost savings and other benefits of the patent(s)-in-suit
- Based on facts and circumstances of each case

# Overview of Guideline License Agreements

- Courts prefer guideline license agreements when available
- Courts have increasingly taken a more narrow interpretation of comparability to patent(s)-in-suit
- Account for differences between the patent(s)-in-suit and the patents in the guideline license agreements
- Courts have ruled both ways on use of settlement agreements
- Courts have allowed use of acquisition agreements
- Depends of facts and circumstances
- May be difficult to use license information from third-party license databases and industry due to difficulty with comparability

# Comparable Profit Margin Method (Analytical Method)

- The royalty calculated under this method is based on the infringer's own internal profit projections for the infringing item at the time the infringement began
- The analytical method is based on the premise that any rate of return in excess of a normal rate of return can be attributed to the patent
- This method takes the profits of the infringer, subtracts the infringer's normal profit, and awards some portion of the remainder to the patent owner
- Depends on facts and circumstances of the case

# Comparable Profit Margin Method (Analytical Method)

- Difficult to find proper benchmark
- May be difficult to use for complex and multi-featured products
- Analytical method discussed in these cases:
  - ❑ *TMW Manufacturing Company v. Dura Corporation*
  - ❑ *Lucent Technologies, Inc. v. Gateway, Inc.*
  - ❑ *Energy Transportation Group, Inc. v. Sonic Innovations Inc.*
  - ❑ *Carnegie Mellon University v. Marvell Technology Group, Ltd.*
  - ❑ *WesternGeco LLC v. Ion Geophysical Corp.*
  - ❑ *Numatics Inc. v. Balluff Inc.*
  - ❑ *Metaswitch Networks Ltd. V. Genbank U.S. LLC*
  - ❑ *Canrig Drilling Ltd. V. Trinidad Drilling LP*

# Differential Income Method (With and Without the Infringing Patent(s)-In-Suit)

- The analyst uses a discounted cash flow analysis comparing the profitability of a product with and without the patent(s)-in-suit
- The difference between these two analyses, the differential income, indicates the damages amount
- The differential income is then used to estimate a reasonable royalty
- May be based on (1) plaintiff's profit margins with and without the patent(s)-in-suit as discussed above or (2) plaintiff's profit margin and defendant's profit margin

# Profit Split Methods

- Evolving area
- Forced to use in situations in which there is no guideline license agreements
- High *Daubert* risk for the damages experts
- Nash Bargaining Solution – mixed bag with courts
- Rubenstein-Muthoo Model of Bargaining – mixed bag with courts
- Footprint methodology developed by Aaron Fahrenkrog of Robins Kaplan – not ruled on by the courts yet

# Nash Bargaining Solution Model

- Theoretical construct developed by a mathematician known as John Nash
- The royalty rate should be an even split of the infringer's profits between the patent owner and infringer if the parties have an equal bargaining position
- The equal split may be adjusted if the relative bargaining position of the parties is not equal
- Nash Bargaining Solution model was discussed in these cases:
  - ❑ *VirnetX, Inc. v. Cisco*
  - ❑ *Oracle v. Google*
  - ❑ *Sentius v. Microsoft*
  - ❑ *Suffolk Technology LLC v. AOL Inc. and Google Inc.*



# Nash Bargaining Solution Model

- Nash Bargaining Solution model was discussed in these cases:
  - ❑ *Information Technologies, Inc. v. RIM*
  - ❑ *Gen-Probe, Inc. v. Becton Dickinson & Company*
  - ❑ *Sentius v. Microsoft*
  - ❑ *Robocast, Inc. v. Microsoft*

# Rubenstein-Muthoo Model of Bargaining

- The Rubenstein-Muthoo model provides a framework for analyzing profit sharing in an economic negotiation
- This model is based on relative contributions and economic negotiation that can be applied, given appropriate circumstances, and tied to the specific facts of the case
- Based on discount rates/cost of capital of reaching a negotiated agreement
- There are no assumptions of equal negotiating strength
- The lower discount rates enjoy greater bargaining power
- The Rubenstein-Muthoo model was allowed in *Content Guard Holdings v. Amazon* and excluded in *Omega Patents v. CalAmp*

# Footprint Methodology Model

- The footprint methodology uses three steps:
  - 1) identifying alternatives to the claimed invention
  - 2) quantifying the additional technical benefits achieved by the invention compared to the alternatives; and
  - 3) translating the invention's additional technical benefits to the resulting additional profit versus a non-infringing alternative
- The model looks at revenue and costs from either the patentee's perspective or the infringer's perspective and can represent either of the following two options:
  - 1) the patentee's difference in revenues and costs in the actual with infringement and hypothetical (without infringement) scenarios; or
  - 2) the infringer's revenues and costs in the actual and hypothetical scenarios

# Reasonable Royalty Based on Research and Development Costs and Savings

- Reasonable royalty based on research and development expenditures and cost savings and other benefits of the patent(s)-in-suit
- Relevant factor that needs to be considered
- This issue has been discussed in several cases:
  - 1) *3M v. GDC*
  - 2) *AstraZeneca AB vs. Apotex Corp.*
  - 3) *Powell v. Home Depot U.S.A., Inc.*
  - 4) *TracBeam LLC v. AT&T Inc.*