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KEY IDEAS:

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SIX RULES ON THE ROAD TO LOST PROFITS DAMAGES

Just because a corporate patent owner has standing to sue, it does not mean the corporation has standing to recover lost profit damages. This distinction, which may be worth millions, needs to be part of your IP IQ.

Standing to sue for patent infringement is a threshold question of law. While we are not addressing that issue here, we will discuss a corporate patent owner's ability to recover lost-profit damages after standing is established. *See Poly-America, L.P. v. GSE Lining Tech., Inc.*, 383 F.3d 1303, 1311 (Fed. Cir. 2004) ("While Poly-America may have the right to sue under its patents, both as an owner and as a back-licensee, it can recover only its own lost profits, not Poly-Flex's.").

The statutory basis for patent-infringement damages is spelled out in 35 U.S.C. § 284, which provides,

> Upon finding for the claimant 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, together with interest and costs as fixed by the court.

The statute clearly sets reasonable royalty damages as a floor. Since it is generally perceived, however, that lost-profit damages exceed reasonable royalty damages, patent owners often try contortionist moves to try to recover lost-profit damages. "Despite the broad damages language of § 284, patentees tend to try to fit their damages cases into the 'lost profits' framework, or else fall back on the statutory grant of a reasonable royalty." *Mars, Inc. v. Coin Acceptors, Inc.*, 527 F.3d 1359, 1366 (Fed. Cir. 2008), *cert. denied*, 77 U.S.L.W. 3281 (U.S. Dec. 1, 2008) (No. 08-563) (*citations omitted*).[1]

1 Lost profits and a reasonable royalty are not necessarily the only measure of damages under § 284. *Mars, Inc.*, 527 F.3d at 1366 ("But while lost profits is plainly one way to measure the amount of damages that will "fully compensate" the patentee under § 284, we have never held that it is the *only* one. 'The assessment of adequate damages under section 284 does not limit the patent holder to the amount of diverted sales of a commercial embodiment of the patented product.' *Minco, Inc. v. Combustion Eng'g, Inc.*, 95 F.3d 1109, 1118 (Fed. Cir. 1996); *see also Rite-Hite*, 56 F.3d at 1544 ('[T]he language of the statute is expansive rather than limiting. It affirmatively states that damages must be adequate, while providing only a lower limit and *no other limitation*.')."

ABOUT SHB

Shook, Hardy & Bacon offers expert, efficient and innovative representation to our clients. We know that the successful resolution of intellectual property issues requires a comprehensive strategy developed in partnership with our clients.

So, how can you fairly claim lost profit damages? Here are six key rules for corporate patent owners seeking lost profit damages:

1. Lost profits availability is a question of law. *Wechsler v. Macke Int'l Trade, Inc.*, 486 F.3d 1286, 1293 (Fed. Cir. 2007); *Poly-Am., L.P. v. GSE Lining Tech., Inc.,* 383 F.3d 1303, 1311 (Fed.Cir. 2004); *Rite-Hite Corp. v. Kelley Co.,* 56 F.3d 1538, 1544 (Fed.Cir.1995) (en banc). The correct measure of damages involves a highly case-specific and fact-specific analysis. *Mars, Inc.*, 527 F.3d at 1366-67; *See Hebert v. Lisle Corp.,* 99 F.3d 1109, 1119 (Fed. Cir. 1996); *Rite-Hite,* 56 F.3d at 1546.

2. To recover lost profits, the patent owner must show "causation in fact," establishing that "but for" the infringement, he would have made additional profits. *Wechsler*, 486 F.3d at 1293; *Grain Processing Corp. v. Am. Maize-Prods. Co.,* 185 F.3d 1341, 1349 (Fed. Cir. 1999); *King Instruments Corp. v. Perego,* 65 F.3d 941, 952 (Fed. Cir. 1995).

3. Generally, if the patentee is not selling a product, by definition there can be no lost profits.[2] *Wechsler*, 486 F.3d at 1293; *Poly-America, L.P.*, 383 F.3d at 1311; *Rite-Hite,* 56 F.3d at 1548.

4. Lost profits are not recoverable for losses suffered by a mere licensee, even if the licensee and licensor are part of the same corporate family. *Poly-America, L.P.*, 383 F.3d at 1305, 1311. The Federal Circuit's analysis of this issue in the *Poly-America* case was succinct: "Poly-America argues that Poly-Flex's lost profits on its lost sales are legally compensable to Ply-America, its licensor. We disagree." *Poly-America, L.P.*, 383 F.3d at 1311.

The court's analysis was in three parts. **First**, the court observed, "We have held that a licensee generally may not sue for damages unless it has exclusive rights under a patent, including the right to sue. *See Rite-Hite,* 56 F.3d at 1552; *Ortho Pharm. Corp. v. Genetics Inst., Inc.,* 52 F.3d 1026, 1032 (Fed. Cir. 1995)." *Poly-America, L.P.*, 383 F.3d at 1311. **Second**, turning to the case before it, the court held, "Poly-Flex does not have exclusive rights. It is clearly identified in the license agreement as a non-exclusive licensee, and as such, it received only a "bare license" and has no entitlement under the patent statutes to itself collect lost profits damages for any losses it incurred due to infringement. *Rite-Hite,* 56 F.3d at 1552." *Id.* **Third**, responding to the patent owner's argument that the language of the license altered the result, the court concluded, "The provision of the license agreement between Poly-America and Poly-Flex providing that Poly-America 'desires to have the contractual right to collect all damages accruing to Poly-Flex for certain past infringements of the Patents' does not change this situation. . . . Although parties to a lawsuit may allocate the disposition of infringement damages between themselves, as they appear to have done here, they cannot create lost profits for a patentee if there are none." *Id.* at 1311–12.

2 There is one exception. *Wechsler*, 486 F.3d at 1293 (**"**The only exception is where the patentee has the ability to manufacture and market a product, but for some legitimate reason does not. Even in these situations, though, 'the burden on a patentee who has not begun to manufacture the patented product is commensurately heavy.' *Hebert v. Lisle Corp.,* 99 F.3d 1109, 1120 (Fed. Cir. 1996)").

5. Separate corporate structures cannot be used as both a "sword and shield." Having established separate corporate entities, the patent owner cannot disregard those entities when it suits its needs. *Poly-America, L.P.*, 383 F.3d at 1311 ("While we do not speculate concerning the benefits that the two companies reap from dividing their operations and separating the owner of the patent from the seller of the patented product, Poly-America and Poly-Flex may not enjoy the advantages of their separate corporate structure and, at the same time, avoid the consequential limitations of that structure—in this case, the inability of the patent holder to claim the lost profits of its non-exclusive licensee.")

6. If the profits of the licensee "flow inexorably" to the patent-owner parent, the patent owner ***may*** have the right to recover lost-profit damages. *Mars, Inc.*, 527 F.3d at 1367. **("**Because we conclude that MEI's profits did not—as Mars argued—flow inexorably to Mars, we, like the *Poly-America* court, need not decide whether a parent company can recover on a lost profits theory when profits of a subsidiary actually *do* flow inexorably up to the parent. . . . We hold simply that the facts of this case cannot support recovery under a lost profits theory.").

Although there are no reported decisions adopting an "inexorable flow" theory of lost-profit damages, the Federal Circuit appears to invite such a theory in *Mars, Inc.* But proponents of such a theory should consider that (a) they will be making new law; (b) tax-based considerations may have driven the separate corporate structure that they are now trying to collapse; and (c) collapsing two corporations into one may come back to haunt them later.

Cases Cited:

Mars, Inc. v. Coin Acceptors, Inc., 527 F.3d 1359 (Fed. Cir. 2008), *cert. denied*, 77 U.S.L.W. 3281 (U.S. Dec. 1, 2008) (No. 08-563)

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