Patent Damages Post Festo

Law360, New York (September 29, 2010) -- With the cost of litigating and losing patent infringement cases spiraling ever upward over the past 10 years, Congress has struggled with patent-related legislation including hotly contested provisions to limit damages awards.

The Federal Circuit and district courts have moderated damages awards and reaffirmed the areas of required proof by liability and damages experts. However, the U.S. Supreme Court itself has provided a previously under-appreciated basis for a strategy to provide greater rigor for damages claims.

Festo Corp. v. Shoketsu Kinzoku Kogyo Kabushiki Co.,[1] which governs the interpretation of prosecution-narrowed claims during the course of nonliteral patent infringement litigation in the merits phase, less obviously also provides support for a strategy during the damages phase — even in cases of literal infringement.

Festo potentially increases the likelihood that lost profits will be awarded. It is, therefore, the case with arguably the greatest impact on patent litigation infringement issues since Markman[2] addressed claim construction. This article addresses the ramifications of Festo on both liability and damages phases of patent infringement litigation.

Patent Litigation Liability Phase

A principal function of patent claims is to place the public on notice of the patentee’s exclusive rights. During the course of patent prosecution, the applicant will narrow claims to avoid prior art. Courts developed the “doctrine of equivalents” to extend the scope of the claimed invention beyond the literal language, ameliorating the difficulties in describing an invention.[3]

Because the expansive nature of equivalents is at odds with the notice function of patent claims, courts developed prosecution history estoppel as a policy-oriented limitation to temper the broadening effect of equivalents if the proposed scope of the claim was limited during prosecution,
effectively strengthening the notice function of the claims. During litigation, the interrelationship of prosecution history estoppel and the application of equivalents defines the likelihood (or risk) of the alleged infringer's liability.[4]

Festo defines the relationship of the doctrine of equivalents and prosecution history estoppel in equivalents infringement litigation. Before the Supreme Court ruling in Festo, courts precluded the patentee from asserting any equivalents to the scope of prosecution-narrowed issued claims. The notice function of the claims and certainty of definition were favored (as a matter of policy) over the expanded claim breadth associated with the equitable concept of equivalents.

Patentees assumed the burden of the costs associated with ensuring that the issuing patent claims were broad enough to encompass any alleged infringements — literally — and litigation costs were contained. Festo rejected this rigid analysis, holding that, even for amended claims, equivalents must be determined in context.

Festo thus increased the likelihood that the patentee will typically establish infringement by encompassing insubstantial differences. It is concomitantly more difficult for the alleged infringer to avoid infringement, making its defense more costly. Festo thus shifts some of the risks and burdens of patent interpretation from the patent owner at the prosecution stage to the alleged infringer during litigation.

However, Festo did not shift the burdens absolutely. The court identified factors that limit the expansive application of the doctrine: Unforeseeability of the asserted equivalents, the peripheral relationship to the later proposed equivalent(s), and the inability to craft language adequate to describe the invention.

**Patent Litigation Damages Phase**

With respect to damages stemming from equivalents patent infringement, Festo is a double-edged sword. Festo can also have a profound impact on the effects of literal infringement in cases in which equivalents infringement of prosecution-narrowed claims has been asserted, regardless of the outcome.

By statute, the successful patentee is awarded “damages adequate to compensate ... but in no event less than a reasonable royalty ...” The commonly used methodologies for determining damages are “lost profits” and “reasonable royalties.”

Lost profits provide the patent holder with the full amount of profits that it would have earned having made or used the product/process itself, while a reasonable royalty theoretically apportions the
available profit between patentee and infringer. The amount awarded as lost profits is typically greater than the amount resulting from a reasonable royalty.

To meet its burden in establishing lost profits, the patentee must meet the so-called “Panduit” test, which requires a showing that the patentee would have made the sales/profits “but for” the infringement. This usually requires proof that there was no noninfringing competitive product or process, so the availability of a noninfringing substitute moderates the scope of recoverable damages.

To avoid the imposition of lost profits, the infringer may argue that it did or would have introduced a noninfringing equivalent product or process during the period of infringement to defeat the patentee’s claim for lost profits. The analysis may include relevant alternative actions that the infringer foreseeably would have undertaken had he not infringed. Where the but-for test is not met, or the infringer shows the availability of a suitable noninfringing product/process, the patentee may recover a reasonable royalty.

**Festo’s Ramifications on Damages for both Literal and Equivalents Infringement**

Festo limits the evidence the patentee is permitted to broaden the scope of equivalents of prosecution-narrowed claims during the merits phase, to that relating to foreseeability and substantial equivalence of products and processes.

This is the same evidence on which an infringer has traditionally relied to establish acceptable noninfringing alternatives to defeat a demand for lost profits, so the same evidence of equivalents identified during the liability phase of infringement litigation may provide a road map to identifying specific noninfringing substitutes for the purposes of damages assessment.

After Festo, to the extent that equivalents infringement is successfully asserted in the merits phase, the infringer’s universe of substantial noninfringing alternatives will be theoretically diminished, decreasing the likelihood of avoiding lost profits damages. This holds true regardless of whether literal infringement was also successfully asserted against other products or processes.

Conversely, where literal infringement is established over certain products or processes but an allegation of equivalents over another product/process is unsuccessful, the evidence on which the patentee unsuccessfully relied in the merits phase may be used by the literal infringer to make its case for an available noninfringing alternative to avoid lost profits damages.

Thus, an infringer may be able to identify available alternative products or processes that would not
infringe based on claim-narrowing during prosecution, evidence that Festo explicitly permits (and which will likely have been already admitted during the merits phase).

In Cohesive Technologies, the Federal Circuit suggested that, on remand, the presence of the acceptable alternative 2.1 X 20 mm columns (outside the scope of equivalents) could suffice to defeat a claim for lost profits regardless of whether the 25µ columns infringe, and if the 25µ columns are found not to infringe (literally or equivalents), then they would be also available as acceptable noninfringing alternatives.[9]

In other words, where the patentee has successfully asserted equivalents infringement, the universe of substantial noninfringing alternatives is smaller and lost profits thus more likely to be established in the damages phase than if the patentee loses on equivalents infringement. From the infringer’s perspective, after Festo, it is able to rely on an alternative that could have been foreseen or described at the time of prosecution, posit this alternative as a noninfringing substitute, and follow the path to a theory of damages based on a reasonable royalty.

The infringer’s ability to identify suitable noninfringing alternatives outside the scope of the claim according to Festo may also provide a benchmark or cap for reasonable royalty damages (to the extent of the cost of development of the alternative design). At the time of a hypothetical negotiation of a reasonable royalty, the infringer would have paid no more to license the patent than its cost to switch to a noninfringing alternative outside the scope of the claim.

**Implications for Case Strategy**

Festo has not only altered the way we prepare for and litigate nonliteral infringement on the merits, but can also be used to affect profoundly the evidence and estimation of compensation during the damages phase. An asserted expansive scope of equivalents may increase the patentee’s likelihood of success on the merits, and may also provide support for a claim of lost profits.

Should the asserted equivalents not encompass the alleged infringing product or process, there is a greater likelihood that the patentee must rely on reasonable royalties to compensate for the literally infringed claims. However, should compensation be limited to reasonable royalties, the same evidence may assist the infringer to constrain or limit the reasonable royalties calculation.

**Litigation Liability Strategy**

- The strategy for managing the costs of the liability phase in nonliteral patent litigation must be considered early. Intellectual property owners should emphasize high-quality prosecution for potentially valuable or litigated properties to ensure claims of the broadest patentable scope with the
least possible narrowing during prosecution.

- Patentees in litigious fields should also consider the preparation and maintenance of documents reflecting the commercial advantages of the product/process encompassed by the full scope of the claims throughout prosecution. Attorneys for potential alleged infringers will want to review any potentially adverse patent claims and applications, and identify prior art and market alternatives.

- After litigation has been threatened, attorneys on both sides should closely analyze the patent, prosecution history, related applications and foreign prosecution, as well as cited and other prior art. Case law reflects that, barring unusual circumstances, all these sources may be considered to establish the limitations of estoppel under Festo and the potential acceptable noninfringing substitutes for damages.

- During litigation, both patentee and alleged infringer should balance the merits of a trial to the court and staying the damages phase if trial is to a jury.

**Litigation Damages Strategy**

- As the complexity and costs of patent litigation increase in equivalents patent litigation, potential damages claims may decrease due to the expanded ability of infringers to identify available, suitable noninfringing alternatives. This trade-off is a factor to consider when deciding whether or not to proceed with litigation, when determining the focus of resources during litigation and when considering settlement.

- Documentation of the advantages of the claimed invention during prosecution in which the claims are narrowed may be reviewed in subsequent litigation for evidence of unforeseeable alternatives within the scope of the narrowed claims. Documentation which indicates that narrowed claims provide more commercially acceptable benefits of the patent is likely to increase the patentee’s chances of establishing lost profits.

- Companies that monitor competitors’ patent prosecution may also benefit from evaluating the advantages of the claim scope relinquished during prosecution in accordance with Festo. Incorporating a feature that was the subject of a rejection during prosecution may significantly reduce exposure to subsequent assertions of nonliteral patent infringement, and may reduce the risk of damages calculated as lost profits.

- Potential confusion arises due to the similarity of the terms discussed at the different phases of a litigation. Counsel and financial advisers should consider providing a short tutorial for the fact finder regarding the terms “equivalent,” suitable noninfringing alternative” and “foreseeable/foreseeability”
— especially if the fact finder is the same in both phases of the litigation.

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[4] Theoretically, the greater the scope of equivalents, the greater the risk that the alleged infringer will be found liable, but also the greater the cost of asserting infringement and defending a counterclaim of invalidity.


