

14 IIC 85 (1983)

*Jochen Pagenberg **

Assessment of Damages for Patent Infringement

A. Comment on Two Recent Decisions of the German Federal Supreme Court

Following decades of a more or less uniform practice in determining and calculating damages for the infringement of industrial property rights, German law in this area now seems to be in a stage of development following discussions and some heavy attacks against the established case law by scholars as well as practitioners. In patent law, especially, where the German Federal Supreme Court had, on the one hand, developed a doctrine of claim interpretation which could be regarded as rather favorable to the patentee, it was felt that the sanctions against infringers as developed and applied by the courts were, on the other hand, far from satisfactory and against the patentee's interests.

1. The Former Case Law

a. Damages Only Against Infringers Acting with Fault

One reason for concern was that courts awarded damages only against infringers acting with fault. This requirement already precluded in most cases the award of damages before the patentee had sent a warning letter. A second consequence of the application of the tort rules was, however, that a three-year statute of limitation applied. Since especially smaller companies or individual patent owners could not take the risk of filing an infringement suit before the end of the opposition proceeding, they often lost several years of damages to the advantage of the infringer who was usually one of the opponents and would do anything to prolong proceeding.

Another result of the fact that fault was considered a condition for an award of damages was that compensation was precluded in cases where the question of infringement and/or validity of the patent was doubtful or other reasons were given so that fault could not be established on the part of the infringer.

b. Calculation of Damages

An equally important point of discussion was the amount of damages awarded to the patentee, i.e. the methods of calculation applied by the courts. Although everyone seemed to agree that damages should be a deterrent against infringement, a realistic calculation of an infringer, based upon the case law of the courts generally resulted in his decision to continue

his production and sales rather than give up a line of business which was commercially successful.

This situation was due to the fact that the vast majority of all damage claims were directed to the payment of a royalty, because of the difficulty of proof and/or the unwillingness to disclose business secrets which would have been necessary if lost profits of the patentee or the surrender of the infringer's profits were claimed. In view of the Court's practice to grant a "reasonable royalty" at rates equal to voluntary licenses in industry even against willful infringers, legal writers had argued in favor of the award of multiple or at least increased royalties. 1)

2. The New Trend of the Federal Supreme Court

a. Claims for Unjust Enrichment Awarded

In a 1976 decision (Plastic Hollow Section I), 2) the Supreme Court for the first time applied the rules of unjust enrichment in a case involving the infringement of a utility model, and thus awarded compensation to the owner of a utility model where the infringer had acted without fault.

This meant that instead of formerly 3 years, the patentee could go back as far as 30 years from the date of filing suit for a claim of unjust enrichment. Although the compensation due under these rules does not match the damages due under tort law, the general acknowledgement of the applicability of Sec. 812 of the Civil Code (Unjust Enrichment) improved the situation of the patentee to a considerable extent.

b. Claims for Multiple Damages Denied

In a later decision (Tolbutamide), 3) a case of deliberate infringement where the amount of damages and the percentage of royalties to be awarded to the patentee were at issue, the Supreme Court considered the arguments raised in the literature in favor of increased royalty rates, but failed to arrive at a significantly higher rate, allegedly because of the particular facts of the case. The main criticism of this decision centered on the Court's theory that the patentee could only recover a "reasonable" or "adequate" royalty, which the Court regarded to be a rate that a voluntary licensee would have been willing to pay after normal negotiations with the patentee. It was argued by the critics that such a practice reduces the risk for any infringer considerably, since he can rely on the presumption that even after years of litigation, and even if clear intent can be demonstrated, he would only be liable for an amount which he would already have paid much earlier had he entered into a license agreement. Together with a number of other advantages favoring an infringer this case law would, for many intentional infringers at least, be an invitation to imitate in particular those products which had shown success on the market.

Although the Supreme Court held it to be within the trial court's discretion whether the particular facts of the case warranted the award of increased royalties, it stated at the same time that the trial court should only in exceptional cases consider the differences between the position of a patent infringer and a voluntary licensee for the determination of the royalty rate.

c. The Test of the "Reasonable Businessmen"

With the two new decisions reprinted here, 4) the Supreme Court has taken further steps toward differentiating between an infringer and a voluntary licensee.

aa. In the Heel Support Device decision, 5) the Court agrees that one may take into account certain advantages of the infringer's position as compared to the position of a voluntary licensee. According to the Court, "reasonable contracting parties" would have agreed on annual royalty payments so that a payment by an infringer for past years of litigation should include the payment of interest, since such a provision would have been agreed to by the parties in case of a voluntary license contract.

However, in interpreting its former Tolbutamide decision, it expressly holds that courts need not generally consider the differences between the position of an infringer and that of a voluntary licensee; in particular, a general increase of the royalty rate in case of intentional infringement or because of the generally more favorable position of an infringer vis-à-vis a voluntary licensee is not warranted, according to the Court.

bb. The main issue of the second case reprinted in this issue - Plastic Hollow Section II 6) - concerns a further aspect of a claim for unjust enrichment as compared with damages in a case where the infringer acted with fault. The Court interprets the rather difficult rules of the German law of unjust enrichment and applies them to a case of infringement of an industrial property right. According to the Court the enrichment which the infringer acquired for which he must pay compensation is the value of being able to use an industrial property right, which value can only be determined on the basis of a royalty and not, as the patentee contended, on the basis of the infringer's profits. If the gains obtained from such unauthorized use on the part of the (non-intentional) infringer are higher in a particular case than a reasonable royalty, the infringer would not be required to turn them over to the patentee. Such an interpretation is correct and in conformity with German case law under the rules of unjust enrichment: a person who does not know that he is making profits with another's property, need not surrender the profits if he has made them due to his own ingenuity and effort. Only the "enrichment" which he has obtained to the disadvantage of the other party must be turned over.

Another question, i.e. whether under the rules of unjust enrichment interest must be paid in addition to the royalty rates, was answered by the Court in favor of the patentee as in the Heel Support Device decision. The Court reiterated its position that, where reasonable businessmen would have agreed to pay interest in case of the belated payment of royalties, such interest is also due if the royalties are not paid as "damages" in the strict sense, but as a form of reimbursement of unjust enrichment.

3. Comment

a. The Practice of License Analogy

The two decisions show, and this has been confirmed by members of the Patent Chamber of the Supreme Court in public discussions, that the justices are willing to consider arguments in

favor of a better compensation of the patentee whose patent has been infringed. In this respect the "new trend" can only be welcomed. The Patent Chamber of the highest German Court opens new doors which were closed to the patentee for more than 100 years. However being on the right path does not necessarily mean that the Court has already reached what the patentee would consider the "promised land."

The reason for this slight reservation is the test of "reasonable businessmen" which the Court applies, i.e. the construction of a fictitious license negotiation between infringer and patentee from which the terms and conditions of an equally fictitious license agreement are derived. The Court expressly points out that "the infringer should not be at a disadvantage as compared to a contractual user of the rights at issue."

This principle was already announced by the Court of Appeals in the Heel Support Device decision, and it repeats prior holdings of the Federal Supreme Court. It is true that the German Patent Act and the German civil law in general do not contain any provision comparable to Sec. 284 of the US Patent Act which provides for increased damages "up to three times the amount found or assessed. " Under US law this provision is by some courts interpreted as a discretion to grant punitive damages 7) while other courts regarded this a compensation for the difficulty of the infringer to prove actual damages. 8) Any determination of damages under German law must start from the civil law definition of damages which are only intended to be a restitution of the prior situation, i.e. the situation without an infringement, by way of money compensation. Since one of the forms of compensation developed by the Supreme Court which the plaintiff can apply is a claim for the infringer's profits, there is a good reason to believe that also under German law the infringer should not be better off with the infringement when without it.

Keeping these principles in mind, a general punitive surcharge (Strafzuschlag) is certainly not warranted under present German law, not even as compensation for the plaintiff's difficulty of proving damages; here only the legislature would be competent to make any change. What patentees have repeatedly asked for is that courts take into account, when applying the so-called license analogy, all aspects of an infringer's situation which have economic effects and, as such, are also taken into consideration by the infringer when deciding whether it is worthwhile continuing the infringement after having received a warning letter, or whether economic considerations speak in favor of discontinuing. Even if one agrees that under German law the courts are bound not to treat the infringer at a disadvantage in comparison to a voluntary licensee, the equivalent principle that he should not be better off has at least equal weight.

Several factors and circumstances can be put forward which demonstrate the less advantageous position of a voluntary licensee in comparison to an infringer:

- the voluntary licensee must first of all persuade the licensor to grant a license;
- he must normally accept the royalty rate which is requested by the licensor without the licensor being required to prove that the rate is justified;
- he must usually bear the risk of marketing when accepting a minimum royalty per year;
- a voluntary licensee is mostly bound by a no-contest clause, so that he may not even take the chance of attacking the patent, even if competitors start infringing it;

- in case of a voluntary license, the licensee cannot request that the royalties be paid back by the patentee after the patent is (retroactively) invalidated. However, if an infringer succeeds with his nullity suit, the infringement action will be dismissed, and even a final judgment with damages awarded to the patentee can be invalidated by way of an action of restitution;
- a contractual licensee has a much higher economic risk as to the development of the product and its marketing, whereas the infringer in practice always imitates and copies a product which has already gained success on the market'
- the infringer often profits by the reputation of the patentee, especially as far as pharmaceuticals are concerned, where the safety and reliability of the product is often due to experienced and high-level research departments of renowned drug manufacturers;
- the infringer often pays royalties with ten years' delay compared with a voluntary licensee so that not only interest but also inflation are factors to his advantage.

Although several of these factors had been put forward by the plaintiff in the Tolbutamide decision, and some of them were also discussed by the Court of Appeals in the Heel Support Device decision, they did not influence the royalty rate finally granted to the respective plaintiffs. The estimate of the plaintiff in the Tolbutamide decision as to the economic value of these factors was only 11% requested as an increase, resulting in an overall percentage of 26%. The Court rejected the calculation method of the plaintiff and was only willing to increase the "normal" rate of 6% to a rate of 8%, although the enormous savings on the side of the infringer allowed the latter to undersell the patentee on the market with the infringing product by 42%. The fictitious license agreement on which the Court based its calculation method would have included the following, indeed fictitious conditions:

1. contract with unlimited time and without possibility of cancellation;
2. royalty rate left open and to be fixed at 8% only 14 years after the conclusion of the agreement;
3. prices to be charged for the licensed product at the discretion of the licensee;
4. full liberty of the licensee to attack the licensed patent;
5. payment of royalties starts 15 years after first sales of the licensed product;
6. no interest due on royalties;
7. no compensation for inflation;
8. no share in advertising and marketing costs.

There are not many license contracts which contain such terms, and a plaintiff who claims an additional 11% as compensation for these advantages should normally not be regarded as unreasonable.

In view of the generally favorable attitude of the Supreme Court toward patentees and an effective enforcement of patent rights it may well be that the somewhat surprising result in that case was due to a misunderstanding by the Court of Appeals which, when rejecting the claim for increased royalties, spoke of an inadmissible "infringer's surcharge" (Strafzuschlag), although plaintiff had explained that this increase was claimed as compensation for the several advantages the infringer had enjoyed in comparison to a voluntary licensee.

This misunderstanding was unfortunate since the Supreme Court in the decision on the appeal on the law held "that the royalty rate to be awarded has to be based on the objective value Of the usurped right to use" and that this objective value could be influenced by circumstances of

the particular infringement in question. 9) Since the Supreme Court emphasized the wide discretion which the trial court has in taking these factors into consideration, it may be hoped that the lower courts will indeed be more generous in the future.

There is, however, one point to be clarified. In the Plastic Hollow Section case the Supreme Court stated under III. 3 that "the infringer should not be at a disadvantage as compared to a contractual user of the rights at issue...". Trial courts (and infringers) may well take this as an argument against royalty rates which are higher than the current rates in industry, although when applying the "objective value" test a perhaps considerable increase would be warranted.

Here one should first remember that the Plastic Hollow Section II decision was not a case of deliberate infringement. The sentence immediately preceding the aforementioned citation reads: "for the assessment of the value replacements on the basis of unjust enrichment... " (emphasis added). Furthermore, when citing the above comparison with a contractual infringer, one should not overlook the second part of the sentence which says that the infringer "should not fare better either." This means that if evident economic advantages in the position of the infringer are not taken into account, the infringer would indeed "fare better" than a voluntary licensee.

b. "Objective Value" Test vs. "Reasonable Businessmen"

When applying these principles to an individual case it may be questioned whether the test of a "reasonable businessman" does not sometimes come to a different or even contradictory result in comparison to the general principle of "objective value" described before. The "reasonable businessman" is the example of a contractual licensee. However, as shown before, there are often advantages which the infringer enjoys and which have an economic value, which would never be discussed between reasonable businessmen and which the infringer has unilaterally usurped, e.g. of the above-cited points 1, 2, and 4 for which no "current rate" exists. Others, e.g. Nos. 3, 5, 6, 7 and 8, could generally influence the royalty rate, but if discussed ex ante parties would often come to considerably different rates than a judge, after 10 years of extensive sales of the product in question, when the actual extent of use of the protected right is known. In such a case, therefore, it should not be asked what the result of fictitious license negotiations would have been - especially where the patentee would never have dreamed of negotiating at all - but to what extent the infringer has profited from the market opportunities offered to him by the industrial property right in question.

When applied to the facts of the Heel Support Device case, therefore, the question should not be whether contracting partners would have agreed to pay interest on the royalties, but rather how much interest the infringer has actually saved by not paying the royalty each year or during any shorter period which is customary in the industry. Such a realistic and concrete approach, e.g. based upon the interest rates charged by banks in the relevant periods, was applied, for example, in a number of U.S. decisions. 10)

And why should the infringer not pay a surplus in consideration of the fact that he has "taken" a license without asking the patentee, when the latter can prove that he never grants licenses at all? A reasonable share in advertising and other marketing costs, which the licensee must usually bear, should also be added to the royalty rate to be paid by the infringer. As to the latter point, again one should not ask how much a fictitious licensee would have agreed to pay but whether and to what extent the infringer has taken advantage of the advertising of the protected product by the patentee.

Even if one disregards the difficulties in determining ex post fictitious contractual terms between parties who would perhaps never have come together on a voluntary basis, such a procedure is often unfair to the patentee if one only takes the development of interest and inflation: no reasonable businessman would accept postponement of payment by 10 years or more, even with interest, because he cannot predict the development of the interest rate; and to provide for an increase of royalties in relation to the inflation rate in a contract, is even forbidden under German law. Such factors can only be considered ex post by determining the value of the infringer's position objectively on the basis of all available facts.

Of course, and this has also been pointed out, disadvantages on the side of the infringer in comparison to a voluntary licensee must also be taken into consideration. In this context it may, however, be doubtful whether, as the Supreme Court indicates, the fact that the infringer always lives under the threat of being sued for infringement, and that he is exposed to the surrender of his profits (instead of merely paying a royalty) is always a factor which would reduce the royalty rate. Many willful infringers live quite happily with such a threat, and they can rely on the difficulty of proving the amount of profits. If, however, in an individual case it can be shown that this threat has influenced the business decisions of the infringer who, for example left 50% of his production capacity idle after having received the patentee's warning letter, such a fact could be taken into consideration. However, as this example shows, it is indeed mere fiction to assume that such a possibility would have been included by a reasonable businessman in the contract. Therefore, a general royalty decreasing factor on the side of the infringer ("fear rebate") is equally unacceptable since it is a general surcharge in favor of the patentee. The determination of the royalty rate should be the result of an overall evaluation of any possible factors which have an economic value, not based upon a fictitious situation of 10 years before, but on the actual facts presented to the court.

Taking into account how far the Court has already departed from what for decades had been well-established law, one may be optimistic that it will take a further step so that the infringer, when comparing his financial situation based on the calculation method of the Court with and without the infringement, will come to the conclusion that infringement does not pay.

*) Dr.jur.; L.L.M. Harvard University; Attorney-at-Law. Munich; Member of the Staff of the Max Planck Institute for Foreign and International Patent, Copyright and Competition Law. Munich.

1) See FRITZE, GRUR 1979 290 ; PIETZCKER, GRUR 1975 55 ; PREU, GRUR 1979 753 ; VON FALCK & OHL, GRUR 1971 541 ; PAGENBERG, 11 IIC 723 (1980); id., GRUR 1980 286 , 295 et seq.

2) See 9 IIC 156 (1978) - Plastic Hollow Section I, with editorial note.

3) See 11 IIC 763 (1980).

4) See this issue at 111 - Heel Support Device and at 115 - Plastic Hollow Section.

5) See this issue at 111

6) See this issue at 115.

7) Cf. *Coleman Co., Inc. v. Holly Mfg. Co.*, 122 USPQ 559, 562 (9th Cir. 1969); *Zegers v. Zegers*, 173 USPQ 385 (7th Cir. 1972); *Broadview Chemical Corp. v. Loctite Corp.*, 164 USPQ 419, 424 (D. Conn. 1970); *Tri-Tron International v. Velto*, 188 USPQ 177 (9th Cir 1975).

8) Cf. the references in *Broadview Chemical Corp. v. Loctite Corp.*, 164 USPQ 419, 424 (D. Conn. 1970); *Grasseli Chemical Co. v. National Aniline & Chemical Co., Inc.*, 282 F.2nd (S. D. N. Y. 1920); *Activated Sludge, Inc. v. Sanitary District of Chicago*. 68 USPQ 137, 139 (N. D. III 1946).



9) See English translation of the decision in 11 11C 767 (1980). A similar statement, however, interpreted under the somewhat different aspects of a claim for unjust enrichment, was made in the Plastic Hollow Section II case, this issue at p. 118.

10) *Pitcairn v. United States*, 188 USPQ 35 (Ct.Cl. 1975); *Maurice A. Gardell, Inc. v. The Boeing Co.*, 180 USPQ 294 (C.D. Cal. 1973), *aff'd*. 192 USPQ 481 (9th Cir. 1976).