Global Arbitration Review

The Guide to IP Arbitration

Editors

John V H Pierce and Pierre-Yves Gunter

In association with

The Guide to IP Arbitration

Editors

John V H Pierce and Pierre-Yves Gunter

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For further information please contact Natalie.Clarke@lbresearch.com

Publisher
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Copy-editor
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Proofreader
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Publisher's Note

Global Arbitration Review, in association with Intellectual Asset Management and World Trademark Review, is delighted to publish *The Guide to IP Arbitration*.

For those unfamiliar with GAR, we are the online home for international arbitration specialists; we tell them all they need to know about everything that matters. Most know us for our daily news and analysis service (you can sign up for our free headlines on www.globalarbitrationreview.com), but we also provide more in-depth content: books and regional reviews; conferences; and workflow tools. Visit www.globalarbitrationreview.com to learn more.

Being at the heart of the international arbitration community, we often become aware of gaps in the literature – topics yet to be fully explored. The intersection of IP and arbitration is one such area. Hitherto, the two fields have not mingled as well as one might expect. Large IP owners, such as banks, are known in arbitration circles as being sceptical about the medium. They shouldn't be. In many ways, international arbitration is perfect for them: a private, bespoke process, invented to bridge cultural divides. Above all else, it is internationally enforceable.

Recently, this antipathy towards arbitration has shown signs of fading. There are now IP owners who are international arbitration evangelists.

We are therefore delighted to publish the first edition of *The Guide to IP Arbitration*, in conjunction with two of our sister brands that cover the world of IP: Intellectual Asset Management and World Trade Mark Review.

This book is in five parts and will be of interest both to newcomers to arbitration and those who are already aficionados. Future editions will be expanded with the viewpoints of arbitrators and in-house counsel.

If you find it useful, you may enjoy other GAR Guides in the same series, which cover energy; construction; M&A disputes; advocacy; damages; mining; and challenging and enforcing awards. We are also very proud of our citation manual, UCIA (*Universal Citation in International Arbitration*).

Lastly, sincere thanks to our two editors, John V H Pierce and Pierre-Yves Gunter, for taking the idea that I pitched and running with it so well. I was on a skiing holiday at the time – my, those days seem a long time ago! And thank you to all of my Law Business Research colleagues for the elan with which they've brought our vision to life.

Part IV

Remedies in International IP Arbitration

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Damages in International IP Arbitration

Gregory K Bell, Peter J Rankin and Andrew Tepperman[1]

Introduction

Intellectual property (IP) encompasses some of the most valuable assets in the global economy, from trade secrets to copyrights to patents. When IP is usurped, damages may be significant. Nonetheless, the goal of the damages inquiry in IP arbitration is the standard one: to restore a claimant to the financial position it would have achieved had the improper conduct not occurred. This principle applies across a range of types of disputes and jurisdictions, though it is recognised that its implementation may depend on the applicable law.

Consider a contractual relationship between a claimant and a respondent, and a dispute involving the unauthorised or insufficiently compensated use of the claimant's IP by the respondent. The approach in this regard is to determine the claimant's lost 'profits' (broadly interpreted) as a result of the respondent's actions. In this context, it is useful to consider two different types of lost profits: lost profits due to lost sales and lost profits due to lost payments related to the unauthorised use of IP. Lost profits due to lost sales may arise in circumstances in which the claimant otherwise would have exploited the IP via increased sales of its products in the marketplace. This situation frequently arises in disputes involving unauthorised use of patented technology or trade secrets.[2] Lost profits due to lost payments encompass various types of royalty disputes, including, for example, the use of patented technology or copyrights by a respondent outside the use permitted under an existing licence agreement. This chapter considers both types of lost profits with respect to damages related to IP.

1 Gregory K Bell is group vice president and Peter J Rankin and Andrew Tepperman are vice presidents at Charles River Associates.

2 In some jurisdictions, a remedy for patent infringement or the theft of trade secrets may be unjust enrichment (or an account of the profits), a topic that we do not explore in this chapter.

The chapter is organised as follows. The next section characterises the distinction between the two types of lost profit assessments regarding IP. The third section delves into some of the issues associated with lost profits due to lost sales that result from the unauthorised use of IP and the fourth section considers the issues associated with determining an appropriate payment for other unauthorised uses of IP.

Lost profits and IP

Fundamentally, IP represents a factor in the production process of a good or service that generates value for that good or service. This IP could be a trade secret, such as the layout of a factory floor to optimise a production process or the formulation of a product, such as Coca-Cola; it could be a trademark that is associated with certain attributes of a brand, such as Disney; it could be copyrighted material that reflects creative effort; or it could be a patent that protects the exclusivity of access to a disclosed product or technology. IP does not tend to be consumed in the production process and its use for one purpose does not preclude or limit its use for others. Accordingly, when IP is usurped, damages tend not to be the total value of the IP per se, but rather the value of the inappropriate use of the IP that represents economic harm sustained by the claimant.

It is useful to consider two ways that the respondent's inappropriate use of IP could cause harm and lead to damages sustained by the claimant.

The respondent could disadvantage the claimant competitively by making sales that, but for its inappropriate use of the claimant's IP, otherwise would be made by the claimant. This is the lost sales aspect of IP damages.

If the respondent's inappropriate use of the IP does not lead to lost sales for the claimant, then the claimant has still been denied its appropriate payment for the use of the IP. This represents the lost payment aspect of IP damages.

Either way, the claimant has lost profits because it did not make an additional sale or because it was owed for the respondent's unauthorised use of its IP. If the respondent's unauthorised use of IP leads to a reduction in the value of the IP, that also would be considered an element of lost profits sustained by the claimant. Suppose, for example, that a respondent infringes a product patent and sells the infringing product at a lower price than the claimant. This could lead not only to lost unit sales for the claimant, but also to longer-term price erosion of the claimant's current and future sales.

The longer-term price erosion generated by infringing competition is clearly an element of lost profits sustained by the claimant related to the lost sales aspect of IP damages. As another example, suppose that a respondent's infringing use of a trademark reduces the ongoing value of the trademark to the claimant. This too represents an element of lost profits sustained by the claimant. As a result of damage to the value of the trademark, the claimant could lose future sales or need to expend additional effort (such as marketing and promotion) to make future sales. The lost value of the trademark is assessed in consideration of its impact on the amount and profitability of future sales.

Accordingly, the first step in assessing damages related to IP is to determine how the claimant has been harmed. Has the claimant lost sales as a result of the respondent's inappropriate use of the claimant's IP? To the extent that the respondent's inappropriate use of the IP did not generate lost sales for the claimant, what should the respondent have paid for its use of the IP?

It is not unusual for both types of lost profit damages related to IP to be present in the same matter. Typically, this would be situations in which the claimant, respondent and others compete in the market for sale of the product or the claimant and respondent compete in some but not in all segments of the market in which the respondent makes sales that inappropriately use IP. For those segments of the market in which the claimant and respondent compete, the respondent may have made sales that, but for its unauthorised use of IP, the claimant otherwise would have made. On these sales by the respondent, it is appropriate that the claimant be awarded its lost profits from the associated lost sales. On all other sales made by the respondent related to the unauthorised use of IP, the claimant has not lost sales but has lost the payment owed as a result of the respondent's unauthorised use of IP.

Lost sales due to IP

As a general matter, to support a claim for lost profits that result from lost sales due to the respondent's unauthorised use of IP, the claimant should show the following:[3]

- the respondent would not have made the sale but for the unauthorised use of the claimant's IP (demand);
- the claimant otherwise had the ability to make the sale (capacity); and
- profit that the claimant would have been earned as a result of the lost sale (valuation).

Demand

From an IP damages perspective, a claim of lost sales requires that the respondent's sale was made because of the unauthorised use of IP. This should not be construed as a characterisation that the claimant's IP was the only driver of demand for the product or service in question; rather, it should be established that, but for the unauthorised use of claimant's IP, the respondent would not have made the sale and the claimant would have made the sale.[4] In such circumstances, it would be evident that it was the respondent's unauthorised use of the IP that caused the claimant to lose the sale and consequently the profit that would have been associated with the sale.

There are a few reasons why the respondent's inappropriate use of IP associated with the sale of a product or service would not lead to a lost sale for the claimant, including the existence of other competitors and price considerations.

Often, the claimant and the respondent are not the only two companies with competing products for sale. As such, the respondent's inappropriate use of IP may be the reason that the respondent made the sale, but, in the absence of the respondent, it is not necessarily the case that the claimant would have made the sale. Typically, one assumes that the claimant would have made a share of the respondent's sales based on claimant's share of competing sales. For example, if there were three companies competing in the market segment, with

3 This can be thought of as a modified version of the four-pronged test commonly applied in patent infringement cases in the United States, as articulated in *Panduit Corp. v. Stahlin Bros. Fibre Works, Inc.*, 575 F.2d 1152 (6th Cir. 1978). Some jurisdictions require claimants to meet additional requirements, such as the United Kingdom's requirement to show that recovery for the loss is not excluded by public or social policy (*Gerber Garment Technology v. Lectra Systems*, [1995] RPC 383, at 393).

4 For an articulation of this principle, see, as a US case example, *Rite-Hite Corp. v. Kelley Co.*, 56 F.3d 1538, at 1545 (Fed. Cir. 1995), and as a UK case example, *Meters Ltd. v. Metropolitan Gas Meters Ltd.*, [1911] 28 RPC 157, at 163.

the claimant having a 40 per cent share of sales, the respondent having a 20 per cent share of sales and the third company having the remaining 40 per cent of sales, then one typically would assume that half of the respondent's sales otherwise would have been sales made by the claimant.[5] Thus, the claimant would claim damages as lost profits on the lost sales related to half of the respondent's sales and would claim damages as lost profit due to lost payment for the inappropriate use of IP that allowed the respondent to make the other half of its sales.

Price is a determinant of demand. There is no issue if the claimant and the respondent each sold competing products for approximately the same price. To the extent, however, that the respondent sells the product for a meaningfully lower price than the claimant, then it may be that, but for the respondent making the sale, the claimant would not have made the sale. It may be that the customers who purchased the respondent's product would not have paid the higher price required to purchase the claimant's product. These customers may be part of a different segment of the market for which the claimant has chosen not to compete. In such circumstances, the claimant should not be able to collect damages based on lost sales, because no claimant sales were lost; rather, the respondent made sales that the claimant was never going to make. As such, the claimant's damages are not lost profits due to a lost sale but rather lost profits due to a lost payment from the respondent for its inappropriate use of IP.

Of course, it may be that the claimant reacts to the respondent's lower price by lowering its own price. This is sometimes called price erosion. In such circumstances, the claimant should not only receive damages as lost profits on the sales it lost to the respondent, but it also may be appropriate to receive damages based on the reduction in price required to make the sales that it did make. Care must be taken, however, not to ignore the price elasticity of demand. An axiom of economics is that a lower price leads to increased unit sales of a product. Accordingly, when assessing damages related to price erosion, one must consider whether the claimant actually would have made all the sales that it did make had it not lowered the price to compete with the respondent.[6]

Related to the demand element is the lack of an available alternative to the respondent's inappropriate use of the IP. To the extent that the respondent had an available alternative to inappropriate use of the IP such that the respondent still would have made the sale, then it cannot be that the primary reason for the respondent making the sale was the inappropriate use of the IP.[7] In such circumstances, the appropriate measure of damages is not the claimant's lost profits due to a lost sale; rather, the appropriate measure of damages would be lost profits due to a lost payment from the respondent for its inappropriate use of IP. As to the size of such a payment, the additional cost avoided by the respondent as a result of using the IP rather than taking advantage of the available alternative is likely to be a major consideration.

5 Excluding the respondent's sales, the claimant accounts for 50 per cent of the rest of the sales: 40/(40 + 40).

6 For an example from US case law, see *Crystal Semiconductor v. Tritech Microelectronics*, 246 F. 3d 1336, at 1359 (Fed. Cir. 2001); for an example from UK case law, see *Ultraframe (UK) Ltd. v. Eurocell Building Plastics Ltd.*, [2006] EWHC 1344 (Pat).

7 See, as a US example, *Grain Processing Corp. v. American Maize-Products*, 185 F. 3d 1341 at 1356 (Fed. Cir. 1999), and as a Canadian example, *Merck & Co., Inc. v. Apotex Inc.*, 2015 FCA 171, at ¶¶ 41–43, 48–50, 59–60 (CanLII).

Capacity

For the claimant otherwise to have been able to make the sales made by the respondent as a result of the respondent's inappropriate use of the claimant's IP, the claimant must have had access to the capacity required to make those sales. For a manufactured product, this means that the claimant must have been able to increase its production or otherwise satisfy the demand that the respondent's sales addressed, perhaps by drawing down inventories. To the extent that the claimant otherwise would have had to expand or access additional capacity to make the sales made by the respondent when those sales were made, the increased costs necessary for such expansion would need to be accounted for in the assessment of quantum. Similarly, it might be that the claimant would have needed labour to work overtime or acquire additional raw materials at higher costs. If so, these issues would also need to be accounted for in the assessment of quantum.

Capacity, however, is not only an issue for manufacturing; it is also an issue for marketing and distribution reach. A good example would be the respondent's inappropriate use of the claimant's IP to introduce a product in a geographic region that is not served by the claimant. But for the respondent, it may be that the claimant never would have made the sales because it had not been marketing the product in that country. Similarly, it may be that the respondent inappropriately uses the claimant's IP and markets the product for a separate use or in another sector of the economy. Again, it may be that, but for the respondent, the claimant never would have made those sales because it had not been marketing the product for that use or to that sector of the economy. Note that the advent of e-commerce does not render this issue moot. The claimant's product may have been available via e-commerce but the respondent's physical presence and approach may have led to sales that the claimant otherwise would not have made.

Thus, to the extent that the claimant did not have the capacity (either manufacturing or marketing and distribution) required to make the sales made by the respondent, the claimant would be unable to collect damages as lost profits due to lost sales that otherwise it never would have made. On those sales made by the respondent, the claimant would receive damages limited to the lost payment for the respondent's unauthorised use of the IP.

Valuation

In most situations, accounting records should be sufficient to support a claim for lost profits due to lost sales. The focus, however, should be on a comprehensive perspective regarding the assessment of lost profits due to lost sales, particularly with respect to incremental costs.

Lost profits are calculated as the incremental revenues less the incremental costs associated with the incremental unit sales that the claimant would have made but for the respondent's actions. The key word here is incremental. Incremental costs are not average costs; they are the additional costs that the claimant would have incurred to make the sales that the respondent made. For example, the incremental costs related to lost sales typically would not include additional expenditures of fixed costs, such as the overhead that may be associated with head office salaries or the rent on an office building. Instead, incremental costs are usually the per-unit variable costs that may be associated with manufacturing, such as raw materials and direct labour, or the per-sale commissions that may be associated with salespeople. As discussed above, however, capacity costs also should be considered. If the claimant were going to need extra capacity to make its share of the respondent's sales and that capacity were available to the claimant, then the assessment of lost profits due to lost sales would need to include the additional costs required for the additional capacity.

Conclusion

In summary, damages resulting from the respondent's unauthorised use of the claimant's IP may be based on the claimant's lost profits due to lost sales if the following two criteria are met.

- The respondent's use of the claimant's IP was the principal reason for the sale made by the respondent. If so, it should be that, without using the IP, the respondent would not have made the sale.
- The claimant otherwise had the capacity to make the sale where and when the respondent made the sale and there is no reason to believe that, but for the respondent's actions, the claimant otherwise would not have made the sale.

Then, to the extent that the claimant has lost sales as a result of the respondent's unauthorised use of IP, lost profits should be quantified based on the incremental costs that the claimant otherwise would have incurred to support those lost sales.

Lost payments for IP

To the extent that the respondent's unauthorised use of IP does not lead to lost sales for the claimant, then damages should be based on the lost profits sustained by the claimant as a result of lost payments for the respondent's unauthorised use of IP.

In the marketplace, payment for the use of IP is typically the result of a negotiation between the owner of the IP and the prospective user of the IP. The negotiation would consider how the prospective user is likely to use the IP and how that use of the IP generates value. The payment that results from the negotiation thus considers both the value associated with the prospective intended use of the IP and how that value should be divided between the owner of the IP and the user of the IP. Such payments for the use of IP often are referred to as royalties.

A standard concern is the assertion that the claimant never would have licensed the IP to the respondent. There even may have been negotiations between the parties for access to the IP that ultimately were unsuccessful. Nonetheless, damages in the arbitration must be determined; if liability has been found, the respondent made inappropriate use of the claimant's IP, whether or not the claimant otherwise would have licensed the IP to the respondent. Typically, the claimant's refusal to license may be based on concerns that licensing enables a prospective competitor (respondent) to make sales that otherwise would have been made by the claimant. However, to the extent such a concern regarding lost sales is valid, that concern is addressed above as the claimant is able to receive damages in the form of lost profits due to lost sales. Accordingly, the hypothetical negotiation would be concerned with the respondent's use of the IP to the extent that such use does not lead to lost sales for the claimant.

Hypothetical negotiation

As the goal of the damages inquiry is to return the claimant to the economic position it would have been in but for the respondent's inappropriate actions, it is appropriate to estimate the value of lost payments by considering a hypothetical negotiation that would have occurred between the claimant and the respondent on the eve of the respondent's first inappropriate use of the claimant's IP.[8] Such a negotiation presumes the claimant to be a willing licensor of the IP at issue and the respondent to be a willing licensee, with each party seeking to negotiate a licence to the IP in the ordinary course of business. The timing of such a negotiation would often be expected to have an impact on the outcome of the negotiation. Any upfront fees or milestone payments that may be associated with the use of the IP, as well as any royalty rate, will be affected by the then-current expectations of the potential value of the technology and by the then-current relative bargaining power of the parties to the negotiation.

Typically, the best perspective on the likely result of such a hypothetical negotiation is gained through a review of agreements or licences for the same or similar IP. The more comparable the agreement (considering the type of IP), the expected use of the IP, the position of the licensor and licensee, and the timing, the more likely it is that a comparable agreement (or agreements) would reflect the outcome of the hypothetical negotiation. In such circumstances, a market-based negotiation already has occurred and spoken to the expected value of the IP, the relative bargaining power of the parties and the appropriate structure of the payments for the use of the IP.

A review of comparable agreements may yield a relevant range for the result of the hypothetical negotiation. There may be a range of upfront payments required to enter into an agreement for use of the IP; there may be a range of payments associated with certain milestones related to the development and commercialisation of products or services associated with the IP, such as the launch of a product or milestones related to annual or cumulative sales; and there may be a range of royalty rates associated with per-unit use of the IP. Within these ranges, a determination must be made with respect to the results of the hypothetical negotiation between the claimant and the respondent related to the IP at issue, such that the claimant's lost profits related to the lost payments from the respondent may be determined.

How such a determination is reached should consider a number of factors related to the expected value of the IP and the bargaining power of the two parties to the negotiation. As noted above, these considerations should be evaluated assuming the hypothetical negotiation occurs just prior to the respondent's first unauthorised use of the IP.

Expected value of use

Regarding the expected value of the IP as it relates to the respondent's use, there are a number of factors to consider. As one would anticipate, the greater the expected value of the IP in a particular use, the greater the payment for that use of the IP, all else being equal.

Exclusivity

Many agreements related to IP note the exclusivity with which rights may be granted. Exclusive rights are worth more than non-exclusive rights. Of consideration in the

8 The canonical reference in US case law is *Georgia-Pacific Corp. v. United States Plywood Corp.*, 318 F. Supp. 1116 at 1120 (S.D.N.Y. 1970); in UK case law the canonical reference is *General Tire & Rubber Co Ltd. v. Firestone Tyre & Rubber Co Ltd.*, [1975] 1 W.L.R. 819; in Canadian case law the canonical reference is *AlliedSignal Inc. v. Du Pont Canada Inc.* (1998), 78 C.P.R. (3d) 129.

hypothetical negotiation would be the rights that the respondent would seek to acquire. As the arbitration is happening after the fact, it is likely that only non-exclusive rights would be at issue. After all, the claimant had continued to retain the right to license the IP and had not surrendered its own rights to use the IP.

Field of use

Many agreements related to IP specify fields of use for which the IP rights may be granted. The rights to certain geographic markets or fields of use may be more valuable than the rights to other geographic markets or fields of use. For example, the rights to a biotechnology innovation may be more valuable in fields of use that include human therapeutics in the United States as compared to agriculture in the European Union. Global rights would be worth at least as much as, and likely more than, more restricted geographic rights, particularly with respect to upfront and development milestone payments as these fixed costs may enable the opportunity to exploit the IP across a broader market. The same is not necessarily true regarding per-use payments for the IP, such as a percentage-of-sales royalty, as different geographic markets may be more or less profitable than others.

Duration

The duration of a licence agreement would be expected to have an impact on its value. Licences with longer durations would typically be worth more than those with shorter durations. This effect, however, is likely to be seen more with respect to upfront and development milestone payments, than with per-use payments, as the upfront and milestone fixed costs enable the opportunity to exploit the IP for longer with a longer licence.

Expected profitability of the product or service associated with the IP

The more profitable the market opportunity associated with the IP, the more valuable the IP would be in terms of opening up that market opportunity.

Expected incremental benefit of the IP itself

The more significant the contribution of the IP to the value of the market opportunity, the more valuable the IP would be. One manifestation would be in the degree of improvement represented by the IP relative to the prior technology.

Convoyed sales

To the extent that the respondent's use of the claimant's IP opens up the opportunity for sales of the respondent's other products that do not embody the IP at issue, then that too would increase the value of the IP with respect to the respondent's expected use.

Relative bargaining power

Similarly, with respect to the relative bargaining power of the parties to the negotiation, there are a number of factors to consider. The greater the bargaining power possessed by the claimant, the greater the negotiated payment for use of the claimant's IP.

History of licensing

To the extent that the claimant has sought to preserve its exclusivity with respect to the IP at issue, this would be expected to have an effect of increasing bargaining power in favour of the claimant.

Potential competitors

To the extent that the claimant licensing its IP to the respondent would strengthen the respondent's position as a competitor to the claimant, this too would shift bargaining power in favour of the claimant. However, even if the claimant and the respondent are not direct competitors, if there are direct competitors of the respondent that otherwise would have been able to compete with the respondent for the right to license the IP from the claimant then that would also shift bargaining power in favour of the claimant.

Result of the hypothetical negotiation

Every negotiation and every agreement is different. The above-listed factors may be more or less significant for the hypothetical negotiation between the claimant and the respondent and consideration of each factor may move the result of the hypothetical negotiation to the upper or lower end of the relevant range framed by the comparable agreements being considered. To sort through this information, one approach would be to assign each factor a level of significance for the hypothetical negotiation at issue and then assess whether consideration of the factor would tend to move the result of the negotiation towards the upper or lower end of the relevant range. This methodology enables a transparent, disciplined approach to the evaluation of multiple factors that are likely to have an impact on the hypothetical negotiation and makes it apparent how consideration of each factor could influence the outcome of the negotiation.

For example, if consideration of all relevant factors tends to push towards the upper end of the range, then an appropriate conclusion would be that the outcome of the hypothetical negotiation should be the upper end of the range. Similarly, if consideration of all relevant factors tends to push towards the lower end of the range, then an appropriate conclusion would be that the outcome of the hypothetical negotiation should be the lower end of the range. In addition, multiple studies of bargaining games show that relatively equal positions of bargaining power lead to relatively equal distributions of the results of a negotiation; in this case, that would mean a payment for the respondent's use of the claimant's IP that represents an intermediate value.

To demonstrate our methodology for determining the outcome of a hypothetical negotiation involving the rights to IP, consider the following example. Suppose there exist other licence agreements for IP that are considered to be comparable to the IP at issue in the arbitration that exhibit royalty rates that range from 5 to 15 per cent of sales. To determine where in this relevant range the outcome of the hypothetical negotiation would be, we consider the eight factors identified above. We follow the steps indicated below.

- Assign a level of significance to each of the factors: a value of 1 indicates a factor of relatively low significance; a value of 2 indicates a factor of moderate significance; and a value of 3 indicates a factor of relatively high significance.

- Total the significance value of the factors to be considered in the hypothetical negotiation. For example, as shown in the table below, we might find four of the factors to be of high significance, two of the factors to be of moderate significance and two of the factors to be of low significance. The result is a negotiation with a total significance value of 18.
- Assess whether consideration of each factor would tend to move the result of the hypothetical negotiation to an outcome in the upper end of the range or in the lower end of the range. Consideration of a factor that would move the result towards the lower end of the range would not earn any of the significance value of the factor; consideration of a factor that would move the result of the negotiation to the upper end of the range would be assigned the full significance value of the factor. For example, consideration of a factor of relatively high significance that would move the result of the negotiation to the upper end of the range would yield the full three points of significance. Note that the treatment of a factor may be similar in the agreements that frame the relevant range and similar to what would be expected from the hypothetical negotiation. For example, the other licence agreements may be for non-exclusive rights to IP; accordingly, consideration of the exclusivity factor would lead to an outcome in the middle of the range for a hypothetical negotiation that also would have been focused on non-exclusive rights. In such circumstance, half of the significance value of the exclusivity factor would be realised.
- Add up the significance points earned in the hypothetical negotiation. As shown in the table, we determine that 12 of the 18 significance points were realised in the example.
- Determine the consequent movement along the relevant range. As shown in the table, we find that two-thirds of the significance points were realised in the example. This implies an outcome for the hypothetical negotiation, with appropriate consideration of the factors, that is two-thirds of the way along the royalty rate range from 5 to 15 per cent. The result of this hypothetical negotiation is thus a royalty rate of 11.7 per cent.

Factor	*Factor significance (a)*	*Factor value (b)*	*Effect on royalty (c)*	*Points (d)*
Exclusivity	Moderate	2	Middle	1
Field of use	High	3	Upper	3
Duration	Low	1	Upper	1
Expected profitability	High	3	Upper	3
Expected incremental benefit	High	3	Lower	0
Convoyed sales	Moderate	2	Lower	0
History of licensing	Low	1	Upper	1
Potential competitors	High	3	Upper	3
Sum		18		12
Percentage of possible score			67%	
Minimum royalty			5%	
Maximum royalty			15%	
Resulting royalty rate			11.7%	

Conclusion

As stated, the goal of the damages inquiry for IP disputes is generally to restore the claimant to the financial position it would have achieved had the respondent not made inappropriate use of the claimant's IP. To calculate these damages, a lost profits analysis is generally appropriate. There are two types of lost profits to consider in such an analysis. First, if the claimant lost sales because the respondent made inappropriate use of the claimant's IP, then damages should be the claimant's lost profits due to those lost sales. Second, for all other inappropriate uses of the claimant's IP, damages should be the lost profits due to the claimant's lost payments for use of the IP. These payments may be a combination of upfront payments for access to the IP, milestone payments related to development or commercialisation associated with the IP and 'per-unit of use' payments. The construct of a hypothetical negotiation is an effective and often-employed methodology for determining the claimant's lost payments for the respondent's use of the IP.

Appendix 1

The Contributing Authors

Gregory K Bell
Charles River Associates

Gregory K Bell is a group vice president at CRA. As an expert witness, he frequently testifies on damages in intellectual property, finance and antitrust litigation in courts and arbitration proceedings in North America, Europe, Asia and Australia. Dr Bell's business consulting engagements focus on the economics of business strategy, working with firms to develop sustainable competitive advantages in specific product markets. He has led and consulted to numerous projects concerning game theory and competitive strategy, global launch strategy, product pricing and positioning, capital budgeting and real options, and cost-benefit analyses. Dr Bell is a chartered accountant in Canada and earned his MBA and PhD in business economics from Harvard University.

Peter J Rankin
Charles River Associates

Peter J Rankin is a vice president at CRA, specialising in economic and strategic evaluation. His work involves estimates of monetary damages from commercial and intellectual property disputes, international arbitration involving contract disputes, assessment of patent extension antitrust claims and product reimbursement strategies in the life sciences industries. In addition, Dr Rankin has authored public and proprietary policy evaluation projects involving healthcare reform, reimbursement methodologies, antitrust exemptions, research and development incentives, and research productivity. Dr Rankin has served as an expert in litigation and arbitration, and has testified before the US Congress. He holds a PhD in economics from Duke University.

Andrew Tepperman
Charles River Associates

Andrew Tepperman is a vice president at CRA, based in Toronto, Canada. He specialises in providing economic and damages analyses for clients involved in arbitration and litigation proceedings. Dr Tepperman has assessed damages in a wide range of disputes, including intellectual property, breach of contract and antitrust matters. He has also performed economic analyses of liability issues in arbitration proceedings, including assessment of commercially reasonable effort and antitrust litigation matters, including analyses of market definition and market power. His work has encompassed a variety of industries, including pharmaceuticals, biologics, diagnostics, medical devices, telecommunications, and computer hardware and software. He has provided expert testimony in Canadian and US court proceedings. He holds a PhD in economics from the University of Toronto.

Charles River Associates

401 Bay Street, Suite 900
PO Box 46
Toronto, ON M5H 2Y4
Canada
Tel: +1 416 413 4084
atepperman@crai.com

200 Clarendon St
Boston, MA 02116-5092
United States
Tel: +1 617 425 3357
Fax: +1 617 425 3132
gbell@crai.com

1201 F Street, Suite 800
Washington, DC 20004-1229
United States
Tel: +1 202 662 3935
Fax: +1 202 662 3910
prankin@crai.com

www.crai.com

Until recently, large IP owners were hesitant about international arbitration – it was too scary (no prospect of appeal, etc.). Now, many are changing their minds.

This timely book sets out how arbitration can be tailored to meet the needs of IP owners and dispels some of the myths surrounding its use. It is in five parts that mirror the life cycle of disputes and will be of interest to newcomers and aficionados alike.

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