



IP High Court Grand Panel Decisions on Calculating Amount of Damages

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Abstract

The Intellectual Property (IP) High Court Grand Panel handed down decisions on June 7, 2019, in an infringement lawsuit between Japanese cosmetics companies (Case No. 2018 (Ne) 10063). The main issues of this case relate to the methods for calculating the amount of damages based on the infringer's profit (Article 102, paragraph 2 of the Patent Law), and based on reasonable royalty (Article 102, paragraph 3 of the Patent Law). These Grand Panel decisions will have a considerable impact, since they are expected to increase the amount of compensation as damages, and thereby act as a deterrent to intentional infringement. This article summarizes these court decisions.

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1. Summary of the methods for calculating the amount of damages under the Japan Patent Law

A patentee, whose patent right has been infringed by an unauthorized third party can file a lawsuit seeking remedies for the infringement with the court. One remedy is compensation for damages, which allows the patentee to recover monetary compensation for the damage caused by the defendant's previous act of intentionally or negligently infringing the patent (Article 709 of the Civil Law). However, since a patent right is an intangible property right, it is difficult for a patentee to establish the amount of damages resulting from infringement.

In order to alleviate such difficulty, the Patent Law includes three special provisions for calculating the amount of damage, as follows:

Article 102, paragraph 1 (the amount of damages based on patentee's lost profit):

The sum of money calculated by multiplying the number of products sold by the infringer by the profit per unit of the products which the patentee could have sold in the absence of the infringement (patentee's lost profit) may be estimated as the amount of damages, within a limit not exceeding an amount attainable, depending on the working capability of the patentee. If there is any circumstance that prevents the patentee from selling a part or the whole of the number of products sold by the infringer, a sum equivalent to the number of products which could not have been sold by the patentee shall be deducted.

Article 102, paragraph 2 (the amount of damages based on infringer's profit):

The profits gained by the infringer through the infringement (infringer's profit) shall be presumed to be the amount of damages incurred by the patentee.

Article 102, paragraph 3 (the amount of damages based on reasonable royalty):

A patentee may claim the amount of the royalty which the patentee would be entitled to receive for its patent right (reasonable royalty) as the amount of damages incurred by the patentee.

2. Overview of this case

First instance: Osaka District Court Case No. 2015 (Wa) 4292

Second instance: IP High Court Case No. 2018 (Ne) 10063

Relevant Patents: JP 4659980 B and JP 4912492 B

(corresponding to US 6689339 B1 and US 6689339 B1, respectively)

Title of Invention: Viscous compositions containing carbon dioxide

Patentee (Plaintiff in the 1st instance, Appellee in the 2nd instance): Medion Research Laboratories Inc.

Alleged Infringers (Defendants in the 1st instance, Appellants in the 2nd instance):

NeoChemir Inc., Cosmepro Co., Ltd., Airica Co. Ltd., Chiara Macchiato Co., Ltd., WINGSENSE Co., Ltd., Cosmebose Inc., and Clear-noir Inc.

This case relates to a patent infringement lawsuit lodged by Medion Research Laboratories Inc. (hereinafter “the Patentee”), a Japanese cosmetics company which owns two patents titled “Viscous compositions containing carbon dioxide” (JP 4659980 B and JP 4912492 B), against Japanese cosmetics companies including NeoChemir Inc., etc. (hereinafter “the Defendants”). Since in the first instance, the Osaka District Court rendered a decision of patent infringement and granted compensation for damages alleged by the Patentee, the Defendants appealed to the IP High Court. The IP High Court sent this case to the Grand Panel, and in the appellate decision (the present decision), the IP High Court Grand Panel upheld the first instance decision, and dismissed the appeal.

Further, the Grand Panel established interpretation criteria with respect to the methods for calculating the amount of damages prescribed in Article 102, paragraphs 2 and 3 of the Patent Law. These criteria are expected to increase the amount of damages awarded by these methods, and thereby act as a deterrent to intentional infringement.

3. Main issues

The main issues of this case relate to the methods for calculating the amount of damages prescribed in Article 102, paragraph 2 (infringer’s profit) and paragraph 3 (reasonable royalty) of the Patent Law.

(1) Issue 1: The infringer’s profit (Art. 102, Para. 2)

With regard to “*the profits gained by the infringer*” prescribed in Article 102, paragraph 2 of the Patent Law, the Defendants argued that expenses incurred for selling the Defendants’ products, such as personnel expenses, outsourced experiment and research expenses, advertising and promotion expenses, sample cost, and cost for products in stock, etc., should be deducted from the profits.

Therefore, whether or not such expenses can be deducted from the profits gained by the infringer was disputed.

(2) Issue 2: Grounds for rebutting the presumption (Art. 102, para. 2)

In general, since Article 102, paragraph 2 of the Patent Law is a presumptive rule, it can be rebutted if the defendant proves that there are no grounds for presumption, i.e., the damages incurred by the patentee are smaller than the profits gained by the defendant.

In this particular case, the Defendants argued that the presumption should be rebutted, since:

- (a) there are many competing products other than the Defendants' products;
- (b) the Defendants' products have enhanced convenience, and the sales of their products are based largely on their marketing efforts;
- (c) the Defendants' products have a remarkable effect relative to the Patentee's product;
- (d) the Defendants' products are based on implementation of another patent, which is owned by the Patentee, NeoChemir Inc., and include a patent marking thereon;
- (e) the technical value of the patented invention is low, in comparison with prior art;
- (f) the Defendants' products contain butylene glycol, which is not contained in the patented invention, and thus the contribution of the patented invention to the Defendants' products is small; and
- (g) the Defendants' products do not infringe on the dependent claims of the patent, and thus the contribution of the patented invention to the Defendants' products is small, etc.

Therefore, the second main issue was whether or not these circumstances (a) to (g) alleged by the Defendants can be grounds for rebutting the presumption of Article 102, paragraph 2 of the Patent Law.

(3) Issue 3: Reasonable royalty (Art. 102, para. 3)

The Patentee submitted exhibits proving that the average royalty rate in the chemical industry in recent years is 5.3% according to a questionnaire to Japanese chemical companies, and 6.1% according to court decisions. The Patentee also submitted exhibits showing that they received settlements out of court, which amount to 10% of sales figures, in other infringement cases based on another of the Patentee's patents. Based on these exhibits, the Patentees alleged that the reasonable royalty should be 10% of the Defendants' sales figures.

On the other hand, the Defendants asserted that the royalty rate should be less than 3% of their sales figures, since the technical value and contribution of the patented invention are low.

Therefore, the royalty rate of the reasonable royalty was disputed as the third main issue.

4. IP High Court Grand Panel decisions

(1) Issue 1: The infringer's profit (Art. 102, para. 2)

The Grand Panel held that the profits gained by the infringer as prescribed in Article 102, paragraph 2 of the Patent Law refers to *the entire amount of the profits gained by the infringer, and thus the entire amount of the profits gained by the infringer shall be presumed to be the amount of damages incurred by the patentee*. The Grand Panel further held that such infringer's profits refer to *the marginal profit*, which is calculated by deducting

additional expenses which were directly incurred for producing and selling the defendant's product from the sales figures of the infringing product, and *the burden of proving such infringer's profits is on the patentee*. The expenses to be deducted include, for example, raw material expenses, purchasing expenses and transportation cost for the infringing product, and in general, do not include personnel expenses, traveling expenses and communication expenses, etc., in the administrative division.

In this particular case, the Grand Panel judged that most of the expenses alleged by the Defendants, such as the personnel expenses, sample cost and cost for products in stock should not be deducted, since the relationship between these expenses and the sales of the Defendants' products are unclear. On the other hand, some of the outsourced experiment and research expenses, as well as advertising and promotion expenses were deducted, since the Defendants successfully proved that they are *additional expenses which were directly incurred* for producing and selling the defendant's product.

(2) Issue 2: Grounds for rebutting the presumption (Art. 102, para. 2)

The Grand Panel held that if there are grounds for rebutting the presumption, i.e., *circumstances which deny the causal relationship between the infringement act and the damages incurred by the patentee*, the presumption of Article 102, paragraph 2 of the Patent Law can be rebutted, and that *the burden of proving such circumstances is on the infringer*.

The Grand Panel further held that, for example, the following circumstances can be taken into consideration as grounds for rebutting the presumption:

- (i) market difference between the infringer's business and the patentee's business;
- (ii) existence of competing products on the market;
- (iii) marketing efforts by the infringer (brand power and advertising, etc.);
- (iv) performance of the infringing product (features other than those of the patented invention, such as function and design, etc.);
- (v) the patented invention relates to only a portion of the infringing product;
- (vi) the infringing product has a remarkable effect relative to the patented invention; and
- (vii) the infringing product involves the implementation of another patent(s), etc.

In this particular case, the Grand Panel judged that above circumstances (a) to (g) alleged by the Defendants do not establish grounds for rebutting the presumption of Article 102, paragraph 2 of the Patent Law, based on the following reasons:

(a) Existence of competing products

The patentee's product and the Defendants' products both relate to a two-component type cosmetic carbon dioxide gas pack product, comprising an aqueous carbonate composition (a first component) and an acid in powder form (a second component), wherein the two components are mixed so as to react with each other and produce carbon dioxide gas.

However, the products asserted by the Defendants as competing products are not two-component type, but have a different product form.

The Grand Panel acknowledged the significance of the “two-component” form in the market of the cosmetic carbon dioxide gas packs, and judged that products having another product form are not competing products, and cannot be grounds for rebutting the presumption.

(b) Convenience of the Defendants’ products and marketing efforts by the Defendants

The Grand Panel judged that the improvement and the marketing efforts by the Defendants are not beyond the extent of anticipated improvement and marketing efforts, and thus they cannot be grounds for rebutting the presumption.

(c) Remarkable effects of the Defendants’ products

The Grand Panel judged that the effects of the Defendants’ products cannot be grounds for rebutting the presumption, since there is no evidence proving that they contribute to the sales of the Defendants’ products.

(d) Implementation of another patent

The Grand Panel judged that there is no evidence proving that the Defendants’ products fall within the scope of the “another patent” indicated by the Defendants, and thus such an argument by the Defendants cannot be grounds for rebutting the presumption.

(e) Technical value of the patented invention

The Defendants argued that the technical value of the patented invention is low, in comparison with prior art. However, the Grand Panel judged that the prior art indicated by the Defendants cannot exhibit the technical effect of the patented invention and have nothing to do with the damage incurred by the Patentee, and thus such an argument by the Defendants cannot be grounds for rebutting the presumption.

(f) Inclusion of butylene glycol

The Grand Panel judged that the patented invention contributes to the entire sales and profit of the Defendants’ products, since the patented invention relates to a two-component type, cosmetic carbon dioxide gas pack product, which is the same as the Defendants’ products. Further, Grand Panel judged that there is no evidence proving that the inclusion of butylene glycol contributes to the sales of the Defendants’ products, and thus it cannot be grounds for rebutting the presumption.

(g) Non-infringement of dependent claims

The Grand Panel judged that non-infringement of dependent claims has nothing to do with the damage incurred by the Patentee, and thus such an argument by the Defendants cannot be grounds for rebutting the presumption.

(3) Issue 3: Reasonable royalty (Art. 102, para. 3)

The Grand Panel first confirmed that the amount of royalty which the Patentee would be entitled to receive for its patent right prescribed in Article 102, paragraph 3 of the Patent Law should be calculated by *multiplying the sales figures of the infringing product by a royalty rate*.

With regard to the royalty rate, attention should be paid to the revision of Article 102, paragraph 3 of the Patent Law in 1998. Before the revision, it prescribed that “the royalty which the patentee would be *normally entitled to receive* for its patent right”. Thus, under the old law, the amount of damages awarded based on the reasonable royalty tended to be notably low, since the amount of damages tended to be calculated based on the average royalty at the early stage of negotiation with no infringement, not the higher royalty at the later stage of negotiation between a patentee and an infringer. In order to address this issue, the law was revised so as to delete “normally” therefrom and to prescribe --the royalty which the patentee would be *entitled to receive* for its patent right--.

In light of the spirit of this revision, the Grand Panel held that *a royalty rate, which is decided with the fact that the patent was infringed, should necessarily be higher than the normal royalty rate, which the patentee would be entitled to receive for its patent right*.

The Grand Panel further held that a royalty rate should be decided by taking into consideration the entirety of the circumstances, which are discovered in a lawsuit, for example:

- (i) actual royalty rates, which were agreed in previous license negotiations relating to the patent, and if they are not available, standard royalty rates in the market;
- (ii) technical value and significance of the patent, existence of alternative techniques;
- (iii) contribution of the patent to the sales and profit of the infringing product, and circumstances of infringement; and
- (iv) relationship between the patentee and the infringer in the market (whether they are competitors or not), and the patentee’s business policy, etc.

In this particular case, the Grand Panel judged that a royalty rate should be 10% of the sales figures of the Defendants’ product, in view of the following:

regarding item (i), the average royalty rate in the chemical industry in recent years is 5.3% according to a questionnaire to Japanese chemical companies, and 6.1% according to court decisions. Further, the Patentee actually received settlements that amount to 10% of sales

figures, in other infringement cases based on the Patentee's other patent(s); regarding items (ii) and (iii), the Grand Panel acknowledged the technical significance and the contribution of the patented invention to the entire sales and profit of the Defendants' product, and that the effect of the patented invention cannot be achieved by an alternative technique; and regarding item (iv), the Grand Panel also acknowledged the fact that the Patentee and the Defendants are competitors, etc.

5. Our comments

Regarding the main issues (1) and (2), the most important takeaways of this case, we believe, are that the Grand Panel clearly denied the idea of a "contribution rate" of a patent, which has been usually taken into consideration in determining the infringer's profit, and shifted the burden of proof for circumstances, which can reduce the infringer's profit, from patentees to infringers.

Specifically, before these decisions, courts tended to judge a "contribution rate" of a patent, in view of the implementation rate of the patent in the infringing product and the technical significance of the patent, etc., and reduced the infringer's profit based on the contribution rate. Moreover, it was not clear as to whether the burden of proving circumstances for determining a "contribution rate" was on the patentee or the infringer. In not a few cases, the burden of proof was on the patentee, and as a result, the amount of compensation calculated for damages tended to be rather small.

In this regard, the Grand Panel abolished the idea of a "contribution rate" of a patent, by judging that *the entire amount of the profits gained by the infringer shall be presumed to be the amount of damages incurred by the patentee*. Further, the Grand Panel held that *the burden of proving the entire amount of the infringer's profits is on the patentee, while the burden of proving grounds for rebutting the presumption is on the infringer*. These decisions mean that the circumstances, which have been considered in the context of "contribution rate", such as those in items (i) to (vii) in above section 3. (2), will be considered as "grounds for rebutting the presumption", for which *the burden of proof is on the infringer*.

Further, with regard to "infringer's profits" in Article 102, paragraph (2) of the Patent Law, there was a dispute relating to interpretation of "infringer's profits", i.e., as to whether they referred to, for example, the marginal profit, the gross profit or any other profits.

In this regard, the Grand Panel clearly held that the infringer's profits refer to *the marginal profit*, which is calculated by deducting *additional expenses which were directly incurred* for producing and selling the defendant's product from the sales figures of the infringing product, and established criteria that, in general, raw material expenses, purchasing expenses and transportation cost for the infringing product can be deducted, while personnel expenses, traveling expenses and communication expenses, etc., in the administrative division cannot

be deducted. These criteria are expected to be an important guidance for calculating “infringer’s profits”.

Furthermore, with regard to grounds for rebutting the presumption of Article 102, paragraph (2) of the Patent Law, it was not clear as to what circumstances can be considered as grounds for rebutting the presumption.

In this regard, the Grand Panel exemplified the factors, which can be considered therein, i.e., those in items (i) to (vii) in above section 3. (2). Although the grounds for rebutting the presumption were not established in this particular case, these decisions are expected to enable courts to more flexibly and appropriately judge the grounds for rebutting the presumption.

Lastly, with regard to the main issue (3), the Grand Panel explicitly held that a reasonable royalty under Article 102, paragraph 3 of the Patent Law *should necessarily be higher* than the normal royalty, and that a royalty rate should be decided by taking into consideration the entire circumstances that have been found in the lawsuit. In other words, the fact of infringement can be considered when calculating the amount of damages based on a reasonable royalty, which is expected to increase the amount of damages based on the reasonable royalty, and thereby act as a deterrent to intentional infringement.

Incidentally, Article 102 of the Patent Law will be revised in 2019¹, so as to introduce a new paragraph 4, which will prescribe that the royalty, which a patentee and an infringer would have agreed with based on the fact of infringement, can be considered in calculating the amount of damages based on a reasonable royalty according to paragraph 3. Therefore, we believe that these Grand Panel decisions will also comply with this revision of the Law.

END

¹ For more details, please also refer to Seiwa IP News dated April 17, 2019 (<http://www.seiwapat.jp/en/IP/2019-revisions-to-the-patent-and-design-laws-etcpart-i-revisions-relating-to-infringement-lawsuits.html>).