IP High Court Grand Panel Decision on Calculating Amount of Damages based on Patentee's Lost Profit

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Abstract

The 14th IP High Court Grand Panel decision was handed down on February 28, 2020, in an infringement lawsuit (Case No. 2019 (Ne) 10003). The main issues of this case relate to the methods for calculating the amount of damages based on *patentee's lost profit* (Article 102, *paragraph 1* of the Patent Law), while the last (13th) IP High Court Grand Panel decision related to the amount of damages based on infringer's profit (Article 102, paragraph 2 of the Patent Law)[1]. These Grand Panel decisions established unified rulings, i.e., *abolishment of the idea of contribution rate, and clarification of infringer's burden of proving the grounds for rebutting the presumption*. These rulings are expected to increase the amount of compensation as damages, and thereby act as a deterrent to intentional infringement. This article summarizes the 14th IP High Court Grand Panel decision.

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[1] For details of the 13th IP High Court Grand Panel decision, please refer to Seiwa IP News dated July 5, 2019 (http://www.seiwapat.jp/en/IP/ip-high-court-grand-panel-decisions-on-calculating-amount-of-damages.html)

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 damages, as follows:

Article 102, paragraph 1 (the amount of damages based on patentee's lost profit)[2]:
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] This Art. 102, para. 1 is the old law, which the 14th IP High Court Grand Panel decision is based on. It was revised in the 2019 revision and came into force on April 1, 2020, so as to enable the patentee to recover the damages for the number of infringer's product sold that exceeds the patentee's working capability as a reasonable royalty. For more details, please 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)

2. Overview of this case

First instance: Osaka District Court, Case No. 2016 (Wa) 5345
Second instance: IP High Court, Case No. 2019 (Ne) 10003
Relevant Patents: JP 5356625 B and JP 5847904 B (no counterpart English documents)
Title of Invention: Beauty Instrument
Patentee (Plaintiff in the 1st instance, Appellee/Appellant in the 2nd instance): MTG Co. Ltd.
Alleged Infringer (Defendants in the 1st instance, Appellant/Appellee in the 2nd instance): Fivestars Inc.

This case relates to a patent infringement lawsuit lodged by MTG Inc. (hereinafter "the Patentee"), a beauty/wellness brand development company which owns two patents titled "Beauty Instrument" (JP 5356625 B and JP 5847904 B), against a beauty/cosmetics company Fivestars Inc. (hereinafter "the Defendant"). In the first instance, the Osaka District Court affirmed an infringement of JP 5847904 B and granted compensation for damages based on Art. 102, para. 1, alleged by the Patentee. However, the court reduced the amount of damages by 90%, since the "contribution rate" of the patent is low, as the essential feature of the patented invention is directed only to a portion (inner bearing) of the product. Therefore, both the Patentee and the Defendant appealed to the IP High Court, which designated this case as the 14th Grand Panel case. In the decision, the Grand Panel abolished the idea of "contribution rate" of a patent, and reduced the deduction rate to 60% (the amount of damages increased by 30%) based on the existence of "the grounds for rebutting the presumption", and dismissed the appeal.

3. Main issues

(1) Issue 1: The profit per unit of patentee's product

(a) Regarding "the profit per unit"

With regard to "*the profit per unit of the products which the patentee could have sold in the absence of the infringement*" prescribed in Article 102, paragraph 1 of the Patent Law, the Patentees alleged that the profit per unit of the Patentee's product is calculated by deducting the expenses for producing and selling the product, such as sales commission, promotion and advertising cost, etc., from the selling price (JPY 23,800) of the Patentee's product. Accordingly, the profit per unit of the Patentee's product is JPY 5,547.

On the other hand, the Defendant argued that, in addition to the expenses that the Patentees indicated, employment cost, transportation cost and communication cost, etc., should also be deducted from the selling price of the Patentee's product.

(b) Regarding "contribution rate"

The patented invention is directed to a beauty instrument (11) as shown in the attached Figures, the essential feature of which resides in the inner bearing (25) of the instrument.

In this regard, the Patentee argued that the contribution rate of the patent is 100%, since the subject matter of the claims is "a beauty instrument" (a whole product); the inner bearing is a necessary and important element for the product's value; and whether or not the inner bearing is visible from outside the product is not relevant to the contribution rate.

On the other hand, the Defendant argued that the contribution rate of the patent is 0%, since the essential feature of the patented invention resides only in a portion (inner bearing) of the product; and the portion is not visible to consumers, etc.

(2) Issue 2: Circumstances that prevent the patentee from selling

Article 102, paragraph 1 prescribes that if there is any circumstance that prevents the patentee from selling a part or the whole of the number of the 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.

In this regard, the Defendants argued that the patentee could not have been able to sell the whole of the number of products sold, since:
(a) the selling price of the Patentee's product (JPY 23,800) is significantly different from that of the Defendant's product (JPY 3,000 to 5,000) and thus the market is different; and
(b) the Patentee's product has a microscopic current-generating function, which the Defendant's product does not have, and thus consumers who purchase the Defendant's product would not purchase the Patentee's product, even if there were no Defendant's product on the market.

4. IP High Court Grand Panel decision

(1) Issue 1: The profit per unit of patentee's product

The Grand Panel held that the "profit" per unit of patentee's product prescribed in Article 102, paragraph 1 refers to "*the marginal profit,* which is calculated by deducting *additional expenses which were directly incurred* for producing and selling the patentee's product from the sales figures of the patentee's product, and ... *the burden of proving such patentee's profit is on the patentee*", and that "expenses which were not directly incurred for producing and selling the patentee's product should not be deducted therefrom, and in general, administrative costs, such as employment cost, transportation cost and communication cost, etc., correspond to such expenses." Further, Grand Panel held that "*even if the patented invention is implemented in only a part of the patentee's product, the entire amount of the*

marginal profit ... shall be presumed, as a matter of fact, to be the amount of patentee's lost profit".

In this particular case, the Grand Panel judged that the expenses alleged by the Patentee should be deducted from the selling price of the Patentee's product, while all of the expenses alleged by the Defendant, such as fabrication cost, employment cost, transportation cost and communication cost, etc., should not be deducted therefrom. Accordingly, the Grand Panel presumed as a matter of fact that the entire amount of the marginal profit that the Patentee alleged (JPY 390,060,000) is presumed to be the Patentee's lost profit.

However, in view of the fact that the essential point of the patented invention resides in a portion of the patentee's product, and the Patentee's product has a microscopic current-generating function, which enhances the attractiveness of the product, etc., the Grand Panel judged that "the patented invention does not necessarily contribute to the entire amount of the profit of the Patentee's product, and ... *the amount of the profit should be rebutted by 60%, considering all of the circumstances that have emerged in this particular case*, such as the position of the patent invention in the Patentee's product, the features that the Patentee's product has other than the essential feature of the patented invention, etc." Regarding the idea of contribution rate that the Osaka District Court affirmed, the Grand Panel explicitly abolished it by judging that "there is no provision that prescribes the idea of contribution rate, and accordingly such a deduction based on contribution rate cannot be accepted".

(2) Issue 2: Circumstances that prevent the patentee from selling

The Grand Panel held that "*the burden of proving the circumstances that prevent the patentee from selling is on the infringer*, and if such circumstances are alleged and proven by the infringer, the amount corresponding to the number of products that the patentee could not have been able to sell due to the circumstances should be deducted." Further, the Grand Panel held that "such circumstances refer to ... c*ircumstances which deny the causal relationship between the infringement act and the decrease in the sales of the patentee's product*", such as:
(i) market difference between the infringer's business and the patentee's business, for example, difference in their price range;
(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.), etc.

In this particular case, the Grand Panel accepted above circumstance (a) alleged by the Defendant, i.e., the market difference due to the price difference, as a "circumstance that prevents the patentee from selling" prescribed in Article 102, paragraph 1, since consumers who purchase the Defendant's product would not necessarily purchase the Patentee's product, even if there were no Defendant's product on the market. On the other hand,

regarding circumstance (b) alleged by the Defendant, i.e., the difference in the function/technical effect, the Grand Panel judged that it cannot be accepted as a "circumstance" prescribed in Article 102, paragraph 1, but it would rather attract consumers to purchase the Patentee's product, even though the price is higher than the Defendant's product. Accordingly, the Grand Panel judged that the Patentee could not have been able to sell 50% (175,862) of the number of the Defendant's product sold (351,724), due to the circumstances in this particular case.

(3) Conclusion

Accordingly, the Grand Panel judged that the amount of damages based on Article 102, paragraph 1, in this particular case, is calculated as follows:
The amount of damages = (the number of products sold by the infringer) × (the profit per unit of the products)
= (351,724 × deduction rate of 50%) × (JPY 5,547 ×rebutting rate of 60%)
= JPY 390,060,000.

5. Our comments

The most important takeaways of this case should be *abolishment of the idea of "contribution rate" of a patent*, which has been usually taken into consideration in determining the profit per unit of the patentee's product under Japanese court practice, and *clarification of the infringer's burden of proving the grounds for rebutting the presumption,* which would reduce the profit per unit of the patentee's product.

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 profit per unit of the patentee's product 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 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 "*even if the patented invention is implemented in only a part of the patentee's product, the entire amount of the marginal profit ... shall be presumed, as a matter of fact, to be the amount of patentee's lost profit*". This ruling also clarifies that the calculation method of Article 102, paragraph 1 is not merely a calculation method, but a factual presumption, i.e., the burden of proving the grounds for rebutting the presumption is on the infringer, and is expected to increase the amount of damages calculated based on Article 102, paragraph 1, since if an infringer cannot allege and prove grounds for rebutting the presumption, then the entire amount of the marginal profit will be the amount of damages.

Another important ruing of this case relates to the interpretation of "profit per unit" of the Patentee's product in Article 102, paragraph 1. Before the decision, there was a dispute relating to interpretation of "profit per unit", i.e., as to whether it referred to, for example, the marginal profit, the gross profit or any other profits.

In this regard, the Grand Panel explicitly held that the profit is "*the marginal profit,* which is calculated by deducting *additional expenses which were directly incurred* for producing and selling the patentee's products from the sales figures of the patentee's products", and judged that employment cost, transportation cost and communication cost, etc., that the Defendant alleged cannot be deducted. These criteria and judgment are expected to be an important guidance for calculating "profits per unit" of the patentee's product.

Incidentally, similar rulings on "contribution rate", "burden of proving the grounds for rebutting the presumption" and "marginal profit" in relation to Article 102, *paragraph 2 (the amount of damages based on infringer's profit)*, were held in the last (13th) IP High Court Grand Panel decision. For details, please also refer to Seiwa IP News dated July 5, 2019[3].

Lastly, Article 102 of the Patent Law was revised in 2019[4], and came into force on April 1, 2020. Before the revision, a patentee was not able to recover damages that exceed the patentee's working capability based on the provision of old Article 102, paragraph 1 (please refer to above Section 1). However, according to the provision of revised Article 102, paragraph 1, it became possible for a patentee to recover damages that exceed the patentee's working capability, *as a reasonable royalty* (New Article 102, paragraph 1, item 2). Further, a new paragraph 4 was introduced to Article 102 which prescribes 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, i.e., the idea of "hypothetical negotiation" has been introduced.

Therefore, we believe that these rulings, as well as the revision to Article 102, will increase the amount of compensation as damages, and thereby act as a deterrent to intentional infringement.

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[3] For more details, please also refer to Seiwa IP News dated July 5, 2019 (http://www.seiwapat.jp/en/IP/ip-high-court-grand-panel-decisions-on-calculating-amount-of-damages.html)
[4] 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).

Appendix: Figs.1, 4 and 8 of Patent No. JP 5847904 B

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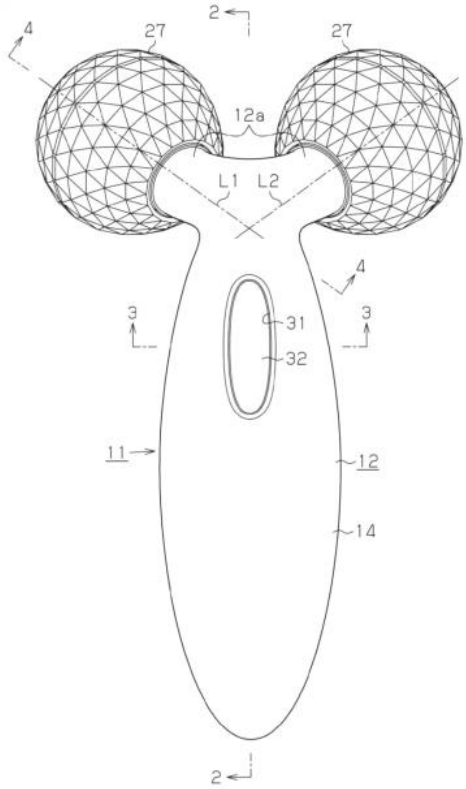

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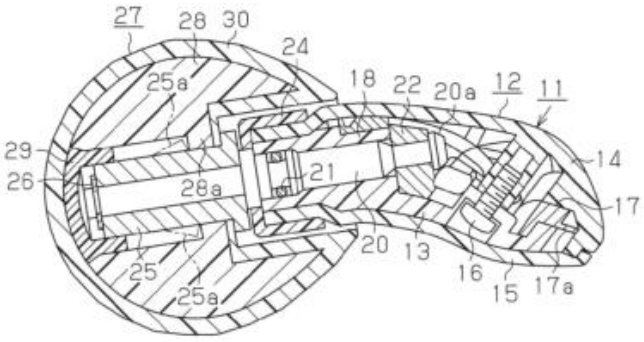

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