PATENT REMEDIES AND COMPLEX PRODUCTS

Through a collaboration among twenty legal scholars from eleven countries in North America, Europe, and Asia, *Patent Remedies and Complex Products* presents an international consensus on the use of patent remedies for complex products such as smartphones, computer networks, and the Internet of Things. It covers the application of both monetary remedies like reasonable royalties, lost profits, and enhanced damages, as well as injunctive relief. Readers will also learn about the effect of competition laws and agreements to license standards-essential patents on terms that are “fair, reasonable, and nondiscriminatory” (FRAND) on patent remedies. Where national values and policy make consensus difficult, contributors discuss the nature and direction of further research required to resolve disagreements. This title is also available as Open Access on Cambridge Core at doi.org/10.1017/9781108594981.

C. Bradford Biddle is Principal at Biddle Law PC and Faculty Fellow at the Center for Law, Science and Innovation, Sandra Day O’Connor College of Law, Arizona State University (ASU). He has taught courses on technology standard setting and internet law as an Adjunct Professor at ASU and elsewhere, and was a Fellow with Stanford Law School’s Center for Internet and Society.

Jorge L. Contreras is a Professor of Law at the S. J. Quinney College of Law, University of Utah. He is the editor of five books, has published more than 100 articles and book chapters, and has served on high-level advisory boards at the US National Institutes of Health, National Academies of Science and American National Standards Institute, among others.

Brian J. Love is an Associate Professor of Law at School of Law, Santa Clara University, California, where he serves as Co-Director of the School’s High Tech Law Institute and teaches courses in intellectual property law and remedies. Prior to joining Santa Clara, Brian was a Teaching Fellow at Stanford Law School a patent litigator, and a law clerk at several courts.

Norman V. Siebrasse is a Professor of Law at the University of New Brunswick, Canada. His research focuses on pharmaceutical patent law, patent remedies and the intersection of intellectual property law and commercial law. His writing is regularly cited by the Canadian courts, including the Supreme Court of Canada. He served as a law clerk at the Supreme Court of Canada.
Patent Remedies and Complex Products

TOWARD A GLOBAL CONSENSUS

Edited by

C. BRADFORD BIDDLE
Arizona State University, Sandra Day O’Connor College of Law

JORGE L. CONTRERAS
University of Utah, S. J. Quinney College of Law

BRIAN J. LOVE
Santa Clara University, School of Law

NORMAN V. SIEBRASSE
University of New Brunswick (Canada), Faculty of Law
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Contributors

Colleen V. Chien
Professor of Law, Santa Clara University School of Law

Chien is an associate professor at Santa Clara University School of Law where she teaches, writes, and mentors students. From 2013 to 2015, she served in the Obama White House as a senior advisor, Intellectual Property and Innovation, working on a broad range of patent, copyright, technology transfer, open innovation, educational innovation, and other issues. Professor Chien is nationally known for her research and publications on domestic and international patent law and policy issues. She has testified on multiple occasions before Congress, the DOJ, the FTC, and the U.S. Patent and Trademark Office on patent issues, frequently lectures at national law conferences, and has published several in-depth empirical studies, including of patent litigation, patent-assertion entities (PAEs) (a term that she coined), and the secondary market for patents. Prior to joining the Santa Clara University School of Law faculty in 2007, Professor Chien prosecuted patents at Fenwick & West LLP in San Francisco, as an associate and then Special Counsel, and was a fellow at the Stanford Center for Law and the Biosciences. In 2017, Professor Chien was awarded the American Law Institute’s Early Career Medal; she also has received the Vanguard Award for Public Service, and has been named Eric Yamamoto Emerging Scholar, a Tech Law Leader, one of Silicon Valley’s “Women of Influence,” and one of the 50 Most Influential People in Intellectual Property in the world. Chien is a graduate of Stanford (engineering) and Berkeley Law School and lives in Oakland with her husband and their two sons, Max and Benjie.

Jorge L. Contreras
Professor of Law, University of Utah S.J. Quinney College of Law

Contreras is a professor of law at the University of Utah S.J. Quinney College of Law and a senior fellow of the Centre for International Governance Innovation (CIGI). He has written and spoken extensively on institutional structures and policy implications of intellectual property, technical standardization, and scientific
List of Contributors

Professor Contreras serves as Co-Chair of the ABA Section of Science & Technology Law’s Interdisciplinary Division and is a member of the American National Standards Institute (ANSI) IPR Policy Committee and of NIH’s Council of Councils. He previously served as a member of the U.S. National Academy of Science’s (NAS) Committee on IP Management in Standard-Setting Processes, which produced the 2013 report *Intelectual Property Challenges for Standard-Setting in the Global Economy*. Professor Contreras edited the ABA’s Technical Standards Patent Policy Manual (2007) and the Cambridge Handbook of Technical Standardization Law (vol. 1, 2017; vol. 2, 2019 forthcoming) and has published more than one hundred scholarly articles, reports, white papers, and book chapters in publications including *Science, Nature, Georgetown Law Journal, University of Illinois Law Review, North Carolina Law Review, Antitrust Law Journal, Harvard Journal of Law and Technology*, and *Berkeley Technology Law Journal*. He is the founding editor of SSRN’s *Law, Policy and Economics of Technical Standards* e-journal, and was the winner of the Standards Engineering Society’s (SES) 2011 and 2015 scholarly paper competitions. Before entering academia, Professor Contreras was a partner at the international law firm Wilmer Cutler Pickering Hale and Dorr LLP, where he practiced international corporate and intellectual property transactional law.

**Thomas F. Cotter**
Briggs and Morgan Professor of Law, *University of Minnesota Law School*

Cotter is the Briggs and Morgan Professor of Law at the University of Minnesota Law School. He received his bachelor’s and master’s degrees in economics from the University of Wisconsin, and in 1987 graduated *magna cum laude* from the University of Wisconsin Law School, where he served as Senior Articles Editor of the Wisconsin Law Review. From 1987 to 1989, Cotter clerked for the Honorable Lawrence W. Pierce, United States Court of Appeals for the Second Circuit. He practiced law at Cravath, Swaine & Moore from 1988 to 1990, and at Jenner & Block from 1990 to 1994. From 1994 to 2005, he taught at the University of Florida College of Law and from 2005 to 2006 at Washington and Lee University School of Law. He joined the Minnesota faculty in 2006. Professor Cotter’s research and teaching focuses on intellectual property law, antitrust, and law and economics. He is the author of four books – *Law and Economics: Positive, Normative, and Behavioral Perspectives* (co-authored with Jeffrey L. Harrison) (3rd ed., 2013); *Comparative Patent Remedies: A Legal and Economic Analysis* (2013); *Trademarks, Unfair Competition, and Business Torts* (co-authored with Barton Beebe, Mark A. Lemley, Peter S. Menell, and Robert P. Merges) (2011); and *Intellectual Property: Economic and Legal Dimensions of Rights and Remedies* (co-authored with Roger D. Blair) (Cambridge University Press 2005). He has authored or co-authored over fifty other scholarly works, including articles in the *California Law Review,*
Damien Geradin
Professor of Competition Law & Economics, Tilburg Law School, Tilburg University

Geradin is a professor of competition law and economics at Tilburg University (the Netherlands) and at George Mason University School of Law (Washington, D.C.). He is also a visiting professor at University College London. Professor Geradin has also held visiting professorships at Columbia Law School, Harvard Law School, the University of Michigan Law School, UCLA School of Law, and the College of Europe, Bruges. He was a visiting lecturer at the University of Paris II (Assas) and at King’s College London, and also a Fulbright scholar and visiting lecturer at Yale Law School. He is also the founding partner of EDGE | Legal Thinking, a Brussels-based boutique law firm specialized in EU competition law and intellectual property law. Over the past twenty years, he has authored, co-authored, or edited over twenty books and one hundred scientific papers in the field of competition law, IP law, and the regulation of network industries – including *EU Competition Law & Economics* (with Nicolas Petit and Anne Layne-Farrar) (2012) and *Global Antitrust Law & Economics* (with Einer Elhauge) (2nd ed., 2012). Professor Geradin is a co-editor-in-chief of the *Journal of Competition Law & Economics*, a nongovernmental advisor to the International Competition Network (ICN), and a member of the International Task Force of the ABA’s Section of Antitrust. His work has been cited by the Court of Justice of the EU, the Supreme Court of the United States, and various U.S. Courts of Appeals, and in regulatory proceedings.

John M. Golden
Loomer Family Professor in Law, University of Texas at Austin School of Law

Golden is the Loomer Family Professor in Law at the University of Texas at Austin, where he has taught administrative law, contracts, patent law, and seminars relating to innovation and intellectual property. Since 2011, he has served as faculty director of the Andrew Ben White Center in Law, Science and Social Policy. Professor Golden has a JD from Harvard Law School, a PhD in physics from Harvard University, and an AB in physics and history from Harvard College. After law school, he clerked for the Honorable Michael Boudin of the United States Court of Appeals for the First Circuit and for Associate Justice Stephen Breyer of the Supreme Court of the United States. Professor Golden also worked as an associate in the intellectual property department of Wilmer Cutler Pickering Hale and Dorr LLP.

Haijun Jin
Professor of Law, Renmin University of China School of Law

Jin is a professor of law at Renmin University of China School of Law. He also studied and worked in foreign institutions for the last decade as, among others, a visiting professor at the University of Frankfurt am Main and the University of
List of Contributors


**Alison Jones**  
Professor of Law, *Dickson Poon School of Law, King’s College London*

Jones is Professor of Law at King’s College London and a solicitor at Freshfields Bruckhaus Deringer LLP. Prior to joining King’s in 1992, Professor Jones read law at Girton College, Cambridge, worked at Slaughter & May, and completed a BCL at Christ Church, Oxford. Since joining King’s, she has taught competition law (EU, UK, and U.S.), trusts, property, and EU law. Her main research interests are currently in the area of EU competition and U.S. antitrust law. Professor Jones is co-author of Jones and Sufrin on EU Competition Law and a regional editor for the Restitution Law Review; and writes two of the Centre of European Law’s modules for the Diploma in EU competition law. She is also Director of the LLB Law with European Legal Studies programme.

**Sang Jo Jong**  
Professor of Law, *Seoul National University School of Law*

Jong is a professor of law at Seoul National University and has served as Dean of the School of Law, SNU. Professor Jong is a graduate of Seoul National University and received his PhD from the London School of Economics, with a doctoral thesis titled “The Legal Protection of Computer Programs.” His research and teaching mostly center on copyright, trademark, patent, unfair competition, antitrust, and Internet laws. He has published more than one hundred scholarly articles in law journals (mostly in Korean) and has submitted several policy papers to government agencies. Professor Jong taught Korean Law at Harvard Law School in 2015 and at the University of Washington School of Law in 2014 and also taught comparative intellectual property laws at Georgetown University Law Center in 2007 and at Duke Law School in 2003. He has served as a civilian member of the Presidential Council of Intellectual Property, the President of the Korea Game Law & Policy Society, the Director of the SNU Center for Law & Technology, and a panel member of the WIPO Arbitration and Mediation Center.
List of Contributors

Oskar Liivak
Professor of Law, Cornell Law School, Cornell University

Liivak, Professor of Law at Cornell Law School, graduated from Rutgers College with highest honors in 1994, received a PhD in 2000 in physics from Cornell University focusing on techniques for determining protein structure, and received a JD from the Yale Law School in 2005. From 2000 to 2001, he was a post-doctoral scientist working on physical realization of quantum computing in the Quantum Information Group at IBM’s Almaden Research Center in San Jose, California. Prior to law school, he served as a patent agent in the Boston office of Fish and Richardson P.C. Most recently, Professor Liivak served as a law clerk to Judge Sharon Prost on the United States Court of Appeals for the Federal Circuit. Professor Liivak has published articles on patents and intellectual property law in the Cornell Law Review, the Harvard Journal of Law & Technology, the UC Davis Law Review, and many other publications.

Brian J. Love
Associate Professor of Law, Santa Clara University School of Law

Love is an associate professor at the Santa Clara University School of Law, where he serves as Co-Director of the High Tech Law Institute and teaches courses in patent law, intellectual property law, and remedies. His research focuses on patent law and policy, with an emphasis on the empirical study of patent litigation. His academic writing has been published by the law reviews of Stanford University, the University of Chicago, the University of Pennsylvania, the University of California Berkeley, the University of Virginia, and Washington University in St. Louis, among others. His articles have been cited by the U.S. Court of Appeals for the Federal Circuit, the U.S. Federal Trade Commission, the U.S. Department of Justice, the U.S. Council of Economic Advisers, and the U.S. Congressional Research Service. Love is also a frequent media commentator, with op-eds appearing in The Wall Street Journal, USA Today, Los Angeles Times, The Hill, Wired, and TechCrunch. Prior to joining Santa Clara, Professor Love was a lecturer and teaching fellow at Stanford Law School, where he oversaw the LLM Program in Law, Science & Technology. He also practiced law in Fish & Richardson’s litigation department and served as a law clerk to the Hon. Dorothy W. Nelson of the U.S. Court of Appeals for the Ninth Circuit and to the Hon. David C. Godbey of the U.S. District Court for the Northern District of Texas.

Renato Nazzini
Professor of Law, Dickson Poon School of Law, King’s College London

Nazzini joined King’s College London as Professor of Law in 2012. Previously, he was Professor of Competition Law and Arbitration at the University of Southampton, which he joined from the Office of Fair Trading, then the UK competition authority (now the Competition and Markets Authority), where he was Deputy Director of the Legal and Policy Department and led or advised on
Yogesh Pai
Assistant Professor of Law, National Law University, Delhi

Pai specializes in intellectual property law and has research interests at the interface of intellectual property with competition, trade, and economic policy. He is the Co-Director of the Centre for Innovation, Intellectual Property and Competition (CIIPC) at National Law University, Delhi (NLU, Delhi). He is also the Thomas Edison Fellow (2017–18) at George Mason University, Washington D.C. Before joining NLU, Delhi, Professor Pai was coordinator of the Ministry of Human Resource Development Chair on IPR at NLU, Jodhpur. He was also the Faculty-in-Charge of Trade, Law and Development, rated among the top journals in international trade worldwide. His international work experience involved working with the South Centre, Geneva. He previously has worked with Centad, New Delhi, and has taught as a guest on the faculty at Indian Law Institute, New Delhi. Professor Pai consults with the World Trade Organization for Regional Trade Policy Courses and is a tutor with the WIPO Academy Distance Learning Programme. He has been a speaker on intellectual property issues in India and abroad. His distinguished academic paper presentations include those at the Intellectual Property Scholars Conference (New York 2017); ACRIALA – IPSA, Singapore Management University (2016, 2017); and the Centre for Asian Legal Studies, NUS, Singapore (2015). He has published in national and international journals, including Oxford Journal of Antitrust Enforcement, Journal of World Intellectual Property, Journal of Indian Law Institute, Journal of Intellectual Property Rights, Journal of Indian Society of International Law, NUJS Law Review, and Jindal Global Law Review.
List of Contributors

Nicholas Petit  
Professor of Law, University of Liège School of Law

Petit is Professor of Law at Liege University, Belgium and a research professor at the School of Law of the University of South Australia in Adelaide (UniSA). Professor Petit’s research focuses on antitrust law, intellectual property, and law in a context of technological change. His recent written works deal with the legal challenges created by the introduction of artificial intelligence and robotics in society. He is also working on a book on technology platforms’ competition. Professor Petit holds a PhD from the University of Liege (Belgium), an LLM from the College of Europe (Bruges), a master’s degree from the University of Paris II, and an LLB from the University of Paris V. He practiced law with a leading U.S. law firm in Brussels and served as a clerk at the Commercial Chamber of the French Supreme Court. In 2005 he attended Harvard Law School’s Visiting Researchers Programme. Professor Petit is a co-author of EU Competition Law and Economics (2012) and the author of Droit européen de la concurrence (2013), a monograph that was awarded the prize for the best law book of the year at the Constitutional Court in France. In 2017, he received the Global Competition Review award for academic excellence.

Peter George Picht  
Professor, University of Zurich

Picht studied law at Munich University and Yale Law School, did his PhD (summa cum laude) at Munich University/the Max Planck Institute for Innovation and Competition, and holds a master’s degree from Yale Law School. He has worked with the EU Commission’s DG for Competition, with the Max Planck Institute for Innovation and Competition as a senior research fellow, and with other institutions, as well as with the law firms Allen & Overy LLP and Linklaters LLP. Professor Picht now holds a chair for commercial law at the University of Zurich and is head of the University’s Centre for Intellectual Property and Competition Law (CIPCO). He remains affiliated with the Max Planck Institute as a research fellow. Professor Picht’s academic teaching and writing, as well as his counseling activity, focus on intellectual property law, competition law, and international private and procedural law, in particular commercial arbitration (mainly IP and competition), trusts, and estates. In these fields, he has advised governments, companies, foundations, trusts, and other legal entities, as well as private persons and families. Professor Picht is admitted to the bar in Germany and Switzerland.

Christopher B. Seaman  
Associate Professor of Law, Washington and Lee University School of Law

Seaman joined the Washington and Lee law faculty in 2012. His research and teaching interests include intellectual property, property, and civil procedure, with a particular focus on intellectual property litigation and remedies for the violation of intellectual property rights. Seaman’s intellectual property-related scholarship has
List of Contributors

appeared or is forthcoming in a variety of law reviews and journals, including the Virginia Law Review, the Iowa Law Review, the Washington Law Review, the BYU Law Review, the Harvard Journal of Law and Technology, the Yale Journal of Law and Technology, and the Berkeley Technology Law Review. His empirical study of willful patent infringement and enhanced damages was selected as a winner of the Samsung-Stanford Patent Prize competition for outstanding new scholarship related to patent remedies, and his co-authored article on patent injunctions at the Federal Circuit was chosen as a winner of the Federalist Society’s Young Legal Scholars Paper Competition. Seaman received his BA in 2000 from Swarthmore College and his JD in 2004 from the University of Pennsylvania Law School, where he was an executive editor of the University of Pennsylvania Law Review and a recipient of the Edwin R. Keedy Award. After a judicial clerkship with the Honorable R. Barclay Surrick of the U.S. District Court for the Eastern District of Pennsylvania, he practiced intellectual property law at Sidley Austin LLP in Chicago from 2005 to 2009. Prior to joining Washington and Lee’s faculty, Professor Seaman was a visiting assistant professor at IIT Chicago-Kent College of Law and an adjunct professor at Loyola University Chicago School of Law.

Norman V. Siebrasse

Professor, University of New Brunswick Faculty of Law

Siebrasse joined UNB Law in 1993, after receiving an LLM from the University of Chicago and clerking at the Supreme Court of Canada for the Honorable Madam Justice McLachlin during the 1991 to 1992 term. His research and writing focuses on patent law, particularly pharmaceutical patent law, patent remedies, and the intersection of intellectual property law and commercial law. His blog, Sufficient Description, comments on recent Canadian patent law cases, and is widely read by the Canadian patent bar. His writing, including his blog, is regularly cited by the Canadian courts. He is an active member of the Intellectual Property Institute of Canada (the national association of intellectual property lawyers) and is a member of Life Sciences and Patent Legislation Committees.

Rafal Sikorski

Assistant Professor, Adam Mickiewicz University in Poznań

Sikorski is an assistant professor at the Adam Mickiewicz University in Poznań. He is also Senior Partner at SMM Legal in Poland, where he manages the Intellectual Property Department, advising clients on IP disputes and transactions, industrial property law, combating unfair competition, and the intricacies of competition law. Sikorski graduated from the Faculty of Law and Administration of Adam Mickiewicz University in Poznań in 1999. In 2000, he received the title of LLM in International Business Transactions from the Central European University in Budapest. Since 2005 he has held a PhD in legal science awarded by the Faculty of Law and Administration of Adam Mickiewicz University in Poznań. His scientific accomplishments include a number of publications on copyright law, industrial
property law, unfair competition law, competition law, and private international law. He is currently co-editing a series entitled An Outline of Intellectual Property Law (Zarys Prawa Własności Intelektualnej). Within his scientific work, he mainly focuses on relations between competition law and intellectual property law, with a particular emphasis on standardization and patent pools. Additionally, Professor Sikorski deals with issues in determining the governing law for intellectual property contracts and infringements of such.

Masabumi Suzuki
Dean and Professor of Intellectual Property Law, Nagoya University Graduate School of Law

Suzuki is Dean and a professor of intellectual property law at Nagoya University Graduate School of Law in Japan. Professor Suzuki is a member of the Intellectual Property Committee of the Industrial Structure Council at the Ministry of Economy, Trade and Industry (METI), and Deputy-Chair of the Subdivision on Copyright of the Council for Cultural Affairs at the Agency for Cultural Affairs in the Japanese Government. He also serves as a director of the Japan Association of Industrial Property Law, the Copyright Law Association of Japan, and the Japan Association of International Economic Law. Professor Suzuki has written and lectured widely on intellectual property law in Japanese and English. His publications in English include “Injunctive Relief for Patent Infringement: A New Trend in Japan?,” “Enforcement of FRAND-encumbered SEPs,” “International Investment Agreements, Intellectual Property Rights and Public Health,” “Domestic Measures for Public Health Policy and International IP/Trade Law: The Case of the Australian Plain Packaging Act,” and “Patent Enforcement in Japan” (co-written with Yoshiyuki Tamura). He also has edited several books including Preventive Instruments of Social Governance (2017), Realization of Substantive Law through Legal Proceedings (2017), and Commentary on Trademark Act (2015). Prior to entering academia, Professor Suzuki was an official at METI, where he served as Director of the Office of Intellectual Property Policy and in other positions.

David O. Taylor
Associate Professor of Law and Co-Director of the Tsai Center for Law, Science and Innovation, Dedman School of Law, Southern Methodist University

Taylor is an associate professor and founding Co-Director of the Tsai Center for Law, Science and Innovation at SMU Dedman School of Law. He serves on the Advisory Council of the U.S. Court of Appeals for the Federal Circuit, the Executive Board of the Institute for Law and Technology at the Center for American and International Law, the Amicus Committee and Patentable Subject Matter Task Force of the American Intellectual Property Law Association, and the Advisory Board of The International Lawyer. He has written and spoken extensively on patent law and policy, patent litigation, and civil procedure. He has published numerous articles in journals including the Berkeley Technology Law Journal, the New York
List of Contributors

University Law Review, the Connecticut Law Review, the Georgia Law Review, and the University of California Davis Law Review, and has given presentations at law schools across the United States, including Boston College, Berkeley, Cardozo, Stanford, and Texas, and internationally in China, Taiwan, and Vietnam. He also serves as an expert and consultant in intellectual property disputes. Taylor is the recipient of a Thomas Edison Innovation Fellowship from George Mason University Antonin Scalia Law School’s Center for the Protection of Intellectual Property. Before entering academia, Taylor clerked for the Honorable Sharon Prost of the U.S. Court of Appeals for the Federal Circuit, and engaged in patent litigation, licensing, and prosecution at the international law firm Baker Botts LLP. He earned his bachelor of science, magna cum laude, in mechanical engineering from Texas A&M University and his juris doctor, cum laude, from Harvard Law School.

Jacques de Werra
Professor of Contract and Intellectual Property Law, University of Geneva

de Werra has been Professor of Contract Law and Intellectual Property Law at the Law School of the University of Geneva since 2006 and Vice-Rector of the University since 2015. He completed his PhD thesis in copyright law while a visiting scholar at the Max-Planck Institute for IP, Competition and Tax Law in Munich in 1996. He was admitted to the Swiss bar (1999) and the New York bar (2002), and holds an LLM degree from Columbia Law School (2001). He was a faculty associate at Harvard’s Berkman Center for Internet and Society and has held visiting professor positions at Stanford Law School, Nagoya University, and City University of Hong Kong. Professor de Werra’s scholarly interests cover IP law, contract law, and Internet/IT and technology law. He has developed a particular expertise in IP commercial law and in ADR mechanisms for IP and technology disputes (specifically arbitration). He has published widely in leading law reviews (including the Harvard Journal of Law and Technology and the Columbia VLA Journal of Law and the Arts) and has authored or edited various books of reference, including the Research Handbook on Intellectual Property Licensing (2013) and (co-edited with Prof. Irene Calboli) The Law and Practice of Trademark Transactions (2016). He organizes the joint WIPO – University of Geneva Summer School on IP and the Geneva Internet law summer school. He is the scientific editor of an IP books series containing the proceedings of the annual IP conferences that he organizes at the University of Geneva.
Foreword

Patent systems are designed to provide incentives to innovate by temporarily protecting the intellectual property to which those innovations give rise. While not always perfectly calibrated, most patent systems historically have accomplished that goal. But as the nature of innovation has changed over the years, patent systems have struggled to adapt to those changes. Legal principles that were once quite good at striking a balance between too much patent protection and too little when applied to simple patented technology are less pertinent in our modern world of increasingly complex technology. We no longer live in a world of simple inventions where the patented technology provides most, if not all, of the value of an end product. We no longer live in a world where reasonable royalties for past infringement are readily calculable or where an injunction against ongoing infringement almost always makes sense.

We now live in a world of complex technology – computers operating with sophisticated software, smartphones and similar multifunction devices, interactive televisions, autonomous vehicles, virtual reality, and the “Internet of Things.” Such complex technology creates complexities of a different sort for patent systems. A single end product (or even a single component of an end product) may contain multiple patented technologies, sometimes exponentially more than traditional machines or products. The law of patent remedies was crafted for simpler inventions; it does not neatly address the realities of current innovation.

Determining how our concepts of injunctions, reasonable royalties, lost profits, and enhanced damages should be applied in this new era is challenging. This is particularly true when it comes to properly valuing individual contributing pieces of patented technology. Assessing the value added by a patented invention to complex technology is necessary, but far from easy. And these challenges are magnified by the interaction of those remedies derived from patent law with those stemming from competition and contract law, particularly those contracts that patent holders enter into in return for designation of their patent as a standard-essential patent.
Compounding these challenges is the fact that, while patent laws and their attendant remedial principles are national, technology sales and, thus, a desire to encourage innovation, are global. Individual systems for patent remedies tailored to complex technologies on a national basis thus seem inadequate and short-sighted. Imposing one country’s attempted solution on jurisdictions with different legal and economic traditions cannot be done, however. That is not the solution. Cross-fertilization of ideas presents an opportunity to search out best practices, which can then both be adopted and adapted as appropriate. Finding consensus on what those best practices are is no small task. Such an undertaking would require an international coalition of patent law and economic experts focused on harmonizing disparate patent systems while maintaining respect for each nation’s values and policy goals.

The International Patent Remedies for Complex Products (INPRECOMP) project – involving an impressive group of twenty scholars from distinguished academic institutions in eleven countries – is taking aim at rethinking patent enforcement systems on a global scale. This book is an ambitious attempt to wrestle with the intricacies of intellectual property protection around the world and to seek international consensus on issues affecting patent remedies in the context of complex products.

The INPRECOMP participants have approached their challenging task in a thoughtful manner that is both academically rigorous and practical. I have had the pleasure of watching the INPRECOMP project in action. In March 2017, the INPRECOMP group presented its ideas and proposals for possible international harmonization to a panel of judges and patent law practitioners. I had the privilege to be among those before whom the group tested its concepts and from whom the group sought feedback. The work of the INPRECOMP participants, now reflecting that very feedback, is set forth in this work. This book represents substantial thought and effort directed to an important but very challenging goal. Careful consideration of the group’s ideas will be edifying for judges, legislators, and practitioners alike, as patent disputes relating to complex technology become increasingly more international in scope.

Hon. Kathleen M. O’Malley

U.S. Court of Appeals for the Federal Circuit
Preface and Acknowledgments

This project on International Patent Remedies for Complex Products (INPRECOMP) has an ambitious objective – to engage intellectual property scholars worldwide on the topic of patent remedies for complex products, in order to identify areas of consensus along with topics needing further research and discussion. This project was made possible by a gift from Intel Corporation to the Center for Law, Science & Innovation (CLSI) at the Sandra Day O’Connor College of Law at Arizona State University. Intel provided the funding for a project (with the details to be determined by the CLSI) to advance and broaden scholarly research and dialogue on patent remedies for complex products. Intel encouraged us to involve scholars from as many different perspectives and countries as feasible. Other than that general direction, Intel played no role in the design, participant selection, topic choice, or work product of this project. We appreciate Intel’s support of independent research, and we thank it for making this project possible.

A number of individuals played a central and indispensable role in this project, and each deserves accolades for the commitment, patience, and expertise he or she brought to the project. First and foremost, Brad Biddle, a Faculty Fellow of the ASU Center for Law, Science & Innovation, was key to both launching and administering the project. Brad first broached the subject of this project and made the initial contact with Intel. He operated as our de facto project coordinator, convening meetings and conference calls of our steering committee, which he chaired, pushing gently but firmly to ensure we stayed on schedule, and stepping in to help resolve any disagreements or problems along the way. Brad’s enthusiasm and leadership for this project were, respectively, infectious and effective.

One of the most important things that Brad did at the outset was to recruit two subject matter experts to be the thought leaders of this project. These are law professors Jorge Contreras of the S.J. Quinney College of Law at the University of Utah and Norman Siebrasse of the University of New Brunswick, Faculty of Law. Jorge and Norman are not only tremendously knowledgeable experts on patents and patent remedies, but they are also committed to balance, objectivity, and scholarly
excellence. Jorge’s and Norman’s impressive expertise, extensive contacts in the field, enthusiasm for the subject matter, and good-natured commitment to the project were critical for the project’s success.

In addition to serving on the INPRECOMP steering committee over the two-plus years of the project’s duration, Jorge and Norman were central in selecting the other faculty members of this project, whose biographies can be found above. They assembled an outstanding team of twenty leading intellectual property scholars from eleven countries in North America, Europe, and Asia. These scholars attended two 2-day meetings, one in London and one in Phoenix. After the London meeting, the group split into six working groups with overlapping membership, each dedicated to an individual chapter. The teams participated in numerous conference calls and email exchanges to develop and reach consensus on the material in this book, which was then circulated for comment to the entire group. Their time, expertise, and perspective gave this project its intellectual richness, breadth, and depth, for which we are enormously grateful.

Some of these academic participants did even more. We particularly appreciate the additional work of the following working group chairs: Tom Cotter (Chapter 1), Chris Seaman (Chapter 2), Colleen Chien (Chapter 3), Norman Siebrasse (Chapter 4), Jorge Contreras (Chapter 5), and Alison Jones and Renato Nazzini (Chapter 6). We also thank Alison Jones and Renato Nazzini for hosting and helping to organize the London meeting.

As the working groups began drafting the chapters that ended up being this book, we quickly realized that we needed a lead editor, someone who was knowledgeable about the subject matter and able to work with the author teams to coordinate consensus where it was possible and to identify and manage differences. We found the perfect person for this important role in Brian Love, Associate Professor of Law and Co-director of the High Tech Law Institute at the Santa Clara University School of Law, who was already a member of the INPRECOMP team. Brian did yeoman’s work in collaborating with the teams of authors for each chapter, bringing the discussions to completion, and putting into writing for each chapter the text and recommendations upon which each chapter’s authors could agree. This process involved a tremendous commitment of time and skill, which Brian provided with enthusiasm and excellence.

The other key player in bringing this book to fruition was Jay Jenkins, the Intellectual Property Director of the CLSI at ASU. Jay served as line editor, working closely with Brian to go through each chapter line-by-line to edit the text for clarity, consistency, and impact. Jay also worked in completing all the references, a daunting task given the different nations and languages of the primary materials used in the production of this work. Without Jay’s tireless efforts, this book never would have seen the light of day, and we are very grateful for his dedication and effort.
Another important component of this project was the opportunity to “stress test” our initial ideas with a panel of eminent judges and a panel of leading practitioners. We provided the initial drafts of our chapters and then invited these legal experts to critique, question, and challenge our initial work at the Phoenix meeting. Our judicial panel consisted of the Hon. Marsha Berzon of the U.S. Court of Appeals for the Ninth Circuit, the Hon. Klaus Grabinski of the German Federal Court of Justice (Bundesgerichtshof), the Hon. Kathleen O’Malley of the U.S. Court of Appeals for the Federal Circuit, and the Hon. James Robart of the U.S. District Court for the Western District of Washington. The practitioner panel consisted of Tina Chappell from Intel, Luke McLeroy from Avanci, Mark Selwyn from WilmerHale, and Richard Stark from Cravath, Swaine & Moore. The feedback received from these experts in private practice and the judiciary were extremely insightful and helpful, and greatly assisted the project team in understanding the practical and legal issues presented by patent damages for complex products. We additionally thank Judge O’Malley for writing the preface to this book.

Finally, I would like to thank the staff of the Center for Law, Science & Innovation for their administrative support of this project. Center Director Lauren Burkhart negotiated the agreement with Intel, was in charge of the budgeting for the project, participated on the project steering committee, and organized the meetings, conference calls, and other activities involved with the project. She was ably assisted by Center Coordinator Debb Relph, who among other things coordinated travel arrangements, reimbursement, and logistics. Their excellent assistance was essential for the smooth and successful implementation of this project.

Typically, at the end of a long list of acknowledgments like this, there would be a statement that all errors and misunderstandings are the sole responsibility of the author. That is not possible here because there is no single “author” of this book. Rather, it represents a group process involving a disparate set of knowledgeable experts that produced its chapters as consensus documents, not an easy or simple achievement. In fact, it is probably safe to say that no single member of the team is perfectly satisfied, or even fully agrees with, everything said and how it is said in this book. Rather, this book is part of what we hope will be an ongoing and worldwide consensus-building process. This work does not aspire to represent the final word on these important issues. Rather, by advancing areas of consensus and identifying areas needing further research, we hope we have produced something that can be studied, referenced, quoted, critiqued, agreed or disagreed with, and ultimately further advanced, all with the goal of improving patent remedies for complex products around the world.

Gary Marchant
Regent’s Professor of Law and Faculty Director of the Center for Law, Science and Innovation
Arizona State University
Sandra Day O’Connor College of Law
Executive Summary

In each of the first five chapters of this volume, we summarize the current state of the law of patent remedies among leading jurisdictions, articulate the principal arguments for and against different remedies-related practices adopted in various countries, and provide consensus-based recommendations for improving (and generally harmonizing) the award of remedies for patent infringement. In addition, we identify areas where further research is needed. Below, we briefly summarize the principal recommendations made in each chapter.

CHAPTER 1: REASONABLE ROYALTIES

Chapter 1 addresses “reasonable royalty” damages.

BASIC PRINCIPLES FOR CALCULATING A REASONABLE ROYALTY:

Chapter 1 principally recommends that courts replace the so-called Georgia-Pacific factors used in the United States (and analogous factors used outside the United States) with the following three steps for calculating reasonable royalty damages:

1. Calculate the incremental value of the invention and divide it appropriately between the parties. A license for the use of a patented technology typically requires the licensee to share with the licensor some portion of the incremental value the licensee derives or expects to derive from the use of that technology. To ensure that a reasonable royalty for the unauthorized use of a patented technology accurately reflects this incremental value, ideally a court would (1) estimate the difference between the value the infringer derived from the use of the patented invention (as distinct from the value contributed by other features of the infringing end product), and the value the infringer would have derived by using the next-best available noninfringing alternative instead; (2) divide that differential value between the patent owner and the infringer; and (3) as an aid in carrying out this division, consider any relevant evidence, including possibly
Executive Summary

the use of a rebuttable presumption that the parties would have agreed, *ex ante*, to an even (50/50) split.

(2) **Assess market evidence.** In negotiating licenses for the use of patented technologies, parties often consider the rates and other terms disclosed in relevant comparable licenses (or, where applicable, the rates charged by relevant patent pools or disclosed in publications of industry standard rates). Courts also should consider such evidence for purposes of calculating reasonable royalties for the unauthorized use of patented technologies, albeit subject to appropriate adjustments and with due appreciation for the potential limitations of such evidence.

(3) **Comparison.** When it is feasible and cost justified, courts should carry out both steps described above – each one acting as a “check” on the accuracy of the other – and then attempt to reconcile or adjust the results, as the evidence warrants. That said, one can expect only that courts do the best they can with the evidence available to them. Thus, when the evidence necessary to carry out step 2 is available but the evidence necessary to carry out step 1 is not – as will likely often be the case in litigation involving complex products – courts may need to rely exclusively on market evidence. (The converse will be true when the available evidence relates only to step 1, not 2.)

**PATENTED ALTERNATIVES:**

A conceptual difficulty with step 1 of the above framework arises if the next-best noninfringing alternative is, itself, also patented. It is not at all uncommon that the best substitutes for a patented technology are also patented, as several inventors devise different solutions to the same problem. One possibility is that in such a case the value of the patented invention is zero, on the view that the infringing user in the hypothetical negotiation should be imagined to play one patentee off against another until the patentee is haggled down to its minimum willingness to accept. By the same token, if the infringed technology was not quite as good as the patented alternative, the value of the infringed technology would be zero. Chapter 1 recommends that courts reject this approach, on the ground that although it makes sense from a static welfare perspective, it provides a facially inadequate incentive to invent (zero compensation) and therefore appears inconsistent with the conventionally understood purpose of the patent system.

**DIVIDING INCREMENTAL VALUE:**

Chapter 1 additionally recommends that, to the extent possible, a split of the incremental profit should reflect the value of any ancillary services (such as marketing) or risks that either the patent owner or the infringer, in fact, undertook. While courts should permit the parties to introduce any competent evidence on this issue,
a fact finder may also wish to consider empirical findings that people in Western societies generally view a 50/50 split of benefits as fair, and that economists often use the Nash Bargaining Solution in modeling bargaining behavior.

Moreover, when courts use a hypothetical bargaining construct to split incremental value, Chapter 1 recommends that courts adopt a “contingent ex ante approach” under which the hypothetical negotiation is generally assumed to take place before any sunk costs are incurred, but with the benefit of ex post information. The rationale for this approach is that the bargain must be assumed to take place ex ante, so that the patentee is not entitled to extract any holdup value; but at the same time, using ex post information more accurately reflects the true incremental value of the invention, and so provides a more accurate reward to the patentee.

In addition, courts should consider comparables and other market evidence with caution. Such evidence often may be the best that is available, and even when there is other evidence of the value of the technology over alternatives, it may still be useful to consider market evidence by way of comparison. But courts should be cognizant that there are significant practical and conceptual problems involved with using comparable licenses – even “established” ones – as evidence of a reasonable royalty.

EVIDENTIARY GATEKEEPING AND THE ENTIRE MARKET VALUE RULE:

Chapter 1 also recommends that in jurisdictions employing juries to decide patent cases, courts should require patentees to present royalty evidence using the smallest saleable patent-practicing unit, rather than the entire market value of a larger complex end product, as the royalty base. Framing damages by reference to the value of the entire accused product may have an undue influence on jurors (sometimes known as “anchoring”) in cases where the asserted patent covers just one of many components or features that comprise the entire product, and in such cases may lead to damages awards that are overcompensatory.

Finally, Chapter 1 recommends that courts consider whether individual pieces of expert evidence satisfy a basic threshold of quality in addition to separately examining the overall sufficiency of all relevant evidence. In the absence of a jury or other fact finder distinct from the trial-level adjudicator of questions of law, there is probably less significance to the distinction between (1) the ultimate assessment of the overall sufficiency of evidence to support a damages award and (2) gatekeeping for the relevance and reliability of expert testimony. But although the particular standard for expert testimony gatekeeping has been controversial within the United States, something like Daubert-style review might generally be useful even in jurisdictions that do not try patent cases to juries.
CHAPTER 2: LOST PROFITS AND DISGORGEMENT

Chapter 2 addresses remedies that either (1) award as damages the profits that the patent owner would have earned absent infringement (lost profits), or (2) award to the patent owner the profits earned by the infringing party (disgorgement).

AVAILABILITY OF LOST PROFITS:

Chapter 2 recommends that a patentee’s lost profits (including from lost sales and price erosion) should be the preferred measure of damages when a patentee can establish harm in a product market due to the infringement.

CAUSATION AND NONINFRINGEMENTAL ALTERNATIVES:

Chapter 2 additionally recommends that lost profits should generally be available whenever a practicing patentee can demonstrate “but for” causation by a preponderance of the evidence, rather than only when the patentee can satisfy more detailed standards or requirements, such as the Panduit factors presently used in the United States. This chapter further recommends that courts should consider the availability and substitutability of noninfringing alternatives when analyzing “but for” causation, and overrule decisions (such as United Horse-Shoe in the UK) that hold to the contrary. If the infringer could have competed with the patentee by offering a noninfringing alternative to the patented invention, the patentee would have lost fewer sales (and thus profits) absent the infringement. Even an imperfect substitute that provides some, but not all, of the functionality of the patented invention can affect both the price of the patented product and consumer choice.

LOST PROFITS FOR UNPATENTED PRODUCTS:

In addition to profits on lost sales of patented products, Chapter 2 recommends that patentees should be permitted to recover losses associated with (1) sales of products that incorporate both infringing and noninfringing components, (2) additional contemporaneous sales of distinct but related items, and (3) anticipated future sales of replacement or repair parts, provided that the patentee can demonstrate that such sales were reasonably foreseeable by an infringing competitor in the relevant market.

AVAILABILITY OF DISGORGEMENT:

In jurisdictions where disgorgement is an available remedy, Chapter 2 recommends that the grant of accounting be within the discretion of the court, rather than automatic, given the potential burden on the infringer in taking an accounting.
Courts also should require patentees to elect between an accounting and damages; they should not be permitted to pursue both simultaneously.

DIFFERENTIAL PROFIT METHOD:
Chapter 2 additionally recommends that jurisdictions permitting disgorgement adopt a differential profit approach to calculating the infringer’s profits. Rather than requiring the infringer to disgorge the entire profit made on an infringing product, courts should limit disgorgement recoveries to the difference between the infringer’s actual profits and the profits it would have made had it used the best noninfringing alternative. A contrary rule – such as the accounting profit approach or the U.S. approach in design patent cases – can result in disgorge-ment of profits that are not causally attributable to the infringement, and thus will put the patentee in a better position than it would have been but for the infringement.

CHAPTER 3: ENHANCED DAMAGES, LITIGATION COST RECOVERY, AND INTEREST
Chapter 3 addresses remedies beyond reasonable royalties and profits.

ENHANCED DAMAGES:
Chapter 3 recommends that when enhanced (or “punitive”) damages are awarded, they should be calculated consistent with the objectives of the patent system – for example, by weighing the ability of such awards to deter opportunistic infringement against their countervailing tendency to discourage the dissemination of technological information via patent disclosures – rather than on the basis of subjective notions of retributive punishment.

LITIGATION COST RECOVERY:
Chapter 3 additionally recommends that when litigation costs are awarded to prevailing parties, such awards should aim to compensate for the reasonable and proportionate costs actually incurred by the prevailing party in a meaningful manner unless equity prescribes otherwise, rather than only partially (as is often the case in practice). Moreover, in countries in which fee shifting is not presently the norm, legislatures and courts should consider experimenting with more generous fee shifting rules, as well as discovery reforms designed to reduce the risk that the stronger party will make unnecessary and excessive expenditures with the expectation of reimbursement.
INTEREST:
Chapter 3 recommends that courts be required to award pre- and post-judgment compound interest, nominally at rates that reflect the infringer’s cost of borrowing. To the extent such reforms would be difficult to implement in the short run, legislatures should (as a second-best solution) periodically reconsider statutory interest rates to ensure that they do not differ substantially from market rates.

CHAPTER 4: INJUNCTIVE RELIEF
Chapter 4 addresses the law and policy of injunctive relief, focusing primarily on permanent injunctions.

BASIC PRINCIPLES FOR INJUNCTIVE RELIEF:
Chapter 4 principally recommends that courts should not automatically issue injunctive relief in all cases in which a patentee prevails in a suit for infringement. Instead, courts should have and, in appropriate circumstances, exercise discretion to deny injunctive relief when issuance of an injunction would otherwise generate costs or burdens for others that are disproportionate to the nature of the adjudged infringement and to the noncompensable harms the patentee would suffer in the absence of an injunction. Further, courts should be afforded the flexibility and discretion to tailor injunctive relief in appropriate circumstances to avoid imposing unnecessary hardship on infringers or the general public.

PROPORTIONALITY:
In assessing whether the negative effects of the injunction on enjoined parties would be disproportionate to the nature of the infringement and any noncompensable harm that the patentee will experience without injunctive relief, Chapter 4 additionally recommends that: (1) courts consider only those relevant negative effects on enjoined parties or the general public that have some reasonable likelihood of actually occurring if adjudged infringers and third parties take reasonable mitigating measures in relation to an injunction; and (2) courts consider only the relative, as opposed to absolute, sizes of the patentee’s harm and an injunction’s negative effects.

TAILORING INJUNCTIVE RELIEF:
Chapter 4 additionally recommends that courts consider whether tailoring injunctive relief – for example, by staying an injunction for a period of time to allow redesign of an infringing component of a complex product – may avoid or mitigate
the negative effects an injunction otherwise might impose. Moreover, courts should consider tailoring injunctions in the normal course, even when a proportionality-based test is otherwise satisfied.

ONGOING ROYALTY IN LIEU OF INJUNCTIVE RELIEF:
Chapter 4 recommends that when injunctive relief is not granted (and damages have not separately compensated for future infringement) courts should award as a substitute additional monetary damages in the form of an “ongoing reasonable royalty.” This ongoing royalty should be calculated in accordance with the principle for determining a “reasonable royalty” for past infringement, without any special enhancement due to the ongoing reasonable royalty’s association with activity that occurs after the judgment of infringement.

CHAPTER 5: THE EFFECT OF FRAND COMMITMENTS ON PATENT REMEDIES
Chapter 5 addresses a special category of cases in which an asserted patent is, or has been declared to be, essential to the implementation of a collaboratively developed voluntary consensus standard, and the holder of that patent has agreed to license it to implementers of the standard on terms that are fair, reasonable, and nondiscriminatory (FRAND). Both as a matter of patent law, contract law, and competition law, the existence of such a FRAND commitment may affect a patent holder’s entitlement to monetary damages and injunctive relief.

MONETARY DAMAGES:
Chapter 5 recommends that courts assessing FRAND royalty rates should reject strict application of the Georgia-Pacific framework, and instead select whatever methodology for calculating FRAND rates is best supported by the available evidence. Depending on the evidence available, courts may choose to rely on sufficiently comparable license agreements covering the same patents, general consensus on aggregate royalty rates for an overall standard or technology, and one or both of the “bottom-up” and “top-down” royalty calculation methodologies.

INJUNCTIONS:
Chapter 5 additionally recommends that courts place reasonable conditions on the issuance of injunctions against the infringement of standards-essential patents – such as those discussed in Chapter 4 – even absent a violation of competition law. When balancing equities between the parties, this chapter additionally recommends
that courts incorporate the procedures laid out in *Huawei v. ZTE* or under the law of Japan or Korea. While these procedural analyses were developed with potential violations of competition law or contract law in mind, they nonetheless model a well-functioning bilateral relationship within the standard-setting context and, thus, are relevant to a full and fair assessment of the appropriateness of equitable relief.