The Assumption of Validity and Infringement in Reasonable Royalty Calculations

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My work-in-progress relates to the assumption of validity and infringement courts and damages experts use to calculate reasonable royalty damages in patent infringement cases.

The second approach to reasonable royalty calculations, the so-called “hypothetical negotiation,” seeks to identify the royalty upon which the parties would have agreed had they negotiated the royalty just before the infringer began infringing. One constraint the law places on the hypothetical negotiation is an assumption that contradicts the nature of actual negotiations over royalties for licenses to patents. In particular, courts require damages experts to assume that the negotiation would have been made based on the premise that the asserted patent claims are both valid and infringed. Any real negotiation, however, does not presume that the patent claims are both valid and infringed. Quite the contrary. An actually-negotiated royalty typically reflects the level of risk associated with a finding of invalidity and/or non-infringement.

I have not been able to find any judicial opinion or academic scholarship addressing the basis for the assumption that the asserted patent claims are valid and infringed. The Federal Circuit has only highlighted its contradiction with reality. It once explained that “[t]he hypothetical negotiation tries, as best as possible, to recreate the ex ante licensing negotiation scenario and to describe the resulting agreement.” Lucent Techs., Inc. v. Gateway, Inc., 580 F.3d 1301, 1325 (Fed. Cir. 2009). Remarkably, just two sentences later, the court went on to say that “[t]he hypothetical negotiation . . . assumes that the asserted patent claims are valid and infringed.” Id. It simply cannot be true that the hypothetical negotiation tries to recreate the ex ante licensing negotiation scenario “as best as possible” if it assumes that the patent claims are valid and infringed.

Even though the assumption does not reflect reality, there are various potential pragmatic and policy-based justifications for it. My article studies these justifications and also analyzes potential ways the law governing reasonable royalties otherwise contradicts this assumption. In the end, I identify and suggest ways in which the law governing reasonable royalty damages in patent cases may be better explained (if the assumption should be retained) or better reflect reality (if the assumption should not be retained).