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Can a Reasonable Royalty Ever Exceed Lost Profits?

I have been receiving multiple calls lately about patents. Future cash flow stream is the key to value and historical revenues are a great foundation when it comes to developing a cash purchase price. The story below shows how difficult it is to protect this value against the big competitor that have lots of money to burn. Given the right circumstances and the willingness to fight the long battle, there is a way to cash in from your design.

***Powell v. The Home Depot U.S.A. Inc.*, 2011 U.S. App. LEXIS 22838 (Nov. 14, 2011)**

Ten years ago, The Home Depot—one of the largest, most profitable home improvement retailers—noticed an alarming trend: Every year, its employees were getting badly injured, including losing their fingers, while operating the in-store radial saws used to cut large pieces of lumber for customers. After receiving a directive from the chief executive officer (CEO) to solve the problem, the company began testing a prototype developed by Michael Powell, who'd long provided installation and repair services for the in-store radial saws. The tested units proved effective, and he applied for a patent.
In the meantime, however, Home Depot invited another, larger company (Industriaplex) to build a design that was cheaper than what it had paid for the prototype ($2,000). By 2006, Powell had his patent, but Home Depot had already ordered nearly 2,000 saw guards from Industriaplex and Powell sued for patent infringement. Ultimately, a jury awarded $15 million in damages, or approximately $7,736 per infringing unit. After the court added $3 million for enhanced damages plus another $2.8 million in attorneys' fees, Home Depot appealed to the U.S. Court of Appeals for the Federal Circuit.

Damages measured at the time of infringement. After confirming the findings of willful infringement and related liability issues, the Federal Circuit turned to the damages award. Had the plaintiff successfully negotiated a deal with Home Depot after his creation of the prototype in 2004, a "conservative" estimate of his expected profits would have been $2,180 per unit at the time. However, a reasonable royalty must be calculated at the time infringement began, the court held, in this case, when the plaintiff received his patent in 2006. By this time, "Home Depot had the luxury of nearly two additional years…to observe the effectiveness of the saw guard solution created by [the infringing design]," the court said. As a result, an expected profit of $2,180 per unit in 2004 was not a "reliable approximation of the upper limit that the parties would have reached during a hypothetical negotiation in 2006."
As a second matter, Home Depot argued that damages should have been limited by what it paid for the Industriaplex design, or $1,295 per unit, which was equivalent to a

3% to 5% royalty on infringing sales.

Injury rate fell to zero. In contrast, at trial, the plaintiff's expert presented a range of damages, bounded on one end by the $2,180 per-unit price during the 2004 negotiations and on the other by the roughly $8,500 per unit that Home Depot spent to replace the radial saws with the infringing design in 2005. The expert also testified that after the CEO mandated the installation of saw guards, the injury rate among Home Depot employees dropped to zero, saving the company over $1 million in annual costs.

In addition, while its major competitor (Lowe's) chose to remove radial saws from their stores, Home Depot was able to continue to provide custom-cut lumber, protecting these profits as well as those from related sales of hinges, nails, etc. He also presented the amount that Home Depot spent on replacing any saw guards that were incompatible with the infringing design.

"Reliance upon estimated cost savings from use of the infringing product is a well-settled method of determining a reasonable royalty," the Federal Circuit pointed out. At base, the "paucity" of evidence presented by Home Depot represented "nothing more than what it might have preferred to pay, which is not the test for damages," the court held, in affirming that the jury's $15 million compensatory award was based on sufficient if not "extensive" evidence. Based on evidence of willfulness and litigation misconduct, the court also confirmed the award of enhanced damages and attorneys' fees. A brief dissent would have reversed the findings of willfulness only.

Capital Endeavors, Inc.
P.O. Box 895, 232 Crogan Street, Lawrenceville, Georgia 30046
Web: www.capitalendeavors.com Email: davidstill@capitalendeavors.com
Phone: 770-962-8399 FAX: 770-962-8640