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Grain, Grain, Go Away

A recent Federal Circuit decision is bad news for patent owners.

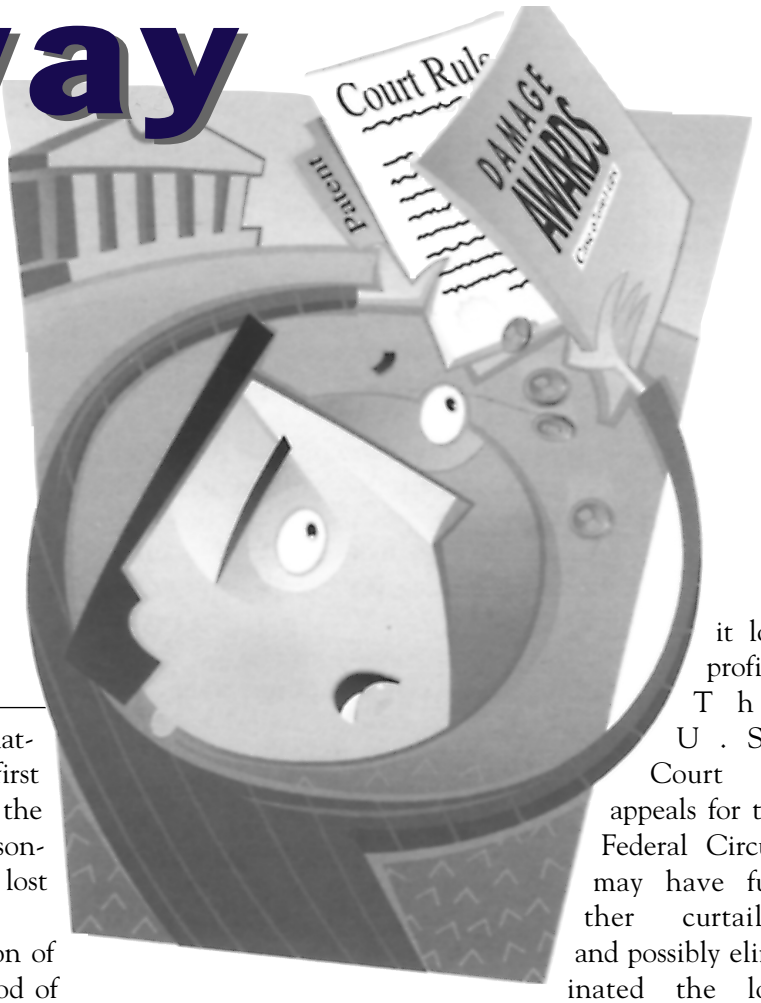

ILLUSTRATION BY GEOFF SMITH

By Alexander I. Poltorak and Paul J. Lerner

There are two accepted approaches to calculating damages for patent infringement. The first is to compute the profits lost as a result of the infringement. The other is to assess a reasonable royalty against infringing sales. Generally, the lost profits measure produces much more lucrative awards.

Recent court decisions, however, raise the question of whether this approach will survive as a viable method of calculating damages. If the lost profits approach dies, patent holders, the public, and the patent system itself will all be losers.

One of the requirements for finding a damage award of lost profits is to establish that there were no substitutes for the patented article at the time of the infringement. If noninfringing substitutes were available, then the buyer had other options than to purchase the infringing product. And if the buyer had other options, then the patent owner could not properly claim it lost profits. The U.S. Court of appeals for the Federal Circuit may have further curtailed and possibly eliminated the lost profits avenue. In *Grain Processing Corp. v. American Maize-Products Co.*, 185 F.3d 1341 (CAFC 1999), that court affirmed a lower court ruling that a patent owner could not recover lost profits if non-infringing substitutes would have been available at the time of infringement. It does not matter that the substitutes were not actually in existence. The court took considerable pains to emphasize that it was merely applying existing precedential law to a specific and unusual set of circumstances. But the effect of the ruling may be far more dire for the patent holders.

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An 18-Year Maze

The Grain Processing case has been in the courts for 18 years of litigation and is the subject of eight prior judicial opinions. It concerns infringement of a patent owned by Grain Processing Corp. on maltodextrins, a family of food additives made from starch.

American Maize-Products Co. began selling maltodextrins in 1974. It made and sold several types of maltodextrins, including Lo-Dex 10. The company made and sold Lo-Dex 10 during the entire time Grain Processing Corp. owned the rights to the patent, from 1979 until expiration in 1991. During this time, however, American Maize used four different processes for producing Lo-Dex 10. Three of these processes infringed the patent and the fourth did not. American Maize adopted the noninfringing fourth process only after the last of the three processes were held by the Federal Circuit to be infringing.

Following the trial court's decision, it took American Maize only two weeks to experiment with, perfect, and begin using for mass production the fourth process. American Maize used this more expensive process until 1991, when it switched back to the cheaper and now-unprotected third process.

In the appeal, the appellate court affirmed a lower court ruling that Grain Processing could not claim lost profits because American Maize "could have produced" a noninfringing substitute, by using the fourth process for the entire period of infringement. Thus, the appellate court held that a noninfringing substitute does not actually have to be in existence for the defendant to escape a lost-profits award.

The test of noninfringing substitutes has never been as clear as it might. The definition of "substitute" and "available" are both subject to debate. In fact, this test "accounts for more appellate litigation…than any other aspect of patent damages law," according to Paul M. Janicke in a 1993 American University Law Review article.

It's no wonder. In 1995 the full Federal Circuit stated that "when an alleged alternative is not on the market during the accounting period [the period of infringement], a trial court may reasonably infer that it was not available as a noninfringing substitute at that time," *Rite-Hite Corp. v. Kelley Co.* 56 F.3d 1132, 1545 (Fed. Cir.)(en banc).

How, then, did the Grain Processing court find that a noninfringing substitute was available for the patented maltodextrins and processes? The court made that finding because American Maize had the necessary chemical materials, the equipment, the know-how, and experience to produce Lo-Dex 10 in a noninfringing way. On this basis the noninfringing substitute was considered to be available.

Lo-Dex 10 was, admittedly, 2.3 percent more expensive to produce without infringement. Further, the court acknowledged that American Maize would have incurred capital costs in converting to the noninfringing process. The court, therefore, deemed 3 percent to be a reasonable royalty rate.

What's so wrong about the Grain Processing decision? In the modern economy, patented inventions usually can be replicated by other more expensive means. In other words, many modern inventions do things more efficiently and cheaply, but not necessarily so differently that there is not an alternative. Thus, according to one interpretation of *Grain Processing*, lost profits awards should be limited to those rare inventions for which a more expensive substitute cannot be found. This interpretation, taken to its logical conclusion, limits the value of the property right of a patent to a reasonable royalty, which is the statutory minimum.

Owners Lose Clout

The reduction in patent value that may result from *Grain Processing* affects all patent holders who are actively commercializing the patented inventions. More specifically, it affects domestic and international corporations who have expended vast resources in securing extensive patent portfolios to protect their intellectual property. These corporations no longer possess the effective threat of a patent lawsuit, which could recover more than a fraction of the actual losses resulting from infringement of their patents.

Under this interpretation, the likely cost of losing a patent infringement lawsuit is now merely a license similar to or only slightly more costly than a negotiated licensing deal. *Grain Processing* thus significantly reduces the incentive for a defendant to settle. Moreover, the innovative process in general may be stunted as economic incentive to invent is diluted. The only entities that stand to gain from such a development are potential defendants.

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