



## **AN OVERVIEW OF TRADEMARK INFRINGEMENT DAMAGES**

*By Daryl Martin, IPmetrics LLC  
November 2010*

### **INTRODUCTION**

Over the years, IPmetrics professional have been involved in a vast number of trademark infringement disputes that focused on the issues of economic damages. The following provides some general thoughts related to trademark infringement damages issues.

In most trademark infringement situations, damages are generally measured in the following contexts:

- 1) Disgorgement of defendant's profits;
- 2) Lost profits suffered by the plaintiff;
- 3) Reasonable royalties; and/or,
- 4) Corrective advertising.

In most cases, each of the first three damages frameworks will be mutually exclusive; unless the analyses are not based on the same set of alleged infringing sales revenue. Alternatively, corrective advertising is separate and distinct from either a profit or royalty analysis and, thus, is incremental to any actual damages conclusions.

### **PROFIT DISGORGEMENT**

For profit disgorgement, the plaintiff is only required to prove infringing sales revenue. The burden to prove the appropriate expense deductions in arriving at profits lies solely with the defendant. When determining expense deductions, it is important for the expert to understand jurisdictional differences. For example, the Ninth Circuit has allowed for the deduction of a portion of the defendant's general expenses, such as overhead, operating expenses, and federal income taxes, so long as they are material to the generation of the revenue, while in other circuits overhead is traditionally not allowed. The central goal in this respect is to determine the proper amount of incremental costs without limiting or biasing the analysis in any way. In sum, the proper assessment of gross profit, incremental profit and net profit margins must be suitably addressed in conjunction with a critical review of the defendant's accounting disclosures in order to bring forward a valid and credible damages framework.

### **LOST PROFITS**

As it relates to lost profits, the expert must determine what portion of the infringing sales revenue would have accrued to the plaintiff, but for the infringement by the defendant. One way to accomplish this is to apportion the gross infringing sales revenue according to the plaintiff's actual respective market share. Simply assuming that all of the infringing sales revenue would have accrued to the plaintiff (absent the infringement) does not take into consideration the plaintiff's market position relative to the competition or other factors, such as geographical distribution constraints. Moreover, independent verification as to the plaintiff's manufacturing capacity should be performed in order to evaluate the plaintiff's ability to absorb

the increase in production. Analysis of the plaintiff's manufacturing operation may reveal an inability to increase production (e.g., due to operating at or near full capacity); therefore, significant investment could be necessary for the plaintiff to credibly be able to absorb the vast majority of the alleged infringing sales.

## PROFIT APPORTIONMENT

With respect to both profit disgorgement and lost profits analyses, the proximate cause argument must be examined. First, it must be determined to what degree the infringing usage is directly responsible for the generation of the revenue in dispute. Second, the profits analysis should take into consideration the relative importance of the infringed asset in relation to the defendant's overall operation (i.e., profit apportionment). While the infringed asset may be important to the sales and marketing process, the defendant may possess other assets that are important to the generation of the sales revenue. These other assets can include: co-branding relationships, key sponsorship and endorsement deals, exclusive or differentiated technology, promotional partners, distinct breadth and quality of products, pricing strategy, channels of distribution, skilled sales force, customer relationships, manufacturing capabilities and reputation and goodwill, among others. It is important to understand the relative contribution of these asset groups in order to allocate the company's profits accordingly.

Thus, the profit apportionment exercise is another key element of an effective intellectual property damages assessment. While accountants (CPAs) and economists are well-versed in the mechanics of analyzing revenues and profits, the apportionment of those profits among the contributory assets is where a skilled intellectual property practitioner can add tremendous value. As trademarks do not travel in a vacuum, the identification and quantification of the contributory value of these additional elements can help to isolate the value attributable to the infringing use. This is especially important in light of the recent decisions involving the apportionment of profits (e.g., *Mattel v. MGA*).

## REASONABLE ROYALTY

As an alternative to profit analysis, the concept of a reasonable royalty on infringing sales is gaining favor with the courts. The reasonable royalty is designed to isolate that portion of the revenue specifically attributable to the use of the infringed asset. In applying the reasonable royalty technique, there are a couple of key considerations to contemplate.

First, while more information on royalty rates is becoming available in the public domain, some experts still rely on incomplete data sets in opining to fair market royalty rates. A royalty rate cannot be considered in isolation. It is important to understand the other key terms embedded within the royalty rate agreement in order to be confident that a truly comparable situation exists. For example, as the preponderance of available royalty rate data is generally provided at the wholesale level, applying wholesale royalty rates to retail level sales will grossly overstate the damages estimation. Therefore, it is important to match royalty rate data with the level of commerce in which the defendant participates (e.g., retail v. wholesale v. first cost).

In addition to finding comparable royalty rates for the infringed asset, the expert must also consider whether the comparable royalty rates make sense in terms of the defendant's overall cost structure. For example, if the defendant is realizing a 12% operating profit margin, the conclusion of an 8% royalty rate would be unrealistic (e.g., 2/3 of the operating profit). In this example, the company's 12% operating profit margin is attributable to the entire portfolio of assets supporting the product line—not just the trademark at issue. Thus, the concluded royalty rate must consider the return on all assets (tangible and intangible) employed in the manufacture and distribution of the product.

## CORRECTIVE ADVERTISING

In addition to actual damages, successful plaintiffs can also be awarded damages in the form of corrective advertising. For some time, The “Big O Tire” case provided a general guideline (25% of defendant’s marketing spend) as to the relative level of corrective advertising damages awarded to successful plaintiffs in order to compensate them for overcoming any negative associations resulting from the infringing actions of the defendant. While this precedent can serve as a guideline for corrective advertising measurement, there are other important considerations in analyzing the defendant’s marketing activities. For example, if the defendant uses internet-based marketing channels (e.g., press releases) to promote its product or service, simply analyzing the direct expense associated with a press release fails to consider the “viral” nature of the Internet. Thus, further analysis is necessary to evaluate the breadth of distribution for the press release, which can result in the identification of millions of additional consumer impressions—generally unaccounted for in the defendant’s accounting records. In sum, effective corrective advertising analyses are not just a function of applying a 25% factor to the defendant’s actual marketing expenses.

Daryl Martin is Managing Principal at IPmetrics LLC

He can be reached at [dmartin@ipmetrics.net](mailto:dmartin@ipmetrics.net)

or (858) 538-1533 ext. 203