Determining An Appropriate Royalty Rate For Reasonable Royalty Trademark Damages

A Modified *Georgia-Pacific* Framework

By David Drews

When a plaintiff believes that its trademark has been infringed, an important element is oftentimes the determination of damages suffered by the plaintiff. At the federal level, the calculation of damages is dictated by the Lanham Act.[1] Once liability has been proven, the Lanham Act provides for the recovery of defendant's profits, actual damages sustained by the plaintiff and the costs of the action, subject to principles of equity.[2]

Although the Lanham Act does not explicitly list a reasonable royalty as a valid remedy in trademark infringement matters, the award of a reasonable royalty as compensation for trademark infringement damages has been recognized as an appropriate alternative for decades.[3] This makes sense from an economic perspective since royalty rates have long been utilized as pricing and value indicators for intellectual property of all kinds, including trademarks. However, it is important to note that a reasonable royalty is not appropriate in every trademark infringement situation.

It should also be noted that the recovery of a reasonable royalty in a trademark infringement action is limited by some jurisdictions to those situations in which the licensing of the mark has already taken place with a third party, or has at least been contemplated by the plaintiff.[4] Other jurisdictions accept a hypothetical negotiation between the plaintiff and the defendant, even in situations where the plaintiff has categorically stated that it would not license its mark to anyone, including the defendant.[5]

Depending on the facts of the case, the use of a reasonable royalty to calculate damages is a fairly straightforward exercise once the infringing revenue and appropriate royalty rate have been identified. Royalty rates can also figure prominently in a lost market value assessment of the damages resulting from trademark infringement. In a lost market value assessment, an analysis calculating the change in the value of the brand or trademark resulting from the defendant's alleged infringing actions can be based on the fact that the owner of a trademark does not have to pay royalties to a third party in order to use it.[6]

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However, the selection of an appropriate royalty rate has typically been one of the most contentious areas of disagreement among parties involved in a trademark infringement action, even when both plaintiffs and defendants agree that a reasonable royalty is the proper method for calculating damages. With patent infringement damages, the identification of an appropriate royalty rate has been guided for several decades by the fifteen-factor test described in *Georgia-Pacific Corp. v. U.S. Plywood Corp.*, which takes into consideration numerous aspects of the relevant economic, financial and competitive characteristics associated with the infringing use and the parties involved.[7] As of yet, a preferred method for

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1. This article is concerned with reasonable royalty damages in a federal trademark infringement action. While damages associated with state or common law trademark infringement actions may utilize similar approaches, they are outside the scope of this discussion. Also, this article assumes that a reasonable royalty has been determined to be an appropriate damages remedy for a particular infringement scenario.

2. 15 U.S.C. § 1117(a).

3. For example, see *Sands, Taylor & Wood Co. v. Quaker Oats Co.*, 978 F.2d 947, 963, 24 U.S.P.Q.2d 1001 (7th Circuit 1992).

4. For example, see *Trovan Ltd. v. Pfizer, Inc.*, No. CV-98-0094 WL 709149 (United States District Court, Central District of California, May 24, 2000). In this case, the court explicitly stated that the Ninth Circuit would not recognize a reasonable royalty as a measure of damages where no evidence had been proffered that a party intended to license its trademark.

5. For example, see *Sands, Taylor & Wood v. Quaker Oats Co.*, 978 F.2d 947 ¶57 (7th Circuit 1992). In this case, the court stated that a "generous approximation of the royalties Quaker would have had to pay STW for the use of the THIRST-AID mark had it recognized the validity of STW's claims seems to us an appropriate measure of damages…"

6. Known as a "Relief from Royalty" analysis, it measures the value of the trademark by quantifying the present value of avoided costs, *i.e.*, the royalty payments not made due to ownership of the asset.

identifying an appropriate royalty rate for trademark damages purposes has not been as well documented by the courts.

This has led to an inconsistent application of reasonable royalty analyses across the various federal circuits. In my experience, I have found that using a modified *Georgia-Pacific* analysis can oftentimes provide a framework for identifying an appropriate royalty rate in trademark infringement situations.

Georgia-Pacific and Trademark Infringement

The *Georgia-Pacific* factors used in patent infringement reasonable royalty analyses were originally selected to help determine the outcome of a hypothetical negotiation between the two parties involved in the lawsuit. The framework was designed to identify and incorporate the respective negotiating positions of the two parties for a hypothetical grant of rights associated with the infringed patent under circumstances similar to the use of the patent embodied in the infringing activities.

A similar analysis may be appropriate when determining the royalty rate to use in trademark infringement damages analyses. Most of the factors are analyzed in the context of the hypothetical negotiation, which is usually set at a point immediately preceding the start of the infringement period. The analysis is therefore typically restricted to what was known or knowable at the time of the hypothetical negotiation, including reasonable forecasts of expected results.

Some of the factors, however, suggest the inclusion of analysis that considers activity that is subsequent to the date of the hypothetical negotiation, which oftentimes incorporates information beyond that which would have been known or knowable at the time of the negotiation. Without getting too far into the "Book of Wisdom"[8] or *ex ante* versus *ex post* damages analyses discussions,[9] which are deserving of their own articles, the potential use of any information that becomes available after the hypothetical negotiation takes place should be considered on a case-by-case basis when determining a reasonable royalty rate in a trademark litigation.

Also, there is more involved with using a *Georgia-Pacific* factor analysis in relation to trademark infringement than simply substituting the word "trademark" for the word "patent" in each of the factors. As is noted below, modifications within some factors are oftentimes necessary, and the differences between patents and trademarks in general need to be acknowledged.

With patents, for example, attention has to be paid to the "Entire Market Value Rule, which, *inter alia*, is concerned with the extent to which the patented invention is the basis for consumer demand for the product that features the invention. As was highlighted in *Paper Converting Machine Co. v. Magna-Graphics Corp.*,[10] when the invention is the basis for consumer demand, one should calculate the reasonable royalty on total sales of the accused products. However, if other aspects are responsible for a portion of the consumer demand, it is necessary to determine the portion of sales associated with the patented invention and limit the calculation of the reasonable royalty to one based only on that portion of accused sales. Since all of the infringing sales in trademark litigation typically feature the use of the trademark, no such limitation is necessary.

The discussion that follows identifies each *Georgia-Pacific* factor, as well as indications of some of the modifications necessary to make it more relevant to a trademark infringement action.

Factor One—The royalties received by the patentee for the licensing of the patent in suit, proving or tending to prove an established royalty.

As discussed above, the concepts in each factor are analyzed for their applicability to trademarks. Obviously, information regarding the royalties earned by licensing the trademark in suit is extremely relevant. When assessing the plaintiff's licensing of the trademark in suit, the expert should take into consideration the timeframe, geography and product categories of the various licenses, including how those factors may have changed during the period between when the actual license was negotiated and when the hypothetical license would have been negotiated.

The form of compensation and royalty rate struc-

7. *Georgia-Pacific Corp. v. U.S. Plywood Corp.*, 318 F. Supp. 1116, 166 U.S.P.Q. 235 (S.D. N.Y. 1970).

8. *Sinclair Refining Co. v. Jenkins Petroleum Process Co.*, 289 U.S. 689, 53 Supreme Court 736, 77 L. Ed. 1449 (1933).

9. For example, the "Litigation Services Handbook: The Role of the Financial Expert," by Roman L. Weil and Peter B. Frank has a chapter on *ex ante* versus *ex post* damages calculations.

10. *Paper Converting Machine Co. v. Magna-Graphics Corp.*, 745 F.2d 11 (Federal Circuit 1984). This precedent has been refined numerous times since 1984, recently by *Lucent Technologies, Inc. v. Gateway, Inc.*, 580 F.3d 1301 (Federal Circuit 2009) and *Uniloc USA, Inc. v. Microsoft Corp.*, 632 F.3d 1292 (Federal Circuit 2011), and perhaps most significantly by *Laserdynamics, Inc. v. Quanta Computer, Inc.*, 694 F.3d 51 (Federal Circuit 2012), in which the court indicated that the royalty base should be the "smallest saleable patent-practicing unit."

ture are important elements as well. Items such as guaranteed minimums, marketing contributions, per unit versus percentage of net sales royalty bases and upfront payments all need to be analyzed. In addition, the comparability of the plaintiff's previous licensing activity to the set of circumstances in the lawsuit needs to be considered.

Information associated with offers to license the trademark in suit made by the plaintiff can provide information on the plaintiff's perception of value. Care must also be taken to distinguish between licenses granted via unforced negotiations and those that result from settled litigation, or between arm's-length agreements and those entered into by related parties, and some of the plaintiff's licenses may not be relevant to the instant case at all. In general, not much modification from the patent framework may be necessary with this factor.

Factor Two—The rates paid by the licensee for the use of other patents comparable to the patent in suit.

Like Factor One, the information related to what the defendant has paid to license similar trademarks may also be relevant. Here again, there is not much need for modification. Generally, it is important to assess the comparability of the defendant's past licensing activity in terms of timing, scope, compensation terms, geographical constraints and approved product categories, as well as the comparability of the actual asset or assets being licensed, including the relative strength, awareness or heritage of the respective marks.

Factor Three—The nature or scope of the license, as exclusive or non-exclusive; or as restricted or non-restricted in terms of territory or with respect to whom the manufactured product may be sold.

Factor Three is concerned with making sure that the hypothetical negotiation tracks closely with the parameters surrounding the alleged infringing activity. This factor is not necessarily modified from the patent scenario in terms of how it is analyzed; rather, the existing elements are simply applied to the trademark infringement scenario. As with a patent infringement analysis, the hypothetical negotiation is typically constructed on a non-exclusive basis and is restricted to those geographies in which the infringement activity allegedly took place.

In addition to the exclusivity and territory characteristics mentioned in the factor description, when applied to a trademark infringement this factor is also associated with items such as approved product categories, distribution channels and other constraints or requirements that may be applicable to the infringing situation. The closer the comparable license agreements from Factors One, Two and Twelve match with the parameters of the infringing activity, the more relevance they may have to the hypothetical negotiation.

Factor Four—The licensor's established policy and marketing program to maintain its patent monopoly by not licensing others to use the invention or by granting licenses under special conditions designed to preserve that monopoly.

When analyzed in the context of a trademark infringement, Factor Four is concerned with more than the license/not license question or special conditions listed in the description. It is also concerned with the overall trademark licensing policy of the plaintiff, including marks other than those in suit. While the license/not license question and any special conditions will certainly be important, the plaintiff's policies regarding other elements, such as those having to do with required compensation, required or forbidden product categories, exclusivity versus non-exclusivity, geographical constraints and required or forbidden distribution channels will also be significant.

A plaintiff with a long history of licensing its trademarks on an arm's-length basis will be better positioned to defend its royalty rate demands than one that has only limited experience in this area. Also, a trademark owner that has defended its mark against all instances of alleged infringement helps demonstrate its willingness and ability to maintain its rights in the trademark.

Factor Five—The commercial relationship between the licensor and licensee, such as whether they are competitors in the same territory in the same line of business, or whether they are inventor and promoter.

The commercial relationship between the parties is naturally important. If the two are direct competitors, the plaintiff would typically demand a higher royalty rate since the defendant is likely either (1) making sales that the plaintiff believes it could have made or, (2) in a case where the plaintiff does not distribute its products in the defendant's territories or distribution channels, preventing the plaintiff from expanding its operations.

Situations in which the two are not direct competitors typically argue for a relatively lower royalty rate conclusion, although a supplier/customer relationship between the parties can complicate matters. The complication arises because a defendant who is also a key supplier or customer may induce the plaintiff to accept even lower compensation than would otherwise be the case.

Factor Six—The effect of selling the patented specialty in promoting sales of other products of the licensee, the existing value of the invention to the licensor as a generator of sales of his non-patented items, and the extent of such derivative or convoyed sales.

It is very rare when a trademark infringement situation features a concept akin to "convoyed sales," *i.e.*, sales of products that do not utilize the trademark but should be included as part of the royalty base. In trademarks, there is scope to license a trademark to be used in marketing a composite good when a component's trademark assists in differentiating the final good in the consumer's perception. Such is the case with the use of the Intel Inside® trademark by several computer manufacturers. Competitive considerations in determining the reasonable royalty rate in these situations will likely include the competitive environment among licensees in addition to that between the plaintiff and the defendant. Also, a defendant may occasionally require customers to purchase products associated with one of its other (non-infringing) brands in order to purchase the products that feature the allegedly infringing trademark.

Without convoyed sales, this factor is typically scored as neutral or slightly favorable to the defendant. If there are indeed convoyed sales, it argues for a higher royalty rate than otherwise since the defendant is enjoying additional sales activity and building a more extensive relationship with customers/retailers.

Factor Seven—The duration of the patent and the term of the license.

This factor provides one of the main contrasts between the patent-centric analysis typically found with *Georgia-Pacific* and the modified version used to analyze a reasonable royalty rate in a trademark infringement situation. As long as a trademark is continuously used in commerce, the registration fees are paid on a timely basis and the owner defends it against all instances of infringement, the trademark will continue to remain valid. For example, the Fruit of the Loom® and Coca-Cola® trademarks have been in continuous use since the late 1800s.[11]

The expected term of the hypothetically negotiated license is typically dictated by the duration of the infringing activity, although the previous licensing activity of the two parties and/or the industry comparable license agreements may also be important. In general, this factor has little or no bearing on the determination of the royalty rate, unless different royalty rates are associated with different durations in the parties' relevant licenses and/or the comparable agreements. Also, to the extent that a longer license term allows the defendant to develop customer relationships that may endure beyond the life of the hypothetical license agreement, it may indicate the need for a higher royalty rate.

Factor Eight—The established profitability of the product made under the patent, its commercial success, and its current popularity.

With this factor, in addition to the analysis of the product-related aspects listed in the description, one must also pay attention to the popularity and awareness of the trademark itself. The use of the trademark may enable a greater level of success than the product would achieve without it. Currently, Apple® is a good example of a trademark that instantly conveys status on a new product offering.

With the demise of the 25% rule in patent litigation,[12] it is safe to assume that this technique is no longer a suitable choice in trademark reasonable royalty rate analyses either. Therefore, the established profitability of products featuring the infringed trademark can no longer be a direct input to the formula used to determine a reasonable royalty rate. However, the established profitability and commercial success of products that featured the trademark in suit prior to the hypothetical negotiation are still important indicators of the relative strength and level of consumer awareness of the trademark, and will help narrow a relatively wide range of comparable property royalty rates to one that is more appropriate. Generally, a more established, more successful trademark will command a higher royalty rate than one without a similar track record of success, *ceteris paribus*.

Also, the profitability of the underlying product line typically is an important limit on the royalty rate, as no licensee would willingly transfer all or most of its profits to a trademark licensor. That said, trademark licensors typically demand higher royalty rates for uses in particularly profitable categories than in undifferentiated, commodity products.

As stated above, most factors are analyzed in the

11. *www.uspto.gov*, Registration Numbers 0238146 and 0174998, respectively.

12. *Uniloc USA, Inc. v. Microsoft Corp.*, 632 F.3d 1292, 1315, 98 U.S.P.Q.2d 1203 (Federal Circuit 2011). In this case, the court stated that "[t]he court now holds as a matter of Federal Circuit law that the 25 percent rule of thumb is a fundamentally flawed tool for determining a baseline royalty in a hypothetical negotiation."

context of the hypothetical negotiation, which is usually set at a point immediately preceding the start of the infringement period. Factor Eight, however, explicitly requires analysis of the "current popularity" of the asset. Certainly, subsequent information regarding the level of sales actually achieved is required to calculate reasonable royalty damages. When analyzing the factors to determine the royalty rate, however, the potential use of any information that becomes available after the hypothetical negotiation takes place should be considered on a case-by-case basis.

In trademark cases, Factors Nine and Ten are frequently analyzed together since they are similar and essentially define the impact that the trademark has in the marketplace. I have elected to follow that convention in this article.

Factor Nine—The utility and advantages of the patent property over the old modes or devices (if any) that had been used for working out similar results; and,

Factor Ten—The nature of the patented invention; the character of the commercial embodiment of it as owned and produced by the licensor; and the benefits to those who have used the invention.

Factors Nine and Ten deal with the utility and nature of the assets being licensed. The utility and nature of a trademark is that it identifies the source of a product and it harbors any goodwill generated among its customers. It also conveys information regarding the reputation and characteristics of the associated brand. For example, Tiffany & Co.® and Wal-Mart® convey information to consumers about what they will find and experience at the two retailers' establishments (*e.g.*, luxury goods and low prices, respectively).[13] Therefore, a trademark with high relative strength and awareness attributes and a long successful history in the marketplace (essentially, more "utility") will generally command a higher royalty rate than one without those features.

Also, a trademark will have more "utility" when used with products with which it has been associated for a long time than it will with products for which there is no history of use. For example, Apple® resonates with consumers when used with personal electronics, but may not have the same effect when used with garden tools or laundry detergent.

From a financial perspective, the advantage that a trademark provides may sometimes be measured by the price or market share premia associated with the mark versus generic goods. There may also be a differential when compared to other branded goods, although that is typically a smaller advantage and more difficult to measure.

Factor Eleven—The extent to which the infringer has made use of the invention; and any evidence probative of the value of that use.

This factor is oftentimes used to inform the analysis surrounding Factor Three regarding the nature and scope of the license; the extent of use typically outlines the geographic scope, distribution channels and product categories covered by the hypothetical negotiation. This is also where evidence of actual confusion (or lack of) and surveys indicating likelihood of confusion (or lack of) will provide guidance as to the value of the use by the defendant. As with Factor Eight, this factor oftentimes requires analyzing data that is subsequent to the date of the hypothetical negotiation.

If the use of the trademark allowed the defendant to generate increased sales and higher profits, or to enter a distribution channel or geography to which it had not previously had access, the royalty rate called for is typically higher than use that does not provide these kinds of benefits. Generally, the more extensive the use and the greater the benefit enjoyed by the defendant, the higher the royalty rate that is supported.

Factor Twelve—The portion of the profit or of the selling price that may be customary in the particular business or in comparable businesses to allow for the use of the invention or analogous inventions.

This factor incorporates any relevant third-party comparable licenses into the analysis. It is important to narrow the search so that it only includes license agreements for trademarks used during a similar timeframe, on similar product categories and in similar geographies. It is oftentimes possible to adjust for slight differences in these aspects, but the impact of this factor should count for less weight in the overall analysis when these adjustments are utilized.

As with Factors One and Two, the form of compensation and royalty rate structure are important elements. Items such as guaranteed minimums, marketing contributions, per unit versus percentage of net sales royalty bases and upfront payments all need to be analyzed. Also, any constraints, requirements or restrictions need to be considered, as well as differences in the negotiation context. The relative strength and awareness of the trademark

13. *www.tiffany.com* and *www.walmart.com*.

in suit as compared to the trademarks included in the comparable licenses is also a key aspect of this factor analysis.

Finally, it is important that the risks borne by the licensors and licensees in the relevant comparable agreements match up with those hypothetically borne by the plaintiff and defendant in the constructed negotiation framework. Depending upon which trademarks are included in the third-party comparable agreements, this factor analysis will help determine where the trademark in suit should fall on the spectrum of relevant royalty rates.

Factor Thirteen—The portion of the realizable profit that should be credited to the invention as distinguished from non-patented elements, the manufacturing process, business risks, or significant features or improvements added by the infringer.

This factor is modified from the typical patent-oriented analysis to more closely follow a typical trademark apportionment analysis. Ultimately, the determined royalty rate will provide the concluded apportionment; this factor analysis will help to determine what that reasonable royalty rate should be. Elements that may need to be considered include other trademarks owned and used on the accused sales by the defendant, non-infringing trade dress and packaging elements, an experienced and effective management team and sales force, the distribution network utilized by the defendant, relationships with retailers, marketing efforts (trade shows, websites, advertising, etc.), any technology that is incorporated in the products (patents and/or trade secrets), and any other elements that are specific to the products being sold.

Factor Fourteen—The testimony of qualified experts.

Occasionally, evidence related to experts other than the damages experts in a trademark case may have some bearing on the determination of a reasonable royalty rate. Rarer still is the expert analysis or opinion not associated with the instant case that is targeted enough to provide guidance on this question in a litigation environment. When expert opinion is available and relevant, it should be relied upon, at least to the extent that it is deemed to be reliable and accurate. Otherwise, this factor is typically scored as being neutral, or having no impact on the determination of a reasonable royalty.

Factor Fifteen—The amount that a licensor (such as the patentee) and a licensee (such as the infringer) would have agreed upon if both had been reasonably and voluntarily trying to reach an agreement; that is, the amount which a prudent licensee—who desired, as a business proposition, to obtain a license to manufacture and sell a particular article embodying the patented invention—would have been willing to pay as a royalty and yet be able to make a reasonable profit and which amount would have been acceptable by a prudent patentee who was willing to grant a license.

Essentially, this factor is the conclusion of the hypothetical negotiation described via the analysis of the preceding fourteen factors. All of the quantitative and qualitative factors that are relevant to the infringement situation should be weighed by the damages expert to determine an appropriate reasonable royalty rate.

Conclusion

When using a modified *Georgia-Pacific* factor analysis to determine a reasonable royalty rate in a trademark infringement action, it is crucial to understand how the various factors should be applied to trademarks, trademark licensing and the alleged infringement. For example, there are numerous differences between the rights granted by a patent and those associated with a trademark. In general, a patent grants the right to exclude others from practicing the revealed invention for a period of time, whereas a trademark identifies the source of the goods and serves as a repository for any goodwill generated.

In practice, the analysis for a trademark-related reasonable royalty rate will be the same as that for a patent-related reasonable royalty rate for some factors and markedly different for others. The differences may be related to items such as the potential presence of non-infringing alternatives and design-arounds (patents, but not trademarks), the implications of the "Entire Market Value Rule" (again, patents, but not trademarks) and the fact that patents have an explicit expiration, whereas trademarks can continue indefinitely (when certain conditions are met).

As long as the analysis of the various factors has captured the nature and scope of the potential license and trademark in suit, the financial and logistical aspects of the usage, the impact of comparable licensing situations and the relevant risk profiles for both parties, the resulting reasonable royalty rate conclusion for the use of the trademark in the context of the alleged infringing activity should be appropriate and defensible, and could be informative to the trier of fact in considering a suitable remedy. ■