Assessment of Damages in Patent Infringement Cases in Japan

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I. INTRODUCTION

Japan has pursued its policy to increase the international competitiveness of the Japanese economy by protecting intellectual property rights and promoting their utilization as well as encouraging the creation of advanced technologies.

Accordingly, one policy focus has been to strengthen the system of patent protection and its enforcement. Within this framework, various studies have been made with a view to achieving a speedy resolution of patent infringement disputes and offering the patentee sufficient remedies. In the past, there has sometimes been criticism that the plaintiff, when seeking remedies for patent infringement, could not claim sufficient compensation from the defendant. If only a small amount of compensation was to be expected, then practically there would be no measures to stop infringement; and such a

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situation would decrease the incentive to make huge investments to carry out R&D and supply goods of high quality to the market. Such criticism resulted in the revision of the Japanese Patent Act with respect to the damages clause in 1998, by way of establishing Article 102(1).[1]

I would like to briefly discuss the background of the revision and also the practical aspects of patent infringement litigation following the revision.

II. PREVIOUS PROVISIONS RELATING TO THE CALCULATION OF DAMAGES

Prior to the 1998 revision, there were three provisions with respect to the calculation of damages in a patent infringement case.

1. Section 709 of the Civil Code[2]
(Plaintiff's lost profit)

This provision stipulates that the plaintiff may recover damages having a causal relationship with the defendant's unlawful act. In other words, the clause recognizes that the amount of profit the plaintiff would have gained but for the defendant's violative act can be the amount of damages. There is nothing unusual in this provision.

The causal relationship between the defendant's act and the plaintiff's damages will be discussed later in detail.

2. Section 102(2) (formerly Section 102(1)) of the Patent Act
(Presumption of damages based on defendant's profit)

This provision states that, in a case where the defendant has gained a profit by selling goods that infringe a patent, this profit may be presumed to be the plaintiff's damages.

The purpose of this provision is to decrease the plaintiff's burden of proof; however, this presumption clause does not alter the general principle of determining damages under the Civil Code.

3. Section 102(3) (formerly Section (2)) of the Patent Act[3]
(Amount equivalent to royalty)

This provision allows the patentee to claim, as damages, at least an amount equivalent to a license fee generated from the patented product.

However, Japan does not recognize treble or punitive damages. The Japanese laws only allow the recovery of an amount equal to the plaintiff's losses (including both "the

1 See Appendix.
2 See Appendix.
3 See Appendix.

loss that has actually occurred" and "the loss of profit that the plaintiff would gain in the future").

III. Litigation Practices under the Old Provisions

Section 709 of the Civil Code provides the general principle governing legal actions seeking compensation for damages caused by unlawful acts.

In determining damages in patent infringement cases, judges have applied the general principle of the Civil Code in accordance with the interpretation of the relevant provisions and the precedents. Since Section 709 of the Civil Code is a general provision, judges have been mindful of maintaining harmony and consistency in applying the clause to such various cases as (a) calculation of damages for wrongful death or injuries from traffic accidents, industrial accidents or medical malpractice; (b) calculation of business damages caused by fraudulent transactions; (c) calculation of damages for physical harm caused by environmental pollution; and (d) calculation of damages in defamation cases.

Under the general principle of the Civil Code, the injured party can claim from the injuring party an amount equal to the loss suffered by the injured party. The plaintiff can seek full recovery within the limit of the plaintiff's losses, but may not seek recovery beyond such losses. From the perspective of the accused infringer, the infringer would be liable for the same monetary amount whether the infringer obtained a license from the patentee or illegally used the patent without an authorization. It may then follow that the accused infringer could pay less for the illegal use of the patent than the cost of obtaining a legitimate license.

Under the general principle of the Civil Code, the injured party may recover a higher amount of damages in cases involving defamation, damages to good will or bodily harm, since the injured party is entitled to compensation for its mental suffering in addition to the property or physical damages.

In patent infringement cases, however, such a compensatory award is not recognized.

The Japanese courts have never changed this cardinal principle under the Civil Code. If this principle, which has existed for over a hundred years, were to be changed, the adverse effects of disrupting the predictability and legal stability in calculating tort damages would be extraordinary.

Against this background, there has been criticism that protection of the patentee was insufficient in view of the relatively low amount of damages available under Section 709 of the Civil Code in patent infringement cases.

In light of such criticism, the Patent Act was amended in 1998 to provide a new clause – i.e. Section 102(1) – regarding the assessment of damages in patent infringement cases. Section 102(1) of the Patent Act will now be discussed in detail.

IV. CONTENTS AND LEGISLATIVE INTENT OF SECTION 102(1)

1. Section 102(1) of the Patent Law

The provision reads as follows:

> Where a patentee or an exclusive licensee claims from the intentional or negligent infringer of his patent right or exclusive license compensation for the damages he has sustained as a result of infringement, and the infringer has assigned objects composing the act of infringement, the amount of damages sustained by the patentee or the exclusive licensee may be presumed to be the amount of profit per unit of objects which would have been sold by the patentee or the exclusive licensee if there had been no such act of infringement, multiplied by the quantity (hereinafter: the "assigned quantity") of objects assigned by the infringer, the maximum of which shall be the amount attainable by the patentee or the exclusive licensee in light of the capability of the patentee or the exclusive licensee to work [the patented invention]; provided, however, that if any circumstances exist under which the patentee or the exclusive licensee would have been unable to sell the assigned quantity in whole or in part, the amount calculated as the quantity not able to be sold due to such circumstances shall be deducted.

This provision, as written, is difficult to grasp. In short, it is provided that, for the purpose of claiming monetary compensation, the plaintiff should establish:

> (i) the amount calculated by multiplying the number of infringing goods transferred by the infringer with the amount of profit per unit of the goods that could have been sold by the patentee but for the infringement; and
>
> (ii) the plaintiff's sufficient working capacity in excess of the amount of goods the plaintiff has sold (main part of the provision).

On the other hand, the defendant may have the amount of damages reduced in its entirety or in part by substantiating the presence of special circumstances where the plaintiff could not sell the goods in an amount equivalent to the entirety or part of the number of transferred goods (proviso).

2. Legislative Intent of Section 102(1)

With regard to the calculation of damages caused by an unlawful act, Section 709 of the Civil Code provides the general rule. According to Section 709, the defendant shall compensate the plaintiff's losses to the extent that such losses have a causal relationship with the defendant's unlawful act.

As discussed above, however, it may be difficult to establish such a causal link in a case of patent infringement: the plaintiff must prove a fictitious situation that did not actually occur – that is, "how much profit the plaintiff would have made through sales of plaintiff's product but for the defendant's infringement". In addition, strictly speaking, there may not be that many instances where customers would have purchased the plain-

tiff's product even if there had been no infringement by the defendant. In the exceptional situation where the market is totally closed and the total demand of the product is fixed, such causation could be established. For instance, such causation may be readily established when vaccination for all children up to a certain age is mandated under the law and the defendant has infringed the plaintiff's patent on the vaccine. In this case, the plaintiff has lost profit from the decreased sales of the vaccine in an amount equal to that of the vaccine sold by the defendant because the total demand is pre-determined.[4] However, except for such rare instances, there may be very few cases where causation between a defendant's sale of the infringing product and a plaintiff's decreased sales can be established. In most cases, there are products that accomplish substantially the same result as the patented product without using the plaintiff's patent, i.e. substitute products existing in the market. If this is the case, it cannot be necessarily said that consumers would purchase the plaintiff's patented product even if the defendant's infringing goods did not exist. As such, in cases where substitute products are available in the market, it is likely that the causal link between the defendant's sale of the infringing product and the plaintiff's loss of sales may be denied entirely or partially.

For this reason, courts have normally recognized only a small amount of damages in the past except in certain extraordinary cases. As a result, the plaintiff was often awarded a limited amount of damages comparable to royalties.

Accordingly, legislators felt a need to provide a new statutory basis so as to confer on the patentee an appropriate amount of damages, even in cases where the patentee could not have sold the same amount of product as the sales amount of the infringing product. This is the legislative intent underlying the revision of the patent law to provide Article 102(1) in 1998.

3. Theoretical Basis of Section 102(1)

It is possible to enact a *sui generis* law providing a different legal effect exclusively for patent infringement cases, when there is a general provision provided in the Civil Code. To enact such a special law, however, the mere presence of a legislative motive is insufficient; rather, a theoretical basis is needed.

Legislators have offered the following explanations as theoretical bases for establishing such a special provision:[5] (a) the patent right is a right to exclusively practice the patented technology and, therefore, only the patentee can sell the product using the technology; (b) premised on this exclusive nature of the patent right, the number of the

4 Tokyo District Court, decision of Oct. 12, 1998, Hanrei Jihō 1653, 54, where causation between a defendant's sale and a plaintiff's loss of sale was recognized because both parties' products were identical and other companies' products had different characteristics.

5 *See*, for interpretation of Section 102(1), Y. IRINO / N. TAKIGUCHI, Partial amendment to patent law (1998 Law No. 51 and 1999 Law No. 41), Jurisuto 1162, 34; and M. YAMAMOTO, Issues and points on damages under the 1998 patent law amendment, in: Modern System of Trial Law, 269 *et seq.* (all in Japanese).

product sold by the infringer equals the number of the patentee's lost sales, to the extent not exceeding the amount according to the patentee's or exclusive licensee's working capability; (c) accordingly, the amount of damages can be considered equal to the monetary amount calculated by multiplying the number of the product sold by the infringer by the amount of profit per unit of the patentee's product to the extent of the patentee's working capability (the main part of the article); (d) there is a provision, however, that if an actual infringement case fails to satisfy the formula "the number of the product sold by the infringer = the number of the patentee's lost sales" due to such factors as the infringer's marketing ability, the amount attributable to such factors can be deducted subject to the infringer's proof thereof (the proviso of the article).

The newly introduced provision was derived from the above theoretical reasoning, although there are some questions as to the correctness of point (b) above.

4. Advantages for the Patentee under Section 102(1)

The legislators explain that Section 102(1) offers the following two advantages to the patentee.

First, even when the existence of other substitute products is confirmed in litigation, the causal relationship with respect to the lost profit suffered by the plaintiff cannot be entirely denied, although the existence of such products may be considered as reducing the amount of damages. Accordingly, a considerable amount of damages can be awarded even in cases where lost profit would have been denied under the previous approach based on Section 709 of the Civil Code. The significance of this statutory clause lies in the substantial alleviation of the burden of proof on the part of the plaintiff by recognizing the proximate causation between the amount of the plaintiff's lost profit and the amount calculated by multiplying the number of the infringing product sold by the unit profit of the plaintiff's product.

Secondly, this provision allows the plaintiff to meet the burden of proof by merely establishing the amount of the defendant's sales and the profit per unit of the plaintiff's product. Furthermore, the provision also seeks to simplify and facilitate the plaintiff's burden of proof as the plaintiff can prove the profit per unit based on the patentee's own data.[6]

6 *See* Y. IRINO / N. TAKIGUCHI, *supra* note 5.

V. ISSUES ASSOCIATED WITH SECTION 102(1)

1. General Background

As discussed above, this new statutory provision is not easy to understand even though the legislative motivation was expressed. In interpreting the provision, therefore, care must be taken with respect to the following two points.

First, the interpretation should be in harmony with other court decisions rendered under the Civil Code and should not contain contradictions in logic. Second, the interpretation should be made in light of the legislative intent to provide adequate relief to the patentee whose patent right has been infringed.

2. With Regard to the "Patentee's Working Capability"

Regarding the "patentee's working capability", the prevailing view is that a patentee need not show that the patentee was in a position to be able to supply the product in an amount equivalent to that of the infringing product at the time of infringement. Rather, this requirement is interpreted broadly to cover, for example, the patentee's potential capability.

However, there are conflicting views with respect to the "time when the patentee could have worked the patent".

One view requires that the patentee possess the actual capability to supply the product at the time of infringement. This view is based on the reasoning that, since Section 102(1) of the Patent Law is premised on the concept of lost profit – i.e. loss of sales profit – under Section 709 of the Civil Code, it should be interpreted to merely alleviate the burden of proof in harmony with the general principle of the Civil Code.

The other view determines the "time when the patentee could have worked the patent" from the patentee's potential capability during the life term of the patent right. This view is based on the reasoning that, first of all, Section 102(1) derives from the premise that "the patent right is a right to exclusively practice the patented technology, and only the patentee may sell the product using that technology." In light of this exclusive nature of a patent right, it should be recognized that the patented product cannot have a substitute product in the market; and that this new statutory clause was established based on the fiction that the infringing product and the patentee's product are mutually complementary, i.e. they are in a zero-sum relationship in the market. In effect, the loss resulting from the sale of the infringing product equates with a "loss of marketing opportunity", which not only deprives the patentee of the opportunity to market the goods at the time of infringement, but continues to deprive the patentee of subsequent marketing opportunities due to the purchaser's continued use of the infringing product. Therefore, in principle, the patentee must be regarded to possess the capability to work the patent, for example, by way of providing funds based on the patent right or using a subcontractor.[7]

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7 *See* R. MIMURA, With regard to Article 102(1), New Trial Practice, 288 (in Japanese).

3. With Respect to "Circumstances Disabling the Patentee's Sale"

There are also different views with regard to the interpretation of "circumstances that prevent or disable patentee's sale".

Under one view, "circumstances disabling the patentee's sale" should be interpreted to include "the infringer's marketing efforts and the existence of substitute products in the market". To be specific, it should encompass (a) the contribution made to the sale of the infringing product by the infringer's marketing and advertising efforts, market development efforts, unique sales methods, the company size and the brand image; (b) the price competitiveness of the infringer; (c) a superior performance of the infringing product; (d) features of the infringing product which are unrelated to the patent, but are responsible for the sale thereof; and (e) presence of other substitute or competing products in the market besides the infringing product.

The basis of the first theory is the same as that of the first view regarding the patentee's working capability. Section 102(1) of the Patent Act is premised on the concept of lost profit, i.e. loss of sales profit under Section 709 of the Civil Code. Therefore, "circumstances that prevent the patentee's sale" should be interpreted in light of the general principle of the Civil Code.

Under the other view, "circumstances disabling the patentee's sale" should be confined to extraordinary circumstances only. To be specific, such extraordinary circumstances may include (a) inability to operate the product line due to disrupted supply of indispensable parts as a result of a natural disaster or shortage of raw material, which cannot be resolved within the term of the patent; (b) subsequent to the infringement, issuance of a legal measure which prohibits or limits the use of patented invention; and (c) subsequent to the infringement, advent of a superior new technology which has rendered the patent obsolete. Under this view, therefore, the special circumstances should be interpreted as not including the infringer's sales efforts or the presence of competing goods.

The proponents of the second view provide the following reasons. Section 102(1), being founded on the exclusive nature of the patent right, should be interpreted in light of the premise that the infringing product and the patentee's product are in a complementary relationship; therefore, if the phrase "circumstances that prevent the patentee's sale" is to be interpreted as including the infringer's marketing efforts, such as advertisements, and the presence of substitute or competing products, then it would contradict the basic premise. (Each of these situations should be interpreted as having been excluded from the "circumstances that prevent the patentee's sale", when the premise was adopted that the infringing product and the patentee's product are in a complementary relationship in the market.) In applying Section 102(1), since the right holder's product is characterized as a product that practices the patented technology and the infringing product also practices the patent, the infringing product deprives the patentee of marketing opportunities in the market. In other words, because the infringing product has come

into existence by virtue of the patent infringement, the product sold by the defendant – i.e. the infringing product – is in competition with the plaintiff's product to the detriment of the plaintiff's ability to sell the product to dealers or customers. Even though there has been an accumulation of the defendant's marketing efforts, the plaintiff would eventually have sold the same amount of product as the defendant has sold, given a sufficient length of time. Even if the defendant was able to sell the product due to a lower price or any other reason, such factors should not operate to reduce the amount of damages because the plaintiff has lost the opportunity of supplying the plaintiff's own product at the same amount as that of the infringing product as a result of the infringement. Furthermore, even if competing goods other than the defendant's product existed in the market, since the defendant was able to sell a certain amount of the defendant's product, the plaintiff would also have been able to sell the same amount of product that the defendant sold under the same conditions as long as the plaintiff's product performed in a same manner as did the defendant's.[8]

4. Trend of Court Decisions

Court decisions are split as to the interpretation of "circumstances disabling patentee's sale", as provided in the proviso of Section 102(1). A larger number of cases have adopted the second view, providing a higher level of protection to the patentee. That is, in a multiple number of cases, the court held that the damages should not be deducted even if the defendant argued and proved the "defendant's marketing efforts" or the "presence of other substitutes".[9]

On the other hand, in one case where the market shares of the patentee, the infringer and a third party were 35%, 35% and 30% respectively, the court held that the plaintiff was not capable of selling the plaintiff's products in the amount equivalent to the share of 30/75.[10]

5. Sub-conclusion

Given the legislative purpose, conflicting views in interpretation and the recent trend in court decisions surrounding Section 102(1), it seems inappropriate to totally exclude from consideration such factors as the infringer's marketing efforts, unique value added by the infringer or the presence of substitute products, as asserted in the second theory. On the other hand, the first view may seem to contain issues conflicting with the very reason of establishing Article 102(1). The totality of the circumstances may, therefore, need to be taken into account in determining the issue of reducing damages to the reasonable extent.

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8 *Id.*

9 Tokyo District Court, decision of July 17, 2001, 1999 Wa 23013; Tokyo District Court, decision of April 25, 2002, Wa 14945.

10 Tokyo District Court, decision of June 15, 1999, 1697 Hanrei Jihō, 96.

VI. OTHER ISSUES CONCERNING THE CALCULATION OF DAMAGES

1. Profit per Unit

Section 102(1) provides that the damages should be calculated by multiplying the number of infringing goods sold by the infringer with the profit per unit of the right holder's product. The "profit per unit" in this clause should be interpreted as referring to the so-called marginal profit that is calculated by deducting additional expenses that would have been incurred to make an additional number of the patentee's product which could have been sold absent the infringement from the patentee's revenue of the additional sales, and then dividing it by the additional number, that is, deducting variable cost from the sales value of the additional amount of the product and then converting it into the profit per unit.

2. Degree of Contribution

When the patented invention pertains only to a part of the patentee's product, it may raise the issue of contribution – that is, whether the amount of damages should be limited to an amount proportionate to the infringed part. For example, in a product such as an automobile, which involves multitudes of patented technologies from various fields, it would be an excessive remedy favouring the patentee to grant damages based on the entire profit of the whole product even though the infringed patent was associated with only a part of the automobile. Therefore, the majority view generally recognizes the need to limit the amount of damages according to the degree of contribution.

However, it would be inappropriate to simply assess damages in proportion to the monetary value of the patented part over the monetary value of the patentee's whole product. Rather, the scope of limitation should be determined from the role played by the patented invention in attracting or causing the customers to purchase the whole product. In an automobile, for example, an invention of a low-pollution engine cannot be treated on the same footing as an invention for adjusting the angle of a reclining seat, even though both are practiced in the same automobile. If the invention serves the determinative role in motivating the customer to purchase the product, infringement of that single patent may justify the claiming of damages amounting to the entire profit of the whole automobile.[11]

3. Provisions Allowing Reasonable Damages (Section 105-3 of the Patent Act[12])

As discussed above, the patent law provides special provisions in Section 102 Patent Act in consideration of the difficulty associated with proving the amount of damages.

11 *See* MIMURA, *supra* note 7.
12 See Appendix.

Despite such provisions, proving the amount of damages may still be difficult in certain cases.

Therefore, if the infringement has been recognized but the facts necessary to prove the amount of damages remain difficult to ascertain, the provision of Section 105-3 Pate nt Act allows the court to grant a reasonable amount of damages in light of the totality of oral arguments and the result of evidentiary investigation. Through this provision, the plaintiff's burden of proof has been greatly relieved.

VII. CONCLUSION

In conclusion, it can be said that, with the adoption of Section 102(1) in the Japanese Patent Act, the method of calculating damages has been greatly changed, offering a greater level of protection against patent infringement in Japan.