IP Litigator, *Developing Issues in Patent Damages: Future Royalties*, (Nov. 1, 2025)

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Developing Issues in Patent Damages: Future Royalties

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Increasingly, plaintiffs in patent infringement suits are projecting sales through the expiration of the patent, discounting for present value, and then calling the resulting figure a "lump sum" royalty. Figure 1 below illustrates an example of this reasonable royalty theory:

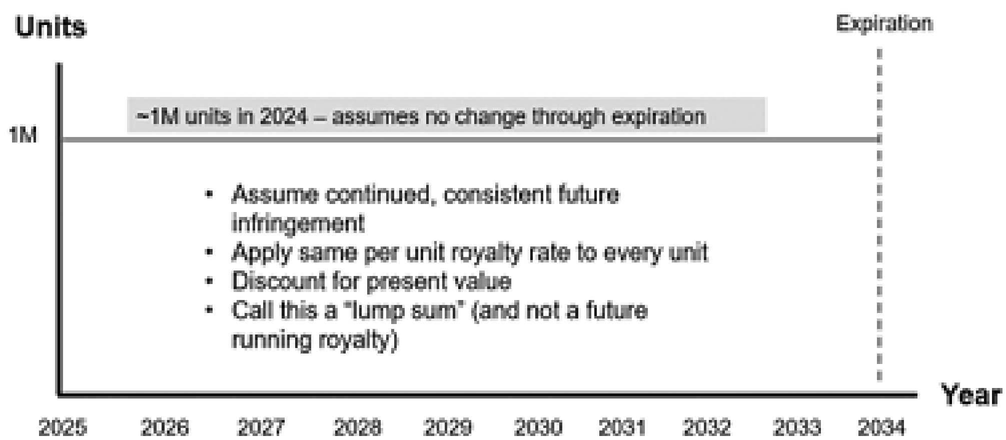
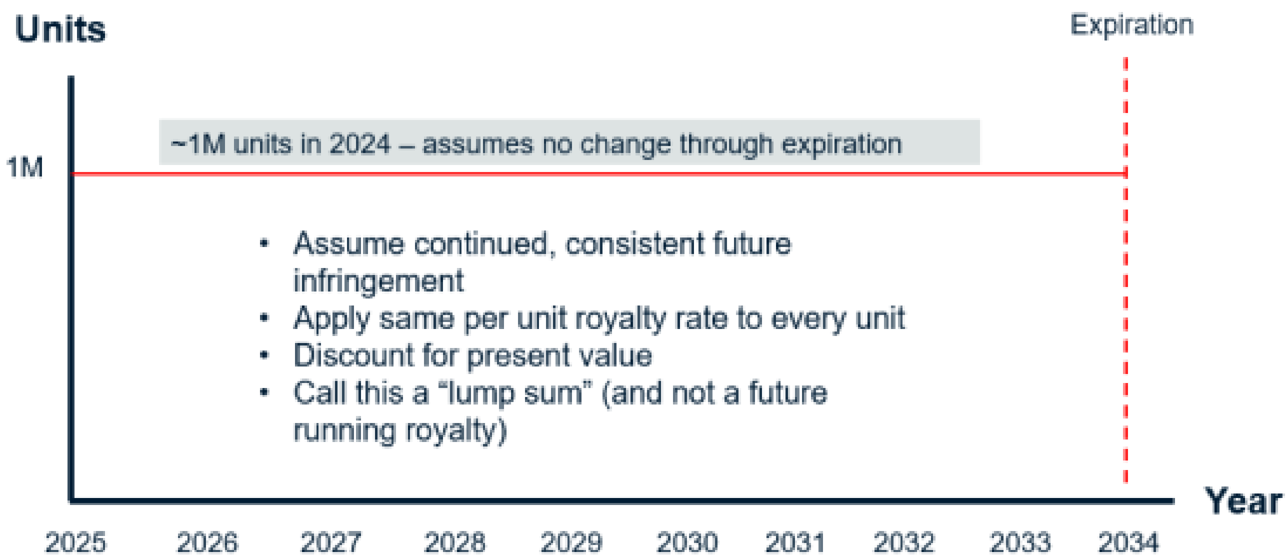


Figure 1: Assumed future royalties through patent expiration



In this example, the trial occurs in 2025. The plaintiff has sales data from the defendant showing its sales trends leading up to the 2025 trial. As to past damages, the plaintiff calculates a per-unit royalty rate for *actual* past sales made before the 2025 trial. As to future damages, the plaintiff's royalty theory assumes that the defendant's sales volume in the year preceding trial will remain constant — the flat line shown above — until 2034, when the patent expires. Without relying on evidence of projected future sales (or at least lacking concrete evidence to show that the defendant will continue selling the accused product for the next nine years), the plaintiff then applies the per-unit rate for past sales to the projected units sold after the 2025 trial through 2034. That gives the plaintiff a dollar amount for future damages, which the plaintiff then discounts to present value. The plaintiff may then refer to this discounted amount as a "lump sum royalty" rather than a "running royalty."

While this damages theory is not uncommon, the damages statute suggests that it might not be acceptable. Under 35 U.S.C. § 285, the court "shall award the claimant damages adequate to compensate for the infringement, but in no event less than a reasonable royalty **for the use made of the invention by the infringer**" (emphasis added). Assuming that the defendant will continue sales nine years into the future, as in the above example, accounts for use of the invention the infringer *has not yet made*, and much can change over nine years.

For example, what if the defendant abandons the product or finds a design-around? Or the market declines and the defendant then pivots to another product? If the defendant loses at trial and the plaintiff is awarded damages through the expiration of the patent in 2034, the defendant will have to pay for nine years of projected sales it may never make.

Calculating reasonable royalties: the analytical method

In *Lucent Technologies, Inc. v. Gateway, Inc.*, 580 F.3d 1301, 1326 (Fed. Cir. 2009), the Federal Circuit identified two accepted methods for calculating reasonable royalties. The first is the **analytical method**, which focuses on the defendant's projections of profit for the alleged infringing product at or around the time the infringement began through the expiration of the patent.[1] The second and more common approach is the **hypothetical negotiation method** of *Georgia-Pacific Corp. v. U.S. Plywood Corp.*, 318 F. Supp. 1116, 1120 (S.D.N.Y. 1970), which attempts to ascertain the royalty upon which the parties would have agreed had they successfully negotiated an agreement at the point the alleged infringement began.

The court in *Lucent* explained that there are "significant differences … between a running royalty license and a lump-sum license." 580 F.3d at 1326. Generally, a running royalty is a true payment per sale, while a lump sum royalty is a projection of what sales *will* be. Running royalties shift risk to the licensor because there is no guarantee of payment. But if the licensed product takes off, the licensor stands to gain greatly, and the licensee is paying for what it uses. In contrast, lump sums provide certainty to both parties at the outset of the license, as they are paid regardless of sales volume or the patented product's success.

The analytical method has been applied in several Federal Circuit cases. For example, in *Interactive Pictures Corp. v. Infinite Pictures, Inc.*, 274 F.3d 1371, 1384 (Fed. Cir. 2001), the defendant, Infinite, had prepared a business plan with future sales projections just two months before the hypothetical negotiation date. The court explained that it had previously upheld awards of damages premised on a lump sum royalty payment based on an infringer's expected sales, finding in the instant case that "those projections would have been available to Infinite at the time of the hypothetical negotiation. The fact that Infinite did not subsequently meet those projections is irrelevant to Infinite's state of mind at the time of the hypothetical negotiation." In *Snellman v. Ricoh, Co.*, 862 F.2d 283, 289 (Fed. Cir. 1988), a jury awarded a lump sum based on evidence consisting of a document projecting Ricoh's anticipated sales and expert testimony related to those calculations. The court found that the jury was authorized to award the lump sum, as it had considered both Snellman's and Ricoh's sales forecasts and accepted Snellman's.

While plaintiffs may rely on *Interactive* and *Snellman* to support the assumed future royalties model, those cases can be distinguished. In both *Interactive* and *Snellman*, the lump sums were based on evidence of the defendant's own sales projections at or around the time the licenses would have been executed (i.e., the beginning of the infringement period). However, the assumed future royalties model assumes that the defendant's sales will continue through patent expiration — and in the case of Figure 1 above, will not change for many years. Thus, if the defendant sold one million units in 2025 and the patent expires in nine years, the plaintiff's calculation would include sales for nine million units. Arguably, this is not the analytical method. Rather, one can argue it appears more like a running royalty in which the plaintiff projects the units expected to be sold in the future and then applies a per-unit rate.

How courts have treated the assumed future royalties model

Defendants who argue that the assumed future royalties model is inconsistent with the statutory language typically claim that § 285 does not apply to infringement that has not yet occurred and that penalizing an accused infringer for future sales would offend basic notions of due process.[2] The defendant, they argue, must be given the choice to stop its conduct, either by designing around the infringed patent or by stopping production of the infringing products. These arguments track analogous circumstances in *Agostini v. Felton*, 521 U.S. 203, 215 (1997). There, the Supreme Court held that it is appropriate to grant relief from an injunction or consent decree where the party seeking relief can show "a significant change either in factual conditions or in law."

There have been at least two cases in which courts appear to have endorsed the assumed future royalties model. In Acc*eleration Bay LLC v. Activision Blizzard, Inc.*, 334 F. Supp. 3d 470, 490-491 (D. Del. 2018), the plaintiff's expert calculated reasonable royalty damages on sales of the infringing products from the date of the hypothetical negotiation through the date of the last patent's expiration. While the defendant characterized this calculation as a "running royalty discounted to the net present value," rather than a lump sum royalty, the court found that the "[p]laintiff clearly articulate[d] that it seeks a lump sum royalty." *Id*. Similarly, in *Red Rock Analytics, LLC c. Samsung Electronics. Co., Ltd*., 2019 WL 13212713 (E.D. Tex. Feb. 6, 2019), the lump sum calculation was based on holding constant the defendant's sales of accused products during 2017 and projecting those sales figures through patent expiration seven years later. The court noted that a lump sum royalty includes compensation for future infringement. *Id*. The court found that, even if the figures were to remain constant once the sales data was received, the defendant made no showing as to why the expert's methodology was "purely speculative." *Id*. These cases may have turned partially on terminology and whether the damages expert called the theory a lump sum rather than a running royalty into the future.

Other district courts have rejected the assumed future royalties model. In *Allergan Sales, LLC v. UCB, Inc.*, 2016 WL 8222619, at *2 (E.D. Tex. Nov. 7, 2016), there were no projections — the damages expert merely calculated a running royalty into the future. The court rejected "an approach in which the jury determines past and future damages all at once" and found that "[a]ny opinion on a future royalty that may accrue from infringement that has not yet occurred (as opposed to a lump-sum royalty) is properly excluded under Rule 702(a)." *Id*. The court noted that "post-trial infringement" is "typically dealt with" using the procedure for ongoing royalty, but also that "a lump sum royalty includes compensation for projected future infringement…The lump sum may be based on developments that have occurred after the date of the hypothetical negotiations, including realistic projections of future sales." *Id*. In *Omnitracs, LLC v. Platform Sci., Inc*. 2024 WL 2214523, at *1 (S.D. Cal. Apr. 8, 2024), the expert calculated future royalties by assuming constant sales out to patent expiration. The court granted a *Daubert* motion "as to calculations based on the present value of assumed future infringement. It is speculative and prejudicial to assume Defendant will continue to practice any of the patents it is alleged to infringe until their expiration." *Id*.

Takeaways

Based on the district court cases above, plaintiffs who advance the assumed future royalty model would be well-served to call it a "lump sum" payment, as courts may reject the theory if it is labeled a "running royalty." Plaintiffs may also attempt to address the argument that such a theory is speculative by projecting future market conditions and fluctuations rather than simply projecting constant sales into the future.

Defendants may respond by citing the language of § 285; by relying on the principle articulated in *Agostini* that an injunction, which is future relief, can be dissolved when factual or legal conditions change; and by arguing that this future royalty theory is different from the analytical approach and has not been accepted by the Federal Circuit.

Footnotes

1 The analytical method is arguably distinguishable from the assumed future royalties method, as the former is based on the defendant's own projections of its future sales near the time of the hypothetical negotiation, whereas the latter is not.

2 The Federal Circuit has held that, to award damages for future injuries, courts must avoid speculation. In *Brooktree Corp. v. Advanced Micro Devices*, 977 F.2d 1555, 1581 (Fed. Cir. 1993), the court noted that "[t]he burden of proving future injury is commensurately greater than that for damages already incurred, for the future always harbors unknowns." In that case, the Federal Circuit affirmed the district court's finding that the evidence of future damages was too speculative to sustain a jury verdict based on the uncertainties of future pricing, competition, and markets in a fast-moving field.