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Exhibit B

Litigation Services Handbook

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Litigation Services Handbook

Fourth Edition

The Role of the Financial Expert

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licenses. The expert cannot use a rate typical for a component and apply it to the entire product.[35]

Regardless of which royalty approach analysts use, they will face the same problem: how does one select a reasonable royalty in the absence of an actual arm's length negotiated agreement between the patentee and the infringer (as a would-be licensee)? Although the insights of game theory can help, solid analytical formulas do not exist. Typically the two parties to the dispute will be far apart on a reasonable royalty. Patent case law provides little enlightenment on the analytics of establishing a rate, but it does suggest a framework for the analysis.

Panduit states that a reasonable royalty equals an amount that a person who wants to manufacture and sell a patented article would willingly pay as a royalty and still realize a reasonable profit on the item. The *Panduit* court also considered the other half of the negotiation, namely, the amount the patentee would have accepted. *Panduit* cited *Egry*, stating that:

> when the patentee's business scheme involves a reasonable expectation of making future profits by the continuing sale to the purchaser of the patented machine, of supplies to be furnished by the patentee, which future business he will lose by licensing a competitor to make the machine, this expectant loss is an element to be considered in retroactively determining a reasonable royalty.[36]

The *Grain Processing* decision in 1999 reinforced this concept.[37] Thus, an expert must analyze the negotiation from both perspectives.

Both of these courts relied on the decision in *Georgia-Pacific* to select the specific royalty rate.[38] The district court in *Georgia-Pacific* summarized 15 factors (discussed in the remainder of this section) used in prior decisions to establish a reasonable royalty. From an economic perspective, some of these factors seem redundant, whereas the court stated others in a fashion that does not reflect all the relevant economic considerations. Moreover, the appropriate weights to place on each factor vary by situation. Finally, the 15 *Georgia-Pacific* factors do not discuss some important economic determinants of a patent's value. Nonetheless, the *Georgia-Pacific* factors provide helpful guidance to the expert. Because courts refer to this case so widely, the practitioner should make explicit use of the 15 *Georgia-Pacific* factors in any reports.[39]

(c) The Hypothetical Negotiation. The most important *Georgia-Pacific* factor is the last one (number 15), because it summarizes and shapes most of the others. This discusses the hypothetical negotiation that *Georgia-Pacific* defines by stating that a reasonable royalty should equal

> the amount that a licensor (such as the patentee) and a licensee (such as the infringer) would have agreed upon (at the time the infringement began) 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.[40]

This criterion assumes that a reasonable royalty would be set at the rate that a generic licensor and licensee (who are similar to the parties) would have