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A SURPRISING RESULT FROM PATENT INFRINGEMENT PRICE ACCRETION INSTEAD OF PRICE EROSION

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Damages in a patent infringement case may include not only damages from sales lost by the patentee to the infringer, but also any lost profits of the patentee from the effect of infringement on the patentee's prices. It is a basic tenet of economics that an increase in competition, e.g., when a new competitor enters a market through infringement of an incumbent's patent, often results in lower prices. In the context of a patent infringement damages analysis, this is known as price erosion. A countervailing possibility is recognized in the economic literature but is not as familiar in the courts: Economic theory holds that, under certain circumstances, increased competition can instead lead to price increases (this effect can be termed price accretion). If price accretion occurs---and is not considered in the analysis of damages--damages may be overstated.

With price accretion (as with price erosion), the patentee (the incumbent firm) changes its price in response to increased competition from an infringing firm. The difference is that the incumbent firm raises its price instead of lowering it.

Why would a firm raise its price in response to increased competition? Economic theory has identified several situations in which a firm might

find it profitable to do just that. These situations involve markets that are segmented or that become segmented with the entry of an infringing product.

Markets can be segmented in a variety of fashions--e.g., by location, by product quality or by product characteristics. In a segmented market some customers will be relatively more attracted to one firm's product than to the other's. And vice versa. An entrant will find it most profitable to enter into a segment of the market where customers will be more attracted to its product than to the incumbent's. But how does that create the possibility for new competition to lead to a higher price? Before the infringement, the patentee may have priced its product low enough to be attractive to a wide swath of customers--including those who now prefer the infringing entrant's product. The incumbent finds that it faces a choice: it can lower its price further to continue to attract those customers who find the entrant's product more attractive or, alternatively, it may surrender those customers to the entrant. However, giving those customers up does not necessarily mean leaving its price unchanged. The incumbent is now left with the customers having a stronger preference for its product and that strong preference may make a price increase profitable.

PRICE ACCRETION - CONTINUED

While the patentee has suffered lost profits damages in the form of lost sales, the increased price on its remaining sales would be an offset.

For price accretion to occur, the incumbent must find it more profitable to surrender those customers who are relatively more attracted to the infringer's product. This can only be the case if the incumbent is not able to charge different prices to the different market segments prior to the

infringement. (If the incumbent already charges different prices to different segments, then the price to each segment would already reflect its different willingness to pay. In this case, entry might cause price erosion but no price accretion.)

Bottom line? Economic analysis of patent infringement damages must always consider the full effect of infringement on competition to yield an accurate measure of damages.