**Introduction**

With Decision No. 5666 of 2 March 2021, the Italian Supreme Court clarified how to apply the reasonable royalty and the gross operating margin (incremental) criteria to calculate damages in patent infringement proceedings under Art. 125 of the Italian Intellectual Property Code (“**IPC**”), which implements Art. 13 of the Enforcement Directive (Directive 2004/48/EC).

**Summary of the case**

Cappellotto S.p.A., an Italian manufacturer of truck chassis mounted equipment for sewer cleaning, is the owner of European patent no. 1050634, titled “Apparatus for unwinding/rewinding a suction hose for draining cesspools, septic tanks and sewers in general”.

In July 2005, Cappellotto started proceedings against Farid Industrie S.p.A. before the Court of Turin claiming that the “Canal Jet” truck manufactured by Farid Industrie infringed the Italian portion of Cappellotto’s patent.

During the proceedings, following opposition before the EPO, the patent was maintained in an amended form and Cappellotto filed the Italian translation of the amended claims with the Italian Patent Office. With an interlocutory decision in 2013, the Court of Turin ruled that the patent, as amended, was valid and that Farid Industrie had infringed it. The case thus continued for the calculation of damages.

The court found that 184 of the 1345 Canal Jet trucks infringed the patent and, by applying the reasonable royalty criterion, ordered Farid Industrie to pay EUR 591,403.96 in damages. The court applied a 3% royalty rate (determined based on prices normally charged in licence agreements for similar technologies) to the average revenue from the sale of each infringing truck, equitably reduced by 20% to take into account the infringer’s incremental manufacturing costs.

Farid Industrie appealed the decision before the Court of Appeal of Turin, which similarly ruled that the patent was valid and had been infringed but that only three Canal Jet trucks infringed the patent.

Cappellotto challenged the first-instance court’s decision not to apply the gross operating margin (incremental) criterion (i.e., the profit margin earned by the patent holder on the patented products is applied to the revenue generated by the infringer from the sale of the infringing products, as if the patent holder had sold the infringing products at the same price) instead of the reasonable royalty criterion and argued that it had demonstrated that its operating margin was 25%. Cappellotto also challenged the court’s further decision to deduct 20% from the revenue from the sale of the infringing trucks, as it argued that, according to caselaw, the reasonable royalty criterion is usually applied to gross revenue (i.e., to the infringer’s total revenue) without equitable reductions related to manufacturing costs. Lastly, Cappellotto argued that, in any case, the 3% royalty rate was too low.

The appeal court denied the application of the gross operating margin (incremental) criterion on the ground that Cappellotto had failed to prove that it had suffered an actual loss of profit resulting from a decrease in sales because of the presence of the infringing machines on the market (beyond the sale of the three infringing Canal Jet trucks), for which it claimed damages.

The appeal court thus upheld the application of the reasonable royalty criterion, which it estimated at 5%. However, the appeal court did not deduct any incremental manufacturing costs from Farid Industrie’s total revenue in order to avoid Farid Industrie’s unjust enrichment and because it found that no definitive evidence of Farid Industrie’s incremental costs had been provided, let alone any useful element to evaluate these costs on an equitable basis.

Cappellotto appealed before the Supreme Court, arguing that (among other things) the appeal court should have applied the criterion determined by Cappellotto to be preferential (i.e., the gross operating margin (incremental) criterion) and that, in any case, the appeal court had not applied the reasonable royalty criterion properly. This because it had not increased the average (i.e., reasonable) royalty rate (in this case, estimated at 5%), thus substantially equating Farid Industrie to a legitimate licensee.

Farid Industrie also appealed the decision for having found the patent valid.

**The Supreme Court decision**

The Supreme Court, after having confirmed that the patent satisfied the patentability requirements, examined the issues related to criteria to calculate the damages.

The Court found that the appeal court had indeed not applied Art. 125 IPC properly.

The Court first noted that Art. 125 IPC refers explicitly to Art. 1226 of the Italian Civil Code and thus allows damages to be calculated on an equitable basis.

Art. 125(1) IPC (which implements Art. 13(1)(a) of the Enforcement Directive) lists several aspects to be taken into account in the calculation of damages, e.g., negative economic consequences, including lost profits suffered by the rightholder and any unfair profits made by the infringer, and, in appropriate cases, non-economic aspects such as moral damage.

Art. 125(2) IPC (which implements Art. 13(1)(b) of the Enforcement Directive) stipulates that damages may be set as a lump sum, which must be no less than the amount of royalties the infringer would have had to pay if the infringer had a licence from the patentee (“reasonable royalty”). Interestingly, the Court noted that Art. 125(2) IPC establishes a special rule for when lost profits cannot be proven “of equitable assessment, allowing the court to calculate the damages in an overall sum established based on the files of the case and the presumptions deriving therefrom”, and the patentee does not have to prove the exact amount of royalties the infringer would owe in a hypothetical deal, as the reasonable royalty does not represent the damage actually suffered by the patentee but a “mandatory minimum”.

Lastly, Art. 125(3) IPC (which implements Art. 13(2) of the Enforcement Directive) establishes, as a further criterion, that the patentee may “in any case” seek recovery of the profits made by the infringer, either as an alternative to compensation for the loss of profits or to the extent they exceed that compensation. As the Court pointed out, this is another form of lump-sum compensation, which performs not a mere reparative or compensatory function but “if not properly a sanctioning function, a function aimed at least at preventing the infringer enriching itself through the unlawful exploitation of a third party’s IP right”.

The Court noted that Cappellotto had proposed a reasonable alternative criterion, i.e., application of its gross operating margin (incremental), which – according to the Court – would have resulted in a higher compensation amount than that obtained by applying the reasonable royalty and been more in line with a fair and effective compensation for the damage suffered.

The Court thus upheld the appeal decision and underlined the following principle of law:

An IP owner may claim compensation for the damage suffered by invoking the criterion of the patent holder’s profit margin applied to the infringer’s turnover of the infringing products, under Art. 125 of the Italian Industrial Property Code …, according to which the damages must be calculated always taking into account the profits made by the infringer, i.e., considering the profit margin achieved and deducting the costs incurred from the total revenue. In this context, the reasonable royalty criterion … only marks the lower limit of damages awarded on an equitable basis, which, however, cannot be applied when the patentee indicates a different reasonable equitable criterion, with the aim of fully compensating the harm suffered by the IP owner.

As to Cappellotto’s second claim, the Court acknowledged that Italian courts often consider it “fair to increase the standard royalty rate (at least by doubling it)”, in order to avoid placing the infringer in the same condition as a legitimate licensee, on the grounds that the infringer does not bear the costs or risks borne by the licensee and therefore can afford to sell the infringing products at a reduced price.

The Court did, however, rule out the existence of a mandatory rule to increase the standard royalty rate. The Court simply stated that Art. 125(2) IPC provides merely a rule for simplifying the equitable assessment of damages when it is difficult to assess the damage actually suffered by the rightholder. In brief, the rule is to set the criterion of the reasonable royalty as a minimum measure, in consideration of the general rule Art. 125(1) IPC, whereby the infringer must pay the rightholder damages in the amount appropriate to the actual prejudice suffered, taking into account all the relevant facts of the case.

**Conclusion**

With this decision, the Supreme Court – in line with the rulings of the Court of Justice of the European Union – has established an important principle according to which application of the reasonable royalty criterion under Art. 125(2) IPC: (a) sets a floor below which the courts are not authorised to go; and (b) requires proof only of the elements necessary to calculate the amount the infringer would have had to pay had they obtained a licence from the patent owner (i.e., the infringer’s revenue and the royalty rate applied in the sector concerned), not proof of all the elements relating to the claimed damages (as required under Art. 125(1) IPC). It follows that patent owners can always claim greater compensation, which will be granted if they provide the more complex proof required.

Summary: Giulia Pasqualetto and Federica Franchetti, BonelliErede