

## ALERT MEMORANDUM

# The Supreme Court Relaxes Standard For Enhanced Damages In Patent Infringement Suits

June 17, 2016

Earlier this week, the Supreme Court rejected the Federal Circuit's multi-part test for enhanced damages in patent infringement suits, and adopted in its place a far more relaxed standard that is expected to increase the availability of enhanced damages in patent litigation.

*Halo Elecs., Inc.* 2016 WL 3221515 (June 13, 2016). The Court's ruling mirrors a pair of 2014 decisions in which it rejected a similar Federal Circuit framework for awarding attorneys' fees in patent suits.<sup>1</sup>

## Background and Procedural History

Since its inception, the Patent Act has given courts discretion to award enhanced damages in infringement suits. After struggling for decades to delineate the appropriate standards for such an award, the Federal Circuit Court of Appeals issued its *en banc* decision in *In re Seagate Technology, LLC*, 497 F.3d 1360 (Fed. Cir. 2007) (*en banc*), establishing a multi-part test with "objective" and "subjective" components: first, the plaintiff must demonstrate that the infringer was "objectively reckless," which a defendant could defeat by raising a "substantial question as to the validity or noninfringement of the patent" even if the defendant did not know of the "substantial question" at the time of the infringement;<sup>2</sup> and, second, the plaintiff must establish the infringer's "subjective" intent – i.e., that the infringer knew the recklessness of its actions at the time.<sup>3</sup> *Seagate* required these showings to be made by clear and convincing evidence and established a multi-part standard for appellate review: the objective recklessness prong was to be reviewed *de novo*, the subjective recklessness prong was to be reviewed for substantial evidence, and the ultimate determination whether to award enhanced damages was to be reviewed for abuse of discretion.<sup>4</sup>

A significant feature of the *Seagate* standard – and one the Supreme Court specifically critiqued in its decision this week – is that, even if an accused infringer intentionally infringed another's patent, it could escape enhanced damages if it managed to muster an "objectively reasonable" defense at trial.<sup>5</sup>

If you have any questions concerning this memorandum, please reach out to your regular firm contact or the following authors:

### New York

**Lawrence B. Friedman**  
+1 212 225 2840  
[lfriedman@cgsh.com](mailto:lfriedman@cgsh.com)

**David H. Herrington**  
+1 212 225 2266  
[dherrington@cgsh.com](mailto:dherrington@cgsh.com)

**Arminda B. Bepko**  
+1 212 225 2517  
[abepko@cgsh.com](mailto:abepko@cgsh.com)

### NEW YORK

One Liberty Plaza  
New York, NY 10006-1470  
T: +1 212 225 2000  
F: +1 212 225 3999



Under this framework, plaintiffs Halo Electronics and Stryker Corporation sought enhanced damages against defendants Pulse Electronics and Zimmer, Inc., respectively.<sup>6</sup> The trial court rejected Halo’s request because it found Pulse’s conduct not to be “objectively baseless.”<sup>7</sup> By contrast, Stryker won enhanced damages at trial on the basis that Zimmer had “virtually instructed” its designers to copy Stryker’s products.<sup>8</sup> Applying *Seagate*, the Federal Circuit affirmed in *Halo*, finding Halo failed to show Pulse’s “objective recklessness,” and reversed in *Stryker* on the basis that Zimmer had sufficiently articulated “reasonable defenses” at trial.<sup>9</sup> Halo and Stryker each filed petitions for Supreme Court review and urged the Court to reject the *Seagate* standard. The Court granted review, consolidated the cases and heard oral argument earlier this year.

### **The Supreme Court’s Decision**

In a unanimous opinion authored by Chief Justice Roberts, the Supreme Court rejected the *Seagate* standard and adopted in its place a more flexible test based on the trial judge’s discretion, just as it did two years ago with respect to the standard for awarding attorney’s fees in patent suits in *Octane Fitness, LLC v. Icon Health & Fitness, Inc.*, 134 S.Ct. 1749 (2014).<sup>10</sup> The Court also lowered the evidentiary threshold from “clear and convincing” evidence to a preponderance of the evidence, and it replaced *Seagate*’s multi-part framework for appellate review with a simple abuse of discretion standard.

#### **A. The Court Finds *Seagate*’s Multi-Part Standard Too Restrictive**

The Court began by recounting the history of enhanced damages for patent infringement, a concept “as old as U.S. patent law,” most recently embodied in § 284 of the 1952 Patent Act, which provides that courts awarding damages in patent infringement cases “may increase the damages up to three times the amount found or assessed.”<sup>11</sup> The Court noted that while “the *Seagate* test reflects, in many respects, a sound recognition that enhanced damages are generally appropriate under § 284 only in egregious

cases,” it nonetheless “impermissibly encumbers the statutory grant of discretion to district courts.”<sup>12</sup>

The Court emphasized that “[t]he principal problem with *Seagate*’s two-part test is that it requires a finding of objective recklessness in every case before district courts may award enhanced damages.”<sup>13</sup> In the Court’s view, the objective recklessness requirement impermissibly allowed even a “‘wanton and malicious pirate’ who intentionally infringes another’s patent – with no doubts about its validity or any notion of a defense – for no purpose other than to steal the patentee’s business” to avoid enhanced damages by showing their infringement was not “objectively reckless” in the abstract.<sup>14</sup>

The Court further criticized the *Seagate* test because an intentional infringer could avoid enhanced damages if it subsequently could “muster a reasonable (even though unsuccessful) defense at the infringement trial,” even if “he did not act on the basis of the defense or was even aware of it.”<sup>15</sup> This meant, in the Court’s view, that even someone who intentionally “plunders a patent” can escape enhanced damages “solely on the strength of his attorney’s ingenuity.”<sup>16</sup> The Court found the availability of a post-hoc defense conflicts with the law’s general standard of assessing an actor’s culpability at the time of their actions.<sup>17</sup>

Based on these concerns, the Court rejected the “objectively reckless” standard, concluding that an infringer’s subjective bad faith alone could warrant the imposition of enhanced damages.<sup>18</sup> The Supreme Court thus ruled that district courts addressing demands for enhanced damages must be permitted to “exercise their discretion in a manner free from the inelastic constraints” of the *Seagate* standard.<sup>19</sup> At the same time, the Court cautioned that “[c]onsistent with nearly two centuries of enhanced damages under patent law, however, such punishment should generally be reserved for egregious cases typified by willful misconduct.”<sup>20</sup>

## B. The Court Rejects *Seagate's* Evidentiary and Appellate Review Standards

Having dispensed with the *Seagate* standard, the Court turned its attention to the burden of proof and standard of review applicable to the claims for enhanced damages. *Seagate* required plaintiffs to demonstrate their entitlement to enhanced damages by “clear and convincing” evidence.<sup>21</sup> Citing *Octane Fitness* and noting that “patent-infringement litigation has always been governed by a preponderance of the evidence standard,” the Court ruled that enhanced damages should not be treated differently, particularly as the plain language of § 284 contains no basis for imposing any specific evidentiary standard, “much less such a high one” as had been established by the Federal Circuit.<sup>22</sup>

The Court similarly rejected *Seagate's* appellate review framework. As noted, *Seagate* created a tripartite standard of review: the first prong, objective recklessness, was reviewed *de novo*; the second, subjective recklessness, was reviewed for substantial evidence, and the final decision whether to award enhanced damages was reviewed for abuse of discretion.<sup>23</sup> Without the multi-prong substantive test, the Court found no need for a complex review framework and opted for a single abuse of discretion standard.<sup>24</sup> In doing so, the Court highlighted that its holding flows from its prior ruling in *Highmark Inc. v. Allcare Health Mgmt. Sys., Inc.*, 134 S.Ct 1744 (2014), which rejected a similar structure the Federal Circuit had used to review attorneys' fee awards for patent infringement.<sup>25</sup> Here too, the Supreme Court emphasized that it did not intend the Federal Circuit to take a hands-off approach to appellate review: “Nearly two centuries of exercising discretion in awarding patent damages in patent cases . . . has given substance to the notion that there are limits to that discretion.”<sup>26</sup>

### Takeaways

In some respects, the Supreme Court’s decision in *Halo* oversimplifies the challenges in assessing demands for enhanced damages by focusing on an easy target: the fact that the *Seagate* test meant

that even a clearly culpable infringer could escape such damages if it managed to conjure an objectively reasonable defense at trial. At the other end of the spectrum, it is easy to conclude that a defendant who had no knowledge, or reason to know, of the patent at issue has not engaged in willful infringement. The more difficult cases are those in which the defendant had some knowledge, or reason to know, of the patent and took some steps to assure itself that the patent did not present an impediment. Years ago, the Federal Circuit effectively put a defendant who had knowledge of a patent at risk of an automatic finding of willfulness unless it could demonstrate that it had obtained an opinion of counsel that the patent was not infringed or invalid. This in turn created thorny privilege waiver issues. To some extent, the Federal Circuit’s adoption of the *Seagate* standard, with its “objectively reckless” prong, represented an effort to avoid these issues.

In a concurring opinion in *Halo* joined by Justices Kennedy and Alito, Justice Breyer sought to address some of the subtler challenges with willfulness claims. Justice Breyer emphasized that enhanced damage awards should be reserved for truly egregious behavior and never should be considered automatic.<sup>27</sup> Justice Breyer further noted that Section 298 of the Patent Act (enacted as part of the America Invents Act of 2011) provides that the “failure of an infringer to obtain the advice of counsel . . . may not be used to prove that the accused infringer wilfully infringed,” and he emphasized that nothing in the Court’s opinion weakens this rule.<sup>28</sup> Justice Breyer also specifically observed that it may be appropriate in some circumstances, such as with smaller companies or start-ups facing a patent threat, to have its own employees review a patent rather than incurring the expense of consulting outside counsel.<sup>29</sup>

The majority opinion likewise devotes several paragraphs to addressing the by respondents and *amici curiae* about the problems that would ensue if the Court dispensed with the *Seagate* framework. Chief among those arguments was the concern that rejecting *Seagate* would increase the potential for enhanced damage awards. This, respondents contended, could

embolden entities commonly referred to as “patent trolls,” companies that hold patents for the purpose of enforcing them against infringers in exchange for lucrative licenses, resulting in a suppression of innovation. In support of this argument, several amici curiae cited a 2004 study by then-professor Kimberly Moore, now a Federal Circuit judge, which determined that willful infringement was found in more than 60 percent of patent infringement cases in the pre-*Seagate* period between 1983 and 2000.<sup>30</sup> By contrast, under the *Seagate* standard, willfulness findings declined by nearly 20 percent in the period between 2007 and 2010.<sup>31</sup>

In addressing these concerns, the Court acknowledged that patent law must balance between protecting intellectual property rights and fostering innovation through refinement, and cautioned lower courts not to award enhanced damages in “garden-variety cases.”<sup>32</sup> As a practical matter, however, the Court’s ruling this week has removed a safe haven from enhanced damages, by eliminating the “objectively reckless” requirement of *Seagate*. It likewise has lowered the evidentiary bar, by adopting a preponderance of evidence test. And it has imposed a less appellant-friendly standard of review, by adopting an abuse of discretion standard. On balance, this likely will lead to more frequent awards of enhanced damages. And at a minimum, it will inject greater uncertainty into any patent suit in which there is a credible claim for such damages – uncertainty that any reasonable defendant will need to consider in assessing its exposure and the settlement value of the suit.

*Halo* may also serve as a counterbalance to a series of recent Supreme Court rulings that have benefited patent litigation defendants. In recent years, the Supreme Court has narrowed the scope of patentability, especially with respect to business methods and abstract ideas generically implemented on a computer, and has modified the standard for invalidating patents based on indefiniteness to make it easier for such challenges to succeed.<sup>33</sup> Moreover, in *Octane Fitness* and *Highmark*, the Court lowered the bar for the prevailing parties in patent suits to recover their attorneys’ fees.<sup>34</sup> Many viewed these decisions

as a judicial effort to rein in overly broad patents and excessive patent litigation, as a response to patent trolls in particular. By contrast, the decision in *Halo*, while perhaps inevitable in light of the Court’s earlier decisions along the same lines in *Octane Fitness* and *Highmark*, is a move in the opposite direction. *Halo*’s relaxation of the requirements for enhanced damages favors patent holders, and may embolden putative plaintiffs, potentially increasing the amount of patent litigation and, by extension, positively affecting patent valuations in general.

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<sup>1</sup> *Octane Fitness, LLC v. Icon Health & Fitness, Inc.*, 134 S.Ct. 1749 (2014); *Highmark Inc. v. Allcare Health Mgmt. Sys., Inc.*, 134 S.Ct. 1744 (2014).

<sup>2</sup> *Seagate*, 497 F.3d at 1374.

<sup>3</sup> *Id.* at 1384.

<sup>4</sup> *Seagate*, 497 F.3d at 1374

<sup>5</sup> *Id.* at 1384; *Halo Elecs., Inc.* 2016 WL 3221515, at \*8 (June 13, 2016).

<sup>6</sup> *Halo Elecs., Inc. v. Pulse Elecs., Inc.*, 769 F.3d 1371, 1374 (Fed. Cir. 2014); *Stryker Corp. v. Zimmer, Inc.*, 782 F.3d 649, 653 (Fed. Cir. 2014).

<sup>7</sup> *Halo Elecs.*, 769 F.3d at 1374.

<sup>8</sup> *Stryker Corp.*, 782 F.3d at 653.

<sup>9</sup> *Halo Elecs.*, 769 F.3d at 1374; *Stryker Corp.*, 782 F.3d at 653.

<sup>10</sup> *Halo Elecs.*, 2016 WL 3221515, at \*8.

<sup>11</sup> 35 U.S.C. § 284.

<sup>12</sup> *Halo Elecs.*, 2016 WL 3221515, at \*8.

<sup>13</sup> *Id.*

<sup>14</sup> *Id.*

<sup>15</sup> *Id.*

<sup>16</sup> *Id.*

<sup>17</sup> *Id.* at \*9 (citing *Safeco Ins. Co of America v. Burr*, 551 U.S. 47 (2007)).

<sup>18</sup> *Id.*

<sup>19</sup> *Id.*

<sup>20</sup> *Id.*

<sup>21</sup> *Seagate*, 497 F.3d at 1371.

<sup>22</sup> *Halo Elecs.*, 2016 WL 3221515, at \*9.

<sup>23</sup> *Id.* at \*5.

<sup>24</sup> *Id.* at \*10.

<sup>25</sup> *Id.*

<sup>26</sup> *Id.*

<sup>27</sup> *Id.* at \*12 (Breyer, J., concurring).

<sup>28</sup> *Id.*

<sup>29</sup> *Id.*

<sup>30</sup> Kimberly A. Moore, *Judges, Juries, and Patent Cases—An Empirical Peek Inside the Black Box*, 99 Mich. L. Rev. 365 (2000) (cited in Brief for Google, Inc. as Amicus Curiae at 17, *Halo Elecs., Inc. v. Pulse Elecs., Inc.*, 2016 WL 322585).

<sup>31</sup> Christopher B. Seaman, *Willful Patent Infringement & Enhanced Damages After In Re Seagate*, 97 Iowa L. Rev. 417 (2012) (cited by cited in Brief for Google, Inc. as Amicus Curiae at 12, 22, *Halo Elecs., Inc. v. Pulse Elecs., Inc.*, 2016 WL 322585).

<sup>32</sup> *Id.* at 15.

<sup>33</sup> *Alice Corp. v. CLS Bank International*, 134 S.Ct 2347 (2014); *Nautilus, Inc. v. Biosig Instruments, Inc.*, 134 S.Ct. 2120 (2014); *Bilski v. Kappos*, 561 U.S. 593 (2010).

<sup>34</sup> *Octane Fitness, LLC*, 134 S.Ct. 1749; *Highmark Inc.*, 134 S.Ct 1744.