



Intellectual Property ADVISORY ■

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Supreme Court Entrusts Enhanced Damages to District Court Judges

By Kirk T. Bradley

Section 284 of the Patent Act provides that, in the event of damages for patent infringement, “the court may increase the damages up to three times the amount found or assessed.” In 2007, the Federal Circuit in *In re Seagate* fashioned a two-part test for proving willful patent infringement, which the court viewed as a predicate of enhanced damages under § 284. In practice, the *Seagate* test proved onerous for patent owners. In last week’s *Halo Electronics v. Pulse Electronics* ruling, the Supreme Court said it had “the effect of insulating some of the worst patent infringers from any liability for enhanced damages.”

In its unanimous decision, the Supreme Court eliminated *Seagate*’s “unduly rigid” two-part test. In its place, the Court entrusted enhanced damages to the sound discretion of a district court judge, to be reviewed on appeal for abuse of discretion. The Court also eased the standard of proof from clear and convincing evidence to a preponderance of the evidence. Further, the Court indicated that while willful misconduct may warrant enhanced damages, any case that is sufficiently “egregious” is a candidate. These new rules will have an immediate, meaningful impact on companies involved in patent litigation as well as those that, although not currently in litigation, seek best practices to avoid future missteps.

Background

The Federal Circuit has long required a showing of willful infringement in order to be eligible for enhanced damages under § 284, despite the general language of the statute. Before *Seagate*, the standard for willful infringement centered on an affirmative duty of due care: “Where ... a potential infringer has actual notice of another’s patent rights, he has an affirmative duty to exercise due care to determine whether or not he is infringing. Such an affirmative duty includes, *inter alia*, the duty to seek and obtain competent legal advice from counsel before the initiation of any possible infringing activity.” *Underwater Devices Inc. v. Morrison-Knudsen Co.*, 717 F.2d 1380, 1389-90 (Fed. Cir. 1983). Subsequent cases clarified that willfulness and the duty of care should be evaluated under the totality of the circumstances.

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A corollary to the duty of care soon developed: If an accused infringer failed to produce and rely on an opinion of counsel to rebut a charge of willful infringement, adverse inferences could be drawn. These inferences increased the likelihood that any infringement would be deemed willful, triggering the possibility of enhanced damages. Later, the Federal Circuit changed course, ruling that an accused infringer's failure to obtain legal advice does not give rise to an adverse inference with respect to willfulness.¹ The net effect of these rules was to place the burden of proof of willfulness on the infringer rather than the patent owner.

The Federal Circuit's 2007 en banc decision in *Seagate* redefined willfulness as it relates to patent infringement. The circuit court eliminated the affirmative duty of care and emphasized that there is no affirmative obligation to obtain an opinion of counsel. Also, drawing from the Supreme Court's then-recent decision in *Safeco Insurance Co. of Am. v. Burr*, 127 S. Ct. 2201 (2007), the Federal Circuit recognized that the "standard civil usage" of "willful" includes reckless behavior. On this backdrop, the court ruled that "proof of willful infringement permitting enhanced damages requires at least a showing of objective recklessness."

Recognizing that the term "reckless" is not self-defining, the *Seagate* court fashioned a two-part test for willful infringement. First, "a patentee must show by clear and convincing evidence that the infringer acted despite an objectively high likelihood that its actions constituted an infringement of a valid patent." Second, "[i]f this threshold objective standard is satisfied, the patentee must also demonstrate [by clear and convincing evidence] that this objectively-defined risk ... was either known or so obvious that it should have been known to the accused infringer." In future cases, the Federal Circuit ruled that the first prong was a matter of law subject to de novo review, the second prong was an issue of fact reviewed for substantial evidence, and the ultimate determination on enhanced damages was an issue for the court, reviewed for abuse of discretion.

Seagate influenced patent practice in many respects. In litigation, defense counsel would at the outset of a case start posturing for any ruling suggesting that the defendant had an objective defense for infringement or invalidity. Such a defense would eradicate the opportunity for the patent owner to present a case of subjective bad faith since *Seagate* made the objective inquiry a threshold requirement. So long as defense counsel could muster a palatable defense, it mattered not that the infringer never knew of it. This state of affairs made willful infringement a rarity. Early motions for summary judgment demonstrating a lack of objective recklessness—an issue of law, according to the Federal Circuit—were common, and often successful, preventing a jury from hearing evidence of the defendant's bad faith in many instances.

Seagate also influenced opinion practice. The ruling called into question defensive opinion policies at many sophisticated companies. In particular, *Seagate* minimized the need for extensive written legal opinions intended primarily to rebut a future allegation of willful infringement. The expense of such opinions became harder to justify since defense counsel could in all likelihood generate a passable defense during ensuing litigation. Willfulness could be avoided by after-the-fact objective reasonableness, minimizing the need for an up-front opinion approving the planned activity. The actor's subjective state of mind simply did not matter in most cases since the patent owner first had to prove objective recklessness—by clear and convincing evidence no less.

¹ In the America Invents Act, Congress incorporated this notion in the Patent Act. See 35 U.S.C. § 298: "The failure of an infringer to obtain the advice of counsel with respect to any allegedly infringed patent, or the failure of the infringer to present such advice to the court or jury, may not be used to prove that the accused infringer willfully infringed the patent or that the infringer intended to induce infringement of the patent."

The Supreme Court's *Halo* Decision

In *Halo*, the Supreme Court rejected *Seagate*'s two-part test as not consistent with the language of § 284. "That language contains no explicit limit or condition, and we have emphasized that the word 'may' clearly connotes discretion." Thus, the Court ruled, "[d]istrict courts enjoy discretion in deciding whether to award enhanced damages, and in what amount."

The Court parroted the approach taken just two years prior in *Octane Fitness, LLC v. ICON Health & Fitness Inc.*, where the Court unanimously discarded the Federal Circuit's "unduly rigid" test for attorneys' fees under 35 U.S.C. § 285. The *Halo* Court emphasized that, as in *Octane Fitness*, there is "no precise rule or formula" for the analysis; instead, "a district court's discretion should be exercised in light of the considerations underlying the grant of that discretion." At the same time, the Court emphasized that "[d]iscretion is not whim." Awards of enhanced damages therefore "are not to be meted out in a typical infringement case, but are instead designed as a 'punitive' or 'vindictive' sanction for egregious infringement behavior."

Although the Federal Circuit in *Seagate* had addressed willfulness as a mandatory predicate of enhanced damages, the *Halo* Court voiced a more flexible approach. "The sort of conduct warranting enhanced damages has been variously described in our cases as willful, wanton, malicious, bad-faith, deliberate, consciously wrongful, flagrant, or—indeed—characteristic of a pirate." Thus, while "[t]he subjective willfulness of a patent infringer, intentional or knowing, may warrant enhanced damages," enhancement may be equally appropriate in any case deemed sufficiently "egregious." While noting that "egregious cases" are "typified by willful misconduct," the Court stopped short of requiring willfulness as a foundation. Instead, enhanced damages are available for "egregious cases of misconduct beyond typical infringement."

A concurring opinion authored by Justice Stephen Breyer and joined by Justices Anthony Kennedy and Samuel Alito underscored that "the Court's opinion, read as a whole and in context, explains that 'enhanced damages are generally appropriate ... *only in egregious cases.*" The concurrence characterized the Court's opinion as not requiring willfulness as a predicate and as not mandating enhanced damages in the event of willfulness either, stating: "And while the Court explains that 'intentional or knowing' infringement 'may' warrant a punitive sanction, the word it uses is *may*, not *must*."

After announcing the new, discretionary standard, the *Halo* Court considered the applicable standard of proof for demonstrating entitlement to enhanced damages. The *Seagate* test, rigid in its own right, was further saddled by a clear and convincing standard of proof. The Court deemed that standard inconsistent with § 284 and deemed it inconsistent with the corresponding standard for § 285 set in *Octane Fitness*. "Like § 285, § 284 'imposes no specific evidentiary burden, much less such a high one.'" The Court therefore lowered the standard of proof, observing that patent infringement litigation "has always been governed by a preponderance of the evidence standard," and "[e]nhanced damages are no exception."

Upon revising the standard of proof, the Court understandably addressed the Federal Circuit's "tripartite framework for appellate review." Under *Seagate*, the appellate court reviewed the objective prong de novo, the subjective prong for substantial evidence and the ultimate determination of enhancement for abuse of discretion. The Supreme Court rejected that complicated approach in favor of the simplified approach taken in *Octane Fitness*, where the Court concluded that "such decisions should be reviewed for abuse of discretion."

Implications on Modern Patent Practice

Halo continues the Supreme Court's efforts to remove bright-line tests or other special rules for patent cases. In recent years, the Court has adopted a more general approach for a myriad of patent issues, including injunctions (*eBay*), obviousness (*KSR*), reverse payments (*Actavis*) and attorneys' fees (*Octane Fitness*). It is not surprising, then, that the Court ruled likewise on the issue of enhanced damages.

The *Halo* ruling will have an immediate and marked effect on patent litigation. *Seagate's* critics—most all patent owners—complained that the test was too difficult to fulfill, emboldening infringers and encouraging "efficient infringement" (that is, tolerating risks of possible infringement since damages beyond a reasonable royalty were unlikely in any event). Potential infringers kept comfort in knowing that litigation counsel likely could spawn some objectively reasonable defense of noninfringement or invalidity. As the *Halo* Court recognized, under *Seagate* an infringer could "escape any comeuppance under § 284 solely on the strength of his attorney's ingenuity" during litigation. The existence of a reasonable defense under *Seagate* "insulate[d] the infringer from enhanced damages, even if he did not act on the basis of the defense or was even aware of it."

But now, under *Halo's* purely discretionary approach, the state of mind of the infringer at the time of infringement will be front and center. And evidence of the conduct is much more likely to reach a jury. Under *Seagate*, the requirement of objective recklessness, which was deemed a matter of law, often foreclosed willfulness at the summary judgment stage, preventing evidence of subjective bad faith from reaching the jury. *Halo* removes that barrier, meaning juries will hear more evidence and more arguments regarding bad faith or other "egregious" conduct. Judges will continue to decide whether to enhance damages, and by how much, but juries will now hear evidence of subjective bad-faith conduct that often was quelled under the *Seagate* approach.

Another key effect on litigation is that, under *Halo*, defenses generated for the first time during litigation will be given less weight or eliminated altogether as a consideration. Indeed, the Supreme Court confirmed the merits of this revised approach, since "culpability is generally measured against the knowledge of the actor at the time of the challenged conduct," not at some later date. The Court accordingly decried consideration of "facts that the defendant neither knew nor had reason to know at the time he acted."

These rules mean that companies should pay closer attention to generating a good-faith defense at the outset, before any litigation. Opinion letters are still not required, but the value proposition has shifted. Because the Court now affords district courts discretion to enhance damages for any conduct deemed egregious, the expense of legal opinions is better justified now than during the *Seagate* era. Indeed, under *Halo* an infringer's subjective knowledge and actions can be pertinent in all cases—without any threshold showing of objective reasonableness as *Seagate* had demanded. The new flexible standard thus creates a powerful incentive to avoid conduct that might be deemed willful, or egregious, or any of the other numerous adjectives offered by the Court.

Companies that had curtailed expenses for IP opinions during the *Seagate* years should reconsider their risk analysis. Prudent companies should consider, on a case-by-case basis, whether and to what extent they should investigate the patent landscape in areas where they operate or intend to operate. *Halo* heightens the incentive to do so. Extensive written opinions are not, however, universally worth the effort and expense in all situations. *Halo* did not undermine the Federal Circuit's rulings, now codified in § 298 of the Patent Act, that failure to obtain legal advice may not be used to prove willful infringement. Moreover, as recognized by the concurring opinion in *Halo*, opinions can be expensive, and so "an owner of a small firm, or a scientist, engineer, or technician working there, might, without being 'wanton' or 'reckless,' reasonably determine that its product does not infringe a particular patent, or that that patent is probably invalid."

Irrespective of who performs the analysis, companies should obtain for their files a record of worthwhile defenses and the underlying support and should preserve pertinent documents and, in some cases, key testimony (which can be memorialized via declarations). So long as these precautions are satisfied, it becomes a business risk whether enough proof—and enough confidence in the results—exists to avoid the expense of involving outside counsel. Companies that lack in-house patent counsel, however, should observe particular caution in weighing the benefits and risks. Notions of recklessness and willful blindness continue to play a role, and any hints of such conduct surely will be intensified during litigation once the patent owner's counsel discovers them.

Granted, the bar is still high for patent owners. To secure enhanced damages, they must demonstrate—by a preponderance of the evidence—an “egregious case[] of misconduct beyond typical infringement.” And even then, enhanced damages do not necessarily follow. In some circumstances, a decision to enhance damages may be easy for a district court, such as in the circumstance offered by the *Halo* Court, involving 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.” Other circumstances may be less clear-cut. The Supreme Court simply proclaimed that its interpretation of § 284 “allows district courts to punish the full range of culpable behavior.”

The Court offered little guidance for district courts attempting to accomplish that discretionary task. Instead, the Court unhelpfully noted that “[i]n applying this discretion, district courts are ‘to be guided by [the] sound legal principles’ developed over nearly two centuries of application and interpretation of the Patent Act.” This gives litigators a panoply of options, given the breadth of patent activity during the past two centuries.

At bottom, the task for district courts is to distinguish “egregious” cases from “typical infringement” and “garden-variety cases.” A number of district courts, such as those in Texas, California and Delaware, will have little trouble making such a distinction due to their deep experience with patent cases. But other courts lack that experience, and so lack the necessary perspective. This may impact choice of venue for patent cases. But the Federal Circuit should, in theory, level any aberrant views. As *Halo*'s concurring opinion informed, the Federal Circuit, while reviewing for an abuse of discretion, “may take advantage of its own experience and expertise in patent law.” Thus, if district courts lack perspective, or have a skewed perspective, part of the Federal Circuit’s task will be to normalize the outcomes.

Conclusion

Under *Halo*, any case that is sufficiently “egregious,” no matter the reason, is now a candidate for enhanced damages. The determination whether to enhance damages, and by how much, is reserved for the sound discretion of district court judges. While this improves prospects for many patent owners, an award of enhanced damages remains confined to “egregious cases of misconduct beyond typical infringement.” The Supreme Court’s ruling enhances the need for legal advice for ongoing or planned activity that may implicate patents held by others. Companies may no longer rely on the efforts of counsel to develop an objectively reasonable defense during litigation. *Halo* eliminated the objective standard that made *Seagate* renowned. Early, competent, well-reasoned advice identifying meaningful defenses is now the name of the game.

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If you have any questions or wish to discuss further, please contact any of the following members of Alston & Bird’s Intellectual Property Group:

Wesley C. Achey
wes.achey@alston.com
404.881.4930

Blas P. Arroyo
blas.arroyo@alston.com
704.444.1012

Dane A. Baltich
dane.baltich@alston.com
404.881.4381

Timothy J. Balts
tim.balts@alston.com
704.444.1185

Ross R. Barton
ross.barton@alston.com
704.444.1287

Philippe Bennett
philippe.bennett@alston.com
212.210.9559

Kirk T. Bradley
kirk.bradley@alston.com
704.444.1030

Keith E. Broyles
keith.broyles@alston.com
404.881.7558

Romy L. Celli
romy.celli@alston.com
650.838.2011

Natalie C. Clayton
natalie.clayton@alston.com
212.210.9573

Michael S. Connor
mike.connor@alston.com
704.444.1022

Jason P. Cooper
jason.cooper@alston.com
404.881.4831

Brian C. Ellsworth
brian.ellsworth@alston.com
704.444.1265

Patrick J. Flinn
patrick.flinn@alston.com
404.881.7920

David Frist
david.frist@alston.com
404.881.7874

Christopher J. Gegg
chris.egg@alston.com
704.444.1024

Michele M. Glessner
michele.glessner@alston.com
704.444.1124

Guy R. Gosnell
guy.gosnell@alston.com
704.444.1029

John D. Haynes
john.haynes@alston.com
404.881.7737

Yitai Hu
yitai.hu@alston.com
650.838.2020
+86 10.8592.7500

Louis A. Karasik
lou.karasik@alston.com
213.576.1148

Ryan W. Koppelman
ryan.koppelman@alston.com
605.838.2009

Robert L. Lee
bob.lee@alston.com
404.881.7635

Joe Liebeschuetz, Ph.D.
joe.liebeschuetz@alston.com
650.838.2038

Jitty Malik, Ph.D.
jitty.malik@alston.com
704.444.1115

Richard M. McDermott
rick.mcdermott@alston.com
704.444.1045

Deepro R. Mukerjee
deepro.mukerjee@alston.com
212.210.9501

Michael J. Newton
mike.newton@alston.com
214.922.3423

A. Shane Nichols
shane.nichols@alston.com
404.881.4540

Thomas J. Parker
thomas.parker@alston.com
212.210.9529

Scott J. Pivnick
scott.pivnick@alston.com
202.239.3634

S. Benjamin Pleune
ben.pleune@alston.com
704.444.1098

Bruce J. Rose
bruce.rose@alston.com
704.444.1036

Casondra Ruga
casondra.ruga@alston.com
213.576.1133

Holly Hawkins Saporito
holly.saporito@alston.com
404.881.4402

Bryan Skelton, Ph.D.
bryan.skelton@alston.com
919.862.2241

Frank G. Smith
frank.smith@alston.com
404.881.7240

David M. Stein
david.stein@alston.com
213.576.1063

M. Scott Stevens
scott.stevens@alston.com
704.444.1025

R. Flynt Strean
flynt.strean@alston.com
704.444.1430

Helen Su
helen.su@alston.com
650.838.2032
+86 10.8592.7588

Ardeshir Tabibi
ardeshir.tabibi@alston.com
650.838.2025

Lance A. Termes
lance.termes@alston.com
650.838.2045

Jamie D. Underwood
jamie.underwood@alston.com
202.239.3706

ALSTON & BIRD

WWW.ALSTON.COM

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ATLANTA: One Atlantic Center ■ 1201 West Peachtree Street ■ Atlanta, Georgia, USA, 30309-3424 ■ 404.881.7000 ■ Fax: 404.881.7777
 BEIJING: Hanwei Plaza West Wing ■ Suite 21B2 ■ No. 7 Guanghua Road ■ Chaoyang District ■ Beijing, 100004 CN ■ +86 10 8592 7500
 BRUSSELS: Level 20 Bastion Tower ■ Place du Champ de Mars ■ B-1050 Brussels, BE ■ +32 2 550 3700 ■ Fax: +32 2 550 3719
 CHARLOTTE: Bank of America Plaza ■ 101 South Tryon Street ■ Suite 4000 ■ Charlotte, North Carolina, USA, 28280-4000 ■ 704.444.1000 ■ Fax: 704.444.1111
 DALLAS: 2828 North Harwood Street ■ 18th Floor ■ Dallas, Texas, USA, 75201 ■ 214.922.3400 ■ Fax: 214.922.3899
 LOS ANGELES: 333 South Hope Street ■ 16th Floor ■ Los Angeles, California, USA, 90071-3004 ■ 213.576.1000 ■ Fax: 213.576.1100
 NEW YORK: 90 Park Avenue ■ 15th Floor ■ New York, New York, USA, 10016-1387 ■ 212.210.9400 ■ Fax: 212.210.9444
 RESEARCH TRIANGLE: 4721 Emperor Blvd. ■ Suite 400 ■ Durham, North Carolina, USA, 27703-85802 ■ 919.862.2200 ■ Fax: 919.862.2260
 SILICON VALLEY: 1950 University Avenue ■ 5th Floor ■ East Palo Alto, California, USA, 94303-2282 ■ 650.838.2000 ■ Fax: 650.838.2001
 WASHINGTON, DC: The Atlantic Building ■ 950 F Street, NW ■ Washington, DC, USA, 20004-1404 ■ 202.239.3300 ■ Fax: 202.239.3333