

AWARDING ENHANCED DAMAGES IN PATENT INFRINGEMENT CASES BY MICHAEL THOMAS

[ABSTRACT]

This term the Supreme Court will take up the issue of awarding enhanced damages in patent infringement cases. Two separate cases petitioned the court to take up the issue after defendants were spared enhanced damages following some questionable activity. The current test used in awarding enhanced damages is a two-part test implemented by the Federal Circuit that incorporates an objective and subjective component. [1]

The following will look at the test that is currently implemented, the cases at issue, and the arguments on both sides.

I. THE STATE OF THE LAW FOR AWARDING ENHANCED DAMAGES

The current language of §284 states: “When the damages are not found by a jury, the court shall assess them. In either event the court may increase the damages up to three times the amount found or assessed.”[2] The statute, which permits the awarding of enhanced damages, does not specify in which situations the court may award enhanced damages. Given the broad wording of the statute, the Federal Circuit has modified its approach over time. Prior to the *Seagate* decision the court basically required the defendant to state that he didn’t think there was a true issue of infringement. Essentially, the defendant had to waive attorney client

privilege and provide the supporting documents. This practice raised issues surrounding how much proof was enough and at what point was other privileged information, beyond the original scope, being provided. The court in *Seagate* noted, “[s]ince *Underwater Devices*, we have recognized the practical concerns stemming from our willfulness doctrine, particularly as related to the attorney-client privilege and work product doctrine.”[3] This concern ultimately led to the two-part test laid out in *Seagate* and the acknowledgement that information requiring the waiving of attorney client privilege was not required.

II. CURRENT TWO-PART TEST FOR AWARDED ENHANCED DAMAGES

“Willful infringement permitting enhanced damages requires at least a showing of objective recklessness.”[4] The court laid out its current two-part test in order to provide some clarity, acknowledging that objective recklessness could be construed in many ways. Meeting both elements of the test is needed in order to reach the level of objective recklessness required.

The first component of the test requires “a patentee must show by clear and convincing evidence that the infringer acted despite an objectively high likelihood that its actions constituted infringement of a valid patent.”[5] The first part of the test is strictly objective and the state of mind of the infringer is not relevant. As will be seen in the two cases at issue, this appears to be a fairly high burden for patent owners to meet.

Once the objective component of the test has been met, the court will consider whether the second, more subjective, requirement has been met. The second part of the test requires “the patentee must also demonstrate that this objectively-defined risk (determined by the record developed in the infringement proceeding) was either known or so obvious that it should have been known to the accused infringer.”[6]

III. REVIEW OF THE CASES AT ISSUE

a. *Halo Electronics Inc. v. Pulse Electronics Inc.*

Halo Electronics Inc. (Halo), the patent owner in this case, is a supplier of electronics components. The patents in the instant case, which were all derived from an application filed in August 1995, are related to the manner in which transformers are mounted in computers and home routers. [7] Pulse Electronics Inc. (Pulse), a competitor in the same field as Halo, began selling a similar product, primarily abroad, but also in the United States. In 2002 Pulse was sent two letters by Halo asking them to enter into a licensing agreement; the letters did not directly accuse Pulse of infringement. [8] Upon receipt of the letters, one of Pulse’s engineers examined the patents for two hours, at which point he concluded the Halo patents were invalid in light of prior products. [9] However, this was the extent to which any opinion was made on whether Pulse was infringing. In 2007 Halo finally sued Pulse for infringement.

At trial Pulse raised the defense that the Halo claims were invalid due to obviousness. The court ultimately found the claims valid and that the Pulse

products sold in the US, as well as those sold outside the US but imported back into the US, did infringe on the Halo patent. [10] Although the court did find infringement, it did not find that the infringement met the requirements for enhanced damages, since Pulse had raised an obviousness defense at trial. “[T]he district court concluded that the objective component of a willfulness inquiry was not satisfied because Pulse “reasonably relied on at least its obviousness defense” and Pulse's unsuccessful obviousness defense was not “objectively baseless.”[11]

On appeal Halo argued that Pulse did meet the reckless standard and that the obviousness defense was only developed after the lawsuit was filed in 2007. Halo argued that Pulse should have been on notice of the infringement in 2002 after the letters were received, claiming that it was insufficient to rely on a single two-hour review by a Pulse engineer stating the patents were obvious. The Federal Circuit ultimately found none of these arguments persuasive, agreeing with the district court ruling that Pulse’s infringement had not met the first prong of the enhanced damages test.

b. *Stryker Corp. v. Zimmer Inc.*

Stryker Corp. (Stryker), the patent owner in this case, is a medical device company. The three patents at issue were all related to a device used in orthopedic surgeries. The device, which was invented by Stryker, was praised in the industry and gave the company a significant advantage in the market until Zimmer Inc. (Zimmer) developed its competing unit. [12] In 2010 Stryker filed suit against Zimmer for infringement of its three patents. Zimmer’s primary defense against the

infringement was with regards to claim construction and obviousness. At trial the patents were held valid and Zimmer was ultimately found to have copied the design invented by Stryker. The district court described it essentially as “Zimmer handed the independent contractor a copy of Stryker's product and said, “Make one for us.””[13] Given expert testimony and extensive evidence, the trial court found that Zimmer’s actions had met the two-part test for enhanced damages.

Zimmer appealed the decision on the issues of claim construction, obviousness, and the awarding of enhanced damages. While siding with the district court on the issue of claim construction, obviousness, and overall infringement, the appeals court reversed the awarding of enhanced damages. [14] The court found that the district court had not looked at Zimmer’s defenses objectively. The court claimed that doing so would have shown that Zimmer raised valid defenses at trial and that the first component of the *Seagate* test had not been met.

IV. QUESTION PRESENTED TO THE SUPREME COURT

In both of the above cases it would be reasonable to find that the activity by the infringing party was done in bad faith. However, neither case meets the objective burden because both infringing parties presented arguments that were not “baseless”. Given the high standard, both petitioners posed the same essential question to the court: “whether the Federal Circuit erred by applying a rigid, two-part test for enhancing patent infringement damages under 35 U.S.C. § 284...”[15]

V. ARGUMENTS AGAINST THE CONTINUED USE OF TWO-PART TEST

The petitioners in both cases want the Supreme Court to discontinue its use of the two-part test. This position is based on a number of different arguments. The United States, along with a number of other parties, has favored this position and has filed a brief in support.

The first issue the petitioners, along with those supporting, address is whether willfulness is a prerequisite to awarding enhanced damages. Petitioners point to the statute itself, which states, “[i]n either event the court may increase the damages up to three times the amount found or assessed”.^[16] Throughout history, awarding damages has included some finding of intentional or bad faith action on the part of the infringer. While it has been understood that something more than mere negligence is needed, discretion has been left to the district courts as to whether the infringer acted in bad faith or in some intentional/reckless manner.

The petitioners argue that the ‘objectively reckless’ standard adopted by the Federal Circuit has no basis in the statute. The petitioners rely on the recent ruling in *Octane Fitness*.^[17] In *Octane*, the Federal Circuit adopted a rather strict test in light of similarly broad statutory language. The Supreme Court overturned this test for something more similar to a ‘totality of the circumstances’ test and lowered the burden of proof from clear and convincing to preponderance of the evidence. In light of this decision the petitioners have a strong case that §284 should be treated the same.

Considering the statute's plain language, consisting of no explicit requirements, the petitioners claim that the two-part test is far too rigid and unduly burdensome. [18] As is evident in the decisions of the current cases, simply stating a defense that is not a 'sham' is likely to relieve a party of liability for enhanced damages. [19] The current test fails to look holistically at actions of the infringing party. In *Halo*, simply having an engineer spend two hours looking at the patent, in conjunction with a 'non-baseless' defense, was enough to escape enhanced damages. The current test makes it fairly easy for an infringing party to escape, and unnecessarily hard for the patent owner to prove. This is all in light of fairly open statutory language, which seems to lean towards awarding the district court some discretion in awarding damages.

The petitioners are requesting a return to the totality of the circumstances assessment, examining the actions of the infringing party as a whole, as to whether enhanced damages should be awarded. This flexible assessment is supported by the broad language of the statute and has the ability to take into account multiple factors. Such factors may include whether there was deliberate copying, good faith examination of the patent possibly infringed, size and financial condition of the infringing party, duration of infringement, and remedial action, and whether there was an attempt to conceal the infringing activity. [20] Allowing the district court to assess and balance these factors at trial would eliminate the high initial burden of proof placed on the patent owner. It would also help to eliminate the trend of

defendants escaping enhanced damages as long as they come up with a reasonable defense for trial.

In light of the proposed changes mentioned above, the petitioners also request that the court lower the burden of proof to preponderance of the evidence. The petitioners raise a strong argument in light of *Octane*, stating that the clear and convincing evidence standard is entirely unsupported by the language of §284 and the standard burden of proof for civil claims should apply. [21] In conjunction with this proposed change, the petitioners ask that the review on appeal be changed from *de novo* to abuse of discretion. The petitioners argue, once again, that there is no support for reviewing decisions *de novo*. The petitioners also raise the point that given how long the district courts live with these cases, the district courts are in a much better position to assess the level of culpability of the infringing party. As seen in *Stryker*, the Court of Appeals overruled the decision of the district court based simply on the fact that the defendant raised a ‘non-sham’ argument in defense. This was in spite of language by the district court, which seemed to implicate known risky behavior by the infringing party.

Overall the petitioners would like a more flexible test that would allow for a decision on enhanced damages to be based on the totality of the circumstances.

V. ARGUMENTS FOR CONTINUED USE OF THE TWO-PART TEST

Respondents, as well as those supporting, request that the court continue to use the two-part test adopted in *Seagate*. They acknowledge that while the statutory language of §284 does not specifically state willfulness is a pre-requisite,

over a century of precedent requires it be read in. [22] The respondents cite to language from Congress, including legislative history, endorsing the use of the willful standard currently used.

Respondents address the Supreme Court's decision in *Octane* by highlighting the different purposes between the two statutes and their intended meanings. The respondents argue that §285 (which was addressed in *Octane*) is not focused on the infringing parties' activity at all but rather, is meant to shift litigation costs based on a party's exceptionally weak 'litigating position'. [23] The respondents further argue that the standard of adopting attorney's fees in certain situations has no effect on innovation, which the patent act is meant to promote.

While endorsing the willful requirement, respondents also feel that the two-part *Seagate* test is a proper implementation of that requirement. They argue that the two-part test provides a predictable, dependable, and workable test for defendants to rely on. They highlight that a totality of the circumstances approach, asked for by the petitioners, would provide uncertainty for defendants on what actions meet the requirements. Due to said uncertainty, the respondent's feel that innovation would ultimately be stifled because companies would be unsure if their actions met the criteria. In addition this uncertainty would increase litigation, as patent owners would feel as though a party's actions would be enough to award them additional damages. [24]

In addition to retaining the current *Seagate* test, the respondents feel that the burden of proof and standard of review are correct. The clear and convincing evidence standard is correct, given its goal is to ensure that enhanced damages are only awarded in the most severe and ‘obviously reckless’ activity by infringing parties. [25] In addition, given the objective standard of the current *Seagate* test, *de novo* review is appropriate. On the whole, the punitive nature of enhanced damages requires a high level of proof as well as review.

V. ANALYSIS OF THE ARGUMENTS

A major concern associated with the petitioners’ request is that doing away with the two-part test will increase the awarding of enhanced damages. While discontinued use of the two-part would certainly cause an increase, it would likely not be a windfall as the respondents and those supporting them suggest. District court judges would simply be allowed to use their discretion, as they do for other situations when enhanced damages are permitted, and would take into account a variety of different factors. While this may require a little more probing at the trial level, it would help ensure a fair result is determined.

Taking *Halo* as an example, simply having an engineer spend a couple of hours looking at a patent and deciding it is invalid should not serve as a justifiable reason to continue use that may be infringing. While a letter asking to enter a license agreement may not expressly accuse of infringing activity, it certainly deserves more inquiry than a two-hour examination. Situations such as this could

be taken into account, along with any other efforts to inquire into possible infringement, by a district court judge and would allow a proper decision to be made. However, the current two-part test largely forces a judge to disregard activity prior to trial as long as the infringing party came up with a reasonable defense at trial. Allowing what appears to be a disregard for the rights of the patent owner and infringing activity is a little more than disheartening. A totality of the circumstances approach, while effectively accounting for unsavory activity, would also account for and balance activity done in good faith.

A clear benefit of the two-part test is that it provides clarity and rather predictable results. It allows parties to clearly delineate what type of activity is called for in order to be liable for enhanced damages. Respondents claim that reverting back to a totality of the circumstances test would in fact chill innovation due to uncertainty by infringing parties if their activity would make them liable for enhanced damages. It is difficult to see how innovation is occurring if a party has such a similar device or method that enhanced damages may be plausible. It would make sense that such a fear may cause a party to develop a new solution or substantial modification to ensure their device is not infringing. This would help to promote innovation and increase competition. Allowing a party to toe the line because they know what will make them liable for enhanced damages does nothing to help protect the quality of innovation.

The two-part test implemented in *Seagate* is another attempt by the Federal Circuit to create a bright line rule where it may not be warranted. One example can

be found in the obviousness test that was used for some time, but ultimately rejected by the Supreme Court. An additional, and closely related one, can be found where the Federal Circuit laid out a two-part test for the awarding of attorney's fees, another test that was ultimately rejected by the Supreme Court. In all of these instances the Federal Circuit implemented a bright-line rule where none was called for by the statutory language. While the two-part test creates a rather clean and bright-line rule, this clarity should not be pursued at the expense of allowing willfully infringing activity.

V. CONCLUSION

While intentional or reckless bad faith activity should be required when awarding enhanced damages, the current two-part test from *Seagate* creates too high of a burden for patent owners and is not consistent with the statutory language. As is evident in the two cases at issue, it allows infringing parties to escape enhanced damages by simply raising a defense at trial that isn't baseless. The current test does not effectively take into account activity prior to the start of litigation and makes it very difficult for the district courts to look at the infringing activities as a whole. The holistic view asked for by petitioners is consistent with the statutory language of 35 U.S.C §284 and would allow for more practical results.

SOURCES

- [1] *In re Seagate Tech., LLC*, 497 F.3d 1360, 1371 (Fed. Cir. 2007).
- [2] 35 U.S.C.A. § 284 (West).
- [3] *In re Seagate Tech., LLC*, 497 F.3d 1360, 1369 (Fed. Cir. 2007).
- [4] *Id.* at 1371.
- [5] *Id.*
- [6] *Id.*
- [7] *Halo Electronics., Inc. v. Pulse Electronics., Inc.*, 769 F.3d 1371, 1374 (Fed. Cir. 2014).
- [8] *Id.* at 1376.
- [9] *Id.*
- [10] *Id.* at 1377.
- [11] *Id.* at 1376.
- [12] *Stryker Corp. v. Zimmer Inc.*, 2013 WL 6231533, at *1 (W.D. Mich. Aug. 7, 2013).
- [13] *Id.*
- [14] *Stryker Corp. v. Zimmer, Inc.*, 782 F.3d 649, 662 (Fed. Cir. 2015).
- [15] Petitioner's Opening Brief at 1, *Halo Electronics, Inc. v. Pulse Electronics, Inc.*, No. 14-1513, 2015 WL 9450143 (U.S.)
- [16] 35 U.S.C.A. § 284 (West).
- [17] *Octane Fitness, LLC v. ICON Health & Fitness, Inc.*, 134 S. Ct. 1749 (2014).
- [18] Petitioner's Opening Brief at 25, *Halo Electronics, Inc. v. Pulse Electronics, Inc.*, No. 14-1513, 2015 WL 9450143 (U.S.)
- [19] Brief For The United States as Amicus Curiae Supporting Petitioners at 23, *Halo Electronics, Inc. v. Pulse Electronics, Inc.*, Nos. 14-1513 and 14-1520, 2015 WL 9181062 (U.S.)
- [20] Petitioner's Opening Brief at 16,17, *Halo Electronics, Inc. v. Pulse Electronics, Inc.*, No. 14-1513, 2015 WL 9450143 (U.S.)
- [21] *Id.* at 26.
- [22] Brief of Respondents at 10, *Halo Electronics, Inc. v. Pulse Electronics, Inc.*, No. 14-1513, 2016 WL 212597 (U.S.)

[23] *Id.* at 52

[24] *Id.* at 43

[25] *Id.* at 40