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## PATENTS

The authors recommend pre-suit investigation and diligence for in-house counsel to mitigate risk of enhanced damages and fee shifting in patent cases.

### Early Risk Assessment in the *Halo* of *Octane Fitness*: Protecting Against Enhanced Damages and Fee Shifting



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**A** key role of in-house litigation counsel is to assess and mitigate risk proactively. In addition to following the trends in the law on patent damages—a topic left for another article—the potential for enhanced damages (as a defendant) and fee shifting (for either party) are two items that must be considered prior to product launch and prior to filing a patent infringement

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complaint. In the wake of recent U.S. Supreme Court decisions, effective planning and early coordination with outside counsel can reduce unexpected risks for all litigants.

The Supreme Court has redefined the framework for early case planning and risk mitigation. In addition to providing an overview of the Supreme Court's guidance, we set forth below how such guidance can be applied proactively to enhance predictability and to install deliberate safeguards against unnecessary risk.

#### I. The Heightened Risk of Fee Shifting: *Octane Fitness* / *Highmark*

The Supreme Court recently made it easier for both plaintiffs and defendants to take advantage of the attorney fee-shifting provision of the Patent Act. By statute, courts are empowered to award reasonable attorney fees to the prevailing party in “exceptional cases.” (35 U.S.C. § 285). For decades after the enactment of the Patent Act, courts determined whether a case was exceptional based on a number of equitable factors, all viewed holistically. The U.S. Court of Appeals for the Federal Circuit changed this approach in 2005, establishing a rigid two-part test: an exceptional case is one in which the claims were (1) objectively baseless and (2) subjectively brought in bad faith. (*Brooks Furniture Mfg., Inc. v. Dutailier Int'l Inc.*, 393 F.3d 1378, 1381, 73 U.S.P.Q.2d 1457 (2005)).

In 2014, the Supreme Court rendered decisions in a pair of cases challenging the Federal Circuit's treatment of the exceptional case inquiry. In *Octane Fitness*, the Supreme Court overturned the two-part test as “overly rigid.” (134 S. Ct. 1749, 1756, 110 U.S.P.Q.2d 1337 (2014)). The Court found no support for the Federal Circuit's approach in the plain language of the Patent Act. Instead, an exceptional case “is simply one that stands out from others with respect to the substantive strength of a party's litigation position (considering both the

governing law and the facts of the case) or the unreasonable manner in which the case was litigated.”

The decision to shift fees is now a case-by-case exercise of the district court’s discretion, based on the totality of the circumstances. The Court also rejected the Federal Circuit’s requirement that entitlement to attorneys’ fees be proved by clear and convincing evidence, in favor of the lower burden of a preponderance of the evidence.

In a second case, *Highmark*, the Supreme Court extended its *Octane Fitness* decision to address the standard for appellate review of the fee-shifting determination. (*Highmark Inc. v. Allcare Health Mgmt. Sys., Inc.*, 134 S. Ct. 1744, 110 U.S.P.Q.2d 1343 (2014)). The Federal Circuit had been reviewing “exceptional case” determinations *de novo* and without deference to the district court. The Supreme Court, however, held that its decision in *Octane Fitness* dictates a far more deferential standard of review; because the “exceptional case” determination is committed to the discretion of the district court, it should be reviewed for abuse of discretion.

In short, the Supreme Court’s decisions in *Octane Fitness* and *Highmark* give courts more discretion to award attorneys’ fees to the prevailing party, and make it more difficult to disturb those determinations on appeal.

## II. Enhanced Damages for Willful Infringement and the Supreme Court’s *Halo* Decision

The Supreme Court’s ruling and rationale in *Octane Fitness* gave patent litigants a clear blueprint to challenge Federal Circuit law on enhancing damages for willful infringement. The Patent Act codified and clarified a long-standing principle in patent law—where infringement is found, courts “may increase the damages up to three times the amount found or assessed.” (35 U.S.C. § 284). This statute has long been interpreted to allow for treble damages in cases of “willful or bad-faith infringement.”

In 2007 in its *Seagate* decision, the Federal Circuit established a two-prong test for determining whether a defendant willfully infringed a patent. (*In re Seagate Tech., LLC*, 497 F.3d 1360, 83 U.S.P.Q.2d 1865 (Fed. Cir. 2007)). The *Seagate* test is highly reminiscent of the now-rejected two-prong test for shifting attorneys’ fees discussed above.

First, there was an objective prong: The patentee had to show “by clear and convincing evidence that the infringer acted despite an objectively high likelihood that its actions constituted infringement of a valid patent.” This was required to be shown without regard to the infringer’s actual state of mind. Under this prong, an accused infringer could defeat a claim of willful infringement merely by “rais[ing] a ‘substantial question’ as to the validity or noninfringement of the patent” at trial, regardless of whether the infringer knew of that defense before being sued. (*Bard Peripheral Vascular, Inc. v. W.L. Gore & Assoc., Inc.*, 776 F.3d 837, 844, 113 U.S.P.Q.2d 1380 (Fed. Cir. 2015)).

Second, there was a subjective prong: the patentee had to show—again by clear and convincing evidence—that the risk of infringement “was either known or so obvious that it should have been known to the accused infringer.” Only if the patentee established willful infringement by satisfying both the objective and subjective prongs could the district court decide whether to enhance damages and by how much. The Federal Cir-

cuit’s *Seagate* decision thus resulted in a three-part standard for appellate review. The objective prong was reviewed *de novo*, the subjective prong was reviewed for substantial evidence, and the decision to award enhanced damages was reviewed for abuse of discretion.

The Supreme Court, though, completely upended the Federal Circuit’s willful infringement law in June 2016 in *Halo*. The Court found no support in the Patent Act for the Federal Circuit’s two-prong analysis. (*Halo Elecs., Inc. v. Pulse Elecs., Inc.*, 136 S. Ct. 1923, 1931 (2016)). The Court was particularly critical of the threshold objective prong of the *Seagate* standard, which would often rule out willful infringement—and enhanced damages—in even the most egregious of circumstances, so long as the infringer’s attorneys could muster a plausible defense at trial.

After rejecting *Seagate*’s two-prong test, the Supreme Court reviewed the case law preceding the *Seagate* standard for guidance as to when enhanced damages are appropriate. The Court summarized the long history of precedent by recognizing that “[t]he 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.” The Court dispensed with the notion that capable trial counsel should be permitted to undo past misconduct with viable litigation defenses resulting in a “close case.” Instead, the Court empowered district courts to exercise their discretion to award (or not award) enhanced damages based on the particular circumstances of each case. And, under *Halo*, a decision with regard to enhanced damages can be disturbed only if it is found on appeal to have been an abuse of discretion. Moreover, *Seagate*’s heightened “clear and convincing evidence” no longer applies and entitlement to enhanced damages must be proven by only a preponderance of the evidence.

Quite similar to the outcome of the Court’s ruling on the attorney fees standard, as a result of *Halo*, prevailing plaintiffs will find it easier to prove willful infringement and it will be more difficult to challenge district court willfulness determinations on appeal.

## III. The Path Forward: Effective Risk Assessment in View of *Halo* and *Octane Fitness*

These new decisions redefine some of the risks of patent litigation, which, in turn, impact the way legal departments assess risk prevention measures. The new precedent does more than simply redefine the circumstances for increased exposure—both *Halo* and *Octane Fitness* set forth some helpful guideposts for avoidance and/or mitigation of these newly-defined risks.

For patent holders, these recent cases amplify the importance of detailed pre-suit analyses to avoid later allegations that fundamental questions of infringement, disclaimer, estoppel and anticipation were not fully considered. Similarly, for would-be defendants, a more methodical approach to product clearance, including the identification of key competitive patents and freedom-to-operate opinions concerning those patents, can help mitigate risk factors.

### A. Pre-Launch and/or Early Case Assessment to Minimize Exposure as a Defendant

As described above, *Halo* removes the ability of defendants to rely purely on litigation-derived defenses as

an escape hatch for willful infringement. Accordingly, the court's magnifying glass will be focused predominantly on evidence of the accused infringer's pre-suit mental state. In short, if there is evidence that a defendant acted recklessly or cavalierly at the time of infringement, i.e., conduct "characteristic of a pirate," there is a heightened risk of a willful infringement finding, and that determination is more likely to stick. (*Halo*, 136 S. Ct. at 1932).

A systematic and documented approach to patent analysis and product clearance can distance conduct from such rogue classification. Because the accused infringer's knowledge of the asserted patents is still a key fact in the willful infringement inquiry, in-house counsel should be keenly aware of the many avenues through which the company may learn about potentially competitive patents. (*WBIP, LLC v. Kohler Co.*, 829 F.3d 1317, 1341, 119 U.S.P.Q.2d 1301 (Fed. Cir. 2016) ("Knowledge of the patent alleged to be willfully infringed continues to be a prerequisite to enhanced damages.")).

Receiving a cease-and-desist letter from an irate patent owner is an obvious way for a defendant to learn about patents, but other sources of knowledge may not always be so obvious. For example, product engineers may look at patents as part of keeping informed about new technologies. Legal departments may learn about competitive patents when submitting prior art to the Patent and Trademark Office on the company's own patent applications. And in evaluating and negotiating transactions, members of the C-Suite may become aware of patents that the company has already used or may one day use. Knowing the many ways a company can learn about competitive patents will help in-house counsel properly evaluate and mitigate risk.

Where there are good arguments why competitive patents do not pose a credible risk, those arguments should be documented and confirmed by independent counsel. Courts have indicated that in evaluating enhancement of damages, they will continue to consider, among other factors, whether and when the infringer formed a good-faith belief that the patent is invalid or not infringed. (*See Imperium IP Holdings (Cayman), Ltd. v. Samsung Elecs. Co.*, 120 U.S.P.Q.2d 1161 (E.D. Tex. Aug. 24, 2016)).

Because of this, formal opinions of counsel have been revitalized as a viable and important tool for mitigating risk. Proactively obtaining and relying in good faith on noninfringement/invalidity opinions from competent, independent counsel can be a highly effective way to avoid enhanced damages. Further, in situations where competitive patents fall too close to products in development, collaboration between legal and R&D teams can help identify potential design-around options to ensure freedom to operate. After all, an easy fix, up front, can significantly reduce exposure down the road.

## **B. Pre-Suit Investigation to Minimize Risk as a Plaintiff**

Although both plaintiffs and defendants need to account for the new rules on fee shifting, early decisions

from post-*Octane Fitness* cases suggest that patent infringement plaintiffs will be the ones to face most of the increased exposure. Studies show that, at least in the first wave of cases after *Octane*, there has been a noticeable uptick in the number of attorney fee awards, and that much of that increase is due to awards against patent holders. (Scott M. Flanz, *Octane Fitness: The Shifting of Patent Attorneys' Fees Moves Into High Gear*, 19 Stan. Tech. L. Rev. 329, 361-62 (2016); Hannah Jiam, *Fee-Shifting and Octane Fitness: An Empirical Approach Toward Understanding "Exceptional,"* 30 Berkeley Tech. L. J. 611, 644 (2015)).

Plaintiffs, however, can take proactive steps to prevent their cases from being deemed "exceptional" and having to pay an accused infringer's legal bills. Under *Octane Fitness*, there are two driving factors that make a case "exceptional": (1) relative weakness of the litigant's arguments, as compared to the opponent, or (2) unreasonable litigation tactics. For plaintiffs, this underscores the importance of a thoughtful and well-documented pre-suit analysis that considers not just whether you can make a case, but whether you have a good case. It is not enough simply to perform a Rule 11 analysis—a case can be "exceptional" without necessarily being sanctionable for failure to satisfy the pre-suit investigation requirements under the Federal Rules of Civil Procedure. (*Octane Fitness*, 134 S. Ct. 1756-57).

Appropriate pre-suit analysis may consider not just the basics of infringement and validity, but also potential defenses and how closely your position hews to positions taken in prior litigation over the same patents or related technology. Early work with outside counsel and a consulting expert can aid in identifying and weighing key case challenges. Also, well-documented pre-suit analyses should be memorialized and presented in a format that can be used later, if necessary, to support a plaintiff's thoughtful conduct. (*Lumen View Tech. LLC v. Findthebest.com, Inc.*, 811 F.3d 479, 483 (Fed. Cir. 2016) (affirming attorney fee award where plaintiff "failed to provide evidence of its pre-filing investigation and infringement assessment to the district court . . .")).

## **IV. Conclusion**

For about a decade, the Federal Circuit's jurisprudence gave litigants multiple shots at avoiding dangerous fee-shifting and enhanced damages awards—if your pre-suit efforts fell short, come up with a good justification for your case by the time of trial, and seek *de novo* review on appeal.

After *Octane Fitness* and *Halo*, litigation-derived positions and appellate review are no longer viable safety nets. This Supreme Court jurisprudence provides that the best way for all litigants to avoid increased exposure in patent litigation is well-documented pre-suit investigation and diligence.