June 14, 2016

Halo Electronics, Inc. v. *Pulse Electronics, Inc.*; *Stryker Corp.* v. *Zimmer, Inc.*

U.S. Supreme Court Rejects Federal Circuit's Framework for Enhancing Damages in Patent Infringement Cases

SUMMARY

The Supreme Court held today in consolidated cases *Halo Electronics, Inc.* v. *Pulse Electronics, Inc.* and *Stryker Corp.* v. *Zimmer, Inc.*[1] that the Patent Act gives district courts discretion to award enhanced damages in "egregious" cases of patent infringement.[2] The Court overruled the Federal Circuit's rigid two-part test that (1) an accused infringer must have acted "despite an objectively high likelihood" that its actions infringed a valid patent and (2) the risk of infringement must have been "either known or so obvious that it should have been known."[3] Dispensing with that test, the Court held that district courts may award enhanced damages in any case in which, based on the infringer's knowledge at the time of the infringement, the misconduct was egregious. Such a determination should be made by a preponderance of the evidence and is subject to review by the Federal Circuit for abuse of discretion. Sullivan & Cromwell LLP served as counsel for the petitioners in *Stryker*, and presented oral argument to the Supreme Court on behalf of the petitioners in both cases.

BACKGROUND

In these two consolidated cases, Halo and Stryker sued alleged infringers for developing and marketing products that were effectively identical to products for which Halo and Stryker held patents. In both cases, the juries found that the patents were valid and that the alleged infringers had willfully infringed those patents. Halo and Stryker therefore sought enhanced damages pursuant to 35 U.S.C. § 284, which provides that in cases of infringement the district court "may increase the damages up to three times the amount found or assessed." The district court granted enhanced damages to Stryker, but not to Halo.

On appeal, the Federal Circuit affirmed the judgments of infringement but held that neither Halo nor Stryker was eligible to receive enhanced damages. Reviewing the judgments below *de novo*, and applying the test it had announced in *In re Seagate Technology, LLC*, 497 F.3d 1360 (2007) (en banc), the Federal Circuit held that the infringers in both cases had put forward reasonable—if unavailing—defenses to infringement at trial. As a result, neither Halo nor Stryker could show by clear and convincing evidence that the infringers had acted with "objective recklessness."[4] The Supreme Court then granted review to consider whether the Federal Circuit's *Seagate* framework is consistent with the enhanced-damages provision of the Patent Act, 35 U.S.C. § 284.

THE SUPREME COURT'S DECISION

In a unanimous decision authored by Chief Justice Roberts, the Supreme Court held that the Federal Circuit's "*Seagate* test" is not consistent with the enhanced-damages provision of the Patent Act, 35 U.S.C. § 284. Under *Seagate*, before a district court could consider whether to grant an enhancement, the patent holder had to show by clear and convincing evidence (1) "that the infringer acted despite an objectively high likelihood that its actions constituted infringement of a valid patent," without regard to the "state of mind of the accused infringer," and (2) that the risk of infringement "was either known or so obvious that it should have been known to the accused infringer."[5] Although *Seagate*'s two-part test reflects "a sound recognition that enhanced damages are generally appropriate . . . only in egregious cases," the Supreme Court reasoned, it has proven "unduly rigid" and has "insulat[ed] some of the worst patent infringers from any liability for enhanced damages."[6]

The Supreme Court observed that enhanced damages had historically been awarded only in "egregious cases of culpable behavior."[7] In the Court's view, Section 284—which provides in discretionary language that a district court "may increase the damages up to three times the amount found or assessed" in cases of patent infringement—was intended to preserve that historical standard. Against that backdrop, the Court held, the "principal problem" with the *Seagate* test was its threshold requirement of "objective recklessness."[8] By "making dispositive the ability of the infringer to muster a reasonable (even though unsuccessful) defense at the infringement trial," the *Seagate* test provided a safe harbor to intentional, bad-faith infringers, even if they "did not act on the basis of the defense or [were not] even aware of it" until litigation ensued.[9]

The Supreme Court also concluded that the Federal Circuit's requirement of clear and convincing evidence lacked any basis in the Patent Act.[10] Invoking its previous rejection of a clear-and-convincing standard for attorney's fee awards in patent cases in *Octane Fitness, LLC* v. *ICON Health & Fitness, Inc*., 134 S. Ct. 1749 (2014), the Court held that neither the text of Section 284 nor its historical application warranted a heightened evidentiary burden rather than the typical preponderance standard.

Finally, the Supreme Court overruled the system of "trifurcated appellate review" that the Federal Circuit had applied under the *Seagate* framework.[11] Drawing on its prior decision regarding appellate review of attorney's fee awards in *Highmark Inc.* v. *Allcare Health Mgmt. Sys., Inc*., 134 S. Ct. 1744 (2014), the Court held that the Federal Circuit should review district courts' enhanced-damages awards for abuse of discretion "in light of the longstanding considerations [the Court] identified as having guided both Congress and the courts."[12]

Justice Breyer, joined by Justices Kennedy and Alito, concurred in the Court's opinion. Justice Breyer agreed that the *Seagate* test imposed "too mechanical an approach to the award of enhanced damages," but wrote separately to emphasize four considerations that, in his view, should limit the circumstances in which district courts would enhance damages.[13] First, Justice Breyer stated that mere knowledge of a patent's existence, without more, should not qualify as sufficiently egregious to warrant enhanced damages.[14] Second, he noted that the Court's decision does not "weaken th[e] rule" adopted by Congress in 35 U.S.C. § 298, which provides that the "failure of an infringer to obtain the advice of counsel . . . may not be used to prove that the accused infringer willfully infringed."[15] Third, he reiterated the Court's conclusion that enhanced damages serve a punitive purpose and "may not serve to compensate patentees."[16] Finally, Justice Breyer suggested that, in applying abuse-of-discretion review, the Federal Circuit "may take advantage of its own experience and expertise in patent law."[17]

IMPLICATIONS

Today's decision allows district courts to exercise their discretion to impose enhanced-damages awards against bad-faith infringers even if those infringers can develop plausible, *post hoc* defenses to their conduct during the course of litigation. Together with the relaxation of the evidentiary and appellate standards that govern enhanced-damages motions, the Court's decision will make enhanced damages easier to obtain where patent holders can plausibly make a showing of culpable infringement. The increased availability of enhanced damages will likely curb the trend of "efficient infringement," whereby companies in highly competitive, technical fields elect to copy a rival's invention knowing that even if found liable for infringement they will be forced to pay no more than a reasonable royalty. The Court's decision thus incentivizes prospective consensual licensing in place of deliberate copying.

On the whole, these developments increase the value of patents and enhance the leverage of patent-holders both in licensing negotiations and in any ensuing litigation. At the same time, the decision does not open the floodgates to frivolous awards: the Court was careful to emphasize that such enhanced-damages awards should be reserved only for "egregious" cases, a determination informed by "nearly two

centuries of enhanced damages under patent law." Accordingly, in seeking or challenging enhancements, it will be important for litigants to show whether the misconduct at issue historically would have justified increasing damages.

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ENDNOTES

1 579 U.S. __, Nos. 14-1513 and 14-1520 (June 13, 2016).

2 Slip op. at 11.

3 *Id.* at 1-2 (quoting *In re Seagate Technology, LLC*, 497 F. 3d 1360, 1371 (2007) (en banc)).

4 *Halo Elecs., Inc.* v. *Pulse Elecs., Inc.*, 769 F.3d 1371, 1382 (Fed. Cir. 2014); *Stryker Corp.* v. *Zimmer, Inc.*, 782 F.3d 649, 661 (Fed. Cir. 2014).

5 *Seagate*, 497 F.3d at 1371.

6 Slip op. at 9.

7 *Id*. at 8-9.

8 *Id.*

9 *Id.* at 10.

10 *Id.* at 12.

11 *Id.* at 5-6.

12 *Id.* at 13.

13 Slip op. at 1 (Breyer, J., concurring).

14 *Id.*

15 *Id.* at 2-3.

16 *Id.* at 3.

17 *Id.* at 5.

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