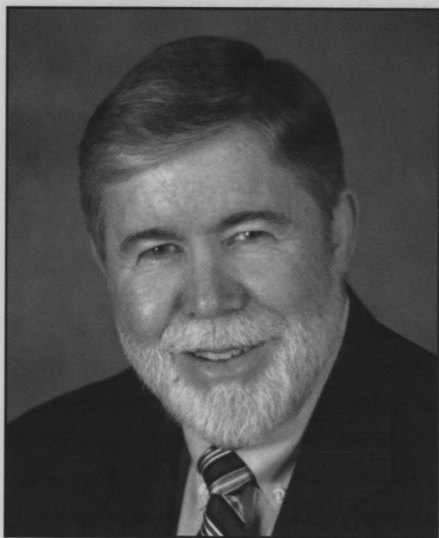


# Enhanced Patent Damages: The “Halo Effect”



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FEW AREAS IN INTELLECTUAL PROPERTY LAW have suffered more ninety-degree turns than the subject of enhanced patent damages. On June 13, 2016, the U.S. Supreme Court set the newest course in a dramatic fashion—in *Halo Electronics, Inc. v. Pulse Electronics, Inc.*<sup>1</sup> and its companion case, *Stryker Corp. v. Zimmer, Inc.*<sup>2</sup> Federal Circuit bright-line authority was rejected.

If found liable in a patent infringement case, an infringer may be enjoined from activity, and may also be liable for damages. Damages may be actual damages proved by the plaintiff, but in no case may they be less than a reasonable royalty.<sup>3</sup> Under certain circumstances, the Court may enhance damages up to a trebling of the underlying damage amount.<sup>4</sup> This is set forth in 35 U.S.C. § 284, which provides:

Upon a finding for the claimant the court shall award the claimant damages adequate to compensate for the infringement but in no event less than a reasonable royalty for the use made of the invention by the infringer, together with interest and costs as fixed by the court.... [¶] [T]he court may increase the damages up to three times the amount found or assessed.

Notably, the statute gives no guidelines for exercise of the court's discretion. That issue was left to develop through case law, which the Federal Circuit set out to provide promptly upon its founding. We look first at the *Underwater Devices* case.<sup>5</sup>

## THE UNDERWATER DEVICES CASE

Prior to *Seagate*,<sup>6</sup> the standard for willfulness decisions for enhanced damages purposes was set by the *Underwater Devices*<sup>7</sup> opin-

ion. *Underwater Devices* was decided in the first year of the Federal Circuit's existence. At the time, perceived widespread disregard for patent rights had prompted the formation of the new Circuit.

Recognizing that deliberate, willful patent infringement was a danger to be tamed, the court in *Underwater Devices* essentially imposed a presumption of willful infringement. The court held that, to avoid a finding of willfulness, a confirmed infringer had to show that it took reasonable steps to avoid liability, including seeking and obtaining an opinion from competent legal counsel before engaging in infringing activity.<sup>8</sup> This imposed an affirmative duty of due care on the defendant to refrain from infringing a third party's patent once the infringer was put on notice of the owner's claimed patent rights. A cottage industry of litigation over reliance on advice of counsel and the associated attorney-client privilege and work product doctrines blossomed.

Thus, the Federal Circuit in *Underwater Devices* viewed willfulness to be a question of fact, and it was for a jury to decide whether the defendant's asserted defenses to infringement were "reasonable." The evidentiary burden was preponderance of the evidence. Appellate review operated under the substantial evidentiary support standard.

Then, in 2007, came *In re Seagate Technology, LLC*.<sup>9</sup>

## SEAGATE, POWELL, AND BARD

In *Seagate*, the Federal Circuit expressly overturned its own decision in *Underwater Devices*. It viewed the *Underwater Devices* standard as unworkable, especially with regard to the reliance of advice of counsel issues.

The court looked at the treatment of "willfulness" in other contexts and by other circuits, and explained that applying a negligence standard under a duty of due care was inappropriate.<sup>10</sup> Instead, the court's analysis equated willfulness more with a measure of recklessness.<sup>11</sup>

The court declared a new two-prong test for willfulness. First, the plaintiff had the burden of showing that the defendant engaged in the activity despite an objectively high likelihood that the defendant's actions constituted infringement of a valid patent.<sup>12</sup> The second prong required plaintiff to show "subjective" recklessness—that the defendant actually knew or should have known of that risk of infringement.<sup>13</sup> If the first prong was not satisfied, the jury would not be asked to evaluate the second prong. The plaintiff was required to prove all this by clear and convincing evidence, rather than the previous standard of preponderance of evidence.<sup>14</sup>

Of course, this more restrictive approach had a signal effect on the imposition of enhanced damages in patent cases. Trial courts applying the *Seagate* standard were often ruling that the objective test for

willfulness had not been satisfied, and not permitting a jury to consider any remaining issue.<sup>15</sup>

After *Seagate*, two later Federal Circuit opinions resolved lingering issues. It is useful to explore their treatment of these issues, for they serve to highlight potential implications of the Supreme Court's holding in *Halo Electronics*.

In *Powell v. Home Depot, Inc.*,<sup>16</sup> the court held that the objective prong could be decided by the district court as a matter of law if founded on a legal issue, such as claim construction.<sup>17</sup> On the other hand, if the objective view of defendant's belief turned on factual questions, such as non-infringement itself, the objective prong was still to be decided by the jury.

Resolution of the objective prong by determination of recklessness is often a mixed question, involving evaluation of issues of both fact and law. In *Bard Peripheral Vascular, Inc. v. W.L. Gore & Associates, Inc.*,<sup>18</sup> the court clarified that those mixed questions of law and fact would not interfere with the district court's objective determination of recklessness as a matter of law.<sup>19</sup> The court stated that the district court was in the best position to determine reasonableness.

Making the district court judge the effective gatekeeper on the objective prong had a significant procedural impact in patent cases, and summary judgment became a more potent defensive tool. While the *Seagate*, *Powell*, and *Bard* holdings did not affect the issue of infringement or various liability defenses *per se*, a district court judge could now more readily throw out the issue of enhanced damages on partial summary judgment because of the objective prong requirement. As a result, the settlement value of the case would appreciably drop.

More subtly, even though this trio of cases largely favored defendants because it made enhanced damages more difficult to obtain, the defendant suffered in one sense as well. The objective/matter of law paradigm affected a defendant's tactical utilization of defenses. A "kitchen sink" approach to arguing all possible defenses, however remotely appropriate, could influence the district court judge's view of how reasonable the defendant's conduct was. Relying on unreasonable defenses suggested recklessness, and hence willfulness, and therefore no partial summary judgment for the defendant on enhanced damages.

In addition, because so much of the evaluation of defendant's conduct was to be resolved as a matter of law, a profound shift occurred in post-trial and appellate review procedure as well. Post-trial, the district judge's hand was strengthened. Those questions of law were also reviewable by the Federal Circuit *de novo*, without deference to substantial evidence supporting the district court's decision.<sup>20</sup>

Thus, these cases removed some of the fear factor for defendants facing a patent jury trial. Even when a jury might be swayed by a strong infringement argument or when the defendant had "bad facts," the risks were based more on increased royalties/lost profits awards. Enhanced damages was a diminished concern.

## THE HALO ELECTRONICS DECISION

In the lower courts, enhanced damages were denied in both *Halo Electronic* and *Stryker* cases under the *Seagate* framework. The Federal Circuit affirmed denial of enhanced damages in the former<sup>21</sup> and reversed a grant of enhanced damages in the latter.<sup>22</sup> The Supreme Court, however, reversed both lower court decisions, holding that the *Seagate* test was not consistent with Section 284.<sup>23</sup>

The Court reasoned that the language of Section 284 had no explicit limitation on when to apply enhanced damages, and that the "word 'may' connotes discretion."<sup>24</sup> Although there was no precise formula for applying Section 284, the Court cited the recent *Octane Fitness*<sup>25</sup> decision in reasoning that "discretion should be exercised in light of the considerations underlying the grant of that discretion."<sup>26</sup> What was meant here was that 180 years of enhanced damage awards demonstrated that such awards were reserved for egregious infringement behavior not found in a typical patent infringement case.<sup>27</sup> While acknowledging that the *Seagate* test generally reflects the historic guidance, the Court stated that it is, in the language from *Octane Fitness*, "unduly rigid...and impermissibly encumbers the statutory grant of discretion to district courts."<sup>28</sup>

The Court focused on three problems. First, requiring an objective test in every case excludes from discretionary punishment the "wanton and malicious pirate" who intentionally infringes with no doubts about validity or notion of defense.<sup>29</sup> Requiring the *Seagate* test would bar consideration of enhanced damages, unless the court first determined that the defendant's infringement was "objectively" reckless. The Court questioned why such a finding was a prerequisite in the context of deliberate wrongdoing.<sup>30</sup>

To support its position, the Court referred to the recent *Octane Fitness* decision. There, a similar two-part test for determining whether a case was "exceptional" for attorney's fees purposes was rejected, and the Court stated that a claim of subjective bad faith alone would warrant a fee award.<sup>31</sup> Thus, here, in *Halo Electronics*, a patent infringer's subjective willfulness would warrant enhanced damages without regard to whether infringement was objectively reckless.<sup>32</sup>

The Court also questioned the ability of a willful infringer to argue that a reasonable defense existed in order to negate willfulness. It noted that *Seagate* required this approach, even if the infringer was unaware of the availability of that defense when acting.<sup>33</sup> Culpability instead should be premised upon the actor's knowledge at the time of its conduct.<sup>34</sup>

The second basis for the holding was *Seagate's* requirement that recklessness be proved by clear and convincing evidence. The Court found that, as in *Octane Fitness*, this was inconsistent with Section 284, which imposes no such higher burden.<sup>35</sup> According to the Court, the fact Congress imposed a higher standard elsewhere in the Patent Act was telling.<sup>36</sup>

Third, the Court discussed the fact that *Seagate's* appellate review framework was suspect. Having rejected the need for determination

of objective recklessness, the Court stated that there was no basis for *de novo* appellate review of that factor.<sup>37</sup> The standard of review for whether enhanced damages was appropriate was abuse of discretion, according to long-standing principles of review.<sup>38</sup>

## NEW COURT DISCRETION; OBSOLETE MODEL JURY INSTRUCTIONS

The Supreme Court's decision states explicitly that district courts cannot be barred from considering the issue of enhanced damages, and clarifies the evidentiary standard to apply: preponderance of the evidence.<sup>39</sup> The opinion provides precious little guidance on how to move forward, however. The Court instructs district courts not to short-circuit willfulness determinations by juries through instructions requiring an objective test—enhanced damages, it says, should be awarded only in “egregious” cases of infringement.<sup>40</sup> The decision implies that a determination of willfulness should be premised on the same so-called standard.

Where does that leave us? One problem is the blurring of concepts. Willfulness is one thing; enhancement of damages is the other. Finding willfulness is now a fact issue, which is a jury function (at least by default). Only the subjective intent survives. Determining the amount of enhanced damages, on the other hand, is reserved for the district court. Yet, the Supreme Court's reasoning seems directed more to the latter, rather than the former. According to the Supreme Court, courts can distinguish garden-variety infringement cases from egregious cases, and they must exercise discretion in awarding enhanced damages, “in light of the considerations underlying the grant of that discretion.”<sup>41</sup> This may be a bit vague, but district courts can deal with that. Moreover, one may argue that this distinction has no practical effect—that is, what does it matter if a jury finds willfulness, by any standard, if the district court retains discretion on determining the consequences of that determination?

Still, we now know that, once again, willfulness is entirely a fact issue to be determined by a jury. Juries by nature have no background in determining how one patent suit is more egregious than another. Presumably, no evidence comparing cases can be presented on these matters to the jury. Instead, we now face the question of how jury instructions should be fashioned on the issue of willfulness.

Instruction 12.1 of the 2016 version of model jury instructions of the American Intellectual Property Law Association (AIPLA) states:

*If you find that it is more likely than not that [the Defendant] infringed [the Plaintiff]'s patent, either literally or under the doctrine of equivalents, then you must also determine whether or not [the Defendant]'s infringement was willful. In contrast to proving that infringement is more likely than not, [the Patentee] must prove willfulness by clear and convincing evidence. Willfulness requires clear and convincing evidence that:*

1. *[The Defendant] acted despite an objectively high likelihood that its actions infringed a valid patent; and*

2. *This objectively high likelihood of infringement was either known or so obvious that it should have been known to [the Defendant].*

*In making the determination of whether [the Defendant] acted despite an objectively high likelihood that its actions infringed a valid patent, you are to consider what a reasonable person would have believed and are not to consider [the Defendant]'s actual state of mind.*<sup>42</sup>

The Federal Circuit Bar Association's model instruction is more detailed but in line with the above.<sup>43</sup> In light of *Halo Electronics*, instructions such as these no longer apply.

A modified AIPLA model version of this instruction, striking the clear and convincing standard and striking the objective test, might look something like this, pending further case law interpretation:

*If you find that it is more likely than not that [the Defendant] infringed [the Plaintiff]'s patent, either literally or under the doctrine of equivalents, then you must also determine whether or not [the Defendant]'s infringement was willful. [The Patentee] must prove willfulness by a preponderance of the evidence that:*

*[The Defendant] acted despite knowing that its actions infringed a valid patent, or acted despite facts which were so obvious that its infringement of a valid patent should have been known to [the Defendant].*

Supplying the jury with factors to consider in determination of willfulness would be helpful, but trial counsel could submit evidence and argue the same points even without explicit language in the instructions. The Federal Circuit Bar Association's model instructions nevertheless lists items such as whether the defendant acted in accordance with applicable standards of commerce, intentionally copied a covered product, made a good-faith effort to avoid infringement or tried to cover up its infringement.<sup>44</sup> Section 298 of the patent statute explicitly states that failure of the defendant to assert that it relied on advice of counsel may not be considered.<sup>45</sup>

Further, note that the “objective evidence” portion of the old standard is not entirely irrelevant under this new holding. That is, evidence showing unreasonable or reckless behavior is not barred; it simply is not determinative. Trial attorneys will continue to focus on this evidence to argue subjective intent, which of course is usually totally elusive.

## IN WHAT OTHER WAYS WILL PATENT LITIGATION CHANGE?

One might suppose that overturning *Seagate*, *Powell*, and *Bard* means a return to the case law that existed before *Seagate*. Because of the strict rules asserting an affirmative duty of due care in *Underwater Devices*, however, that is unlikely. The *Halo Electronics* decision does not address or express approval of such a return. In fact, its reasoning suggests the opposite—that objective tests are out, and subjective intent is the key.

The Supreme Court's decision strengthens the power of district courts significantly. Courts are no longer bound to refrain from enhancing damages where a reasonable defense to infringement could



be asserted, even if the defendant had no notion of it at the time of infringement. Courts are no longer subject to *de novo* review by the Federal Circuit and are given much wider latitude. It is noteworthy, however, that the concurring opinion of Justice Breyer in the *Halo Electronics* case warned that mere notice of the patent and proceeding to sue the infringer does not of itself turn garden-variety infringement into willful infringement.<sup>46</sup> Otherwise, all infringement would perforce be willful.

On the other hand, while the amount of damages remains within their discretion, district courts no longer serve as gatekeepers on willfulness. There is no two-part analysis, where the district court makes the threshold decision based on the objective test.

The previous impact the *Seagate* decision had on patent litigation practices suggests some ways in which things will change. For one thing, partial summary judgments striking willfulness claims will dry up. Genuine issues of material fact almost inescapably exist, when decisions based on matters of law are abrogated. Defendants may again feel freer to assert far-fetched defenses, no longer fearing the inference of recklessness by the district court judge when determining the existence of willfulness at summary judgment.

Perhaps the trend of seeking an administrative trial on the issue of validity needs no further impetus. However, *Halo Electronics* suggests this process will continue unabated. A determination of invalidity makes enhanced damages moot.

And, most obviously, the prospect of a willfulness determination and exposure to enhanced damages will change trial results, settlement negotiations, and even pre-litigation/commercial planning. Enhanced damages will again not only be feared but also factored in. The Supreme Court's opinion cast doubt that this would embolden so-called patent trolls, because of the principles it sets out. We shall see. What is clear, however, is that in legitimate, business-to-business disputes among competitors, all must heed a new damages reality. ♦♦

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#### Endnotes

1. *Halo Electronics, Inc. v. Pulse Electronics, Inc.*, No. 14-1513 (U.S. Jun. 13, 2016).
2. *Stryker Corp. v. Zimmer, Inc.*, No. 14-1520 (U.S. Jun. 13, 2016).
3. 35 U.S.C. § 284.
4. *Id.*
5. *Underwater Devices, Inc. v. Morrison-Knudsen Co.*, 717 F.2d 1380 (Fed. Cir. 1983).

6. *In re Seagate Technology, LLC*, 497 F.3d 1360 (Fed. Cir. 2007).
7. *Underwater Devices*, 717 F.2d 1380.
8. *Id.* at 1390.
9. *Seagate*, 497 F.3d 1360.
10. *Id.* at 1371.
11. *Id.* at 1370.
12. *Id.* at 1371.
13. *Id.*
14. *Id.*
15. See, e.g., *Wisconsin Alumni Research Foundation v. Intel Corp.*, 656 F. Supp. 2d 898 (W.D. Wis. 2009); *Callpod, Inc. v. GN Netcom, Inc.*, 703 F. Supp. 2d 815 (N.D. Ill. 2010); *Cordance Corp. v. Amazon.com, Inc.*, 639 F. Supp. 2d 406 (D. Del. 2009); *Honeywell International, Inc. v. Universal Avionics Systems Corp.*, 585 F. Supp. 2d 636 (D. Del. 2008).
16. *Powell v. Home Depot, Inc.*, 663 F.3d 1221 (Fed. Cir. 2011).
17. *Id.* at 1236.
18. *Bard Peripheral Vascular, Inc. v. W. L. Gore & Associates, Inc.*, 682 F.3d 1003 (Fed. Cir. 2012).
19. *Id.* at 1005.
20. *Id.*
21. *Halo Electronics, Inc. v. Pulse Electronics, Inc.*, No. 14-1513, slip op. at 6 (U.S. Jun. 13, 2016).
22. *Id.* at 7.
23. *Id.* at 2.
24. *Id.* at 8.
25. *Octane Fitness, LLC v. ICON Health & Fitness, Inc.*, 572 U.S. \_\_\_\_ 134 S. Ct. 1749 (2014).
26. *Id.* at 8.
27. *Id.*
28. *Id.* at 9.
29. *Id.*
30. *Id.*
31. *Id.* at 10.
32. *Id.*
33. *Id.*
34. *Id.*
35. *Id.* at 12.
36. *Id.*
37. *Id.* at 12-13.
38. *Id.* at 13.
39. *Id.* at 12.
40. *Id.* at 15.
41. *Id.* at 8.
42. AIPLA Model Patent Instructions, No. 12.1 (2016).
43. Federal Circuit Bar Association Model Patent Instructions, No. B.3.10 (2014).
44. *Id.*
45. 35 U.S.C. § 298.
46. *Halo Electronics, Inc. v. Pulse Electronics, Inc.*, No. 14-1513, concurring op. at 1 (U.S. Jun. 13, 2016).