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Expert Analysis

The Shifting Sands Of Fee-Shifting in Patent Cases

By **Robert C. Scheinfeld**

And **Parker H. Bagley**

Unlike most areas of American jurisprudence, the patent statute expressly permits district judges to shift fees in exceptional cases. "The court in exceptional cases may award reasonable attorney fees to the prevailing party."[1] These seemingly simple words have been the subject of more than one-half century of debate among practitioners and judges alike. What exactly makes a patent case exceptional, and how do you identify one?

Two recent decisions, both issued on the same day by a unanimous Supreme Court, should help clarify what sorts of patent cases may be considered "exceptional" for the purposes of fee-shifting under §285. In *Octane Fitness*, the Supreme Court rejected the Federal Circuit's *Brooks Furniture* test for identifying exceptional cases under the statute and lowered the evidentiary standard for a movant's showing from clear and convincing evidence to a preponderance of the evidence.[2] In the second case, the Supreme Court rejected the Federal Circuit's de novo review of district court judges' decisions pursuant to the fee-shifting provision of the Patent Act, replacing it with the more typical review for abuse of discretion.[3]

Problems with 'American' Rule

In contrast to the English model, in the United States, with few exceptions, litigants are generally expected to pay their own attorney fees. Among the few notable exceptions to this "American" rule are specific statutory provisions that allow for fee-shifting under certain prescribed circumstances. Patent cases, by their technical nature, are typically expensive to litigate either as a plaintiff or defendant. Technical experts are hired to opine on validity and infringement and economists are needed to render opinions on damages in the form of a reasonable royalty resulting from a hypothetical negotiation. The cost of defending against unmeritorious infringement claims has encouraged some less scrupulous Patent Monetization Entities (PAEs) to assert patents of questionable validity and based on dubious infringement theories, and then settle for less than the cost of defending the suit. The "American" rule exacerbates this problem by shielding PAEs from any real financial risks—if a case goes south, the PAE can simply offer to dismiss the case, learn from its mistakes, and perhaps try again against another defendant.

Prior to 1946, the default "American" rule applied to all patent litigation. In 1946, Congress amended the Patent Act to state that the district court "may in its discretion award reasonable attorney's fees to the prevailing party upon the entry of judgment in any patent case."[4] Even under §70, however, fee-shifting was not the default result in a patent case but, rather, an equitable remedy reserved for a case that, in the opinion of the district judge, was exceptional.[5] When, in 1952, Congress again amended the language of the Patent Act, it included the term "exceptional cases," as a precondition for an award of attorney fees.[6] Nevertheless, the amended statute at §285 was understood to clarify the language, not to change the standard.[7]

Abandoning the Totality Test

Prior to 2005, the U.S. Court of Appeals for the Federal Circuit had more or less consistently instructed the district courts to evaluate the totality of the circumstances when making fee-shifting determinations under §285.[8] In 2005, in *Brooks Furniture Mfg. v. Dutailier Int'l*, the Federal Circuit abandoned the totality of the circumstances test. Under *Brooks Furniture*, finding a patent case exceptional under §285 required either "some material inappropriate conduct," i.e., conduct that would violate Fed. R. Civ. P. 11, or a combination of two separate factors: (1) the litigation must be "objectively baseless" and (2) have been "brought in subjective bad faith."[9]

The Federal Circuit later clarified that a case is objectively baseless only when it is "so unreasonable that no reasonable litigant could believe it would succeed," and brought in subject bad faith only when the plaintiff "actually know[s]" that it is objectively baseless.[10] One might think that an attorney filing an objectively baseless infringement case could be presumed to know that fact and, quite recently, the Federal Circuit lowered the bar set by the second prong of the Brooks Furniture test, brought in subjective bad faith, to permit a showing by "reckless conduct."[11]

Although parties frequently moved for fees pursuant to §285 under *Brooks Furniture*, such requests were denied almost as frequently. Even where a party might otherwise be able to satisfy the two-prong test, the Federal Circuit raised the bar further by requiring that a case's exceptionality be "established by clear and convincing evidence," rather than the default evidentiary burden in a civil case, which typically requires proof by a preponderance of the evidence. The Federal Circuit justified the heightened evidentiary burden of clear and convincing evidence based on the "presumption that the assertion of infringement of a duly granted patent is made in good faith." Because the Brooks Furniture test was nearly impossible to satisfy outside of circumstances that would independently qualify for sanctions under Fed. R. Civ. P. 11, the impact of §285 on litigants' behavior was negligible.

Appellate Review

Adding insult to injury, the Federal Circuit had granted itself the power to review district court decisions pursuant to §285 de novo, rath-

ROBERT C. SCHEINFELD *is the partner-in-charge of the New York office of Baker Botts.* PARKER H. BAGLEY *is of counsel at Boies, Schiller & Flexner.* GUY EDDON, *a Baker Botts associate, assisted in the preparation of this article.*

er than for abuse of discretion, the traditional appellate standard of review for matters of discretion. In *Highmark*, a health insurance company sued Allcare for a declaratory judgment of non-infringement and Allcare countersued for patent infringement. After the district court granted summary judgment of non-infringement in favor of *Highmark*, and the Federal Circuit affirmed, Highmark moved for fees under §285. The district court granted Highmark's motion for fee-shifting, noting that Allcare had engaged in "deceitful" and "vexatious" conduct, and "maintained infringement claims well after such claims had been shown by its own experts to be without merit," and awarded over $5 million in attorney fees an costs.

The Federal Circuit held that whether a case is objectively baseless under *Brooks Furniture* "is a question of law based on underlying mixed questions of law and fact and is subject to de novo review." Reviewing the award, de novo, the Federal Circuit then reversed part of the district court's finding that the case was "exceptional" under §285 with respect to Allcare's assertion of one patent claim. Finally, the Supreme Court reversed the Federal Circuit, holding that because, under *Octane Fitness*, "§285 commits the determination whether a case is 'exceptional' to the discretion of the district court, that decision is to be reviewed on appeal for abuse of discretion."

Return to the Previous Test?

In *Octane Fitness*, ICON Health had sued Octane Fitness for infringing a patent covering a type of elliptical exercise machine. The district court granted summary judgment of non-infringement to Octane Fitness, which then moved for attorney fees, arguing that non-infringement was readily apparent to anyone who visually inspected the accused machines and that ICON Health had sued as part of a commercial strategy.

The court denied the motion based on the then-applicable Federal Circuit test set forth in *Brooks Furniture*, finding that the claim was neither objectively baseless nor brought in subjective bad faith. The Federal Circuit reviewed that finding de novo and affirmed, and the Supreme Court granted certiorari on the question of the appropriate standard for determining whether a case is "exceptional" under §285.

The Supreme Court held that "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." Although "there is no precise rule or formula for making these determinations," under the new standard enunciated by the Supreme Court, "[d]istrict courts may determine whether a case is 'exceptional' in the case-by-case exercise of their discretion, considering the totality of the circumstances." Among the factors a district court should consider are "frivolousness, motivation, objective unreasonableness."

Practical Implications

The most obvious impact of *Octane Fitness* will be in a greater number of motions for fee-shifting pursuant to §285 and, more importantly, an increased likelihood that such motions will be granted. Under *Highland*, the raised standard of review for such fee-shifting decisions at the Federal Circuit, for abuse of discretion, means that there is a greater likelihood that a fee award under §285 will be upheld on appeal. Taken together, these decisions may help adjust the power equilibrium away from PAEs and toward their targets. The cost-benefit calculus facing a PAE contemplating asserting its IP has changed.

> Two Supreme Court decisions should help clarify what sorts of patent cases may be considered "exceptional" for the purposes of fee-shifting under §285.

Early Applications of 'Octane'

Both the Federal Circuit and at least one district court have already had the opportunity to consider the impact of *Octane Fitness*. In a brief and unanimous order, the Federal Circuit recently vacated and remanded a district court's denial of fees under the now defunct Brooks Furniture test. Magistrate Judge Paul Singh Grewal in the Northern District of California had denied the request for fees because the defendant had not shown the suit to be objectively baseless—the first prong of the Brooks Furniture test. The Federal Circuit stated that "[t]he district court's order denying declaration of an exceptional case and award of attorneys' fees is vacated and the case is remanded for further proceedings in light of the Supreme Court's decision" in *Octane Fitness*.

In the Eastern District of Texas, Judge William Bryson, a senior member of the Federal Circuit sitting by designation, considered the impact of *Octane Fitness* in the context of a motion for reconsideration of his order denying attorney fees under §285. Bryson had denied the original request under the then-applicable Brooks Furniture test because the movant could not show, by clear and convincing evidence, that plaintiff's inventorship claim at issue in the case was objectively baseless and brought in subjective bad faith.

On reconsideration, Bryson found that waiver prevented the defendant from now arguing for the relaxed Octane Fitness test, even though *Octane Fitness* had only been argued at the Supreme Court, though not yet decided, at the time of his original order. The defendant's "failure to argue in favor of the more liberal standard, even though the continued vitality of that case was subject to question by virtue of the pendency of *Octane Fitness* constitutes a waiver of its right to press that standard."

Nevertheless, as an alternate ground for his decision, Bryson proceeded to analyze the facts under *Octane Fitness*. In Bryson's reading, the Supreme Court took the two-prong Brooks Furniture test, objectively baseless and brought in subjective bad faith, and replaced the 'and' with an 'or.' The district court's previous "finding that neither part of the prior test was satisfied thus largely answers the question whether this case is exceptional under the Supreme Court's new test." Bryson reasoned that since the plaintiff's inventorship claim was neither objectively baseless nor brought in subjective bad faith, it could not be an exceptional case under the new Octane Fitness standard.

Finally, quoting the Supreme Court in *Octane Fitness*, the district court stated that "under the totality of the circumstances, [the plaintiff's] inventorship claim in this case is not 'exceptional' in that it does not 'stand[] out from others with respect to the substantive strength' of [the plaintiff's] litigating position." Whether other district courts will adopt Judge Bryson's 'or' version of the Brooks Furniture test remains to be seen. One open question is whether fee-shifting applications under §285 will be successful when brought by plaintiffs following successful declaratory judgment of non-infringement actions brought in response to demand letters threatening litigation.

Time will tell whether the Supreme Court's relaxed test for fee-shifting under §285 enunciated in *Octane Fitness* serves to strengthen the resolve of proponents for a more aggressive loser-pays regime, or comes to be seen as a sufficient correction in itself.

1. 35 U.S.C. §285
2. *Octane Fitness v. Icon Health and Fitness*, 134 S. Ct. 1749 (April 29, 2014).
3. *Highmark v. Allcare Health Management System*, 134 S. Ct. 1744 (Apr. 29, 2014).
4. 35 U. S. C. §70 (1946 ed.).
5. See, S. Rep. No. 79-1503, p. 2 (1946).
6. 35 U.S.C. §285.
7. *General Motors Corp. v. Devex Corp.*, 461 U. S. 648, 653, n. 8 (1983); S. Rep. No. 82-1979, p. 30 (1952).
8. *Octane Fitness*, 134 S. Ct. at 1754, citing *Rohm & Haas Co. v. Crystal Chemical Co.*, 736 F.2d 688, 691 (1984) and *Yamanouchi Pharmaceutical Co., Ltd. v. Danbury Pharmacal*, 231 F.3d 1339, 1347 (2000) ("In assessing whether a case qualifies as exceptional, the district court must look at the totality of the circumstances").
9. *Brooks Furniture Mfg. v. Dutailier Int'l*, 393 F.3d 1378 (Fed. Cir. 2005).
10. *iLOR v. Google*, 631 F.3d 1372, 1377-78 (Fed. Cir. 2011).
11. *Kilopass Technology, Inc. v. Sidense Corp.*, 738 F.3d 1302, 1310 (Fed. Cir. 2013).