

KEY IDEAS:

"Exceptional Case" Rules1

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TAKING EXCEPTION TO "EXCEPTIONAL CASE"? SUPREME COURT SCRUTINIZES RULES

Tough "exceptionality" standards embedded in "exceptional cases" rules will be under the U.S. Supreme Court's microscope. If the Court eases these standards, it could severely alter patent litigation.

On October 1, the Court granted certiorari in two cases concerning the 35 U.S.C. § 285 "exceptional case." In *Icon*,¹ the Federal Circuit succinctly affirmed a district court's refusal to grant "exceptional case" status over arguments that the standard is too strict, while in *Highmark*,² a deeply divided Federal Circuit concluded that "exceptional case" findings are reviewed *de novo* and accorded no deference on appeal.

Given the Court's propensity for revising Federal Circuit standards it finds too rigid, as well as a growing sense that patent litigation abuses must be curtailed, the dual grants of certiorari could portend a sea change in § 285 law. To understand what might be in store, we briefly review current "exceptional case" standards as well as the two pending Supreme Court cases which could fundamentally change that law.

"Exceptional Case" Rules

By statute, "The court in exceptional circumstances may award reasonable attorney fees to the prevailing party."³ In a 2003 case, the Federal Circuit recognized § 285 as an "exception" to the long-standing American Rule that each party bears its own litigation costs.⁴ In the same case, the Federal Circuit observed, the legislative history "states that, 'it is not contemplated that the recovery of attorney's fees will become an ordinary thing in patent suits.'"⁵ Of course, that was 10 years before today's media-inflamed concerns about patent litigation abuses.

Application of § 285 is intended to be a rigorous two-step process. First, a court must determine whether evidence that the case is exceptional is *clear and convincing*. Second, if the case is considered "exceptional," the court must assess whether, in its discretion, an award of fees to the prevailing party is justified.⁶ The amount of fees awarded depends on the extent to which the court decides that the case is "exceptional."⁷

- **Determining Whether a Case Is "Exceptional"** – Unless misconduct occurs during litigation or in securing the patent, sanctions may be imposed against the patentee "only if both (1) the litigation is brought in subjective bad faith, and (2) the litigation is objectively baseless."⁸ In 2011, the Federal Circuit observed, "Under this exacting standard, the plaintiff's case must

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1 *Icon Health & Fitness, Inc. v. Octane Fitness, LLC*, 496 F. App'x 57 (Fed. Cir. 2012).
 2 *Highmark, Inc. v. Allcare Health Mgmt. Sys., Inc.*, 687 F.3d 1300 (Fed. Cir. 2012).
 3 35 U.S.C. § 285 (emphasis added).
 4 *Forest Labs., Inc. v. Abbott Labs.*, 339 F.3d 1324, 1329 (Fed. Cir. 2003).
 5 *Id.* (quoting S. Rep. No. 79-1503 (1946)) (emphasis added).
 6 *Highmark*, 687 F.3d at 1308; *Digeo, Inc. v. Audible, Inc.*, 505 F.3d 1362, 1366-67 (Fed. Cir. 2007); *Forest Labs., Inc.*, 339 F.3d at 1327-28.
 7 *Highmark*, 687 F.3d at 1308 (citing *Special Devices, Inc. v. OEA, Inc.*, 269 F.3d 1340, 1344 (Fed. Cir. 2001)).
 8 *Brooks Furniture Mfg., Inc. v. Dutailier Int'l, Inc.*, 393 F.3d 1378, 1381 (Fed. Cir. 2005) (citing *Prof'l Real Estate Investors v. Columbia Pictures Indus.*, 508 U.S. 49, 60-61 (1993)) (emphasis added).

“To be objectively baseless, the infringement allegations must be such that no reasonable litigant could reasonably expect success on the merits ... a litigation loss, even on summary judgment, does not warrant an automatic finding”

“... improper conduct and characterization of the case as exceptional must be supported by clear and convincing evidence”

have no objective foundation, and the plaintiff must actually know this.”⁹ The objective/subjective standard applies to patentees asserting infringement as well as accused infringers defending infringement claims.¹⁰

- **“Objectively Baseless”** – “To be objectively baseless, the infringement allegations must be such that no reasonable litigant could reasonably expect success on the merits.”¹¹ In “sham” litigation, the Supreme Court cautioned courts to resist the temptation to engage in *post hoc* reasoning by naturally concluding that an ultimately unsuccessful action must have been unfounded.¹² Thus, a litigation loss, even on summary judgment, does not warrant an automatic finding that the suit was objectively baseless.¹³

Determining whether a case is objectively baseless does not depend on the party’s state of mind when the case was filed.¹⁴ The existence of objective baselessness must be determined based on the record in the infringement proceedings.¹⁵

- **Subjective Bad Faith** – If the case is determined to be objectively baseless, the “subjective” prong of the inquiry requires the prevailing party to prove that the lack of an objective foundation for the claim was “either known or so obvious that it should have been known” by the party asserting the claim.¹⁶
- **Clear and Convincing** – Both the objective (objectively baseless) and subjective (bad faith) prongs of the exceptional case standard must be established by *clear and convincing evidence*.¹⁷ Given the presumption that a claim of infringement of a duly granted patent is made in good faith, improper conduct and characterization of the case as exceptional must be supported by clear and convincing evidence.¹⁸

Icon Health & Fitness, Inc. v. Octane Fitness, LLC.

District Court Proceedings – Icon sued Octane alleging patent infringement.¹⁹ After the district court construed the relevant patent claims, Octane sought and won summary judgment of non-infringement.²⁰

As the prevailing party, Octane sought attorney’s fees under § 285.²¹ In support of its motion, Octane argued that Icon’s infringement arguments were “unreasonable and unsupportable” and that the court’s ruling of non-infringement should have been a foregone conclusion to anyone inspecting the accused machines.²²

The court characterized Icon’s losing summary judgment argument as “confused and repetitive,” but still concluded that it was not objectively baseless.²³ The district court also

⁹ *iLOR, LLC v. Google, Inc.*, 631 F.3d 1372, 1377 (Fed. Cir. 2011) (emphasis added).

¹⁰ *Highmark*, 687 F.3d at 1309 (citing *iLOR, LLC v. Google, Inc.*, 631 F.3d 1372, 1377 (Fed. Cir. 2011)).

¹¹ *Id.* (citing *Dominant Semiconductors Sdn. Bhd. v. OSRAM GmbH*, 524 F.3d 1254, 1260 (Fed. Cir. 2008)) (internal quotation marks omitted); *Prof’l Real Estate Investors v. Columbia Pictures Indus.*, 508 U.S. 49, 62 (1993).

¹² *Prof’l Real Estate Investors*, 508 U.S. at 61 n.5.

¹³ *Aspex Eyewear v. Clariti Eyewear*, 605 F.3d 1305, 1315 (Fed. Cir. 2010).

¹⁴ *Highmark*, 687 F.3d at 1308-09 (citing *Brooks Furniture Mfg., Inc. v. Dutailier Int’l, Inc.*, 393 F.3d 1378, 1381 (Fed. Cir. 2005)).

¹⁵ *iLOR, LLC v. Google, Inc.*, 631 F.3d 1372, 1377-78 (Fed. Cir. 2011).

¹⁶ *Highmark*, 687 F.3d at 1309 (citing *In re Seagate Tech., LLC*, 497 F.3d 1360, 1371 (Fed. Cir. 2007)); see also *iLor, LLC*, 631 F.3d at 1377.

¹⁷ *iLOR, LLC*, 631 F.3d at 1377.

¹⁸ *Brooks Furniture Mfg., Inc.*, 393 F.3d at 1382.

¹⁹ *Icon Health & Fitness, Inc. v. Octane Fitness, LLC*, No. 09-319 ADM/SER, 2011 WL 2457914 (D. Minn. June 17, 2011).

²⁰ *Id.* at *1.

²¹ *Icon Health & Fitness, Inc. v. Octane Fitness, LLC*, No. 09-319 ADM/SER, 2011 WL 3900975, at *1 (D. Minn. Sept. 16, 2011).

²² *Id.* at *2.

²³ *Id.* at *3.

“The Brooks standard is ‘near-impossible’ to meet and encourages litigation abuse by overly aggressive and unscrupulous patent owners who assert weak claims. Moreover, after the court devotes extensive time to resolving claims construction and understanding complex technical issues, it will rarely decide that the case was baseless from the outset.”

considered evidence suggesting that Icon, the larger of the two parties, never commercialized its patent and undertook the litigation as a matter of commercial strategy. The court determined, however, that this argument was not proof that Icon brought suit in bad faith.²⁴

Federal Court Opinion – On appeal, the Federal Circuit affirmed the lower court.²⁵ Ruling on the § 285 issue, the Federal Circuit briefly acknowledged Octane’s argument that the existing standard was overly strict and should be eased to “objectively unreasonable,” but found no error in the lower court’s decision.²⁶

Petition for a Writ of Certiorari – Octane sought Supreme Court review of the “rigid” two-part test for finding a case exceptional under § 285.²⁷ In its petition for writ of certiorari, Octane argued:

- Before *Brooks*, the exceptional case standard looked to the “totality of the circumstances” for “gross injustice.” *Brooks* adopted the strict two-prong standard from the Supreme Court’s decision in *Professional Real Estate Investors*, a “sham” litigation case, without analysis.²⁸
- The *Brooks* standard is “near-impossible” to meet and encourages litigation abuse by overly aggressive and unscrupulous patent owners who assert weak claims. Moreover, after the court devotes extensive time to resolving claims construction and understanding complex technical issues, it will rarely decide that the case was baseless from the outset.²⁹
- The standard actually sets the bar higher for proving that the case was exceptional for prevailing accused infringers than for prevailing patent owners.³⁰
- District courts should be given discretion to award fees where the patent owner unreasonably pursues a case having an objectively low likelihood of success even in the absence of bad faith.³¹

The Supreme Court granted Octane’s petition for a writ of certiorari on October 1.³²

Highmark, Inc. v. Allcare Health Management Systems, Inc.

District Court Proceedings – Highmark, the accused infringer, sued Allcare seeking a declaratory judgment of invalidity, non-infringement and unenforceability of Allcare’s patent. Allcare filed a counterclaim of infringement.³³ When the district court entered summary judgment of non-infringement in Highmark’s favor, the original plaintiff sought attorney’s fees under § 285.³⁴ The district court found the case exceptional under § 285 and sanctioned Allcare’s attorneys under Rule 11, Fed. R. Civ. P.³⁵ The district court subsequently vacated its findings on Rule 11 sanctions,³⁶ but awarded Highmark nearly \$4.7 million in attorney’s fees under § 285.³⁷

24 *Id.* at *4.

25 *Icon Health & Fitness, Inc. v. Octane Fitness, LLC*, 496 F. App’x 57, 58 (Fed. Cir. 2012).

26 *Id.* at 65.

27 Petition for Writ of Certiorari, *Icon*, (No. 12-1184), 2013 WL 130908.

28 *Id.* at *22.

29 *Id.* at *23-25.

30 *Id.* at *26.

31 *Id.* at *33-36.

32 *Octane Fitness, LLC v. Icon Health & Fitness, Inc.*, No. 12-1184, 2013 WL 1283843 (U.S. Oct. 1, 2013).

33 *Highmark, Inc. v. Allcare Health Mgmt. Sys., Inc.*, 706 F. Supp. 2d 713, 717 (N.D. Tex. 2010).

34 *Id.*

35 *Id.* at 716.

36 *Highmark, Inc. v. Allcare Health Mgmt. Sys., Inc.*, 732 F. Supp. 2d 653, 676 (N.D. Tex. 2010).

37 *Highmark, Inc. v. Allcare Health Mgmt. Sys., Inc.*, No. 4:03-CV-1384-Y, 2010 WL 6432945, at *7 (N.D. Tex. Nov. 5, 2010).



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Federal Court Opinion – A divided Federal Circuit panel affirmed in part, reversed in part and remanded the case to the district court.³⁸ Applying a standard of review “clarified” in *Bard Peripheral*, the Federal Circuit reviewed the objective prong of the § 285 test *de novo* and without deference,³⁹ and the subjective prong for clear error.⁴⁰

In a vigorous dissent, Judge Haldane Robert Mayer argued that the court erred in giving no deference to the district court’s finding that the claims asserted by Allcare were objectively unreasonable.⁴¹ He argued that *Bard* was wrongly decided and contrary to Federal Circuit precedent.⁴²

When the Federal Circuit declined petitions for panel rehearing and rehearing *en banc*, five judges filed or joined in dissenting, while two judges wrote to respond to the dissents.⁴³ All of the opinions focused on whether the determination of objective baselessness by a district court should be entitled to no deference and be reviewed *de novo*.

Petition for a Writ of Certiorari – Highmark sought Supreme Court review on the issue of whether a district court’s exceptional case finding under § 285 that a suit is objectively baseless is entitled to deference on appellate review.⁴⁴ The Supreme Court granted certiorari on October 1.⁴⁵

Conclusions

While awaiting the Court’s decision, consider:

- The current two-pronged standard is essentially unattainable except in extreme cases. Historic reasons for this likely include adherence to the “American Rule” and the potentially devastating impact of a § 285 finding on both the litigant and its counsel.
- The Supreme Court could discard what it may view as a “rigid” test of exceptionality in favor of a more holistic approach, as it has in recent cases.⁴⁶
- If the Supreme Court rejects a formulaic approach, look for a less rigid test based on the totality of the circumstances.
- Some level of deference to the findings of the district court that lived with a case seems logical and necessary to avoid injustice.
- Finally, if the Supreme Court lowers the bar for finding a case “exceptional,” the effect on litigation may be pronounced. If losers are more likely to be assessed attorney’s fees, litigants will be required to cross many more “t’s” and dot more “i’s” before they initiate suit or mount defenses. Litigation costs may rise even as the number of lawsuits falls.

³⁸ *Highmark, Inc. v. Allcare Health Mgmt. Sys., Inc.*, No. 2011-1219, 687 F.3d 1300, 1319 (Fed. Cir. 2012).

³⁹ *Id.* at 1309 (citing *Bard Peripheral Vascular, Inc. v. W.L. Gore & Assocs., Inc.*, 682 F.3d 1003, 1004-06 (Fed. Cir. 2012)).

⁴⁰ *Id.* at 1310.

⁴¹ *Id.* at 1319 (Mayer, J., dissenting).

⁴² *Id.* at 1320 *et seq.*

⁴³ *Highmark, Inc. v. Allcare Health Mgmt. Sys., Inc.*, 701 F.3d 1351, 1352 (Fed. Cir. 2012).

⁴⁴ Petition for a Writ of Certiorari, *Highmark*, (No. 12-1163), 2013 WL 1217353.

⁴⁵ *Highmark, Inc. v. Allcare Health Mgmt. Sys., Inc.*, No. 12-1163, 2013 WL 1217353 (U.S. Oct. 1, 2013).

⁴⁶ See, e.g., *KSR Int’l Co. v. Teleflex, Inc.*, 550 U.S. 398 (2007); *eBay Inc. v. MercExchange, L.L.C.*, 547 U.S. 388 (2006).