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KEY IDEAS:

EASING "EXCEPTIONAL CASE" SUPREME COURT AGAIN RELAXES FEDERAL CIRCUIT RULES

Once again easing a "rigid" Federal Circuit standard,[1] the U.S. Supreme Court has relaxed "exceptional case" standards in the district court and on appeal. Does this foreshadow abandonment of the "American Rule" for fee–shifting, or will it stem the growing flood of patent litigation?

In reversing Federal Circuit precedent in *ICON,* the Court said that "an 'exceptional' case is simply *one that stands out from others* with respect to the substantive strength of a party's litigating position . . . or the unreasonable manner in which the case was litigated."[2] Following *ICON,* in *Highmark* the Court decided that a district court's exceptional case determination can be reviewed on appeal for abuse of discretion.[3] Both decisions signal a potential shift in how courts will look at post-award litigation aimed at recovering significant legal fees from "offending" exceptional case losers.

"Exceptional Case" Rules

Under 35 U.S.C. § 285, "The court in *exceptional circumstances* may award reasonable attorneys fees to the prevailing party."[4] For more than five decades, courts applied § 285 and its predecessors in a discretionary manner.[5]

In *Brooks Furniture* and subsequent cases, Federal Circuit application of the statute became a rigorous process. Unless misconduct occurred during litigation or in securing the patent, an award of fees could be imposed against the patentee *only if both* (1) the litigation was brought in subjective bad faith, and (2) the litigation was objectively baseless.[6]

As the Federal Circuit observed, "Under this exacting standard, the plaintiff's case must have *no objective foundation, and the plaintiff must actually know this.*"[7] The exceptional case standard also required *clear and convincing evidence,*[8] and it applied to patentees asserting infringement as well as to accused infringers.[9]

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1 *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).
2 *Octane Fitness, LLC v. ICON Health & Fitness, Inc.,* No. 12-1184, 2014 WL 1672251, at *5 (U.S. Apr. 29, 2014) (emphasis added).
3 *Highmark Inc. v. Allcare Health Mgmt. Sys., Inc.,* No. 12-1163, 2014 WL 1672043, at *3 (U.S. Apr. 29, 2014).
4 (emphasis added).
5 *Octane Fitness, LLC,* No. 12-1184, 2014 WL 1672251, at *3 (U.S. Apr. 29, 2014).
6 *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).
7 *Id.* (emphasis added).
8 *iLOR, LLC . v. Google, Inc.,* 631 F.3d 1372, 1377 (Fed. Cir. 2011).
9 *Highmark,* 687 F.3d at 1309 (citing *iLOR, LLC,* 631 F.3d at 1377).

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

District Court Proceedings – ICON sued Octane alleging patent infringement.[10] When it won summary judgment of non-infringement, Octane sought attorney's fees under **§** 285.[11] The district court denied the motion, concluding that ICON's case was not objectively baseless[12] and was not brought in bad faith.[13]

Federal Court Opinion – The Federal Circuit affirmed the lower court.[14] While the Federal Circuit acknowledged Octane's argument that the existing standard was overly strict, it found no error in the lower court's decision.[15]

Octane asked the Supreme Court to review the "rigid" two-part test for finding a case exceptional under § 285.[16] The Court granted certiorari.[17]

Supreme Court Opinion[18] – The Court examined whether the *Brooks Furniture* framework was consistent with the text of § 285.[19] The Court succinctly held, "[I]t is not."[20] After reviewing the history of statutory fee-shifting provisions from the 1946 Patent Act amendments through *Brooks Furniture*, the Court reversed and remanded the Federal Circuit decision.[21]

… [T]he Court held that an exceptional case is merely one that stands out from others with respect to the substantive strength of the party's litigation position or the unreasonable manner in which the case was conducted.

The Court's analysis began and ended with the statutory language. Because the text of § 285 is "patently clear," the Court construed "exceptional" in accordance with its ordinary meaning.[22] When Congress used the word in § 285, it meant "uncommon, rare, or not ordinary."[23] In light of that meaning, the Court held that an exceptional case is merely one that stands out from others with respect to the substantive strength of the party's litigation position or the unreasonable manner in which the case was conducted.[24]

District courts may now determine whether a case is exceptional using their own discretion.[25] While no precise rule or formula exists for making such a determination,[26] the Court did note a non-exclusive list of factors. Those factors include frivolousness, motivation, objective unreasonableness (both factually and legally), and the potential need to advance considerations of compensation and deterrence.[27]

10 *Octane Fitness, LLC v. ICON Health & Fitness, Inc.*, No. 12-1184, 2014 WL 1672251, at *4 (U.S. Apr. 29, 2014); *ICON Health & Fitness, Inc. v. Octane Fitness, LLC*, No. 09-319 ADM/SER, 2011 WL 2457914 (D. Minn. June 17, 2011).

11 *Octane Fitness, LLC*, 2014 WL 1672251, at *4 (U.S. Apr. 29, 2014); *ICON Health & Fitness, Inc. v. Octane Fitness, LLC*, No. 09-319 ADM/SER, 2011 WL 3900975, at *1 (D. Minn. Sept. 16, 2011).

12 *Octane Fitness, LLC*, 2014 WL 1672251, at *4 (U.S. Apr. 29, 2014); *ICON Health & Fitness, Inc.*, 2011 WL 3900975, at *3 (D. Minn. Sept. 16, 2011).

13 *Octane Fitness, LLC*, 2014 WL 1672251, at *4 (U.S. Apr. 29, 2014); *ICON Health & Fitness, Inc.*, 2011 WL 3900975, at *4 (D. Minn. Sept. 16, 2011).

14 *ICON Health & Fitness, Inc. v. Octane Fitness, LLC*, 496 F. App'x 57, 58 (Fed. Cir. 2012).

15 *Id.* at 65.

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

17 *Octane Fitness, LLC v. ICON Health & Fitness, Inc.*, No. 12-1184, 2013 WL 1283843 (S. Ct. Oct. 1, 2013).

18 *Octane Fitness, LLC v. ICON Health & Fitness, Inc.*, No. 12-1184, 2014 WL 1672251, at *5 (U.S. Apr. 29, 2014).

19 *Id.* at *2.

20 *Id.*

21 *Id.* at *8.

22 *Id.* at *5.

23 *Id.* (internal quotations and citations omitted).

24 *Id.*

25 *Id.*

26 *Id.*

27 *Id.* at *5 n.6 (citing, *Fogerty v. Fantasy, Inc.* 510 U.S. 517, 534 n.19 (1994) (a Copyright Act case)).

The Court's four additional reasons for rejecting the *Brooks Furniture* standard:

- **"Overly Rigid"** – The standard is "overly rigid" and "inflexible."[28] *Brooks Furniture* allowed fees for independently sanctionable conduct, but sanctionable conduct is not the appropriate benchmark. District courts "may award fees in the *rare* case in which a party's unreasonable conduct – while not necessarily independently sanctionable – is nonetheless so 'exceptional' as to justify an award of fees."[29] In addition, while *Brooks Furniture* required both objective *and* subjective bad faith, now *either* might warrant fees.[30]
- **Did not follow from *Professional Real Estate Investors*** – The Court refused to link the § 285 inquiry to the "sham" litigation exception in *Professional Real Estate Investors, Inc.*[31]
- **Rendered § 285 "Superfluous" –** The *Brooks Furniture* standard would render the statute "largely superfluous" even though recognized exceptions exist to the "American Rule" against fee shifting.[32]
- **Rejected "Clear and Convincing" Standard** – Finally, in light of the discretion afforded to the district court under the statute, the Court rejected the Federal Circuit's requirement that the right to fees under § 285 had to be established by "clear and convincing evidence."[33]

> … [I]n light of the discretion afforded to the district court under the statute, the Court rejected the Federal Circuit's requirement that the right to fees under § 285 had to be established by "clear and convincing evidence."

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

District Court Proceedings – Highmark sued Allcare seeking a declaratory judgment of non-infringement, then Allcare filed a counterclaim of infringement.[34] When the district court entered summary judgment of non-infringement in favor of Highmark, Highmark sought attorney's fees under § 285.[35] The district court found the case exceptional under § 285[36] and awarded Highmark nearly $4.7 million in attorney's fees.[37]

Federal Court Opinion –Applying a standard of review "clarified" in *Bard Peripheral,* the Federal Circuit reviewed the objective prong of the § 285 test *de novo,* without deference, and reversed one part of the district court's exceptional case finding.[38]

In a vigorous dissent, Judge Haldane Robert Mayer argued that the court erred in affording no deference to the district court's finding that the claims asserted by Allcare were objectively unreasonable.[39] 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.[40] All of the opinions focused on whether the determination of objective baselessness by a district court should be entitled to no deference and reviewed *de novo.*

Highmark sought Supreme Court review to determine whether a district court's finding under § 285 that a suit is "objectively baseless" is entitled to deference on appellate review.[41] The Supreme Court granted certiorari.[42]

28 *Id.* at *6.
29 *Id.* (emphasis added).
30 *Id.*
31 *Prof'l Real Estate Investors, Inc. v. Columbia Pictures Indus., Inc.,* 508 U.S. 49 (1993) (sham litigation exception to *Noerr-Pennington* doctrine of antitrust immunity).
32 *Octane Fitness, LLC,* 2014 WL 1672251, at *7 (U.S. Apr. 29, 2014).
33 *Id.*
34 *Highmark, Inc. v. Allcare Health Mgmt. Sys., Inc.,* 706 F. Supp. 2d 713, 717 (N.D. Tex. 2010).
35 *Id.*
36 *Id.* at 716.
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).
38 *Highmark, Inc. v. Allcare Health Mgmt. Sys., Inc.,* 687 F.3d 1300, 1309 (Fed. Cir. 2012) (citing *Bard Peripheral Vascular, Inc. v. W.L. Gore & Assocs., Inc.,* 682 F.3d 1003, 1004-06 (Fed. Cir. 2012)).
39 *Id.* at 1319.
40 *Highmark, Inc. v. Allcare Health Mgmt. Sys., Inc.,* 701 F.3d 1351, 1352 (Fed. Cir. 2012).
41 Petition for a Writ of Certiorari, *Highmark,* (No. 12-1163), 2013 WL 1217353.
42 *Highmark, Inc. v. Allcare Health Mgmt. Sys., Inc.,* No. 12-1163, 2013 WL 1217353 (S. Ct. Oct. 1, 2013).

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Supreme Court Opinion[43] – Relying heavily on its *ICON* decision, the Court held "that an appellate court should apply an abuse-of-discretion standard in reviewing all aspects of a district court's § 285 determination."[44] The Court noted that a district court is better positioned to decide whether a case is exceptional.[45]

Conclusions

- Importantly, the Court did call the "exceptional" case "rare."[46] This will remain true as long as district courts implicitly adhere to the "American Rule" given the potentially devastating impact of a § 285 finding on both the non-winning litigant and its counsel. The effect on curbing frivolous patent litigation could be a long time coming.
- For the short term at least, expect § 285 motions to be filed by prevailing parties in virtually every case. Just because the rule applies only in "rare" cases doesn't mean that every case isn't going to be characterized as "rare."
- 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. In light of this and a bevy of § 285 motions, all-in litigation costs may rise substantially even if the number of lawsuits falls.
- Be wary of "bright line" tests in patent cases. For at least the third time, the Supreme Court has relaxed a "rigid" Federal Circuit test (this time of "exceptionality") in favor of a more holistic approach.[47]
- Don't hold your breath on the continued vitality of *de novo* review of claims construction now that the Court has the issue on certiorari.

43 *Highmark Inc. v. Allcare Health Mgmt. Sys., Inc.*, No. 12-1163, 2014 WL 1672043 (U.S. Apr. 29, 2014).
44 *Id.* at *4.
45 *Id.*
46 *Octane Fitness, LLC*, 2014 WL 1672251, at *6 (U.S. Apr. 29, 2014).
47 *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).