A Trend Towards Abuse of Discretion Review

I. Introduction

In a series of three decisions, the Supreme Court effectively dialed back the Federal Circuit's plenary review of district court determinations that turn on questions of fact. In *Teva Pharmaceuticals USA, Inc. v. Sandoz, Inc.*, 135 S. Ct. 831 (2015), the Supreme Court held that subsidiary questions of fact arising in claim construction are reviewed for clear error, cabining the Federal Circuit's usual *de novo* review of all claim constructions issues. In *Octane Fitness, LLC v. ICON Health & Fitness, Inc*., 134 S. Ct. 1749 (2014), and *Halo Electronics, Inc. v. Pulse Electronics, Inc*., 136 S. Ct. 1923 (2016), the Supreme Court underscored the district courts' analytical freedom in deciding whether to grant attorney's fees and enhanced damages under 35 U.S.C. § 285 and 35 U.S.C. § 284 respectively, further cloaking such decisions in an abuse of discretion standard of review.

These three decisions seem to recognize that by hearing first-hand the evidence and arguments through the life of the case, the district courts are well positioned to weight the evidence and make credibility determinations. But what are the practical results of *Teva*, *Octane Fitness*, and *Halo* in granting district courts more power? Do the issues addressed by these cases benefit from having plenary review by the Federal Circuit given the technical nature of patent cases? How might the increased role and deference to the district courts drive litigants' decision-making in whether to file and how to litigate? What does this trend towards greater deference suggest for district courts in the future? This paper considers these three cases and their possible implications for district court litigation.

II. *Teva* and Claim Construction

The Supreme Court's *Teva* decision continued its recent trend against more rigid frameworks in favor of a broader, more flexible, case-by-case analyses. In particular, *Teva* considered the level of deference to be applied on appeal to factual findings that underpin patent claim construction.

1. Background

In *Teva*, the Supreme Court changed the standard under which claim construction rulings will be reviewed on appeal. Prior to *Teva*, the Federal Circuit reviewed *de novo* all aspects of a district court's claim construction, even subsidiary facts. *Teva* determined that factual findings made during claim construction must be reviewed for clear error. The Supreme Court reasoned that Federal Rule 52(a)(6) states that a court's findings of facts must be accepted unless they are "clearly erroneous," and, as a practical matter, "[a] district court judge who has presided over, and listened to, the entirety of a proceeding has a comparatively greater opportunity to gain that familiarity than an appeals court judge who must read a written transcript or perhaps just those portions to which the parties have referred." 135 S. Ct. at 838. *Teva* explains that claim construction based on the intrinsic evidence is subject to *de novo* review, but factual findings regarding the extrinsic evidence—such as the meaning of a term to a person of ordinary skill in the art—must be reviewed for clear error. *Id.* at 840-841.

Thus, in application, where a district court's claim construction is based on the intrinsic record only, the Federal Circuit will apply *de novo* review. *See, e.g.*, *Cadence Pharm. Inc. v. Exela PharmSci Inc.*, 780 F.3d 1364, 1368 (Fed. Cir. 2015); *TomTom, Inc. v. Adolph*, 790 F.3d 1315, 1326 (Fed. Cir. 2015). Similarly, where a district court construes patent claims without making any underlying factual findings, such constructions will also be reviewed under a *de novo* standard. *See, e.g.*, *CardSoft, LLC v. VeriFone, Inc*., 807 F.3d 1346, 1348 (Fed. Cir. 2015). Indeed, even when the district court holds an evidentiary hearing, but makes no factual findings underlying its claim construction, the Federal Circuit will apply a *de novo* review. *See, e.g.*, *Shire Dev., LLC v. Watson Pharm., Inc.*, 787 F.3d 1359, 1368 (Fed. Cir. 2015).

Where the parties rely on extrinsic evidence, however, *Teva* requires that factual findings are reviewed for clear error, which may raise more questions than answers. As *Teva* recognized, the extent of any factual findings and their impact will depend on the dispute at hand: "[i]n some instances, a factual finding will play only a small role in a judge's ultimate legal conclusion about the meaning of the patent term. But in some instances, a factual finding may be close to dispositive of the ultimate legal question of the proper meaning of the term in the context of the patent." *Teva*, 135 S. Ct. at 841-842. Needless to say, this mixed standard of review may leave the parties with a lack of clarity. Until the district court actually construes the claims, the parties may not know whether claim construction will turn on extrinsic evidence. Further, even if a district court makes factual findings, the Federal Circuit may decide that such findings do not outweigh its interpretation of the intrinsic evidence. As a result, it remains to be seen how much practical impact *Teva* will have on ultimate case outcomes.

2. Strategic Effect of Increased Deference for Claim Construction Factual Underpinnings

What *Teva* does do, however, is alter the strategy considerations for parties. This higher standard of review for factual issues on claim construction elevates the importance of the district court record and procedure. For example, if a district court makes factual determinations, those determinations may provide the winning party an advantage in settlement negotiations given the clear error standard of review the Federal Circuit will apply to them. Alternatively, litigants may see this higher standard of review as an opportunity to present extrinsic evidence in an attempt to immunize the resulting claim construction from a plenary review.

Teva may also cause patent litigants to more carefully consider the identity of the fact finder for highly technical or outcome-determinative claim construction questions. To the extent litigants foresee the likelihood of extrinsic evidence in claim construction, they may perceive some venues as being more experienced in patent claim construction issues than others, and thus less likely to require expert evidence about claim meaning. Some district courts may be seen as more permissive in allowing extrinsic evidence in claim construction. Conversely, some litigants may seek venues with less patent claim construction experience in order to advance claim construction positions that might be considered weaker or less favored in more patent-experienced venues. Further, *Teva* may affect parties' calculus in seeking AIA post grant proceedings given that *Teva* applies equally in that forum. *See In re Cuozzo Speed Techs., LLC*, 793 F.3d 1268, 1279-1280 (Fed. Cir. 2015), *aff'd*, 136 S. Ct. 2131 (2016) ("We review the Board's claim construction according to the Supreme Court's decision in *Teva*").

Finally, regardless of the venue, *Teva* may result in more careful arguments by litigants and decision-making by the district courts. Arguments by litigants may become more crisp to ensure that the district court understands the consequence of adopting certain constructions and making certain factual findings. District courts, aware that their findings of fact can have significant case impact and will be reviewed for clear error, hopefully will take care to provide clear reasoning for when and why extrinsic evidence is necessary.

III. *Octane Fitness* and *Halo*

Similar to how *Teva* increased the level of deference given to factual findings in patent claim constructions, *Octane Fitness* and *Halo* increased the level of discretion and expanded the analytical frameworks according to which district courts grant attorney's fees for "exceptional" cases under 35 U.S.C. § 285, or awarding enhanced damages for "egregious" cases under 35 U.S.C. § 284.

1. Background

(a) *Octane Fitness*

Before *Octane Fitness*, the Federal Circuit applied a two-part test for determining when a case qualifies as "exceptional" to support an award of reasonable attorney's fees under § 285. Specifically, in *Brooks Furniture Manufacturing, Inc. v. Dutailier International, Inc*., 393 F.3d 1378 (2005), the Federal Circuit held that an award of fees under § 285 is proper in only two circumstances: (1) "when there has been some material inappropriate conduct related to the matter in litigation, such as willful infringement, fraud or inequitable conduct in procuring the patent, misconduct during litigation, vexatious or unjustified litigation, conduct that violates Fed. R. Civ. P. 11, or like infractions," or (2) when the litigation is both "brought in subjective bad faith" and "objectively baseless." *Id*. at 1381. The Federal Circuit required such showing by clear and convincing evidence. *Id.* at 1382.

Octane Fitness rejected the *Brooks* framework, explaining that it is "unduly rigid, and it impermissibly encumbers the statutory grant of discretion to district courts." 134 S. Ct. at 1755. Rather, a case presenting "subjective bad faith" alone could "sufficiently set itself apart from mine-run cases to warrant a fee award." *Id.* at 1757. *Octane Fitness* therefore recognized that an award of attorney's fees is ultimately within the district court's discretion, based on the totality of the circumstances presented:

> [A]n "exceptional" case is simply one that stands out from others with respect to the substantive strength of a party's litigating position (considering both the governing law and the facts of the case) or the unreasonable manner in which the case was litigated. District courts may determine whether a case is "exceptional" in the case-by-case exercise of their discretion, considering the totality of the circumstances.

Id. at 1756. *Octane Fitness* further rejected a clear and convincing evidence standard for such a showing; instead, the preponderance of the evidence standard applies.

(b) *Halo*

Before *Halo*, the Federal Circuit required a showing of both objective and subjective unreasonableness for enhanced damages for willful infringement under 35 U.S.C. § 284. As articulated in *In re Seagate Technology LLC*, 497 F.3d 1360 (Fed. Cir. 2007), a patentee was required to establish willfulness by showing "that the infringer acted despite an objectively high likelihood that its actions constituted infringement of a valid patent" and that "this objectively-defined risk . . . was either known or so obvious that it should have been known." *Id.* at 1371. If the patentee established these two prongs by clear and convincing evidence, the district court *could* exercise its discretion and award enhanced damages. *Id.*

Halo rejected the *Seagate* framework for the same reasons it rejected the Federal Circuit's prior § 284 framework—saying it is "unduly rigid, and it impermissibly encumbers the statutory grant of discretion to the district courts." 136 S. Ct. at 1932 (quoting *Octane Fitness*, 134 S. Ct. at 1755). As *Halo* explained, "[t]he principal problem with *Seagate's* two-part test is that it requires a finding of objective recklessness in every case before district courts may award enhanced damages." *Id*. Rather, "[t]he subjective willfulness of a patent infringer, intentional or knowing, may warrant enhanced damages, without regard to whether his infringement was objectively reckless." *Id*. at 1933. Thus, although *Halo* acknowledged that the *Seagate* framework "reflects, in many respects, a sound recognition that enhanced damages are generally appropriate under § 284 only in egregious cases," it is not the only basis for enhancing patent damages because requiring a finding of objective recklessness could "exclude[ ] from discretionary punishment many of the most culpable offenders." *Id.* at 1983. Rather, a district court must simply consider whether the defendant's infringement constitutes an "egregious case[] of misconduct beyond typical infringement" and, if so, the appropriate extent of enhanced damages under § 284. *Id*. at 1935. Like *Octane Fitness*, *Halo* rejected a heightened evidentiary burden, imposing only a preponderance of the evidence standard. *Id.* at 1934.

2. Practical Effect of More Discretion For Attorney's Fees and Enhanced Damages Awards

The take-away lesson of *Halo* and *Octane Fitness* seems simple enough—district courts now have more discretion to consider the specific facts of the cases to determine whether enhanced damages or attorney's fees are appropriate. These determinations are reviewed for abuse of discretion and apply the basic preponderance of the evidence standard of proof. *See Halo*, 136 S. Ct. at 1934. More than *Teva*, where the ultimate issue of claim construction remains an issue of law, these rulings are likely to have a practical impact on litigants given that they affect the scope of review of damages and attorney fee awards.

In the two plus years since *Octane Fitness*, for example, the landscape of fee awards has shifted dramatically. One article published on April 26, 2016, the two-year anniversary of *Octane Fitness*, noted that compared to the years preceding the *Octane Fitness* opinion, the number of attorney's fees requests increased by over 50% and the number of attorney's fees awards increased by over 100%. *See* Nirav Desai and Lauren Johnson, *Octane Fitness, Two Years On: How It Has Impacted District Courts' Award of Attorneys' Fees in Patent Cases*, 31 Legal Backgrounder, no. 12 (Apr. 29, 2016). While not as dramatic as the surge in the *number* of motions filed and granted, the *percentage* of § 285 motions granted in full also rose by over

9% from the year prior to *Octane Fitness*. *Id*. Although it is too early to tell if there will be a similar trend for enhanced damages awards after *Halo*, the possibility offers an incentive for parties to seek them. *Halo* will, however, likely have other practical effects on litigants even before suit is filed.

(a) Effects on Litigation

Halo may affect all stages of litigation including pleading, summary judgment, trial, and even appeal. Thus, a short perusal of potential effects at all of these stages is merited.

Motions on the Pleadings: At the pleadings stage, while courts agree that a plaintiff must allege knowledge of the asserted patent, they have taken different approaches as to whether a plaintiff must allege additional facts to establish egregiousness. One approach sets a relatively low bar, requiring only that a patentee plead that the accused infringer had knowledge of the asserted patents that could potentially support a finding of egregiousness. *See, e.g.*, *Blitzsafe Texas LLC v. Volkswagen*, No. 2:15-cv-1274-JRG-RSP, 2016 WL 4778699, at *3 (Aug. 19, 2016); *DermaFocus LLC v. Ulthera, Inc*., No. 15-654-SLR, 2016 WL 4263122, at *6 (D. Del. Aug. 11, 2016); *Audio MPEG, Inc. v. HP Inc.*, No. 2:15-cv-00073-HCM-RJK, 2016 WL 7010947, at *10 (E.D. Va. July 1, 2016). Other approaches set a relatively high bar, requiring that the complaint contain allegations of egregious conduct. *See, e.g., Varian Med. Sys., Inc. v. Elekta AB*, No. 15-cv-871-LPS, 2016 WL 3748772, at *8 (D. Del. July 12, 2016) (granting motion to dismiss where complaint did not "sufficiently articulate how the [defendant's conduct] actually amounted to an egregious case of infringement of the patent"); *CG Tech. Dev., LLC v. Big Fish Games, Inc.*, No. 2:16-cv-00857-RCJ-VCF, 2016 WL 4521682, at *14 (D. Nev. Aug. 29, 2016) (granting motion to dismiss where complaint included only conclusory allegations of knowledge of the patent and continued use of the infringing products). Accordingly, even at the pleading stage, some district courts may exercise their discretion differently and dismiss willful infringement allegations early in the case, while others may choose to keep the willful infringement claim in the litigation.

Summary Judgment: Given the more subjective standard a court will apply to enhanced damages, obtaining summary judgment of no willfulness may be more difficult in some cases. Prior to *Halo*, a party only needed to address the objective prong to show no genuine issue of material fact. Now, the inquiry is one of subjective unreasonableness, and "[a]s a general rule, the factual question of intent is particularly unsuited to disposition on summary judgment." *Copelands' Enters., Inc. v. CNV, Inc*., 945 F.2d 1563, 1567 (Fed. Cir. 1991); *see also Greatbatch Ltd. v. AVX Corp*., No. 13-723-LPS, 2016 WL 7217625, at *2 n.3 (D. Del. Dec. 13, 2016) (noting that "circumstances may not often warrant granting summary judgment on issues of subjective intent"); *Schwendimann v. Arkwright Advanced Coating, Inc*., No. 11-820 (JRT/JSM), 2016 WL 7191568, at *9 (D. Minn. Dec. 12, 2016) (denying summary judgment of no willfulness in part given limited facts presented); *But see LoggerHead Tools, LLC v. Sears Holdings Corp*., No. 12-CV-9033, 2016 WL 5112017, at *4 (N.D. Ill. Sept. 20, 2016) (granting summary judgment where uncontested facts showed no egregious misconduct).

Trial and Appeal: *Halo* may impact trial determinations less than other stages, given that a jury will still make the willfulness determination. Only after these factual findings may the court determine whether to enhance damages. With an abuse of discretion standard, litigants

should take into account that they face an upward battle to obtain a reversal of an unfavorable enhanced damages decision. Unlike in *Teva*, litigants will not be able to argue under a *de novo* standard of review (by, for example, asserting that the intrinsic evidence supports their claim construction). With an unfavorable decision in hand, the losing party may be at a significant disadvantage in settlement negotiations.

(b) Effects on Pre-litigation Conduct

Litigation conduct forms one of two bases according to which a party can seek attorney's fees under § 285; however, litigation conduct constitutes only one of the nine factors the Federal Circuit has outlined for determining whether to enhance a patent infringement damages award under § 284. *See Read Corp. v. Portec, Inc*., 970 F.2d 816, 826 (Fed. Cir. 1992) (abrogated on other grounds). Because several of these factors, as well as the *Halo* opinion, focus more heavily on pre-litigation conduct and the overall strength and justifiability of the defendant's position and behavior, where defendants have awareness of a potential claim, they may modify their pre-litigation behavior to better insulate against a post-*Halo* damages enhancement. Indeed, *Halo* specifically recognized that an infringer can no longer avoid enhanced damages by "muster[ing] a reasonable (even though unsuccessful) defense at the infringement trial." 136 S. Ct. at 1932. Rather, culpability and state of mind is determined by assessing knowledge at the time of the challenged conduct. *Id.*

So what can defendants do, prior to litigation, to minimize damages enhancement? Defendants, in the era of *Halo* enhanced damages analysis, can focus efforts on the collection of evidence that demonstrates the overall reasonableness of their behavior in light of the asserted patent. For example, in some cases patent opinions of counsel may play an increased role—not only in establishing a subjective belief in non-infringement or invalidity, but also in setting forth an objective and well-reasoned basis for why the patent is not infringed or is invalid. Between *Seagate* and *Halo*, defendants sometimes obtained such opinion letters to show subjective belief of non-infringement or invalidity in the event that the court disagreed about the reasonableness of their objective non-infringement or invalidity arguments. In the *Halo* era, such opinion letters could become more of a centerpiece in explaining why the defendant's overall conduct was not egregious. Other pre-litigation actions by the defendant will likely factor into this analysis, including actions to mitigate damages from, or design around, potential infringement, as well as consideration of post grant proceedings to demonstrate the relative strength of invalidity positions.

IV. Broader Implications of More District Court Discretion

The Supreme Court continues to give district courts, the courts most familiar with the facts and the parties, more discretion in making factual determinations. Yet, while discretion allows for focus on the particular case, granting such discretion also may lead to broader implications.

1. Different Approaches for Patent-Heavy Jurisdictions and Those With Fewer Patent Cases?

Both *Halo* and *Octane* instruct district courts to award attorney's fees or enhanced damages for "exceptional cases." In *Octane Fitness*, the Supreme Court described such a case as one that "stands out" from the rest. 134 S. Ct. at 1756. In *Halo*, the Supreme Court outlined that the case must be "egregious." 136 S. Ct. at 1935. This "exceptional" standard may present challenges for courts without substantial patent dockets. In 2015, 44% of patent cases were filed in just one district, the Eastern District of Texas. *See* Colleen V. Chien & Michael Risch, *Recalibrating Patent Venue*, Santa Clara Univ. Legal Studies Research Paper No. 10-1, 3 (Oct. 6, 2016), https://ssrn.com/abstract=2834130. For those patent-heavy jurisdictions and judges who are familiar with patent cases (such as the Eastern District of Texas, the Northern District of California, or the District of Delaware), it may be easier for the district court to determine what "stands out" from the rest and is "egregious." But for jurisdictions with fewer patent cases, determining whether the particular facts are exceptional (or just a challenging patent case, which can be complex even in its simplest forms) may be more difficult. The Supreme Court could further amplify this issue based on its consideration of *TC Heartland LLC v. Kraft Foods Group Brands LLC*, No. 16-341 (U.S.), which raises the question of venue and which may result in patent litigation becoming more dispersed.

2. Can Discretion Be Exercised in a Way that Drive Outcomes?

Given the increased deference to the district courts in patent cases in matters of enhanced damages, attorney's fees, and claim construction, the Federal Circuit likely will be evaluating not whether it would have reached the same conclusions as the district court in these areas, but instead whether the district court applied the correct analytical framework without clear error. This level of discretion permits a wide range of outcomes for a given set of facts, which could lead to different outcomes in different jurisdictions. Some commenters have even suggested that allowing broader discretion for district court determinations could lead to some district courts effectively thwarting the course corrections provided by statutory reform or judicial clarification. *See, e.g.*, Brian J. Love & James C. Yoon, *Predictably Expensive: A Critical Look at Patent Litigation in the Eastern District of Texas*, Santa Clara Univ. Legal Studies Research Paper No. 11-16, 4 (Sept. 21, 2016), http://ssrn.com/abstract=2835799. There may also be a risk of unintentional outcome-driven judicial discretion if a district court feels that the Federal Circuit and Supreme Court precedents do not provide a sufficiently precise framework for the exercise of that discretion, and opts to align what it views as a fair and equitable outcome with the broad legal rubrics set forth by *Teva*, *Octane*, and *Halo*. Regardless, the trend of shifting greater discretion to the district courts will improve judicial certainty and efficiency only to the extent that the appellate courts and the district courts work together to craft sound guidelines for the appropriate and consistent application of such discretion.

3. Will Increased Discretion for District Courts Extend to Other Aspects of Patent Cases?

Should the Supreme Court (or, the Federal Circuit, preemptively) continue to abolish bright-line legal rules in favor of broader, more amorphous analytical frameworks that rely heavily on fact-finding discretion, other areas of patent litigation could change. For example, other legal questions with factual underpinnings could see a *de novo* appellate review disappear for the factual underpinnings, including for patent validity questions such as sufficiency of written description (which leads into legal conclusions of claim validity and priority claim

entitlement), enablement, level of ordinary skill in the art, and definiteness (similar to the definiteness question in *Teva* that was characterized as a claim construction issue). Such increased discretion in favor of district courts could also spill over into other quasi-factual or even purely legal determinations that are best made at the "front lines" of the dispute by a judge or jury who can directly observe the types of behaviors, hints, and cues that are difficult to memorialize in a written record. For example, the Federal Circuit could, under similar reasoning, further empower the district court's factual findings on *Daubert* motions or other expert qualifications.

As a counterpoint, one might consider the 1966 case of *Graham v. John Deere Co.*, 383 U.S. 1, in which the Supreme Court set forth a number of factual inquiries that inform the ultimate legal conclusion of obviousness under 35 U.S.C. § 103. The Supreme Court's identification of these underlying inquiries as factual in nature has not immunized obviousness determinations from reversal on appeal. But another change to obviousness law, *KSR Int'l Co. v. Teleflex, Inc.*, 550 U.S. 398 (2007), in which the Supreme Court expanded the teaching-suggestion-motivation test in favor of a more flexible obviousness framework, did lead to "greater deference to lower tribunal determinations that patents are obvious." Jason Rantanen, *The Federal Circuit's New Obviousness Jurisprudence: An Empirical Study*, 16 Stan. Tech. L. Rev. 709, 713 (2013). The decision of patent appeals after *Teva*, *Octane Fitness*, and *Halo* could follow a similar trajectory: even if the replacement of a former rigid rule with a broad analytical framework does not practically change the outcome in a given case, it may induce the appellate courts to rely more heavily on the district courts as the front-line arbitrator in factual issues.

Elevating the decision-making power of district courts may also promote other changes unrelated to, or in addition to, fact finding, including changes to trial procedure and strategy. For example, litigants might select experts differently based on how a particular district court has treated similarly-situated experts, and based on testimonial demeanor, with less worry to how the experts might appear "on paper." Greater deference may also be given to assessments of litigation conduct, which could affect not only enhanced damages and attorney's fees awards, but also appellate review of the district court's inherent power to conduct its proceedings. Finally, litigants may seek to shift some factual underpinnings from judge to jury, or even to craft jury instructions in a conditional manner that might further insulate a legal conclusion from reversal on appeal by making it seem more inextricably interwoven with factual underpinnings. It will remain to be seen how the Federal Circuit will practically view district court decisions that appear contrary to underlying factual findings by the jury.

4. How Does the Shift in Deference Impact Patent Defendants in General, as Well as Defendants in NPE Cases?

Although as a general matter, broader discretion of district courts should affect all litigants equally, patent defendants may be impacted disparately. For enhanced damages and attorney's fees, there is no longer any objective standard by which to compare a defendant's actions, and prior opinions may not carry the weight they previously did in carving out potential safe harbors. NPEs may also benefit from greater uncertainty and unpredictability in litigation—such uncertainty and unpredictability in litigation tends to benefit most those with less to lose.

Defendants may view patent litigation as a higher-stakes calculation with only one bite of the apple on many issues, which in turn may affect the settlement calculation.

With that said, however, this greater discretion to the district courts may give some NPEs pause in deciding whether to bring an action. An NPE may be more wary in taking unsustainable litigation positions or even in bringing an action with the threat of attorney's fees. NPEs may also be dissuaded from bringing serial actions after obtaining an unhelpful claim construction ruling, as such ruling may assist a court in determining egregiousness against an NPE.

V. Conclusion

The Supreme Court's decisions in *Teva*, *Octane Fitness*, and *Halo* suggest a significant trend in empowering district courts to do what they do best—weigh the evidence and make factual determinations. But these largely untested decisions could impact patent litigation, settlements, and appeals much more broadly for the short term. Given the more deferential standard of review, parties will likely test these holdings with caution, and district courts in turn will hopefully more clearly delineate the portions of their decisions based on factual determinations versus legal conclusions. One benefit of the trend could be a better, more complete, trial record of precisely what factual findings are made by the jury or court and based on what evidence. How much these decisions actually affect litigation, however, remains to be seen.