

Client Alert

June 2014

Supreme Court Year In Review – Patent Cases

The Supreme Court during its 2013–14 term decided on six patent cases, the last on June 19, 2014. These cases will have significant consequences for companies as they work to advance their strategy for protecting their intellectual property. The following summary provides highlights of each case.

***Medtronic, Inc. v. Mirowski Family Ventures, LLC*, 134 S. Ct. 843 (2014).**

Question: First some background: the Supreme Court in *MedImmune, Inc. v. Genentech, Inc.*, 549 U.S. 118, 137 (2007), ruled that a patent licensee in good standing that believes its products do not infringe the licensed patent, and therefore are not subject to royalty payments, is not required to terminate its license agreement before seeking a declaratory judgment in federal court that the underlying patent is not infringed.

The question in this Medtronic case was whether, in such a declaratory judgment action brought by a licensee, the licensee had the burden to prove that its products do not infringe the patent, or did the patentee have to prove infringement. The Federal Circuit concluded that the licensee, as plaintiff, bore that burden, but a unanimous Supreme Court reversed.

Facts: Mirowski Family Ventures, LLC (“Mirowski”) licensed some of its patents to a group that included Medtronic, Inc. (“Medtronic”). The license included a provision that provided that if Mirowski gave notice to Medtronic that a new Medtronic product infringed a Mirowski patent, Medtronic had the option to challenge the infringement by filing a declaratory judgment action while paying royalties into an escrow account. In 2007, this exact scenario occurred, and Medtronic filed a declaratory judgment action of noninfringement and invalidity on several Mirowski patents covered by the license. At trial, although Medtronic was the plaintiff, the district court placed the burden of proving infringement on Mirowski based on the general rule that the burden is always on the patentee to show infringement. On appeal, the Federal Circuit considered the burden of proof question and reversed, holding that the normal rule did not apply here, because Mirowski was “foreclosed” from asserting an “infringement counterclaim” by the continued existence of a license, and thus Medtronic should bear the burden of proving noninfringement.

Decision: On January 22 of this year, the Supreme Court reversed the Federal Circuit, holding that the burden of persuasion is with the patentee, just as it would be had the patentee brought an infringement suit. According to the Court, shifting the burden of proof would create uncertainty for both sides, because even if the licensee failed to prove noninfringement in the declaratory judgment action, the patentee would still need to prove infringement in a separate infringement suit. Furthermore, the Court noted that the patentee is in a better position than an alleged infringer to know, and to be able to point out, just where, how and why a product or process infringes a claim of the patent. The public interest favors keeping patent monopolies within their legitimate scope and thus patentees should bear the burden of proving infringement, even in a declaratory judgment action brought by a licensee. The Court’s decision should serve to embolden licensees to challenge licensed patents without running the risk of having to prove noninfringement in a declaratory judgment action.

***Octane Fitness, LLC v. ICON Health & Fitness, Inc.*, 134 S. Ct. 1749 (2014).**

Question: Whether the Federal Circuit’s two-part test for determining if a case is “exceptional” under 35 U.S.C. §285 improperly appropriates a district court’s discretionary authority to award attorney fees to prevailing accused infringers, thereby setting a high bar for accused infringers to recoup fees? In a unanimous decision, the Supreme Court rejected the Federal Circuit rules governing the award of attorneys’ fees to the prevailing party in patent litigation and appellate review of those awards. The Court gave district courts more discretion to award fees, overturned the “clear and convincing evidence” standard of proof, and insulated the awards from previous *de novo* review, in favor of the “abuse of discretion” standard.

Facts: Icon Health & Fitness, Inc. (“Icon”) is the owner of a patent directed to an elliptical exercise machine (the ‘710 Patent). Icon sued Octane Fitness, LLC (“Octane”), a manufacturer of exercise equipment, alleging that several of Octane’s products infringed the claims of the ‘710 Patent. The trial court sided with Octane, ruling in summary judgment that Octane’s products did not infringe the ‘710 Patent. However, the trial court denied Octane’s motion for attorneys’ fees, based on standards previously articulated by the Federal Circuit. Under §285 of the Patent Act, a trial court may award attorneys’ fees to the prevailing party only in “exceptional cases.” The Federal Circuit interpreted the “exceptional case” requirement to mean that a court could only award attorneys’ fees in two circumstances: 1) where there has been some material inappropriate conduct related to the litigation or the procuring of the patent; or 2) where the patentee brought the litigation in subjective bad faith *and* the litigation was objectively baseless. The Federal Circuit’s rule also required the prevailing party to prove the case was “exceptional” by the higher “clear and convincing evidence” standard. Applying the Federal Circuit’s standard, the trial court found that Icon’s actions failed to bring the case within the “exceptional” realm, and thus Icon would not be required to pay Octane’s attorneys’ fees. On appeal, the Federal Circuit applied its own rule and affirmed the trial court’s decision.

Decision: On April 29, the Supreme Court reversed, finding that the Federal Circuit’s “exceptional cases” standard was more restrictive and inflexible than the language of §285 of the Patent Act itself. Instead, the Supreme Court held that a case is “exceptional” if it “stands out from the others with respect to the substantive strength of the 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.” The Court held that district courts may determine whether a case is “exceptional” in the case-by-case exercise of their discretion. The Court noted that a case may be exceptional if the patentee brought the litigation in bad faith *or* if the case is objectively meritless. The Court also held that the “clear and convincing evidence standard” was not warranted by the Patent Act, and therefore the normal (less stringent) “preponderance of the evidence” standard should apply instead. In theory then, the Supreme Court’s ruling has lowered the bar for a prevailing party in a patent case — particularly a defendant — to prove that it is entitled to an award of attorneys’ fees by establishing that their case is an exceptional case. It remains to be seen how district courts will apply this new, lower standard in practice.

***Highmark, Inc. v. Allcare Health Mgmt. Sys., Inc.*, 134 S. Ct. 1744 (2014).**

Question: This case focused on the standard of review that should apply to a district court’s findings under 28 U.S.C. § 285. Specifically, whether a district court’s exceptional-case finding under 35 U.S.C. §285 is subject to a *de novo* review or entitled to deference on appeal. In a unanimous opinion, the Supreme Court held that all aspects of a district court’s exceptional case determination should be reviewed only for abuse of discretion.

Facts: Allcare Health Management Systems, Inc. (“Allcare”) owns a patent directed to electronically processing health care pre-authorizations and referrals. Highmark, Inc. (“Highmark”) sued Allcare, seeking a declaratory judgment finding of noninfringement, invalidity and unenforceability of Allcare’s patent. The district court entered a judgment of noninfringement in favor of Highmark. Allcare appealed. While the appeal was pending, Highmark moved for an exceptional case finding with respect to Allcare and an award of attorneys’ fees under Rule 11 of the Federal Rules of Civil Procedure. The district court

found the case exceptional and that Allcare attorney's violated Rule 11. The Rule 11 award was later vacated, but the district court maintained the exceptional case finding. Allcare appealed the exceptional case finding. The Federal Circuit, following its own precedent, that if a trial court determined that a patent case was "exceptional" and awarded the prevailing party attorneys' fees, the Federal Circuit would review this determination *de novo*, the highest standard of review, which affords no deference to the trial court's decision. The Federal Circuit affirmed the exceptional case as one of the patent claims, but reversed the district court's finding that Allcare's other claims and actions supported an exceptional case finding. The Federal Circuit accordingly, reduced the award of attorneys' fees to Highmark.

Decision: Also on April 29, the Supreme Court rejected the Federal Circuit's standard, based on its decision in *Octane* (referenced above). Instead of the stricter *de novo* standard, the Court held that a district court's "exceptional case" finding should be reviewed based on the much more deferential "abuse of discretion" standard. Taken together with the Court's holding in *Octane*, not only is it now easier for a trial court to award attorneys' fees to a prevailing party in a patent case, but also the trial court's decision will be given much more deference by an appellate court (and therefore will be more difficult to overturn) if the decision is ever appealed. In light of this, one should expect to see a significant increase in the number of cases in which the trial court awards attorneys' fees to the prevailing party based on an "exceptional case" determination under §285.

Limelight Networks, Inc. v. Akamai Technologies, Inc., No. 12-786 (2014).

Question: This case addresses patent infringement claims involving multiple actors, specifically, whether a defendant may be held liable for inducing infringement under 35 U.S.C. §271(b) when no single party has performed all the steps of a claimed method. Reversing the Federal Circuit, the Supreme Court held that there is no inducement infringement liability where there's been no direct infringement by a single actor under §271(a).

Facts: Akamai Technologies, Inc. ("Akamai") is the exclusive licensee of a patent (the '703 Patent) covering a process for designating components of a content provider's website to be stored on servers (a process known as "tagging") and accessing the components from those servers by using a content delivery network ("CDN"). Limelight Networks, Inc. ("Limelight") operated a CDN and carried out several steps of the method claimed by the '703 Patent. However, while Limelight provided instructions for its customers regarding how to tag, the customers themselves performed the "tagging" step claimed by the '703 Patent, not Limelight. Akamai sued Limelight for infringing the '703 Patent, leading to a series of trials and appeals. Eventually, the Federal Circuit held that while Limelight could not be liable for direct infringement under §271(a) — because it did not perform the tagging step — it was liable for *induced* infringement under §271(b) because, according to the Federal Circuit, induced infringement arises when a party carries out some steps constituting a method patent and encourages others to carry out the remaining steps — even if no one would be liable as a direct infringer under such circumstances. On appeal, the Supreme Court reversed and remanded the Federal Circuit's decision.

Decision: On June 2, the Supreme Court held that based on prior Federal Circuit precedent, a party cannot be held liable for induced infringement unless there was an underlying direct infringement under §271(a) — and according to the Federal Circuit, §271(a) requires that a single actor perform all the steps of a claimed method in order to be held liable for direct infringement. The Court noted that the Federal Circuit should not create liability for inducement based on noninfringing conduct where there is no evidence that Congress intended to do so when it wrote §271(b) of the Patent Act. The Court declined to review the Federal Circuit's standard for direct infringement under §271(a), leaving the door open for the Federal Circuit to potentially expand the concept of direct infringement to include situations like Limelight's using common law theories of *respondeat superior* liability. It remains to be seen whether the Federal Circuit will in fact do so.

Nautilus, Inc. v. Biosig Instruments, Inc., No. 13-369 (2014).

Question: This case focused on the ability of the courts to invalidate vague patent claims. The question presented by this case was whether the Federal Circuit's acceptance of ambiguous patent claims with

multiple reasonable interpretations — so long as not ‘insoluble ambiguous’ — satisfy the definiteness requirement of §112 of the Patent Act. The Supreme Court vacated and remanded the Federal Circuit decision in the case. The Court held a patent is invalid for indefiniteness if its claims, read in light of the patent specification and prosecution history, failed to inform a person having ordinary skill in the art about the scope of the invention.

Facts: Biosig Instruments, Inc. (“Biosig”) is the owner of a patent directed to a grip-activated heart rate monitor (the ‘753 Patent). Among the terms in the independent claim of the ‘753 Patent was a term requiring that the two electrodes on the handle of the monitor be “mounted ... in spaced relationship with each other.” Biosig sued Nautilus, Inc. (“Nautilus”) for infringing several claims of the ‘753 Patent. Following the district court’s claim construction, Nautilus moved for summary judgment, arguing that the term “spaced relationship” was indefinite under §112, ¶2 of the Patent Act, which requires that a patent must “particularly point out and distinctly claim the subject matter which the applicant regards as his invention.” The district court granted Nautilus’ motion and found that the term “spaced relationship” was indefinite. The Federal Circuit reversed and remanded. Applying its own precedent, the Federal Circuit held that a claim is indefinite “only when it is ‘not amenable to construction or ‘insolubly ambiguous.’ ” Under that standard, the Federal Circuit held that the term “spaced relationship” in the ‘753 Patent was not indefinite.

Decision: On appeal, the Supreme Court also on June 2 reversed the Federal Circuit, holding that the appellate court’s standard was too amorphous and tolerated imprecision. Instead, the Court held that a patent’s claims “viewed in light of the specification and prosecution history, [must] inform those skilled in the art about the scope of the invention with reasonable certainty.” The Court held that the Federal Circuit’s “amenable to construction” and “insolubly ambiguous” requirements can breed lower court confusion. However, the Court declined to apply its new standard to the terms of the ‘753 Patent, leaving it to the Federal Circuit to apply the new standard on remand. Nevertheless, the Court’s requirement for more precision in claim language will certainly lead to more indefiniteness challenges by patent defendants as district courts attempt to put the Supreme Court’s ruling into practice.

Alice Corporation Pty. Ltd. v. CLS Bank Int’l., No. 13-298 (2014).

Question: Whether claims directed to computer-implemented systems and methods for mitigating settlement risk using a third-party intermediary are directed to patent-eligible subject matter within the meaning of 35 U.S.C. §101. The Court unanimously affirmed the Federal Circuit, holding that the claims at issue are drawn to the abstract idea of intermediated settlement, and that merely requiring a generic computer implementation failed to transform the abstract idea into a patent-eligible invention.

Facts: Alice Corporation Pty. Ltd. (“Alice”) is the owner of several patents that disclose schemes to manage certain kinds of financial risk (“the Alice patents”). The representative claims of the Alice patents relate to a computerized system and method for mitigating settlement risk — the risk that only one party to an agreed-upon financial exchange will satisfy its obligation. The claims require a third-party intermediary (a computer system) between two entities. The third-party intermediary creates shadow credit and debit records that mirror the balance in the parties’ real-world accounts, updates the shadow records in real time as transactions are entered (allowing only transactions for which the parties’ updated shadow records indicate sufficient resources to satisfy their mutual obligations), and instructs the relevant financial institutions to carry out “permitted” transactions in accordance with the updated shadow records. CLS Bank International and CLS Services Ltd. (together, “CLS”) filed a suit against Alice, seeking a declaratory judgment that the Alice patents were invalid, unenforceable or not infringed. Alice countersued for patent infringement, and the trial court ultimately held that the Alice patents were patent ineligible under 35 U.S.C. §101 because they are directed to an abstract idea. In an *en banc* opinion, the Federal Circuit ultimately affirmed the trial court by an equally divided vote.

Decision: On June 19, the Supreme Court unanimously affirmed the Federal Circuit, holding that the claims of the Alice patents were patent ineligible under section 101 of the Patent Act. The Court applied the two-part framework of *Mayo Collaborative Services v. Prometheus Laboratories, Inc.*, 566 U.S. ____ (2012): (1) whether the claims are directed to one of the patent-ineligible concepts under §101; and if so,

(2) whether there are additional claim elements that transform the nature of the claim into a patent-eligible application — i.e., whether the patent claims include an “inventive concept.” Applying the first *Mayo* step, the Court concluded that the Alice patents were directed to the abstract idea of intermediated settlement. The Court found that the concept of intermediated settlement “is a fundamental economic practice long prevalent in our system of commerce.” Similar to the practice of hedging risk — which the Court found to be patent-ineligible in *Bilski v. Kappos*, 561 U.S. 393 (2010) — intermediated settlement is an abstract idea under §101. The Court declined to delimit the precise contours of the “abstract ideas” category and simply held that there is no meaningful distinction between the concept of risk hedging in *Bilski* and the concept of intermediated settlement.

Next, the Court applied the second step of *Mayo* and found that the Alice patents merely require generic computer implementation and failed to transform the abstract idea of intermediated settlement into a patent-eligible invention. The Court held that a mere recitation of a generic computer cannot transform a patent-ineligible abstract idea into a patent-eligible invention. Otherwise, “an applicant could claim any principle of the physical or social sciences by reciting a computer system configured to implement the relevant concept.” The Court found that the steps of creating and maintaining shadow accounts merely amounted to electronic recordkeeping — a basic computer function. All of the computer-implemented steps of the Alice patents were “well-understood, routine, conventional activities.” Considering the steps together as an ordered combination did not add anything that is not already present when the steps are considered separately. The Alice patents included system claims, but those did not recite any meaningful limitations to the computer hardware and merely implemented the method claims via a computer. Accordingly, the Court held that the Alice patents are patent-ineligible under §101.

While the Court’s decision was limited to the patents at issue, patent-holders and applicants for business method patents should expect increased scrutiny of their inventions under §101, especially in light of the Court’s repeated emphasis that “a mere recitation of a generic computer cannot transform a patent-ineligible abstract idea into a patent-eligible invention.” This will not be the last time the Court is faced with questions about the limits of patent-eligible subject matter under §101.

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