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# Supreme Court Revises Fee-Shifting Rules in Patent Cases: Weeding out Bad Actors in a Level Playing Field

*Adam Mossoff* and Brian O'Shaughnessy†*

On April 29, 2014, the Supreme Court handed down two unanimous decisions in *Octane Fitness v. ICON Health & Fitness* and *Highmark v. Allcare Health Management System*, which radically overhaul the rules governing court-awarded attorneys' fees in patent cases. In brief, the Supreme Court has empowered district courts with greater authority to discourage bad actors in patent litigation. Yet, the *Octane Fitness* and *Highmark* decisions preserve valuable incentives for innovation in an equitable system for patent owners who properly assert valid property rights.

*Octane Fitness* and *Highmark* confirm that it is the proper role for *courts* to address problems created by bad faith patent litigation. This is a lesson that should be heeded by Congress, as it works toward new legislation further modifying our patent laws, including mandating fee-shifting in patent cases. *Octane Fitness* and *Highmark* counsel Congress to reconsider revising our patent laws, and instead allow courts to do what they do best —manage their dockets and craft rules and procedures to ensure the just and efficient resolution of disputes under federal law.
The legal issue in *Octane Fitness* and *Highmark* centered on what is the proper application of 35 U.S.C. § 285, which authorizes courts to award attorney fees "in exceptional cases" to the prevailing party. Since its inception, § 285 has been recognized as an exception to the "American Rule" (i.e., each party pays its own attorney fees regardless of the outcome). The Federal Circuit has construed § 285 as permitting fee-shifting in only two limited circumstances: An award of attorneys' fees is permissible only when it is proven by *clear and convincing evidence* that (1) "there has been some material inappropriate conduct," *or* (2) the litigation was "brought in subjective bad faith" and was "objectively baseless."

The *Octane Fitness* Court found the Federal Circuit's construction of § 285 imposed "an inflexible framework onto statutory text that is inherently flexible." More specifically, the *Octane Fitness* Court struck down the Federal Circuit's test because it conflated the "exceptional case" standard with other legally independent bases of punishing misconduct by a patent owner, such as the inequitable conduct doctrine that is similar to factor (1) of the Federal Circuit's § 285 test. In accord with its plain meaning, the Court construed an "exceptional case" to mean simply a case 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."

Following its construction of "exceptional case" based on both its plain meaning and the legislative history for § 285 (Justice Scalia refused to join the three footnotes in Justice Sotomayor's opinion that discussed the legislative history), the *Octane Fitness* Court held that a district court should have the discretionary authority to award attorney fees if the prevailing party has proven by a *preponderance of evidence* that the *"totality of the circumstances"* justify such an award. The *Octane Fitness* Court thus lowered both the evidentiary and the substantive legal requirements for a district court in awarding attorney fees under § 285—it is now a case-specific, holistic, equitable analysis more in accord with the approach traditionally taken by courts.

In a companion case, the Court in *Highmark* bolstered the authority of district courts to manage their dockets and to punish bad actors by revising the standard of review employed by the Federal Circuit in reviewing fee-shifting decisions under § 285. The Federal Circuit has reviewed *de novo* fee awards under § 285. *Highmark* holds that this was contrary to the fact-specific nature of § 285. Thus, *Highmark* reversed the Federal Circuit, holding that the discretionary award of attorneys' fees under § 285 should be reviewed by an appellate court only for abuse of discretion.

Standing together, *Octane Fitness* and *Highmark* empower district courts to hold accountable those who engage in improper or abusive litigation. This is a valuable reminder that patent infringement suits are merely another form of federal civil litigation, and abusive behavior may be addressed with rules and practices traditionally employed by federal courts.

The carefully crafted holdings in *Octane Fitness* and *Highmark* stand in stark contrast to broad legislation pending in Congress. For example, in December 2013, the House passed H.R. 3309, which would impose *mandatory fee-shifting* to the non-prevailing party. Fees must be paid by the losing party *unless* it can prove that its position was "substantially justified" or that "special circumstances" would make an award of attorney fees unjust. This would create the same "inflexible framework" and inequitable "generalizations" for which the Supreme Court criticized the Federal Circuit in its prior application of § 285.

H.R. 3309 would penalize patent owners by creating an exception to the American rule. This would affect all patent owners, not just bad actors, and would increase risk, and therefore harm individual inventors, start-ups, small companies, universities, and other entities that create and license patented inventions. The risk of bearing the financial burden of both parties' attorney fees would be an enormous disincentive for any poorly capitalized patent owner in enforcing its legitimate property rights in court; this would thus discourage, rather than promote, the progress of the useful arts.

*Octane Fitness* and *Highmark* will promote more responsible behavior among patent litigants. Under the principles enunciated in these two cases, patent owners must be still more careful in conducting pre-litigation due diligence. Before bringing suit, patent owners would be well advised to retain objective and competent counsel to conduct a thorough infringement investigation, and to document the bases on which a suit might be brought. Failure to procure such an opinion before bringing suit would increase a patent owner's exposure to a challenge that the suit was brought without the requisite good faith basis, and with that, a claim for attorney fees.

A legislative approach that mandates fee shifting is a dramatic shift from the traditional American rule. It hinders a judge's discretion and the court's inherent power to impose appropriate sanctions. It will limit remedial measures that judges might otherwise employ to promptly and cost-effectively resolve cases and discourage litigation abuse. Further, it will invite gamesmanship to protect the bad faith litigant from suffering the fate of a "non-prevailing party."

Case by case implementation of the *Octane Fitness* and *Highmark* decisions will afford equitable and predictable enforcement of legitimate patent rights, promoting innovation while preserving the power of the courts to punish bad actors. Overly broad legislation, however, will increase uncertainty and risk in patent enforcement, weaken the patent property right, diminish the commercial value of patents, and discourage innovation. This will have devastating consequences on the innovation economy, and will suppress economic development and job creation. *Octane Fitness* and *Highmark* show that judges, who witness abusive behavior firsthand, are in the best position to address and remedy bad faith litigation and abusive tactics. This is why we have traditionally left it to the courts to address such tactics. The Supreme Court has now clarified and enhanced that power. Congress should defer to the courts in exercising it.

* Professor of Law at George Mason University School of law. Professor Mossoff is also co-founder and Co-Director of Academic Programs of the Center for the Protection of Intellectual Property at Mason Law. Thank you to Steve Tjoe for his assistance with this essay.

† Regional Vice President, USA, of the Licensing Executives Society (USA and Canada), Inc.; and Shareholder in the law firm of RatnerPrestia, Washington, DC.