

SPECIAL

REPORT

SUPREME COURT CHANGES THE STANDARD FOR
PERMANENT INJUNCTIVE RELIEF IN PATENT CASES

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On May 15, in *eBay Inc. v. MercExchange, L.L.C.*,¹ the United States Supreme Court rejected the Federal Circuit's "general rule" in favor of issuance of permanent injunctions at the conclusion of successful patent infringement cases. Instead, the Supreme Court ruled that courts should decide whether to issue a permanent injunction pursuant to the traditional four-factor equitable test applied in other kinds of cases. While such change in the standard is unlikely to affect the frequency with which successful plaintiffs are able to obtain permanent injunctions in many traditional patent suits, it will reduce the certainty with which a plaintiff can expect to obtain an injunction in some situations.

This Special Report summarizes the Supreme Court's decision, including the main opinion and the two important concurring opinions, and addresses the potential impact of the decision on future cases.

I. The Supreme Court's Decision

A. The Main Opinion

The Supreme Court unanimously concluded, in an opinion by Justice Thomas, that both the District Court and the Federal Circuit had erroneously applied "categorical" approaches to the issuance of a permanent injunction. The Court held that before issuing a permanent injunction a district court should apply the traditional equitable test for injunctions, pursuant to which "[a] plaintiff must demonstrate: (1) that it has suffered an irreparable injury; (2) that remedies available at law, such as monetary damages, are inadequate to compensate for that injury;

(3) that, considering the balance of hardships between the plaintiff and defendant, a remedy in equity is warranted; and (4) that the public interest would not be disserved by a permanent injunction." The Court further stated that "[t]he decision to grant or deny permanent injunctive relief is an act of equitable discretion by the district court, reviewable on appeal for abuse of discretion," thus permitting the district court to give varying weight to the four factors to provide an equitable result in an individual case.

MercExchange owns a business method patent pertinent to Internet auction websites. After negotiations for a license failed, MercExchange sued eBay and Half.com, Inc. and a jury found the patent to be valid and infringed. The District Court for the Eastern District of Virginia refused to issue an injunction citing, among other things, the "plaintiff's willingness to license its patents" and "its lack of commercial activity in practicing the patents." The Supreme Court held that reliance on such "expansive principles" or "broad classifications" to deny injunctive relief was not appropriate. The Court commented, by way of example, that "some patent holders, such as university researchers or self-made inventors, might reasonably prefer to license their patents, rather than undertake efforts to secure the financing necessary to bring their works to market themselves" and nonetheless "may be able to satisfy the traditional four-factor test"

The Federal Circuit had reversed the District Court, pursuant to the Federal Circuit's "general rule" that an injunction should issue to a successful patent infringement plaintiff except "in the 'unusual' case, under 'exceptional circumstances' and 'in rare instances . . . to protect the public interest.'" The original rationale of the general rule

¹ 2006 WL 1310670, 78 USPQ2d 1577, 74 USLW 4248 (U.S. 2006)

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was the principle that a patent represents a property right, the most essential aspect of which is the right to exclude the use of the property by others. While the Supreme Court did not challenge the rationale for the rule, it held that a "categorical" approach to issuing injunctions was erroneous and that traditional equitable principles, reflected in the four-factor test, should be applied.

B. The Two Concurring Opinions

While they agreed with the opinion by Justice Thomas, two groups of Justices wrote separately to emphasize certain issues.

Chief Justice Roberts, joined by Justices Scalia and Ginsburg, agreed with the Court's opinion regarding the requirement to apply the four-factor test. However, their concurring opinion emphasized the long history of courts granting injunctive relief "in the vast majority of patent cases." The opinion indicated that such an approach was "not surprising, given the difficulty of protecting a right to *exclude* through monetary remedies that allow an infringer to *use* an invention against the patentee's wishes--a difficulty that often implicates the first two factors of the traditional four-factor test." The opinion suggested that while the lower courts should exercise their discretion pursuant to the four-factor test, they would not be "writing on an entirely clean slate" and that the past history of application of injunctive relief in patent cases would help define legal standards that would ensure consistent outcomes for similar cases.

Justice Kennedy, joined by Justices Stevens, Souter and Breyer, likewise agreed that the four-factor test should be applied without resort to categorical rules as stated in the main opinion, and that history may be instructive in applying the test as stated in the first concurring opinion. However, in contrast to the first concurring opinion, this group emphasized that the prior pattern of routine issuance of injunctions was due to the "contexts then prevalent." The opinion gave two examples of situations where circumstances different from previous cases might present different considerations leading to the denial of an injunction:

- Plaintiffs engaged solely in licensing:

"An industry has developed in which firms use patents not as a basis for producing and selling goods but, instead, primarily for obtaining

licensing fees. For these firms, an injunction, and the potentially serious sanctions resulting from its violation, can be employed as a bargaining tool to charge exorbitant fees to companies that seek to buy licenses to practice the patent."

In support of this point, the opinion cited the Federal Trade Commission's 2003 report on competition and patent law policy, which identified three types of non-practicing entities that assert patents: (1) non-practicing design firms, which patent their inventions but do not make or sell patented products to consumers; (2) "professional" patent assertion companies that buy patents from other companies, particularly those that are bankrupt, and then assert them against practicing entities; and (3) "patent miners," which are companies that assert their patent portfolios against firms outside of their own industry. The opinion also noted as to this point that "[w]hen the patented invention is but a small component of the product the companies seek to produce and the threat of an injunction is employed simply for undue leverage in negotiations, legal damages may well be sufficient to compensate for the infringement and an injunction may not serve the public interest."

- Business method patents:

"In addition injunctive relief may have different consequences for the burgeoning number of patents over business methods, which were not of much economic and legal significance in earlier times. The potential vagueness and suspect validity of some of these patents may affect the calculus under the four-factor test."

II. Analysis

A. Procedural effects

It seems certain that application of the four-factor test will lead to increased litigation over the need for and propriety of permanent injunctions, at least where the defendant has not made alternative arrangements (such as a design-around) by the time of trial. There is likely to be more evidence introduced at trial concerning the four factors, and some judges may permit post-trial hearings on the propriety of injunctive relief. Related discovery will also be pursued in the pretrial stage of the case, marginally increasing the cost and complexity of pretrial proceedings.

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B. Substantive effects

It is unlikely that application of the four-factor test will have a substantial impact on the issuance of injunctions between competitors, particularly where the patent scope is roughly co-extensive with the product. In the situations mentioned in Justice Kennedy's concurring opinion, the effect is more difficult to predict. The concerns articulated in that opinion parallel those raised recently by some critics of so-called "patent trolls." However, as reflected in the *eBay* opinion itself, as well as the prior Supreme Court opinion in *Continental Paper Bag Co. v. Eastern Paper Bag Co.*, 210 U.S. 405 (1908) (cited by Justice Thomas), no consensus has developed concerning the relative legitimacy of a patent utilization program focused on licensing instead of direct manufacturing. Business method patents likewise have their supporters and detractors, but their validity is established before the issue of the propriety of an injunction is addressed by the trial courts. While all those issues will be disputed in future cases, the attitudes of the courts will likely emerge slowly, on a case-by-case basis.

In the meantime, there are some likely effects of *eBay* that potential plaintiffs and defendants in patent cases should take into account. One is that the increased uncertainty that injunctions will be obtained alters the incentives affecting license negotiations, although such effect is only marginal, because a permanent injunction will remain at least a significant possibility in any successful patent suit. Moreover, even where a court does not grant a permanent injunction, a patentee may be able to obtain enhanced damages for post-judgment infringement in some cases.

Also, such negotiations should be conducted in light of Justice Kennedy's comments about "undue leverage" and "exorbitant fees." The Federal Rules of Evidence provide that substance of settlement discussions and licensing negotiations "is not admissible to prove liability for or invalidity of the claim or its amount" and that "[e]vidence of conduct or statements made in compromise negotiations is likewise not admissible." However, such evidence may be admissible for other purposes. Fed. R. Evid. 408. Justice Kennedy's comments raise the possibility that licensing negotiation conduct will be considered relevant and admissible with respect to the right to injunctive relief. Accordingly, we recommend that patent owners exercise even greater circumspection in comments made in such negotiations, especially in writing, and avoid over-

emphasizing the potentially negative consequences of an injunction on the infringer. This is particularly important when the patent owner does not practice the patented invention.

Some preliminary predictions can also be made about the likely application of the individual factors, or prongs, of the four-factor test:

1. **Irreparable injury.** In the context of preliminary (i.e., pre-trial) injunctions, the Federal Circuit has long applied a presumption of irreparable injury, once infringement and validity have been found to be likely, deriving from the property nature of patents. *See Smith Int'l, Inc. v. Hughes Tool Co.*, 718 F.2d 1573, 1581 (Fed. Cir. 1983). Such a presumption will probably now be applied in the context of permanent injunctions, which are addressed after infringement and validity have been established.

2. **Adequacy of remedy at law.** While an infringer can argue that a monetary award is an adequate remedy, the courts are likely, as reflected in Chief Justice Roberts' concurring opinion, to continue to resist routine forced licensing through refusal to grant an injunction, particularly where the patentee is practicing the invention.

3. **Balance of hardships.** A plaintiff who practices the patented invention is likely to be successful in establishing that the hardship to it from denial of an injunction would outweigh the hardship to the infringer from issuance of an injunction. However, *eBay* provides increased opportunity in the case of a non-practicing, licensor plaintiff or a business method patent owner plaintiff for the defendant to raise arguments about the hardships it would suffer from an injunction. Of course, such arguments will need to address past cases recognizing the legitimacy of both patent licensing and business method patents.

4. **Public interest.** Traditionally, the public interest in the patent system, represented by the property nature of patents, has been dominant with respect to this factor in the preliminary injunction context. The only exceptions have tended to be where public health or safety would be negatively affected by an injunction. Post-*eBay*, it will be easier to raise other pro-defendant arguments, but whether they will be accepted is unclear.

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III. Conclusion and Recommendations

While the decision of the Supreme Court in *eBay* is significant, it is not likely to lead to immediate major changes in the availability of injunctions in most patent cases. Over time, however, it may lead to a greater diversity of outcomes where the plaintiff is purely a licensing entity or where the patent relates to a business method or other subject matter not considered in previous cases. In any event, the amount of time and effort spent litigating the right to a permanent injunction will likely increase in many cases.

In view of *eBay*, we recommend consideration of the following:

- When prosecuting patents, inventors should include some claims directed to the product as a whole, with the inventive improvement incorporated, and some claims directed solely to the improvement. This may strengthen the ability to obtain damages on the basis of the sale of the product as a whole, as well as improve the chances that injunctive relief will be available.
- Plaintiffs in patent infringement cases should develop evidence that will support their ultimate request for injunctive relief under the four-factor test. Comparative economic analyses, for example, may assist in demonstrating irreparable harm, the lack of an adequate remedy through damages and the balance of hardships. A focus on evidence of the availability of non-infringing alternatives may also help establish a favorable balance of hardships and consideration of the public interest, but focus on this factor should be weighed against the possible adverse effects of such evidence on the ability to obtain "lost profits" damages.
- Defendants in patent infringement cases should utilize discovery to try to obtain information about all past licensing negotiations that included the patent(s)-in-suit. Such discovery may reveal threats of injunctive relief that can be characterized as "undue leverage," which might assist in avoiding a permanent injunction.
- As noted above, comments by a patentee in patent license negotiations should not refer to the potential effects of injunctive relief on an infringer's business, particularly if the patentee does not practice the invention.
- Because grant or denial of injunctive relief is reviewable by an appellate court only for abuse of discretion, it will be difficult to overturn a decision by a district court either to grant or refuse permanent injunctive relief, provided the district court properly applies the four-factor test. Thus, significant focus should be given to establishing (or, for alleged infringers, contesting) the propriety of an injunction at the district court stage.
- Parties asserting patents against products imported from abroad will have an additional factor to consider in weighing whether to proceed through the International Trade Commission, given that the ITC provides injunctive relief in the form of exclusion orders that are subject to a statutory standard differing somewhat from the standard applied in *eBay*.

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