

The Supreme Court creates licensing doubts

There is no disputing that the Supreme Court's ruling in *eBay v MercExchange* delivered a blow to patent trolls. Less clear, however, is the effect it will have on others who seek to monetise their rights

By Jeffrey Sullivan

On 15th May 2006, the United States Supreme Court issued a decision in *eBay Inc v MercExchange LLC*, overturning the United States Court of Appeals for the Federal Circuit's determination that patentee MercExchange was presumptively entitled to a permanent injunction upon a finding at trial that eBay infringed MercExchange's allegedly broad auction-related business method patents. The Supreme Court's decision is likely to weaken at least somewhat the bargaining power of so-called patent trolls (usually, holding companies that do not commercialise their alleged inventions and are instead perceived as asserting patents mainly or solely to force a monetary settlement). At the same time, the *eBay* decision could have negative implications on more legitimate companies trying to earn profits by asserting their patents. The exact nature and magnitude of these effects, however, remain for now uncertain and unpredictable.

Background to *eBay v MercExchange*

In the trial court, MercExchange had accused eBay of infringing three of its United States patents, ostensibly covering methods for buying and selling goods online. In particular, MercExchange alleged that eBay's fixed-price Buy It Now feature infringed the patents. At trial, MercExchange won a jury verdict of US\$10.5 million in damages. The district court, however, refused to issue an injunction prohibiting eBay from operating the services found to infringe. In denying the injunction, the district court relied heavily on MercExchange's alleged failure to practise

the inventions by commercialising them on a wide scale. The trial court was further influenced by a general concern regarding the arguably questionable validity of certain business method or algorithm patents.

MercExchange appealed to the Federal Circuit, which reversed the trial court decision. The Federal Circuit held that, under its view of longstanding case law, issuance of injunctions should be essentially routine in all patent cases once infringement was found. eBay then successfully petitioned the Supreme Court to review the case upon a writ of *certiorari*.

The Supreme Court's decision

In a unanimous opinion written by Justice Thomas, the Supreme Court vacated the Federal Circuit's decision and remanded the case to the district court for further proceedings. The Court stated forcefully that, in determining whether to grant any permanent injunction, a court should adhere to "well-established principles of equity". In particular, a plaintiff seeking such an injunction (in a patent case or otherwise) must demonstrate that:

1. irreparable injury is likely to occur to the plaintiff if an injunction is not granted;
2. monetary damages would be insufficient to compensate the injury;
3. the balance of the hardships that would respectively be suffered by the plaintiff and the defendant militates towards granting the injunction; and
4. the injunction is not against the public interest.

The Court went on to note that it had found no compelling justification for departing from these generalised

District court denies injunction in post-eBay case

touchstones of equitable relief in the case of patent claims, particularly when the text of the Patent Act specifically states that injunctions “may” issue “in accordance with the principles of equity”. The Court went on to draw a comparison to copyright infringement law. Like patent law, the Court observed, copyright law also accords a “right to exclude”. Yet the Court had repeatedly rejected proposals to establish a general rule in favour of permanent injunctions in all cases of proven copyright infringement. The Court saw no reason for a different result under the patent statute.

Although it overturned the Federal Circuit’s decision requiring an injunction, the Court also rejected the district court’s rationale for denying an injunction. The district court had stated that a “plaintiff’s willingness to license its patents” and “its lack of commercial activity in practising the patents” could be enough to establish the absence of “irreparable harm”. The Supreme Court pointed out that some patentees, such as “university researchers or self-made inventors”, might legitimately prefer (or need) only to license their rights rather than practise the invention, and that this fact alone should not be enough to deny them injunctive relief on a categorical basis. Instead, the Court stated, all requests for injunctive relief should be evaluated using the traditional four-factor test for injunctive relief. The *eBay* case will now return to the district court for determination of whether entry of an injunction is justified based on that test.

In a concurring opinion, Justice Kennedy, joined by three other Justices, wrote separately on the application of the four-factor test in the era of alleged patent trolls or junk patents, noting popular fears that: “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... [f]or these firms, an injunction... can be employed as a bargaining tool to charge exorbitant fees from companies that seek to buy licences...” Justice Kennedy went on to argue that: “When the patented invention is but a small component of the product and the threat of an injunction is employed simply for undue leverage... an injunction may not serve the public interest.” Finally, addressing the relatively recent rise to prominence of business method and other algorithm patents, Justice Kennedy noted that: “The potential vagueness and suspect validity of some of these patents may affect the calculus under the four-factor test.”

While it is early days yet to expect substantial jurisprudence applying the *eBay* decision, on 14th June 2006, the United States District Court for the Eastern District of Texas (interestingly, a forum notorious for attracting numerous troll lawsuits) became among the first courts to do so in issuing an order in *z4 Technologies Inc v Microsoft Corporation and Autodesk Inc*. In *z4 Technologies*, a jury found that Microsoft wilfully infringed z4’s patents claiming methods for limiting the unauthorised use of computer software. The jury awarded z4 US\$115 million in damages against Microsoft and US\$18 million against Autodesk. The district court, however, denied z4’s motion for permanent injunction, citing *eBay*.

The court’s decision denying injunctive relief applied the traditional four-factor test that the US Supreme Court had just specified in *eBay*. First, the court found that z4 would not suffer irreparable harm without an injunction. The court established that “lost profits, the loss of brand name recognition or the loss of market share” are the types of injury that are often incalculable and irreparable. The court found on the facts, though, that z4 would neither suffer lost profits, the loss of brand name recognition, nor the loss of market share due to Microsoft’s continued sale of the infringing products.

The district court next found that z4 had

failed to demonstrate that monetary damages would be insufficient to compensate it for any future infringement by Microsoft. The court observed that the use of z4’s technology in Microsoft’s software did not prevent z4 from selling or licensing its products to the market or threaten z4’s goodwill. Citing Justice Kennedy’s concurrence in *eBay*, the district court further found that z4’s patented technology was a “very small component of the Microsoft Windows and Office software products” and that therefore money damages could be sufficient to make z4 whole.

Turning to the third element of the four-factor test, the district court balanced the hardships that z4 and Microsoft might each incur. It concluded that: “The potential hardships Microsoft could suffer if the injunction were granted outweigh any limited and reparable hardships that z4 would suffer in the absence of an injunction.”

Finally, the district court ruled that a permanent injunction against Microsoft would be likely to disserve the public interest. The court noted that an injunction might lead to an increase in software piracy. It also emphasised that consumers could suffer negative consequences due to an injunction against Microsoft.

If they follow the reasoning of the z4 court, other post-*eBay* courts might not infrequently deny injunctions despite a finding of patent infringement.

The eBay decision could weaken patent trolls

The Supreme Court’s *eBay* decision may potentially weaken the bargaining position of so-called trolls. Prior to the *eBay* decision, an injunction was almost guaranteed to enter once a jury or judge found at trial that a defendant infringed a plaintiff’s patent. Thus, patent trolls have often in the past used the threat of injunction as a lever to extract arguably inordinate settlements from companies they accuse of infringement or to which they have offered a licence. Typically, troll-type patentees have demanded settlements proportional to the cost of defending a complex patent litigation, adding in a premium based on the ominous threat of a business-shattering injunction – rather than basing settlement upon any real-world reasonable royalty calculation reflecting the proportional value of the alleged invention of the patent, as in the traditional licensing realm.

For example, on 23rd March 2006,

Research in Motion (RIM) agreed to pay NTP Inc US\$612.5 million to settle the patent dispute over RIM's popular BlackBerry wireless email system. The threat of injunction against RIM clearly played a principal role in inducing the settlement. If the trial court had, as was customary at the time, entered an injunction upon finding infringement by RIM, the injunction would have led to a shutdown of the entire BlackBerry system, affecting more than 3 million users in the United States. The pre-*eBay* rule of near-automatic injunctions when patent infringement was found thus clearly contributed to the magnitude of the US\$612.5 million settlement.

After the *eBay* decision, however, an injunction is no longer guaranteed even if a court finds that the defendant infringed the plaintiff's patent. As a result, the threat of injunction will almost certainly not be as strong a bargaining chip for patent trolls as it used to be. Because *eBay* removes the threat of an injunction entering automatically, it is reasonable to predict that, all else being equal, settlement amounts in patent troll assertions may decline. In addition, defendant companies will have more options to react to a finding of infringement. Instead of negotiating a settlement with patent trolls to avoid an immediate injunction, defendant companies can hope to continue the allegedly infringing business without an injunction, while pursuing appellate review or filing a request for re-examination of the patent(s) at issue.

Perhaps most germane to the patent troll problem, one of the four elements that a plaintiff must now prove in order to secure an injunction is that the injunction will not be against the public interest. As Justice Kennedy pointed out in his concurrence to the *eBay* decision, "an injunction may not serve the public interest" when "the patented invention is but a small component of the product... and the threat of an injunction is employed simply for undue leverage". Based on Justice Kennedy's observation, courts might become more willing to deny injunctions when they perceive that a possible troll has employed the threat of injunction purely as a litigation tactic in order to obtain undue leverage in forcing settlement.

The *eBay* decision could affect legitimate companies as well

While the *eBay* judgment has a potential negative impact on patent trolls, the rationale of the decision is also likely to affect

technology transfer offices and other legitimate companies that try to make profits by asserting their patents. First, the *eBay* decision could reduce licensing revenues. Many legitimate companies may not have used the threat of injunction as a source of undue bargaining power in licensing negotiations. Nevertheless, the removal of presumptive injunctive relief will most likely enhance the relative bargaining position of license purchasers. Thus, licensing companies may find it necessary to compromise on lower licensing fees and consequently suffer decreasing licensing revenues.

In addition, the *eBay* decision may decrease the overall value of patents that companies own. As owners of intellectual property, patentees (both trolls and legitimate companies) have relied on the implicit or explicit threat of injunctions to maximise the value of the exclusive rights granted by their patents. After the *eBay* decision, however, they will be less able to rely on the presumptive issuance of injunctions. This effect may become prominent especially in the field of the chemical and life sciences. Innovations in these fields (such as blockbuster pharmaceutical compounds) may often be covered by a small number of patents compared to electronics products, which may often embody numerous (alleged) inventions. Companies in the chemical and life sciences may therefore become reluctant to spend as much money on research and development as they used to.

***eBay's* effects on patent trolls may be greater still**

While the *eBay* decision is likely to affect legitimate companies as well as patent trolls, the decision's negative impact may weigh more heavily upon patent trolls. In *eBay*, the US Supreme Court rejected the district court's suggestion that a court should deny injunctions on a bright-line basis to patentees that do not physically practise their inventions. Patent trolls often do not intend to practise their patents and do not manufacture products based on their patented technology.

However, the Supreme Court's rejection of the district court's suggestion is not necessarily good news for patent trolls. In rejecting the district court's reasoning, the Supreme Court specifically indicated that patentees such as "university researchers or self-made inventors" might legitimately prefer or need to license their rights instead of practising their inventions. A court is thus

Possible strategies for mitigating the effects of eBay

likely to take notice of whether a company “feels” like a patent troll (eg, is a mere patent-buying company that played no role even in the research and development of the alleged invention) when it applies the four-point test.

At the same time, it is important to note that the distinction between perceived patent trolls and legitimate companies is often unclear. Potential hallmarks that have been discussed for identifying trolls include the non-commercialisation of company patents, acquiring patents from others for assertion and filing lawsuits in plaintiff-friendly forums. Yet these factors can also be identified in certain companies or organisations that are widely perceived as legitimate, as well. For instance, universities typically do not practise their patents. Many pharmaceutical companies acquire patents from others. Further, some legitimate companies file lawsuits in plaintiff-friendly forums as well.

However, patent trolls tend to manifest a number of these characteristics at once, as compared to legitimate companies. If such a concatenation of multiple red flags becomes apparent to a court, the court may be able to distinguish between likely patent trolls and legitimate companies, and deny injunctions to the former in some or most cases.

Clouding the patent licensing landscape

The *eBay* decision may have potentially negative effects on patent trolls as well as on legitimate companies that wish to monetise their patents. However, the magnitude of such effects is uncertain.

For example, while some courts may prove more likely to deny injunctions to prevent patent trolls from employing them as a source of undue leverage, any court’s issuance or non-issuance of injunctions will depend on how much the court perceives the activities of patent trolls as being against public interest. In addition, patent trolls tend to file infringement actions in jurisdictions that have frequently ruled in favour of patentees. The threat of injunctions may only be one of many tactical advantages that patent trolls employ to obtain a large settlement amount. Thus, patent trolls in the post-*eBay* era (as well as legitimate patentees) might still find many avenues to earn revenue with patents, despite the weakening of the presumption that injunctions should be automatic. These factors may lessen the negative effects that a patentee, troll or otherwise, might suffer from the *eBay* decision.

For the moment, then, predicting the ultimate of the *eBay* decision on court

In light of the potential negative implications of the *eBay* decision on patentees, companies and organisations may need to take measures to mitigate such effects:

- Justice Kennedy pointed out in his concurrence that: “The potential vagueness and suspect validity of some of [the business method and other algorithm] patents may affect the calculus under the four-factor test.” To avoid such ambiguity from persuading the court to deny injunctions, companies should make efforts to provide a clear, enabling disclosure and unambiguous claims when drafting their business method and other algorithm patent applications.
- When possible, companies should try to make and market products based on their patented technology so that they will be able to demonstrate irreparable harm if an injunction is not granted. Having a commercialised product helps companies demonstrate that they will suffer lost profits, the loss of brand name recognition or the loss of market share due to the defendant company’s

continued sale of the infringing product. However, university researchers or self-made inventors may not need to practise their patents because the Supreme Court in *eBay* specifically noted that such technology-originators might be given favourable consideration in granting an injunction even if they have chosen only to license their patents rather than marketing products embodying them.

- Companies should consider avoiding asserting patents against accused products or systems in which the alleged invention of the patent constitutes only a small component of the overall product or system. Justice Kennedy’s concurrence in *eBay* and the district court’s opinion in *z4 Technologies* (see box on page 44) suggest that the extent to which the patented invention is used in an accused product should affect the court’s application of the four-point test in determining whether a plaintiff is likely to suffer irreparable injury without an injunction and whether monetary damages can sufficiently compensate the plaintiff.

rulings in future patent infringement cases remains difficult. The *eBay* decision gives a substantial amount of discretion to district judges in applying the four-point test and deciding whether to grant an injunction.

Because an inherent uncertainty exists as to whether and how courts will decide to deny injunctions, legitimate patentees, like trolls, will also confront difficulty in determining whether an injunction will be granted in a given case. For legitimate companies genuinely concerned with developing, and then protecting with patents, innovative technology, it will be important to monitor closely the development of case law in this area to see how it may affect their competitive intellectual property posture and strategy. ■

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