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Federal Circuit Friday

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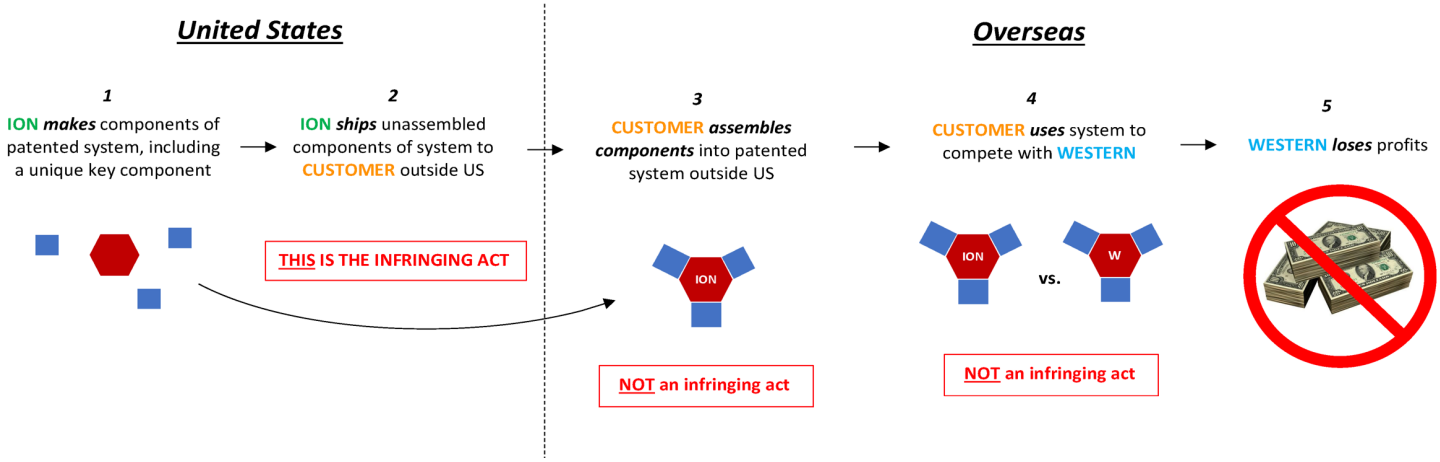
When the US Supreme Court hands down a patent law decision, Federal Circuit Friday temporarily becomes "Supreme Court Friday."

In *WesternGeco v. Ion Geophysical* (June 22), the Supreme Court decided that a patent holder's damages for infringement under 35 USC §271(f)(2)[1] can include profits lost due to *use* of the patented device *outside* the United States to compete with the patent holder. This case might have been wrongly decided, or it might signal a significant expansion of patent damages.

The Facts

To understand the case the facts are critically important. First, Ion made within the United States the components of an ocean floor surveying system that was patented in the United States, including a unique component that was especially made for use in the patented system. Ion never assembled those components within the United States. Second, Ion shipped those unassembled components to customers overseas.[2] Third, the customers assembled the components into finished systems outside the United States, and, fourth, the customers used the systems to compete with the holder of the US patent, WesternGeco. Fifth, that competition caused WesternGeco to lose out on several service contracts and therefore to suffer lost profits. None of the service contracts were entered into within the United States.



[1] Recall that infringement under §271(f) is unique, involving the supply from the United States of either a substantial portion of the components of a patented device or a single, unique component of a patented device, in each case for assembly outside the United States into a device that would infringe a US patent if such assembly occurred within the United States. As eloquently explained by Justice Gorsuch in his dissent in this case, under §271(f) "someone who *almost makes* an invention in this country may be held liable as if he had made the complete invention in this country." (italics in original).

[2] It is not clear whether Ion sold the unassembled components to its customers or whether any such sale occurred within the United States. But it doesn't matter because the sale outside the United States of unassembled components is neither an infringement under §271(a) nor a requirement of either subsection of §271(f).

The Court focused on infringement under §271(f)(2), likely to simplify the analysis and avoid deciding more than absolutely necessary.[3] Under §271(f)(2), the infringing act was Ion's shipping of the specialized component from the United States, accompanied by a specific combination of knowledge and intent.[4] Neither the customers' subsequent *assembly* of the system nor their *use* of the system to compete against WesternGeco infringes the patent under any provision of US patent law[5] and neither act was a necessary prerequisite to Ion's liability under §271(f)(2).[6]

The Issue

The specific issue was whether the general patent damages statute, 35 USC §284, allows for recovery of lost profits caused by Ion's customers' use of the assembled systems to compete against WesternGeco outside the United States – acts that everyone agreed did not infringe the US patent.

Section 284 provides that "the court shall award . . . damages adequate to compensate for the infringement, but in no event less than a reasonable royalty for the use made of the invention by the infringer." Everyone agreed that WesternGeco was entitled at least to a reasonable royalty for ***Ion's*** acts of infringement under §271(f)(2) in shipping the specialized component from the United States. At issue, however, was the award of lost profit damages for 10 survey contracts that WesternGeco lost to ***Ion's customers*** that were using the Ion-supplied system.

WesternGeco contended that it was entitled to the foreign lost profits because but for Ion's supply of the specialized component to its customers, WesternGeco would have won the 10 contracts and made about $90 million in profit. Ion contended that WesternGeco was not entitled to lost profits because each of the 10 contracts involved use of the patented invention exclusively outside of the United States and such extraterritorial use is beyond the jurisdiction of US patent law.[7]

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[3] Under §271(f)(1), the shipping of all or a substantial portion of the components of a patented invention must be accompanied by active inducement of the customer to assemble the components in a manner that would infringe if such assembly was done within the United States. It is not clear whether the required "active inducement" must occur, in whole or in part, within the United States. Also, actual assembly might be required under §271(f)(1) depending on how one interprets the phrase "supply . . . in such a manner as to actively induce the combination of such components outside the United States." The tort could be complete upon the supplier committing an act of inducement regardless of whether such inducement is successful. Or the tort might not be complete until the actual assembly occurs outside the United States. These issues complicate the analysis under §271(f)(1).

[4] Under §271(f)(2), the shipping of the specialized component must be accompanied by knowledge that the "component is especially adapted for use in the invention and not a staple article or commodity of commerce suitable for substantial non-infringing use" and intent that "such component will be combined outside of the United States in a manner that would infringe the patent if such combination occurred within the United States." This required state of mind can exist either within the United States (*e.g.,* on the part of the person who ships the component from the United States) or outside the United States (*e.g.,* on the part of a person who causes the shipping of the component from the United States).

[5] §271(a) applies only to the making or using of a patented invention that occurs within the United States. §271(b) & (c) are each derivative of a direct infringement under §271(a) and therefore are not implicated by the facts. The specialized forms of infringement under §§271(e) and (g) are not applicable to the facts.

[6] Those acts are not elements of the infringement tort defined by §271(f)(2).

[7] Because the contracts were negotiated, formed, and to be performed outside the United States, the "presumption against extraterritoriality," a long-standing legal presumption that federal statutes apply only within the territorial jurisdiction of the United States, becomes relevant. That presumption can be rebutted if the statute at issue provides "a clear indication" that extraterritorial application is intended, and it can be side-stepped if the case involves a domestic application of the statute. Slip. op. at 5 (citing *Morrison v. National Australia Bank Ltd.,* 561 U.S. 247, 255 (2010)(regarding rebuttal) and *RJR Nabisco, Inc. v. European Community,* 579 U.S. __, __ (2016)(slip op. at 9)(regarding side-stepping)).

The Decision

The Supreme Court sided with WesternGeco. The Court determined that that the infringing act under §271(f)(2) is "the domestic act of supplying in or from the United States" a specialized component of a patented invention. In the context of §271(f)(2) infringement, the Court reasoned, §284 is focused on a domestic act of exporting components from the United States such that the presumption against extraterritoriality did not apply.

Thus, in light of the broad language of §284 and its application to a domestic act of infringement, the remedy for infringement under §271(f)(2) extends to lost foreign profits resulting from Ion's customers' use of the US-patented system to compete with WesternGeco outside the United States.

Why the Decision Might Not Be Correct, or Might Signal an Expansion of Patent Damages

There are at least two unusual aspects of the decision that suggest it is not correct or signals an expansion of the scope of damages for patent infringement, both of which are addressed in Justice Gorsuch's dissent.

First, allowing recovery of lost profits for *use* outside the United States of an invention patented in the United States mistakenly "assumes [the US patentee] could have charged monopoly rents abroad premised on a U.S. patent that has no legal force there." Neither 271(f)(2) nor any other provision of US patent law prohibited Ion's customers from competing against WesternGeco outside the United States, regardless of whether they obtained the specialized component and the other unassembled components from Ion in the United States.

Justices Gorsuch and Breyer believe that §284's reference to damages for "the infringement" means damages for acts of infringement under US patent law, which includes only acts occurring within the United States – *e.g.,* making, using, and selling under §271(a) and exporting a specialized component with the requisite state of mind under §271(f)(2). It is for those acts that compensation is due under §284. Compensation is not due for acts that do not amount to infringement under any provision of US patent law.

Thus, the damages remedy under §271(f)(2) should closely track the remedy for infringement under §271(a) – *i.e.,* a reasonable royalty for each US-patented system that was enabled by the export of the specialized components plus lost profits to the extent WesternGeco subsequently lost sales within the United States due to importation of the assembled systems into the United States. No damages should be awarded for foreign sales or use because those acts do not infringe the patent.

In contrast, the majority parsed "legal injury" (infringement) from the "damages arising from that injury" to decide that "damages adequate to compensate for the infringement" under §284 includes recovery of "the difference between [the patent owner's] pecuniary condition after the infringement, and what [the patent owner's] condition would have been if the infringement had not occurred." Essentially this is a "foreseeable harm" standard under which all financial injury resulting from the act of infringement (shipping the unassembled components for assembly abroad) is compensable.[8] The

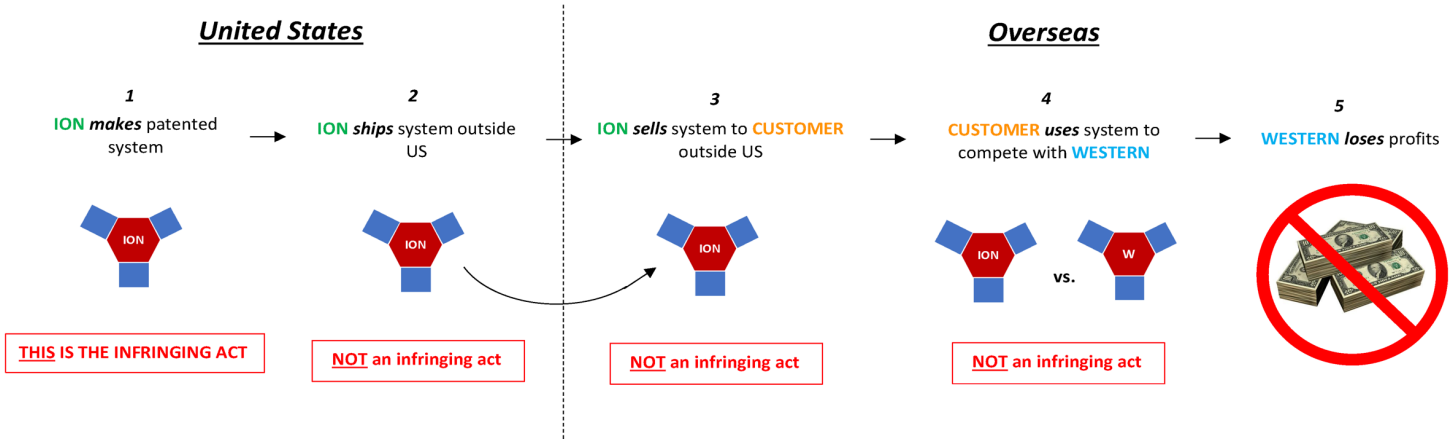
[8] In this sense, the issue is analogous to the convoyed sales doctrine, under which lost sales of unpatented items that are sufficiently functionally related to a patented item can be included in a lost profits remedy. *See, e.g., Warsaw Orthopedic v. NuVasive*, 778 F.3d 1365 (Fed. Cir. 2015), *aff'd on remand at* 824 F.3d 1344 ("A convoyed sale is a sale of a product that is not patented, but is sufficiently related to the patented product such that the patentee may recover lost profits for lost sales") and *Rite-Hite Corp. v. Kelley Co.,* 56 F.3d 1538, 1550 (Fed. Cir. 1995).

majority reached this result almost by default because once a domestic infringing act was identified, extraterritoriality fell to wayside and the majority read "damages adequate to compensate for the infringement" in §284 broadly to include damages for all foreseeable injury inside or outside the United States.

A broad interpretation of the damages remedy under §284 coupled with side-lining the presumption against extraterritoriality sets the stage for the other, and potentially much more significant, aspect of the the decision.

Second, the *reasoning* of the decision could be applied equally to 35 USC §271(a), which provides that it is an infringement to, among other things, make or sell a patented invention within the United States without the patent owner's authorization. If the domestic act of infringement under §271(f)(2) yields damages for foreseeable foreign economic injury, then so should the domestic act of infringement under §271(a) – but as of today, that is not the law.[9]

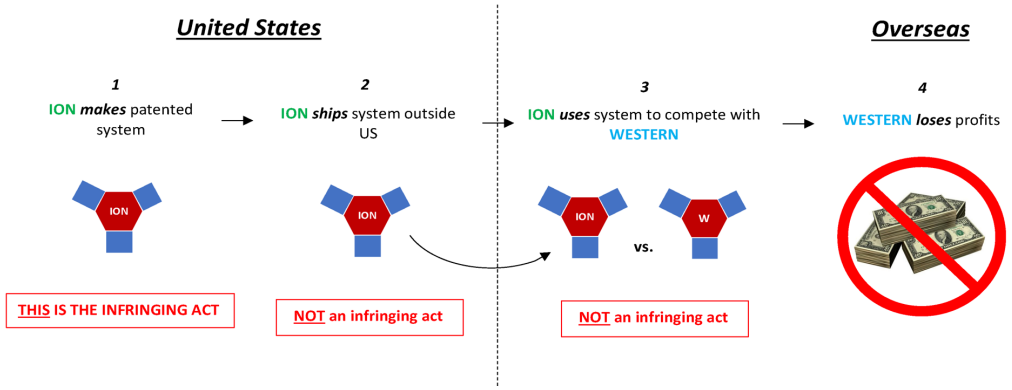
Assume, for example, that Ion had assembled the survey systems within the United States, exported them, and sold them to customers who then used them in competition with WesternGeco on the high seas or elsewhere outside the United States. This hypothetical fact pattern is similar to this case:



This §271(a) scenario involves (i) a domestic act of infringement (*i.e.,* Ion's making of the patented system), (ii) lost profits based on contracts lost outside the United States (*i.e.,* but for Ion's domestic infringement, WesternGeco would have won the contracts), and (iii) infringement damages due per §284. Under the Court's reasoning in this case, the lost profits in this §271(a) scenario should be recoverable because the domestic act of infringement renders the presumption against extraterritoriality inapplicable.

[9] *See Power Integrations, Inc. v. Fairchild Semiconductor Int'l, Inc.*, 711 F.3d 1348 (Fed. Cir. 2013)(In the context of §271(a) infringement where the domestic infringement caused loss of sales in foreign markets, Power Integrations argued that "once a patentee demonstrates an underlying act of domestic infringement, the patentee is entitled to receive full compensation for 'any damages' suffered as a result of the infringement." Sound familiar? But the Federal Circuit held that Power Integrations is not entitled to damages for foreign economic injury – "[i]t is axiomatic that U.S. patent law does not operate extraterritorially to prohibit infringement abroad" and therefore the patent laws of the United States do not "provide compensation for a defendant's foreign exploitation of a patented invention, which is not infringement at all.").

Let's leave the customer out and simplify the scenario by having Ion make the system in the United States, export it, and then use the system to compete directly against WesternGeco:



As with the preceding §271(a) scenario, there is (i) a domestic act of infringement, (ii) lost profits based on contracts lost outside the United States because of that infringement, and (iii) infringement damages due per §284, such that the presumption against extraterritoriality is inapplicable and lost foreign profits should be recoverable.

The majority acknowledged that the Federal Circuit "previously held that §271(a), the general infringement provision, does not allow patent owners to recover for lost foreign sales."[10] So, what is the principled distinction that would preclude the remedy of lost foreign profits in §271(a) scenarios? It cannot be that §271(a) refers to acts "within the United States" because §271(f)(2) also refers to acts occurring domestically ("supplies . . . in or from the United States"). Indeed, a domestic infringing act was the key to side-stepping the presumption against extraterritoriality.

Maybe the distinction is that §271(f)(2) expressly contemplates foreign activity and foreign injury? Perhaps, but that was not the basis or rationale for the Court's decision.

Here's an idea: Maybe there is no principled distinction. The Supreme Court acknowledged the Federal Circuit rule against recovery for foreign lost sales under §271(a), but did not endorse it.[11] If given the opportunity, would the Supreme Court reverse the Federal Circuit rule and allow recovery for foreign sales under §271(a)? If not, then, as Justice Gorsuch points out, the result in this case is anomalous because "[i]t would allow greater recovery when a defendant exports a *component* of an invention in violation of §271(f)(2) then when a defendant exports the *entire* invention in violation of §271(a)."[12]

[10] Slip op. at 3-4 (citing *Power Integrations, Inc. v. Fairchild Semiconductor Int'l, Inc.*, 711 F.3d 1348 (Fed. Cir. 2013)).

[11] *Id*.

[12] Italics in original.