Intellectual Property Alert:
Did Congress Create a New Form of Infringement Without Providing Full Compensation?

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April 18, 2018 — The Supreme Court heard oral arguments April 16, 2018, in *WesternGeco LLC v. ION Geophysical Corporation* (No. 16-1011), another of a series of patent cases in which it may find that a rigid Federal Circuit rule conflicts with the Supreme Court's precedent. The rigid rule holds that damages in the form of lost foreign profits are categorically unavailable to compensate for patent infringement under 35 U.S.C. § 271(f), which codifies infringement liability for *exported* goods.

WesternGeco owns patents that claim systems used to search for gas and oil deposits under the ocean floor, which WesternGeco uses to perform surveys for its customers. ION Geophysical manufactured a component of such a system in the U.S. and sold it to overseas customers who assembled the system and performed surveys. WesternGeco proved that ION infringed its claims under 35 U.S.C. § 271(f)(2) (export of a specially adapted component of an invention patented in the U.S.) and was awarded $12.5 million in reasonable royalties and $93.4 million in lost profits for 10 lost overseas contracts. Because of the different business models of the two litigants, the lost profits of the petitioner dwarf the profits earned by the infringer on the component.

<u>The Federal Circuit decision</u>

Generally, a patent owner can obtain damages by proving either its lost profits or a reasonable royalty. The relevant statute broadly mandates that "the court shall award the [successful infringement] claimant damages adequate to compensate for the infringement….for the use made of the invention by the infringer." 35 U.S.C. § 284. But the Federal Circuit in its panel decision on damages denied lost profits ($93.4 million) as awarded by the Texas jury, because of a "presumption that U.S. law governs domestically but does not rule the world." 791 F.3d 1340, 1350 (Fed. Cir. 2015). The presumption is particularly strong for patent law, the panel stated, citing *Deepsouth Packing Co. v. Laitram Corp.*, a 1972 Supreme Court case that was legislatively overruled by enactment of § 271(f), the very law at issue in the present case. The Federal Circuit affirmed the reasonable royalty awarded ($12.5 million).

The Federal Circuit acknowledged that Congress expanded the territorial scope in 35 U.S.C. § 271(f), but found that Congress failed to expand the scope of the damages provision of § 284, which was not concomitantly amended. The decision also noted that "under § 271(a) the export of a finished product cannot create liability for extraterritorial use of that product." Judge Wallach, in a vigorous dissent, disagreed with the majority's statutory construction and reading of relevant Supreme Court precedent. Indeed, Judge Wallach was so adamant on the issue that he wrote an additional dissent when the case was again before the Federal Circuit on a different issue. 837 F.3d 1358, 1364-69 (Fed. Cir. 2016).

<u>Briefs to the Supreme Court</u>

The petitioner to the Supreme Court, patent owner WesternGeco, focused its brief on statutory construction. It urged that the notion is nonsensical that Congress would amend the categories of infringement in § 271 to add supplying one or more components of a patented invention ***from*** the U.S. for combination ***outside*** the U.S. to form the patented invention, without intending that the infringement would be fully compensable by permitting proof of lost profits ***abroad***. Under a § 271(f) scenario, it was entirely foreseeable that monetary losses would occur from activities abroad. The legislative history did not indicate that damages for this new type of infringement should be limited to the type explicitly referenced as a baseline in § 284, *i.e.,* compensation for the infringement "in no event less than a reasonable royalty."

The U.S. filed an *amicus* brief in favor of petitioner, patent owner WesternGeco. The U.S. urged that barring lost profits measured by activities abroad would prevent adequate compensation within the meaning of § 284. The *amicus* urged that the location in which the economic loss to the patentee occurred was irrelevant because the infringement itself was domestic, as defined in § 271(f). Additionally, it urged that permitting lost profit calculations based on foreign losses would not regulate foreign conduct or implicate extraterritoriality.

Respondent, ION, in its brief characterized the foreign acts as "injuries" that were entirely foreign and separate from the respondent. The foreign acts were the combination by the respondent's customers of the exported components to form the patented system and the use of the system in marine geological surveys. The use of the combined systems by third party customers abroad should not be available as a measure of damages for the respondent's act of supplying the component, it urged.

<u>Oral Arguments at the Supreme Court</u>

The petitioner, the respondent, and the U.S. as *amicus* differed in their characterizations of the acts creating liability as well as the legal basis supporting their desired outcome. The petitioner and the *amicus* characterized the supplying of the component from the U.S. to customers abroad as a domestic injury. They urged that the domestic injury had foreseeable consequences, which damaged the business interests of the petitioner abroad. The foreseeable consequences were the combination of the component into the system and the use of the system in competition with the petitioner. The respondent, in contrast, urged that the supplying was a domestic injury but the damaged business interests were a separate injury that its customers inflicted by using the combined system outside of the U.S. The respondent should not, it urged, be responsible for the separate injury inflicted by others. The remedy for such separate injury, it urged, is patent suits against the customers in foreign countries.

WesternGeco argued to the Court, "[W]e're not collecting damages for the combination itself. What we're doing is we are collecting damages for the foreseeable consequences of the domestic act of infringement." Similarly, the *amicus* argued, "The rule that we're advocating of full compensation is already the rule that applies basically everywhere else in U.S. law, in tort, in contract, in copyright, that this Court previously assumed applied in patent law as well, and it hasn't given rise to any significant foreign relations problems in -- in any of those areas." ION argued, "[I]t is very easy to conceive of why the damages are foreign because there really are two distinct factual injuries here." It provided a test for distinguishing permissible damages from impermissible foreign damages: "Our test is quite simple. In determining whether damages are foreign or domestic, you should look to the situs of the factual injury and you should also look to whether there is subsequent substantial foreign conduct after the act of infringement that gives rise to the injury."

The parties repeatedly tried to use tort hypotheticals to make their points regarding the availability of damages for consequential damages. They posited automobile accidents in the U.S. involving foreign nationals, and automobile accidents occurring on state borders with one collision occurring on each side of the border. The justices seemed to treat these analogies as classic law school examples that illustrate that the tortfeasor is liable for foreseeable, consequential damages. Justice Kagan noted, "[W]hat struck me about your hypo is that it's a classic law school proximate-cause hypo. I mean, that's what that hypo is. And it suggests that if there's a problem here, it's a problem about where you draw the causal line. It's not a problem about some categorical extraterritoriality rule."

The justices questioned the petitioner and *amicus* about how narrowly the presumption against extraterritoriality should be applied. Did the presumption not apply to § 271(f) because it specifically contemplated foreign combination? Did it not apply to all patent damages under § 284? Should the presumption ever apply to damages provisions in general? The petitioner had originally argued only that the presumption should not apply to § 271(f), but the *amicus* had argued that it should not apply to any patent infringement under § 284. When pushed in oral argument, the U.S. could not think of a reason why the presumption should apply to any damage provision. The respondent's argument focused on the application of the presumption to § 284, which failed to explicitly state that damages for foreign losses were compensable.

During arguments of the petitioner, Justice Breyer expressed concern that if the categorical extraterritoriality rule was weakened, other countries might do the same. He posited that chaos might result as other countries tried to regulate the actions of U.S. parties. The *amicus* responded to such scenarios, stating, “All that we’re saying is the right way to approach that problem [comity, international chaos] is with the doctrines of causation in fact and proximate cause that are tailor-made to answer those kinds of questions.” Justice Ginsburg’s comment also seemed to calm these concerns. She stated, “But the liability is [ ] imposed on a U.S. entity. There’s nothing in this picture that regulates anything that occurs abroad. The question is the damages that flow from domestic conduct and not regulation of conduct elsewhere.”

Conclusion

If the petitioner is correct, a ruling in its favor will not change the law but restore *status quo ante* the Federal Circuit’s decision below. The hypothetical floodgates of international comity violations posited by the respondent would thus be unlikely to occur. Some pundits have speculated that a ruling against application of the presumption against extraterritoriality would lead patent owners to more creative damages theories and larger damages awards in the U.S. If true, that might make U.S. patents more valuable.

Click here to download the transcript of the arguments in *WesternGeco LLC v. ION Geophysical Corporation*.