

eBay v. MercExchange:

The Supreme Court Re-establishes the Traditional Four-Factor Test for Awarding Injunctive Relief in Patent and, Presumably, Copyright Cases

By Proprietary Rights Committee, Computer Law Section,
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Introduction

In the *eBay* case, a unanimous Supreme Court held on May 15, 2006 that a permanent injunction under the Patent Act, 15 U.S.C. § 283, is to be granted under the “principles of equity¹” traditionally used by the courts of equity instead of the prior federal circuit’s presumption that an injunction must issue, “absent a sound reason for denying it.²” This ruling came a mere two months too late for Blackberry maker, Research in Motion Ltd. (*i. e.*, “RIM”), who, under threat of a permanent injunction, agreed to settle its long-running patent litigation with the patent holding company NTP Inc. (*i. e.*, “NTP”) for \$612.5 million³. NTP had sued RIM for patent infringement, and it won under the then-prevailing rule of law that a patent holder who won at trial was almost always entitled to a permanent injunction against the sale of the infringing device.

Patent holding companies are often referred to as patent “trolls” — patent owners who have no plan to practice the invention but threaten to shut down a defendant’s commercial operations via injunction if licensing fees are not paid.

In *eBay*, the Supreme Court held that as a matter of statutory interpretation, a court may only grant an injunction when “equitable” as determined by the traditional four-factor injunction test⁴. Also, because the Court stated that “this

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approach is consistent with our treatment of injunctions under the Copyright Act,⁵ it is believed that the Court is or will also require that the same four-factor test be applied in copyright cases. Until now, the lower courts routinely and inevitably grant permanent injunctions in copyright cases under 17 U.S.C. § 102(a) upon a finding of infringement despite the explicit language of the statute that the court “may” grant injunctive relief “on such terms as it may deem reasonable to prevent or restrain infringement of copyright.”⁶

Part I of this report takes a look at the history of the *eBay* case, including the main opinion of the Court and the first and second concurring opinions. Part II of this report looks at how the lower courts may utilize the guidance of the first concurring opinion based on older precedent. Part III of this report looks at how lower courts have already utilized the guidance of the second concurring opinion.

The eBay Case

At the District Court

MercExchange LLC, an invention holding company founded by inventor Thomas Woolston, filed a patent infringement suit in the U.S. District Court for the Eastern District of Virginia against eBay Inc. and its subsidiary, Half.com Inc. MercExchange claimed that the defendants infringed its patents (6,202,051, 5,845,265, and 6,085,176) on e-commerce technology. (U.S. Patents are available at <http://patft.uspto.gov/netahtml/PTO/search-adv.htm>) MercExchange claimed that its patents were infringed by eBay’s “Buy It Now” feature, which allows buyers and sellers to bypass the auction process and complete the transaction at a price set in advance by the seller.

A jury trial resulted in a judgment that eBay had directly and willfully infringed all of the pertinent claims of two of the patents and that those two patents were valid. Following the verdict, the court entered an award of \$25.5 million, but refused to impose a permanent injunction against eBay⁷. In reaching its decision, the court recited the traditional four-factor test, as set forth in the Supreme Court’s 1982 decision in *Weinberger v. Romero-Barcelo*, 456 U.S. 305 (1982), which asks: (1) whether there will be irreparable injury absent an injunction; (2) whether monetary damages will be inadequate to make the patent holder whole; (3) how the hardships between the patent owner and the infringer balance out; and (4) whether the public interest will be harmed by imposition of an injunction.

The court categorically denied the injunction on a finding that MercExchange would not suffer irreparable harm in the absence of an injunction. The court cited the plaintiff’s “lack of commercial activity in practicing the patents.” Furthermore, the court reasoned that MercExchange exists “merely to license its patented technology to others” and that MercExchange was willing to grant licenses to eBay as it had previously done with other companies, but had failed to reach an agreement.

Furthermore, the district court said that denying the motion for an injunction would serve the public interest, because of “the growing concern over the issuance of business-method patents.” This, combined with MercExchange’s licensing practice, was significant, the court said. Finally, the court said that the balance of

hardships weighed in eBay's favor because any harm suffered by MercExchange could be adequately compensated by money damages and because an injunction would result in a complex series of contempt proceedings as eBay tried to work around the patents.

At the Court of Appeals

The U.S. Court of Appeals for the Federal Circuit departed in the opposite direction of the four-factor test, reversed the district court's ruling, and categorically granted the injunctive relief. The court applied its own general rule that courts are to "issue permanent injunctions against patent infringement absent exceptional circumstances."⁸ The court further indicated that injunctions should be denied only in the "unusual" case "in rare instances . . . to protect the public interest."

At the Supreme Court

Main Opinion

Justice Thomas, who delivered the Court's unanimous opinion, agreed that the district court recited the proper test as set forth in *Romero-Barcelo*⁹:

According to well-established principles of equity, a plaintiff seeking a permanent injunction must satisfy a four-factor test before a court may grant such relief. 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.¹⁰

However, the Court noted that the district court abused its discretion by not properly applying the four-factor test. The lower court gave undue weight to the fact that the patent holder was willing to license its patent and did not actually practice the patented inventions. Consequently, the Court said the district court's decision was in tension with the *Paper Bag* case.¹¹

Furthermore, according to the Court, "university researchers" or "self-made inventors," for example, should still be eligible for injunctive relief by satisfying the four-factor test. Such patent holders typically license their patents rather than commercially exploit their patented inventions themselves.

The Court emphasized, citing 35 U.S.C. § 283, that "the Patent Act expressly provides that injunctions 'may' issue 'in accordance with the principles of equity.'"

The Court also rejected the argument that because patents are defined as a type of property, this automatically changes the type of remedy available. This argument had been used by the Federal Circuit in presuming an injunction must issue absent a sound reason for denying it. The Court pointed out that 35 U.S.C. § 261 states that "patents shall have the attributes of personal property '[s]ubject to the provisions of this title,'" (*i.e.*, subject to § 283's imposition of the principles of equity).

According to the Court, this reading of the Patent Statute was consistent with the court's standards for issuing injunctions under the Copyright Act and, in particular, under 17 U.S.C. § 502(a). Copyrights, like patents, are treated as a type of property right (*i.e.*, a right to exclude others from using the property). The Court cited the copyright case *New York Times Co. v. Tasini*, 533 U.S. 483, for the proposition that injunctions will not automatically issue upon an infringement ruling.

Of particular interest is the citation of the court of the *Lumbermen's* copyright case¹² wherein the lower court had denied injunctive relief and limited the plaintiff to the recovery of damages. There, most of the defendant's work consisted of non-infringing material combined with a small amount of infringing material. The lower court found that the amount of misappropriated material was "so insufficient compared to the injury from stopping appellee's use of their enormous volume of independently acquired information that an injunction would be unconscionable."¹³ Consequently, the court held that the lower court's findings would not be disturbed.

Given the language of the Patent Act, the Court finally held, “[t]he decision whether to grant or deny injunctive relief rests within the equitable discretion by the district courts, and that such discretion must be exercised consistent with traditional principles of equity”¹⁴

Because neither lower court had properly applied the traditional four-factor test, the court vacated the Federal Circuit’s judgment and remanded the case back to the district court to properly apply the four-factor test. The Court said it took no position on the question of whether an injunction should issue in the case.

First Concurring Opinion

In the first concurring opinion, Chief Justice Roberts, joined by Justices Scalia and Ginsburg, emphasized that historically (*i.e.*, from at least as early as the 19th century), injunctions have been granted “in the vast majority of patent cases.” According to Justice Roberts’ opinion, such a history does not mean that there is a general rule that a patentee is entitled to an injunction, but “[w]hen it comes to discerning and applying [the four-part test], in this area as others, ‘a page of history is worth a volume of logic.’”¹⁵

Second Concurring Opinion

In a second concurring opinion, Justice Kennedy, joined by Justices Stevens, Souter, and Breyer, suggested that while history might be instructive, the economic function of the patent holder, as well as the nature of the patent being enforced, are also instructive, especially where the patent holders do not use patents as a basis for producing and selling goods, but primarily for obtaining licensing fees.

“When 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. 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.”¹⁶

The “potential vagueness and suspect validity” of some business-method patents, Justice Kennedy said, might well affect the analysis under the four-part test.

Historically, Courts Rarely Denied Permanent Injunctive Relief in Patent Cases Where Liability Has Been Found

As stated in the first concurring opinion, from early on courts have granted injunctive relief “in the vast majority of patent cases.” However, the exercise of judicial discretion in equity gave rise to two exceptions in addition to the traditional equitable defenses of laches and estoppel.

Balance of Hardships

A first exception to the routine enjoining of infringers occurred when the hardship to the infringer if the injunction was granted clearly outweighed the hardship to the patent holder if such relief was not granted.

In *Dorsey Harvester Revolving Rake Co. v. Marsh*¹⁷, the plaintiff patent holder did not manufacture his patented reaping machine, and the defendant infringer in good faith had invested large sums of money in the manufacture of such machines that would be lost if he were enjoined. The court stayed the injunction and only granted the plaintiff damages.

In *Electric Smelting & Aluminum Co. v. Carborundum Co.*¹⁸, plaintiff patent holder and defendant infringers were manufacturers in different industries. In citing the *Dorsey* case with approval, the court stayed the injunction and only awarded damages since it was not, therefore, the case of willful and deliberate entry by an infringer into competition with an established business . . . but rather the infringer in good faith used the patented process in a branch of industry in which the patentee did not do business. Also, such an injunction would destroy the infringer’s existing business and throw 150 people out of work.

*Continental Paper Bag Co. v. Eastern Paper Bag Co.*¹⁹ (*Paper Bag case*) was cited by Justice Thomas as rejecting the categorical rule that “a court of equity has no jurisdiction to grant injunctive relief to a patent holder who has intentionally decided not to use the patent.” A manufacturer of paper bags who had patented a relatively small part of a machine for manufacturing bags, sued a competing manufacturer for infringement, although the patentee was not using or licensing the patented mechanism himself, but rather was using a non-patented mechanism in its machine. The patentee would have suffered substantial injury to his business if his infringing competitor was permitted to use the patented device. Therefore, an injunction issued against the competitor. Therefore, it can be said that the patent holder was using its patent to protect its market even though it was not manufacturing or producing any product covered by the invention.

In *Nerney v. New York, N.H. & H.R.R.*²⁰, an injunction was denied against a defendant railroad which used infringing coupling devices which were a small part of railroad cars. The court emphasized much greater injury would befall the patent infringer and the public than benefit to the patentee if the injunction were to be granted.

In *Foster v. American Machine & Foundry Co.*²¹, the court refused to award an injunction on the ground that the patentee himself neither manufactured the patented device used in a welding system nor granted any licenses for such manufacture. The patented device was but a small part of the overall system. Of interest is that the patent owner was a patent solicitor and a member of the State Bar of New York.

Public Interest

The second exception to the routine enjoining of infringers occurred when the court found that an injunction would sufficiently impair the “public interest” to warrant money damages in lieu of injunction.

In *City of Milwaukee v. Activated Sludge, Inc.*²², (cited with approval in the *Nerney* case), the Seventh Circuit dissolved an injunction that would have affected the sewage disposal for the city of Milwaukee into Lake Michigan to avoid endangering the public health and safety. The patentee was not using its patent and, consequently, an injunction would have caused great harm to the public health and welfare without any substantial benefit to the patentee. Apparently, the sewage could have been treated chemically, but the court did not want to risk the lives and health of more than half a million people.

New Circumstances – Applying eBay to Deny a Permanent Injunction Against Microsoft

Applying the standards set forth in the *eBay* case, together with suggestions contained in the second concurring opinion of Justice Kennedy, the U.S. District Court for the Eastern District of Texas ruled June 14, 2006 that the principles of equity as set forth in a fourpart test did not call for a injunction against Microsoft Corp. (*i.e.*, “Microsoft”), which had been found to have infringed plaintiff’s product activation patents.²³

z4 Technologies Inc. (*i.e.*, “z4”) of Commerce Township, Michigan, holds two patents (6,044,471 and 6,785,825) for methods of limiting unauthorized use of computer software, or product activation. The methods prevent the use of a computer program until the user has “activated” it through the product activation system.

z4 sued Microsoft and AutoDesk Inc. (*i.e.*, “AutoDesk”) for patent infringement. z4 alleged that the product activation system that Microsoft used for its Microsoft Windows and Microsoft Office programs infringed z4’s patents. A jury found infringement and awarded \$115 million to z4. The jury also awarded \$18 million in damages against AutoDesk.

In its ruling on z4’s motion for a permanent injunction against Microsoft, the court noted the four equitable factors that a prevailing plaintiff in a patent infringement dispute must demonstrate to secure permanent injunctive relief, as set forth in *eBay*.

Irreparable Harm. In this case, the court said, there was no showing of irreparable harm to z4 because Microsoft’s infringement of z4’s patents did not interfere with the current or future market for licensing the patents (which was the business of z4 because z4 did not make such production activation systems), and Microsoft does not compete

with z4 in the market for product activation systems. The court said:

There is no logical reason that a potential consumer or licensee of z4's technology would have been dissuaded from purchasing or licensing z4's product activation technology for use in its own software due to Microsoft's infringement. Similarly, Microsoft's continued infringement does not inhibit z4's ability to market, sell, or license its patented technology to other entities in the market. Microsoft does not produce product activation software that it then individually sells, distributes, or licenses to other software manufacturers or consumers. If it did, then z4 might suffer irreparable harm in that Microsoft would be excluding z4 from selling or licensing its technology to those software manufactures or consumers. However, Microsoft only uses the infringing technology as a small component of its own software, and it is not likely that any consumer of Microsoft's Windows or Office software purchases these products for their product activation functionality.²⁴

In the absence of a permanent injunction, the court said, z4 does not stand to lose profits, brand-name recognition, or market share. Thus, the court concluded, there was no irreparable harm.

Adequacy of Legal Remedies. Turning to the next equitable factor – the adequacy of legal remedies – the court concluded that any harm caused z4 by Microsoft's continuing infringement would be adequately compensated by monetary damages in the form of reasonable royalties.

The court rejected the argument that the existence of a right to exclude, the basic right of patent ownership, does not imply that monetary damages are inadequate compensation for infringement. The court did acknowledge that there is a possibility that violation of the right to exclude can result in damages not compensable by damages, but that was not the case here. The court said:

The violation of a patent owner's right to exclude can present a situation where monetary damages cannot adequately compensate the patent holder for that injury. For example, when an infringer saturates the market for a patented invention with an infringing product or damages the patent holder's good will or brand name recognition by selling infringing products that infringer violates the patent holder's exclusionary right in manner that cannot be compensated through monetary damages. This is because it is impossible to determine the portions of the market the patent owner would have secured but for the infringer or how much damages was done to the patent owner's brand recognition or good will due to the infringement.²⁵

In contrast, the court said, in this case, Microsoft's infringement has interfered only with z4's potential income from licensing its patents to Microsoft itself, not to any other portion of z4's market (which again is licensing its patents).

Here, the court quoted from a statement in Justice Kennedy's concurring opinion in *eBay*, which stated that when "a 'patented invention is but a small component of the product the companies seek to produce,' in such a situation, 'legal damages may well be sufficient to compensate for the infringement, and an injunction may not serve the public interest.'"²⁶

Furthermore, the court pointed out that Microsoft would end its infringement starting January 2007, when it planned to introduce its new versions of Windows and Office.

"Calculating the appropriate royalty rate for any future infringement based on the sale of the older Microsoft products should not be too indefinite or difficult," the court said. "Such future damages will not be based on injuries that are difficult to measure such as the loss of market share or damage to brand name recognition and good will, but will be based on a reasonable royalty for each of the infringing products sold by Microsoft."²⁷

Balance of Hardships and Public Interest. Taking up the final two equitable factors – balancing the hardships between the plaintiff and the defendant, and whether the public would be served by an injunction – the court concluded that the potential hardships to be faced by Microsoft under a permanent injunction outweighed the limited and reparable hardships that z4 would suffer in the absence of an injunction. In particular, the court noted Microsoft's claim that redesigning

the software to remove the product activation software was an enormous task requiring enormous resources and that “the repercussions of ‘turning off’ its product activation system are incalculable, particularly in the likely event that the public became aware of the fact that the activation servers were deactivated” and the market became flooded with pirated copies of Microsoft software.

The court also held that the public interest would be harmed by a permanent injunction because Windows and Office are relied on by system builders and the “vast majority” of computer users, and taking those products off the market would harm both retailers and consumers.

The court concluded that application of the four-part equitable test showed that imposition of a permanent injunction was not appropriate in this case.

Conclusion

The *eBay* case has without question reshaped patent litigation strategy and probably also copyright litigation strategy. No longer can patent holders presume the issuance of a permanent injunction absent extraordinary circumstances. The lower courts must now apply the traditional four-factor test which Congress had incorporated into the Patent and Copyright Statutes. Some of the factors that the court must now consider include the following economic factors: irretrievable loss of market share and key personnel, other layoffs, loss of business, loss of goodwill, and even the financial demise of a party.

While the chances of would-be infringers avoiding an injunction are better if they are manufacturing but a small component of a larger system and the patent holder is not commercially exploiting the patented invention, it is still dangerous (*i. e., see the Paper Bag case*) for a would-be patent or copyright infringer to categorically assume that a permanent injunction has no chance of issuing in view of the four-factor test.

Individuals, businesses, and academic institutions throughout this country make inventions, patent those inventions, and seek the patent system’s financial incentives by licensing or attempting to license their patented inventions rather than making and selling their inventions on their own.²⁸ The *eBay* case makes it more difficult, but not impossible, for such patent holders to obtain injunctive relief.

Endnotes

- 1 *eBay Inc. v. MercExchange LLC*, 126 S.Ct. 1837 (2006).
- 2 *Richardson v. Suzuki Motor Co.*, 868 F.2d 1226, 1247 (Fed. Cir. 1989).
- 3 *NTP Inc. v. Research in Motion Ltd.*, 71 BNA’s PTCJ 487.
- 4 *eBay*, 126 S.Ct. at 1839.
- 5 *eBay*, 126 S.Ct. at 1840.
- 6 M. Nimmer, NIMMER ON COPYRIGHT § 14.06[B] at 14-148 (2006).
- 7 275 F.Supp.2d 695 (2003).
- 8 401 F.3d 1323, 1339 (2005).
- 9 *Weinberger v. Romero-Barcelo*, 456 U.S. 305, 311-313 (1982).
- 10 *eBay*, 126 S.Ct. at 1839.
- 11 *Continental Paper Bag Co. v. Eastern Paper Bag Co.*, 210 U.S. 405, 422-430 (1902). (Permanent injunction granted to patent holder against a competitor even though the patent holder was not practicing nor licensing the patent and the invention was a relatively small part of system).

- 12 *Dun v. Lumbermen's Credit Assn.*, 209 U.S. 20, 23-24 (1908). Another copyright case of interest is the case *Abend v. MCA, Inc.*, 863 F.2d 1465, 1479 (9th Cir. 1988), wherein a film maker was not enjoined because of the hardship to the movie producer who had produced a film at great cost while infringing the underlying short story.
- 13 *Id.*
- 14 *eBay*, 126 S.Ct. at 1841.
- 15 *eBay*, 126 S.Ct. at 1842.
- 16 *Id.*
- 17 7 Fed. Cas. 939, 945 (N. 4014) (C.C.E.D. Pa. 1873).
- 18 189 Fed. 710 (C.C.W.D. Pa. 1900).
- 19 210 U.S. 405 (1908).
- 20 83 F.2d 409 (2d Cir. 1936).
- 21 492 F.2d 1317 (2d Cir. 1974).
- 22 69 F.2d 577 (1934).
- 23 *z4 Technologies Inc. v. Microsoft Corp.*, 434 F.Supp.2d 437 (E.D. Tex. 2006).
- 24 *z4*, 434 F.Supp.2d at 440.
- 25 *z4*, 434 F.Supp.2d at 441.
- 26 *eBay*, 126 S.Ct. at 1842.
- 27 *z4*, 434 F.Supp.2d at 442.
- 28 Many colleges and universities earn considerable royalties from their intellectual property. For example, the University of Michigan has reported royalty earnings of \$16.7 million in one year. *See* University of Michigan Tech Transfer, 2005 *Annual Report* (2005).