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Federal Circuit Patent Bulletin: *Energy Recovery, Inc. v. Hauge*

March 20, 2014

"[T]he scope of a consent decree must be discerned within its four corners, and not by reference to what might satisfy the purposes of one of the parties to it."

On March 20, 2014, in *Energy Recovery, Inc. v. Hauge*, the U.S. Court of Appeals for the Federal Circuit (Rader, Reyna, Wallach*) reversed and vacated the district court's order finding Hauge in contempt of its 2001 order adopting the parties' settlement agreement involving U.S. Patents No. 4,887,942, No. 5,338,158, No. 5,988,993, and No. 6,659,731, which related to energy recovery devices used in reverse osmosis known as pressure exchangers. The Federal Circuit stated:

To establish civil contempt, clear and convincing evidence must support each of the following elements: (1) the existence of a valid decree of which the alleged contemnor had actual or constructive knowledge; (2) that the decree was in the movant's favor; (3) that the alleged contemnor by its conduct violated the terms of the decree, and had knowledge (at least constructive knowledge) of such violations; and (4) that the movant suffered harm as a result. At issue in this case is element (3): whether Mr. Hauge by his conduct violated any terms of the district court's 2001 order.

Mr. Hauge argues he did not violate any provision of the 2001 Order. He contends that in reaching the Agreement the parties were both aware of the possibility that he would eventually compete with ERI by selling devices in the pressure exchanger industry. . . . ERI responds that Mr. Hauge is free to develop and commercialize new technology relating to the energy recovery field; he is not, however, able "to appropriate the very pressure exchanger technology" that he explicitly transferred to ERI in 2001.

ERI further emphasizes the "tremendous effort and money" spent developing the allegedly proprietary technology pre-dating the Agreement. To ERI, Mr. Hauge is necessarily employing the same proprietary technology he agreed to transfer. It relies on evidence that Mr. Hauge hired two of ERI's employees who set up [Hauge's company Isobaric Strategies, Inc. (Isobarix)] facility, similar to that of ERI's pre-2001 facility, and that the Isobarix pressure exchanger is made "out of essentially the same ceramic material" as ERI's, the manipulation of which requires special techniques not known outside of ERI.

None of Mr. Hauge's challenged conduct violates any provision of the 2001 Order. . . . The Agreement only required Mr. Hauge to transfer ownership of the pre-Agreement pressure exchanger intellectual property; "cooperate fully in executing any and all documents necessary" to do so; refrain from competing for two years; and announce in a press release that ERI was the "sole source for Pressure Exchangers built pursuant to such patents, patent applications, and technology." Nothing in the 2001 Order expressly precludes Mr. Hauge from using any manufacturing process.

Mr. Hauge's manufacture of the XPR pressure exchanger is not inconsistent with the 2001 Order's requirement that Mr. Hauge transfer all "intellectual property and other rights relating to pressure exchanger technology *pre-dating this Agreement*." Civil contempt is an appropriate sanction only if the district court can point to an order of the court which "sets forth in specific detail an unequivocal command which a party has violated." ERI cannot point to such a command. Mr. Hauge is not claiming ownership of ERI's intellectual property. Nor did Mr. Hauge start selling pressure exchanger products before the expiration of the Agreement's non-compete clause. Finally, if in fact Mr. Hauge is using ERI's manufacturing processes, he may be in violation of the patent laws or state trade secret laws, but he is not in violation of any "unequivocal command" in the 2001 Order.

To the extent the "sole source" language in the Agreement puts an affirmative duty on Mr. Hauge not to create pressure exchangers pursuant to ERI's intellectual property, an infringement analysis would be necessary to determine whether such a violation occurred. As recognized by the district court and conceded by both parties, the instant contempt proceeding does not implicate patent infringement. . . . The district court stated: "[A]lthough the [c]ourt expresses no judgment as to the separate issue of whether Defendant is actually infringing ERI's patents, [Mr. Hauge] does little to dispel any doubt that he is in fact using ERI's technology." Because ERI explicitly stated during the contempt hearing that it was not alleging contempt on the basis that Mr. Hauge's new pressure exchanger . . . infringes any of ERI's patents, the district court was not required to address patent infringement.

The district court was also concerned by Mr. Hauge's conduct in hiring two (then current) employees of ERI. Mr. Hauge admitted hiring the ERI employees, explaining they were "skilled trade persons . . . and of course no one would hire at this cost and expect no benefit from past work experience." Mr. Hauge's professed motivation for the hires was that when he was the president of ERI, "we basically went through the complete setup of commercial production. And what we were about to do was pretty much all over again doing what I did in [19]98." This conduct does not violate any provision of the 2001 Order, however. While it may constitute trade secret misappropriation, that would not justify a finding of contempt in this case. Notably, ERI's trade secret claim in California state court based on the same conduct resulted in a unanimous jury verdict in favor of Mr. Hauge. The district court found that Mr. Hauge had "violated the letter and spirit of the [] Agreement."

However, [a] consent decree must be discerned within its four corners: Consent decrees are entered into by parties to a case after careful negotiation has produced agreement on their precise terms. The parties waive their right to litigate the issues involved in the case and thus save themselves the time, expense, and inevitable risk of litigation. Naturally, the agreement reached normally embodies a compromise; in exchange for the saving of cost and elimination of risk, the parties each give up something they might have won had they proceeded with the litigation. *Thus the decree itself cannot be said to have a purpose*; rather the parties have purposes, generally opposed to each other, and the resultant decree embodies as much of those opposing purposes as the respective parties have the bargaining power and skill to achieve. *For these reasons, the scope of a consent decree must be discerned within its four corners, and not by reference to what might satisfy the purposes of one of the parties to it.*

Because Mr. Hauge did not violate any provision of the 2001 Order, the district court abused its discretion in holding Mr. Hauge in contempt. That finding is accordingly reversed.