

Privilege And Adverse Inferences In Patent Infringement Litigation

BY ROY SIMON

These are anxious times for patent litigators. In September 2003, in a highly unusual move, the Federal Circuit announced that it was reconsidering some key Federal Circuit precedents. In *KnorrBremse Systeme Fuer Nutzfahrzeuge GmbH v. Dana Corp.*, 344 F.3d 1336, 68 U.S.P.Q.2d 1383 (Fed. Cir. 2003), the Federal Circuit announced *sua sponte* that it was taking the appeal en banc skipping the usual review by a three judge panel so that the court could "reconsider its precedent concerning the drawing of adverse inferences, with respect to willful patent infringement, based on the actions of the party charged with infringement in obtaining legal advice, and withholding that advice from discovery." The court then articulated four specific questions, including the following two that I will focus upon in this article:

1. When the attorney-client privilege and/or work product privilege is invoked by a defendant in an infringement suit, is it appropriate for the trier of fact to draw an adverse inference with respect to willful infringement?
2. When the defendant has not obtained legal advice, is it appropriate to draw an adverse inference with respect to willful infringement?

Because these issues are so important, the court welcomed *amicus curiae* briefs from bar associations, trade or industry associations, and government entities. Recognizing how much was at stake, eighteen separate entities took up the invitation to submit amicus briefs. Oral argument was held on February 5, 2004, and the entire patent bar is anxiously awaiting the Federal Circuit's en banc opinion. This article will focus on the context and background of the *KnorrBremse* case.

The scenarios giving rise to the problem

Suppose Patentee sues Infringer for willfully infringing Patentee's patent on a new kind of veeblefitzer. (In case you did not read Mad magazine when you were growing up, a "veeblefitzer" is a Yiddish widget.) The claim that the infringement was willful is important because, under 35 U.S.C. § 284, a court that finds willful infringement has discretion to award up to treble damages and to order the willful infringer to pay the patent holder's attorney fees for the litigation. (Willfulness is established when a consideration of the "totality of the circumstances" shows, by clear and convincing evidence, that the infringer acted in disregard of the patent and had no reasonable basis for believing it had a right to engage in the infringing acts.) If infringement is accidental or innocent, however, the court does not have discretion to award increased damages for infringement.

To refute the claim that the infringement was willful, *Infringer may offer an advice-of-counsel defense i.e.*, "We consulted patent counsel before we began marketing the product, and counsel advised us that our product would not infringe on Patentee's patent, so our infringement, if any, was not willful." An opinion from counsel is not dispositive, but it is a factor in determining whether infringement was willful.

But what if the Infringer refuses to divulge the content of counsel's opinion on grounds that counsel's advice is protected by the attorney client privilege? In that situation, is it appropriate for the court to draw the adverse inference that the advice of counsel was negative? In other words, should the court infer that Infringer's counsel advised Infringer that marketing the veeblefitzer would infringe on Patentee's patent? This is one of the questions posed in the *KnorrBremse* case.

And what if Infringer did not even obtain an opinion of counsel before using Patentee's patented product? Does a failure to obtain the advice of counsel avoid the Scylla and Charybdis of either producing a damning opinion ("Marketing your product will infringe the patent") or withholding the opinion on privilege grounds and suffering a powerful adverse inference? This question is also posed in *KnorrBremse*.

In sum, when a patent holder sues a possible infringer for willful infringement, the courts always confront one of three scenarios: (1) the defendant never obtained an opinion of counsel before commencing the allegedly infringing activity; (2) the defendant obtained an opinion of counsel but refuses to waive the attorney client privilege; or (3) the defendant obtained an opinion of counsel and waives the attorney client privilege that would otherwise protect counsel's opinion letter and related advice. I now turn to the law governing the first two scenarios - no opinion, or an opinion but no waiver.

The precedents under reconsideration

In its order deciding *sua sponte* to take the *KnorrBremse* case en banc, the Federal Circuit said it would reconsider the court's precedents concerning adverse inferences that arise in willful patent infringement litigation if the party charged with infringement obtained pre-infringement legal advice but withholds that advice from discovery. The Federal Circuit expressly cited two examples ("*See, e.g.*") of these precedents: *Kloster Speedsteel AB v. Crucible Inc.*, 793 F.2d 1565 (Fed.Cir.1986); and *Underwater Devices, Inc. v. MorrisonKnudsen Co.*, 717 F.2d 1380 (Fed.Cir.1983). Those two cases therefore furnish a logical starting place for looking at the existing law regarding adverse inferences.

Underwater Devices, Inc. v. MorrisonKnudsen Co. concerned defendant's alleged infringement of a patented method and apparatus for laying underwater pipes such as sewer lines. The defendant obtained a favorable opinion from a lawyer, but not until after it commenced the allegedly infringing activity. The District Court found that the infringement was willful and awarded treble damages. The Federal Circuit affirmed, stating:

Where, as here, a potential infringer has actual notice of another's patent rights, he has an affirmative duty to exercise due care to determine whether or not he is infringing. Such an affirmative duty includes, *inter alia*, the duty to seek and obtain competent legal advice from counsel before the initiation of any possible infringing activity.

MorrisonKnudson ("MK") argued that it had proceeded with the infringing activities in good faith based on the advice of its own in-house counsel (a man named Schlanger), but the Federal Circuit disagreed because:

... M-K knew or should have known that it proceeded without the type of competent legal advice upon which it could justifiably have relied. M-K knew that the attorney from whom it sought advice was its own in-house counsel. While this fact alone does not demonstrate M-K's lack of

good faith, it is a fact to be weighed. In addition, M-K knew or should have known that Mr. Schlanger was not a patent attorney. Again, this fact alone is not controlling, but does bear on the question whether M-K, when it sought advice, did so in good faith.

The court added that M-K could have tried to demonstrate that "despite any inference arising from these circumstances, it was in fact justified in believing Mr. Schlanger was capable of rendering an independent and competent opinion because he did take the steps normally considered to be necessary and proper in preparing an opinion," but Morrison-Knudson failed to do so. Thus, the memoranda "clearly demonstrated" M-K's willful disregard for the patents in question.

In *Kloster Speedsteel*, the court addressed a situation in which the alleged infringer had never sought or obtained an opinion from counsel as to whether marketing a certain type of steel in the United States would infringe on the plaintiff's patent. The infringer was well aware of the plaintiff's patent, but consciously decided to adopt an "aggressive strategy" in which it would first market the steel and then search for prior art in the Patent Office, the patent literature, and the technical literature. If the evaluation of the prior art yielded the right result, the defendant (the infringer) would seek a declaratory judgment that the patents in question were invalid. The District Court did not find the infringement to be willful, but the Federal Circuit reversed.

The Federal Circuit began its opinion by quoting from the *Underwater Devices* case, repeating that where a potential infringer has actual notice of another's patent rights, "he has an affirmative duty to exercise due care to determine whether or not he is infringing," including the duty to "seek and obtain competent legal advice from counsel before the initiation of any possible infringing activity." A mere hope that the patent in question will be held invalid, the Kloster court said, "cannot substitute for the advice of competent counsel before the onset of infringement" In a significant footnote, the court added:

An "aggressive strategy" unsupported by any competent advice of counsel, thorough investigation of validity and infringement, discovery of more pertinent uncited prior art, or similar factors, is the type of activity the reference in the patent law to increased damages seeks to prevent. An alleged infringer who intentionally blinds himself to the facts and law, continues to infringe, and employs the judicial process with no solidly-based expectation of success, can hardly be surprised when his infringement is found to have been willful.

In other cases, the Federal Circuit has since elaborated on the nuances of adverse inferences. In *Fromson v. Western Litho Plate and Supply Co.*, 853 F.2d 1568 (Fed. Cir. 1988), for example, the court said: "Where the infringer fails to introduce an exculpatory opinion of counsel at trial, a court must be free to infer that either no opinion was obtained or, if an opinion were obtained, it was contrary to the infringer's desire to initiate or continue its use of the patentee's invention." In *Electro Medical Systems, S.A. v. Cooper Life Sciences, Inc.*, 34 F.3d 1048 (Fed. Cir. 1994), the court held that "when an infringer refuses to produce an exculpatory opinion of counsel in response to a charge of willful infringement, an inference may be drawn that either no opinion was obtained or, if an opinion was obtained, it was unfavorable." An inference that an opinion was unfavorable does not foreclose consideration of other relevant factors because "[p]ossession of a favorable opinion of counsel is not essential to avoid a willfulness determination; it is only one factor to be considered" but it is "an important one." And in *L.A. Gear, Inc. v. Thom McAn Shoe Company*, 988 F.2d 1117 (Fed. Cir. 1993), a case originating in the Southern District of New York, the Federal Circuit reversed the district court's finding that the defendant's infringement of

plaintiff's sneaker design was not willful. Noting that the infringer had introduced "no evidence of whether it obtained an opinion of counsel that the '081 patent was not valid or not infringed, or any other support for a good faith belief that it was entitled to perform the infringing acts," the Federal Circuit said:

Although a party to litigation may indeed withhold disclosure of the advice given by its counsel, as a privileged communication, it will not be presumed that such withheld advice was favorable to the party's position. We have held that the assertion of privilege with respect to infringement and validity opinions of counsel may support the drawing of adverse inferences.

A particularly interesting case in light of the Federal Circuit's pending review of its precedent is *Pioneer HiBred International, Inc. v. Ottawa Plant Food, Inc.*, 219 F.R.D. 135 (N.D. Iowa 2003). In *Pioneer*, the alleged infringer (Ottawa) claimed to have obtained an opinion of counsel that it was not infringing Pioneer's patents, but Ottawa refused to disclose the specifics of the opinion on grounds of attorney-client privilege and the work product doctrine. Pioneer filed a motion in limine seeking (a) to exclude the opinion from evidence, and since there would then be no evidence of an opinion (b) to permit the trier of fact to draw adverse inferences from Ottawa's failure to disclose the specifics of the purported opinion. Ottawa pointed out that the Federal Circuit was currently reconsidering its precedent concerning adverse inferences, but Pioneer countered that the en banc decision in *KnorrBremse* was likely to have prospective effect only. The District Court resolved this dispute by saying:

... The court doubts that any change in the adverse inference rule wrought by a forthcoming decision in the *KnorrBremse* case would have only prospective effect, where the parties in ongoing litigation have raised the same issue. However, the court also believes that it is inappropriate for this court to attempt to predict or anticipate what the ruling of the Federal Circuit Court of Appeals may be at some indefinite time in the future. Rather, the court must follow what is controlling law at this time. Moreover, the court believes that the issue of admissibility of Ottawa's purported opinion of counsel presented here is less a question of the continued viability of the adverse inferences rule than it is a question controlled by the balancing of probative value against unfair prejudice under Rule 403 of the Federal Rules of Evidence.

... Controlling law currently holds that asserting privilege or otherwise failing to produce an opinion of counsel may support adverse inferences with respect to willfulness. However, ... controlling law also holds that allowing a party to assert privilege as to an opinion of counsel, then admitting evidence of that opinion of counsel, to establish an inference that the party acted in a legally responsible manner with respect to infringement, would prejudice the opposing party.

Consequently, based on Rule 403, the court excluded any evidence of Ottawa's purported opinion of counsel "unless Ottawa withdraws its claim of attorney-client or work-product privilege and discloses the documents embodying the purported opinion of counsel of non-infringement"

How should the Federal Circuit decide *KnorrBremse*?

How should the Federal Circuit decide *KnorrBremse*? To help answer that question, I will now look at various amicus briefs filed with the Federal Circuit. The Federal Circuit Bar Association ("FCBA"), a national organization of 2,600 attorneys who practice before the Federal Circuit, noted that willful patent infringement is ultimately found in only a small fraction of litigated cases but is pleaded in almost every

case because of "a possible financial windfall and the opportunity to investigate the mind of the adversary's counsel." Consequently, the burdens involved in litigating issues of privilege, waiver and potential disqualification "are imposed on virtually every litigant and every trial court." The FCBA then evaluated the current situation as follows:

Current law encourages asserting willfulness and exacerbates the discovery problems associated with it. Under applicable precedent, anyone who fails to obtain an exculpatory opinion before committing an infringing act risks being labeled willful and anyone who obtains an opinion but asserts privilege for it risks the inference that the advice was unfavorable, an overwhelming problem in a jury trial. While the burden of proving willfulness is ostensibly imposed on the patentee, the combination of the affirmative duty to seek legal advice and the adverse inference drawn from the failure to disclose it effectively shifts the burden. Once the patentee proves the infringer knew of the patent, it becomes the infringer's burden to prove it exercised good faith.

As a result, clients must retain both opinion counsel and trial counsel and isolate them from each other to avoid disqualification issues. When privilege is waived, as it usually is, there are disputes over the scope of the waiver, a matter about which the district courts impose widely divergent rules....

The FCBA then explained why it opposes the Federal Circuit's existing precedent regarding adverse inferences.

Clients may well have entirely positive reasons to invoke privilege. A favorable candid opinion may contain trial strategies or raise possible defenses, arguments, and adverse theories that may appear to be admissions to a jury. A client may be confident in its defenses but not wish to educate its opponent with an opinion that addresses adverse positions and issues, or subject itself to the burdens of the ensuing discovery and the uncertainty as to the scope of the waiver.

The Association of the Bar of the City of New York, acting through its Committee on Patents, acknowledged in its amicus brief that the issues were "not straightforward." The Committee's vote with respect to each issue was closely split.

The Committee opposed the adverse inference that currently arises when an alleged infringer refuses to waive the attorney-client privilege. The current dominance of the legal advice factor "reflects the importance the Court has placed on the policy of encouraging the use of qualified counsel to avoid infringement and determine the potential exposure in infringement suits." Obtaining and waiving competent exculpatory legal advice is now "a practical necessity" to avoid the possibility of treble damages, which are punitive and not compensatory. Although courts state that the negative inference is not by itself determinative of willfulness, "an infringer's inability to produce sufficient evidence to rebut the inference can have no other outcome."

To avoid the negative inference of willful infringement by asserting good faith reliance on advice of counsel, the infringer must waive the attorney-client privilege attached to the opinion. This is bad policy. The adverse inference for refusing to waive the attorney-client privilege punishes those who sought advice but "cannot disclose it in litigation for good and sufficient reasons based on the intimate, privileged relationship of client and counsel." This leads to a "pernicious paradox," and permits punitive

damages (i.e., up to treble the actual damages) based on a much lower standard that is required for a plaintiff to obtain punitive damages in other fields of law. In *State Farm Mutual Auto Ins. Co. v. Campbell*, 123 S. Ct. 1513 (2003), for example, the Supreme Court held that punitive damages should be awarded only when culpability is so reprehensible as to warrant punishment or deterrence. Moreover, no such negative inference arises when a defendant refuses to disclose advice of counsel in other fields of law, such as trademark infringement or breach of contract.

Regarding infringers who failed to seek legal advice at all after notice of a relevant patent, however, the City Bar split into three. A slim majority favored retaining the adverse inference against those who fail to seek legal advice, arguing that it encourages potential infringers to seek the advice of patent counsel. But a significant minority opposed the adverse inference for those with no opinion, arguing that infringers "should not have to obtain legal advice in lieu of an opinion of one of ordinary skill." Still other members of the Committee opposed the adverse inference unless there was "actual notice of infringement, such as of the type that would be considered sufficient to support a declaratory judgment action." The Committee concluded:

Certainly, when no legal advice is obtained after the infringer obtains actual notice of the patent, imposing an adverse inference seems more appropriate. When notice is more attenuated, however, imposing an adverse inference seems less appropriate. The discomfort with the negative inference may be due more to the liberal construction of "notice" under willfulness jurisprudence than the imposition of an adverse inference.

The New York Intellectual Property Law Association ("NYIPLA"), an association of more than 1,300 attorneys who practice patent, copyright, trademark, and other intellectual property law, noted that infringement defendants armed with an opinion of counsel are currently "force fed" a difficult choice either waive the privilege or suffer an adverse inference that supports a finding of willfulness. Most defendants waive the privilege because an adverse inference can be devastating, especially in jury trials. This choice "undermines the attorney-client privilege and work product immunity" and is "unduly prejudicial and unnecessary to effectuate the patent laws." Accordingly, like the City Bar, the NYIPLA urged the Federal Circuit to hold that a defendant's invocation of the attorney-client privilege and work product immunity "does not give rise to an adverse inference with respect to willful infringement."

Breaking with the City Bar, however, the NYIPLA urged the Federal Circuit to hold that no adverse inference of willful infringement should arise "merely from the fact that the defendant did not obtain an opinion of counsel." Defendants without an attorney's opinion "may honestly believe that a patent is invalid, not infringed or unenforceable." An adverse inference might be appropriate when a defendant had an "obligation" to seek legal advice before the filing of an infringement suit but failed to do so. However, whether an obligation to seek legal advice existed "should depend on the totality of the circumstances, not solely on whether the defendant had actual notice of a patent." That rule "will better encourage defendants to obtain opinions of counsel, without punishing those who had actual notice and a reasonable basis for not seeking advice."

The Biotechnology Industry Organization ("BIO"), a trade association of over 1000 companies, academic institutions, and biotechnology centers involved in researching and developing healthcare, agricultural and environmental products, urged the Federal Circuit to abandon the adverse inference that arises when a defendant claims the attorney-client privilege because that inference "unduly burdens innovators by creating a need to obtain legal opinions solely to defend against a willfulness finding and possible treble damages, and discourages obtaining objective legal advice required for everyday decision-making."

High Cost of Competent Opinion

BIO also urged the Federal Circuit to abandon the adverse inference that arises when a defendant has not obtained an opinion from counsel. Even when a company obtains an opinion of counsel, the opinion might not overcome the adverse inference because "courts have questioned the competency of oral opinions; opinions from "in house" and foreign counsel; those not analyzing the prosecution history or covering every infringement and validity theory; etc." The result, BIO continued, is that:

[A] prototypical "exculpatory opinion" can carry quite a price tag. "Simple" opinions can start at \$10,000, but complicated ones have been known to creep beyond \$100,000!

However, even at these princely sums utterly vast for most biotechnology companies there are no guarantees that the duty of due care has been discharged successfully once, at trial, a hindsight analysis exposes some lacuna in the law or misunderstanding of a complex bucket of facts.

Therefore, instead of demanding those defendants secure a "full, formal, competent legal opinion that is decisively exculpatory, less formal manifestations of appropriate care ought to suffice."

The American Bar Association ("ABA") noted that not only the defendant but also the defendant's lawyer "faces a Hobson's choice." By giving candid advice, a lawyer places the client at risk, because the client must later either disclose the candid opinion or suffer an adverse inference for refusing to disclose it. "The lawyer's only alternative is to produce a sanitized opinion in the nature of a brief with the expectation that it will be disclosed," the ABA concludes. The adverse inference that punishes nondisclosure "not only undermines the privilege but may well tarnish the advice given."

Conclusion: Split the baby?

The amicus briefs generally favor dropping the adverse inference that arises when a defendant refuses to disclose a pre-infringement opinion of counsel based on attorney-client privilege grounds, because these opinions may also discuss legal strategies and other information that a defendant legitimately does not want to disclose. But I do not understand why that problem cannot be dealt with by redaction. The main question is whether and why counsel concluded that the planned conduct would or would not infringe the plaintiff's patent. An adverse inference seems fair if a defendant claims that it received a favorable opinion of counsel, but refuses to disclose counsel's conclusion and reasoning. It isn't fair for the defendant to have it both ways.

On the other hand, failing to obtain any opinion at all may well be justified, and the virtual requirement of obtaining an opinion of counsel under today's adverse inference precedent seems unduly burdensome to innovative companies struggling to stay alive in a world of giants. Whether an adverse inference

should arise should depend on the totality of the circumstances, including all of the reasons that a defendant chose not to obtain an opinion from counsel, and what alternatives it pursued. By splitting the baby in this way keeping one adverse inference but dropping the other the Federal Circuit can preserve both fairness and common sense in patent infringement litigation.

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