

September 17, 2004

Federal Circuit Reverses Adverse Inference Rule for Failure to Produce Exculpatory Advice of Counsel

On September 13, 2004, the United States Court of Appeals for the Federal Circuit ("Federal Circuit") issued a decision reversing the longstanding adverse inference rule in patent cases with regard to an accused infringer's failure to produce an advice of counsel letter. The Federal Circuit's *en banc* decision in *Knorr-Bremse Systeme Fuer Nutzfahrzeuge GMBH v. Dana Corp.*, Fed. Cir. No. 01-1357, -1376, 02-1221, -1256, overturns *Kloster Speedsteel AB v. Crucible Inc.*, 793 F.2d 1565, 230 USPQ 81 (Fed. Cir. 1986). This is an important decision because it allows accused patent infringers to seek advice of counsel about potential infringement claims while reducing the risk that a later decision not to disclose the contents of that advice will be held against it in the court's evaluation of willfulness.

The Adverse Inference Rule Prior to This Decision

Companies accused of patent infringement regularly seek the advice of counsel to determine whether a threatened or actual infringement claim has any merit. This advice letter (sometimes called an opinion of counsel) usually encompasses an analysis of the likelihood that the company's product or process infringes the asserted patent and/or an analysis of the validity of the patent. Under *Kloster Speedsteel*, if an accused infringer did not produce an advice of counsel letter opining that there was no likely infringement and/or that the patent was invalid, the court could infer that the advice of counsel opinion was unfavorable to the accused infringer. A company that had been notified of a possible infringement claim thus faced a difficult decision:

- If it received an unfavorable advice of counsel letter, producing it at trial would support a finding of willful infringement and the treble damages that can accompany it.
- If it received an unfavorable advice of counsel letter, refusal to produce it at trial on the basis of the attorney-client privilege and/or the work-product privilege would lead the court to infer that the contents of that letter were unfavorable. Indeed, even if a favorable opinion were obtained but a litigant decided not to rely upon it (out of concern, for example, of the scope of any waiver), a negative inference would be drawn.
- Failure to ask for an advice of counsel letter after a company had been put on notice of an infringement claim might also support a finding of willfulness.

The Federal Circuit's Decision in *Knorr-Bremse*

In December 1998, Knorr-Bremse notified Dana, an American corporation, of patent disputes in Europe with Dana's affiliate Haldex involving certain brake technology. In August 1999, Knorr-Bremse again notified Dana of ongoing patent litigation with Haldex and that Knorr-Bremse's '445 patent had issued in the United States the month before. Knorr-Bremse sued Dana and Haldex in May 2000. On the issue of willful infringement, Haldex told the court that it had consulted European and U.S. counsel about the Knorr-Bremse patents but did not produce any advice of counsel letters. Dana told the court that it relied on Haldex's work on this issue. After infringement was decided in favor of the patent holder, the Eastern District of Virginia inferred that the legal opinions Haldex sought for itself and Dana were unfavorable, and found them liable for willful infringement. *Knorr-Bremse Systeme Fuer Nutzfahrzeuge GMBH v. Dana Corp.*, 133 F. Supp. 2d 843, 863 (E.D. Va. 2001).

Judge Pauline Newman, writing for the court, resolved the four questions posed for *en banc* review as follows:

- **No adverse inference from invocation of the attorney-client or work product privileges.**

It is not appropriate for the trier of fact to draw an adverse inference with respect to willful infringement when the defendant in an infringement suit invokes the attorney-client privilege and/or work product privilege. Judge Newman noted that the adverse inference “can distort the attorney-client relationship, in derogation of the foundations of that relationship,” and that a “special rule” affecting that relationship in patent cases was not warranted.

- **No adverse inference from an accused infringer’s failure to consult counsel.**

It is not appropriate to draw an adverse inference with respect to willful infringement when the defendant has not obtained legal advice. There is no legal duty for accused infringers to consult with counsel, especially in light of the “burdens and costs of the requirement, as pressed in litigation, for early and full study by counsel of every potentially adverse patent of which the defendant had knowledge,” a point urged by the many amicus curiae in the case.

- **The willful infringement finding was vacated and remanded.**

Because elimination of the adverse inference drawn by the district court is a material change in the totality of the circumstances, the finding of willful infringement in the case was vacated and remanded for reconsideration of the evidence on that issue. The court expressly declined to say whether or not counsel was consulted is part of the totality of the circumstances to be considered by the fact finder. The court also vacated the award of attorneys fees in light of its vacatur on willfulness.

- **A substantial infringement defense is no per se bar to willfulness.**

The existence of a substantial defense to infringement is not sufficient to defeat liability for willful infringement even if no legal advice has been secured, but instead is to be considered with others as part of the totality of the circumstances. The court noted that “We deem this approach preferable to abstracting any factor for per se treatment, for this greater flexibility enables the trier of fact to fit the decision to all of the circumstances.”

Judge Timothy Dyk agreed with the elimination of the adverse inference from the failure to disclose opinion of counsel. However, he disagreed with the majority opinion to the extent that it can be read as reaffirming the proposition in *Underwater Devices, Inc. v. Morrison-Knudsen Co.*, 717 F.2d 1380, 219 USPOQ 569 (Fed. Cir. 1983), that a potential infringer with actual notice of another’s patent rights has an affirmative duty to exercise due care to determine whether or not he is infringing.

Whatever justification there may have been for the due care approach in the past, according to Judge Dyk, that doctrine has been undermined by the Supreme Court rulings since 1996. In *BMW of N. Am., Inc. v. Gore*, 517 U.S. 559 (1996), and decisions that followed, the Court required as a matter of due process a finding of reprehensibility for an award of punitive damages. Awards of enhanced damages under 35 U.S.C. §284 are a form of punitive damages which may be warranted for certain types of willful infringement, but a potential infringer’s mere failure to engage in due care is not itself reprehensible conduct, he explained.

Judge Dyk concluded:

Patent law is not an island separated from the main body of American jurisprudence. The same requirement of reprehensibility restricts an award of enhanced damages in patent cases as in other cases. When an infringer merely fails to exercise his supposed duty of care, there are “none of the circumstances ordinarily associated with egregiously improper conduct” that could be sufficiently reprehensible to warrant imposition of punitive damages, as in *Gore*.

* * *

This information is not intended as legal advice, which may often turn on specific facts. Readers should seek specific legal advice before acting with regard to the subjects mentioned herein.

If you have any questions concerning the material discussed in this client alert, please call any of the following members of our Patent Practice Group:

Kurt Calia	202.662.5602	kcalia@cov.com
Elizabeth Brown	415.591.7082	eabrown@cov.com

Covington & Burling is one of the world's preeminent law firms known for handling sensitive and important client matters. This alert is intended to bring breaking developments to our clients and other interested colleagues in areas of interest to them. If you do not want to receive alerts like this in the future, please contact us by sending an e-mail to unsubscribe@cov.com.