

Ding-Dong, the Inference Is Dead

When *Knorr-Bremse* killed the adverse inference rule, accused patent infringers got their attorney-client privilege back.

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Imagine you were managing a small company before Sept. 13, 2004. One day a letter arrives, most likely on law firm stationery and sent by registered mail. The letter informs you of a patent that the owner—whose sole business may be enforcement of patents—insists your company is infringing.

The letter presents a choice: Stop what you are doing, or take a royalty-bearing license (usually accompanied by a steep “sign-up” fee). The letter informs you that if your company continues on its current course, it will be willfully infringing the owner’s patent rights and may be liable for up to treble damages.

You consult with your patent counsel and learn that your company needs to investigate the claim made in this notice letter and may need to negotiate a license. If your company concludes that the patent is invalid or that your activities do not infringe, you may certainly choose not to pay the licensing fees—but you should still obtain an exculpatory opinion from your patent counsel to defend against a charge of willful infringement.

“How much,” you wonder aloud, “will such an opinion cost?”

“Well,” replies your counsel, “there is a broad range, but you should think in the range of \$10,000 to \$100,000.”

“Because they sent us a simple letter?”—a letter that you later learn was mailed to you and everyone else in your industry.

“Yes,” she patiently explains. “Under current law, you not only have a duty to avoid infringement, but if you have reason to believe you may be infringing, you also must obtain an exculpatory opinion. The opinion should show that after careful consideration of the patents and your products, counsel concludes that your activities are legal.”

“Do you mean that for the cost of that letter, they can force an entire industry to go through this? Why, this is blackmail!”

“It gets worse,” your counsel says. “If they sue, you have to waive the attorney-client privilege in the opinion, or the

judge will all but assume you're a willful infringer."

"And," she continues, "you can expect the patent owner to use that waiver to attempt to obtain discovery of your communications with all the lawyers involved in your defense."

You shake your head in disbelief.

Since Sept. 13, all that has changed. In its long-awaited decision, an almost unanimous U.S. Court of Appeals for the Federal Circuit, sitting *en banc*, overturned 18 years of precedent to revoke the so-called adverse inference rule. In the case of *Knorr-Bremse Systeme für Nutzfahrzeuge GmbH v. Dana Corp.*, the court concluded that the adverse inference rule inappropriately interfered with the attorney-client relationship.

A SIGNIFICANT DILEMMA

As do many (if not most) patent infringement disputes, this scenario presents the issue of how to determine if an incident of patent infringement was willful. This is an important issue to any company. If a patent owner can establish willful infringement, she can obtain much higher (up to treble) damages. Because evidence of deliberate copying of a patent is rarely available, courts traditionally have focused on whether an accused infringer had a good-faith belief that its conduct was proper.

In *Underwater Devices Inc v. Morrison-Knudsen Co.* (1983), the Federal Circuit imposed an affirmative duty on a potential infringer to act with due care, which includes obtaining a competent opinion of counsel. Later, in *Kloster Speed steel AB v. Crucible Inc.* (1986), the court went further, holding that a failure to obtain opinion of counsel could warrant an inference that any such opinion would have been adverse. Finally, in *Fromson v. Western Litho Plate & Supply Co.* (1988), the Federal Circuit held that the failure to introduce an opinion of counsel could also lead to an adverse inference.

This was the legal landscape against which the *Knorr-Bremse* decision arose. This chain of precedent imposed a significant dilemma on those confronted with allegations of willful infringement. On the one hand, an accused infringer who had obtained an opinion from counsel could waive the attorney-client privilege, and sometimes his attorney's work-product exemption, to reveal that opinion as well as materials considered by counsel. On the other hand, an accused infringer could elect not to reveal that opinion or not to reveal whether it had obtained an opinion at all—in which case, the court drew the adverse inference. Faced with this choice, accused infringers often produced the opinions and waived attorney-client privilege and work-product protections.

In *Knorr-Bremse*, the Federal Circuit, after having reviewed the record and two dozen amicus briefs, overruled this long-standing precedent and alleviated the dilemma faced by accused willful infringers. The court held that it is improper for the trier of fact to draw an adverse inference when the attorney-client privilege or work-product privilege is invoked. It is also improper for the trier of fact to draw an adverse inference when an accused infringer had not obtained an opinion of counsel.

LIMITING ADVERSE INFERENCES

The case arose when Knorr-Bremse sued the Dana Corp. and Haldex Brake Products AB alleging willful infringement of a single U.S. patent.

Dana (an American corporation) and Haldex had agreed to sell a disk brake in the United States that Haldex originally manufactured in Sweden. More than a year before filing suit, Knorr-Bremse orally notified Dana that Knorr-Bremse was involved in a patent dispute with Haldex in Europe over the disk brake and that Knorr-Bremse had a pending U.S. patent application. Soon after, Knorr-Bremse's U.S. patent issued. A year later, Knorr-Bremse sued Dana and Haldex.

Haldex informed the court that it had consulted European and U.S. counsel regarding Knorr-Bremse's patents, but citing the attorney-client privilege, it did not produce any legal advice received from counsel. Dana did not itself consult counsel, relying instead on Haldex. The district court, invoking Federal Circuit precedent, determined that "it is reasonable to conclude that such opinions were unfavorable." Applying a totality-of-the-circumstances analysis, the court concluded that the infringement was willful.

After a Federal Circuit panel heard oral argument, the Federal Circuit *sua sponte* announced that it would consider *en banc* the adverse inference rule as well as whether a defendant that presents a substantial defense to an infringement claim can defeat an allegation of willfulness on that basis alone.

In its ruling, the Federal Circuit addressed three separate questions of law:

First, it asked whether when the attorney-client privilege and/or work-product privilege is invoked by a defendant in an infringement suit, it is appropriate for the trier of fact to draw an adverse inference with respect to willful infringement. The court answered with an emphatic no. The Federal Circuit determined no adverse inference should be drawn, despite the fact that an accused infringer still has a duty to avoid infringement. Weighing the attorney-client relationship against the duty to disclose opinions of counsel, the Federal Circuit pronounced that "a special rule affecting attorney-client relationships in patent cases is not warranted."

Next, the court considered whether in situations where the defendant had not obtained legal advice it is appropriate to draw an adverse inference with respect to willful infringement. The court answered with another no, finding that there is no legal duty to consult with counsel to avoid any adverse inference or legal presumption.

Finally, the Federal Circuit held that raising a substantial defense to infringement alone is not sufficient to defeat liability for willful infringement, but is simply a factor to be weighed in the totality-of-the-circumstances analysis.

WHAT DOES IT MEAN?

What does *Knorr-Bremse* mean for companies after Sept. 13? The Federal Circuit's decision does not lessen the prudence of obtaining an opinion of counsel when faced with a nonfrivolous

patent infringement allegation. Indeed, a competent exculpatory opinion from counsel remains a powerful tool in defending against a claim of willful infringement.

And the analysis that goes into opinion drafting can be informative, helping you to determine whether the allegation may have merit. You may be led to a simple design-around for a patent claim. Patent counsel may indicate that your company's own work, before the filing of the application for the patent that you are accused of infringing, may present you with substantive noninfringement or invalidity defenses. You may also learn that the patent suffers from other infirmities such as claims of indefinite scope. The possibilities are many.

Before *Knorr-Bremse*, an allegation of willful infringement was often used to pressure an accused infringer during litigation. Patent owners used the threat of the adverse inference to get the attorney-client waiver, which they then tried to expand to obtain broad discovery—even for materials communicated by, as well as the attorney work product of, litigation counsel. In many of the district court cases cited in the various amicus briefs, the patent owners were remarkably successful in their quest, all but gutting the attorney-client privilege with defense counsel.

Without the crutch of the adverse inference rule—and absent the pressure to release opinions of counsel—the patent owner's burden to prove willful infringement or to obtain intrusive discovery has increased significantly. Patent owners will now have to find evidence of willful actions taken by the accused infringer to meet the totality-of-the-circumstances test—actions such as deliberate copying, concealment of infringing activity, infringement despite only frivolous defenses, and infringement designed to injure a competitor.

An accused infringer can still be forced to consider waiving privilege and introducing a favorable opinion letter in hopes of avoiding a conclusion of willfulness if the patent owner can garner enough factual support through discovery to establish willfulness factors. But absent the adverse inference rule, an accused infringer can bide its time while discovery goes forward. It can make its decision as to whether it will rely on opinion of counsel only if it thinks there is a risk of a willfulness finding under the totality-of-the-circumstances test without such an opinion.

Even better (for defendants) is that in the wake of *Knorr-Bremse*, when disputes arise over the scope of the waiver in patent cases where exculpatory opinions of counsel are introduced, courts will look to the traditional jurisprudence of the regional circuit for the scope of the remaining privilege. In almost every instance, the regional circuit court rules are far more protective of privilege than the special (and intrusive) jurisprudence that was born in the wake of the adverse inference rule.

Today, if you receive a letter using a patent claim to troll for dollars, you are still well advised to consult with patent counsel. But the outcome of that consultation is far more likely to be calibrated to the seriousness of the allegation and will not result in the automatic recommendation that an exculpatory opinion be obtained as soon as possible.

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