Warning to Corporate Officers

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In the usual patent infringement case, a patent owner sues a company for patent infringement. Sometimes individuals, particularly corporate officers, are named as co-defendants with their company. Generally, the "corporate veil" shields corporate officers from liability for tortious conduct, such as patent infringement, occurring in the regular course of their employment.

The laws in Pennsylvania, New Jersey and Delaware all provide this safe haven for corporate officers. Personal liability in such instances is imposed only where an officer or director breaches his or her duty of loyalty to the company as a result of self-dealing, willful misconduct or recklessness.

Corporate officers need to be aware that this usual case does not always apply — in some circumstances corporate officers can be found personally liable for patent infringement, right alongside their company. Although courts start from the general rule that a corporate entity should be recognized and upheld, exceptions do exist.

Two exceptions that may be applied by a court are not unique to patent litigation. The first exception is when the accused company appears to be merely the officer's "alter ego," such that the officer has acted outside the scope of his employment. The second exception is when the accused company is undercapitalized or has failed to comply with the formalities of corporate organization. With these two exceptions, the corporate veil is pierced to prevent fraud, illegality or other injustice.

A third exception exists, which is the main focus of this article, and it occurs when the corporate officer actively aids and abets in the patent infringement committed by the corporation. With this third exception, the corporate officer may be found personally liable for inducing infringement, even if the corporation is not the alter ego of the corporate officer.

The patent infringement statute, 35 U.S.C. 271, provides for liability both for direct infringement and for indirect infringement (active inducement or contributory infringement). Direct infringement is defined by Section 271(a), which states, "whoever without authority makes, uses or sells any patented invention … infringes the patent." Indirect infringement is defined by Section 271(b), which states, "[w]hoever actively induces infringement of a patent shall be liable as an infringer."

A corporate officer may be found personally liable as a direct infringer only if the corporate veil is pierced. In comparison, a corporate officer may be found personally liable as an indirect infringer if sufficient evidence of personal culpability is shown.

A recent case focuses on the distinction between these two types of corporate officer liability. In Wordtech Systems Inc. v. Integrated Networks Solutions Inc., the patent owner Wordtech sued Integrated and two of Integrated's officers for patent infringement. The asserted patents concerned programmable compact disk duplication systems. Integrated, a Nevada corporation, had not filed mandatory annual statements with the state for two consecutive years. However, after suit was filed, Integrated revived its corporate status in Nevada.

Following trial, the jury found that the defendants, Integrated and the two officers, willfully infringed the patents and awarded damages against all three defendants. On appeal, the officers challenged the liability verdicts on grounds that they could not be individually liable for direct infringement, contributory infringement or inducement. The officers asserted that they were company "employees," that they had not personally participated in the infringement, and that Integrated was a valid Nevada corporation during all periods of the alleged infringement.

Wordtech claimed that Integrated was "non-existent" during the alleged infringement because Integrated had failed to make mandatory payments to the state of Nevada for two consecutive years. However, Nevada permits corporations to revive active status for up to five years and allows the revival to be retroactive. Integrated had revived its corporate status, thereby establishing itself as a valid corporate entity at the time of the infringing activity. Even though the two officers were the only full-time employees of Integrated and were responsible for product development and sales, because the district court never instructed the jury on Integrated's corporate status, the Federal Circuit reversed and remanded the direct infringement verdict against the officers.

Importantly, in finding that the corporate veil was not appropriately pierced, the Federal Circuit did not rule out indirect infringement by the two corporate officers. Instead, the court rejected the officers' corporate veil defense as being irrelevant to the issues of inducement and contributory infringement. Nevertheless, the Federal Circuit also found the jury instructions flawed on the indirect infringement issue and likewise remanded this issue.

The Wordtech case illustrates that even where the corporate veil remains in place, corporate officers cannot assume that they will avoid personal liability for patent infringement.

Whether an officer can be held personally liable for aiding and abetting infringement is intensely fact-dependent. Earlier cases shed some light on the circumstances for which personal liability for indirect infringement is likely to be imposed.

In Hoover Group Inc. v. Custom Metalcraft Inc., the CEO promptly consulted counsel, and the company made a "straightforward commercial response" to the infringement assertions. Because there was no bad faith, no fraud and no culpable intent shown, the court reversed the finding that the CEO was personally liable for infringement.

In Manville Sales Corp. v. Paramount Systems Inc., two corporate officers at Paramount obtained a drawing of the patented design from a state government agency and forwarded this drawing to Paramount's designer for use in designing a competing device. Although the corporate officers had knowledge of their acts, these acts were deemed within the scope of their employment, such that the corporate veil was not pierced. Moreover, although some persons at Paramount knew of Manville's patent prior to the lawsuit, the court found that Paramount's continued infringement was not in bad faith, based on the advice of counsel that Paramount was not infringing. The two officers were not personally aware of Manville's patent until after the lawsuit was filed, and they also reasonably relied on the legal advice the company had received.

On these facts, it was error to find the two officers liable for inducing infringement. Similarly, in Al-Site Corp. v. VSI Int'l Inc., an officer who consulted counsel after receiving a cease and desist letter, but before continuing to produce accused infringing products, was found not personally liable for indirect infringement.

Even when a company is found to willfully infringe, an officer will not be held personally liable for inducing that infringement unless the officer had a specific intent to aid and abet the infringement. In Wechsler v. Macke Int'l Trade Inc., Wechsler sued Macke and O'Rourke, Macke's president, lone stockholder and sole employee, for patent infringement based on a portable drink device for pets. Upon learning of Wechsler's patent, O'Rourke did not secure an opinion of counsel, but rather he personally analyzed the patent, the prior art and his own device to form a belief that Macke was not infringing.

Notwithstanding his belief, O'Rourke entered into licensing negotiations with Macke. When those negotiations broke down, O'Rourke redesigned his company's product, but he kept the product accused of infringement on the market for another eight months. Even though a jury found Macke to be a willful infringer, and even if O'Rourke had acted negligently, the court held this was insufficient to overturn the jury's finding that O'Rourke was not personally liable for inducing infringement.

The court distinguished the standard for willful infringement (whether the infringer had a good faith belief that the patent was invalid or not infringed) from the standard for imposing personal liability on an officer for inducement of infringement (whether the officer has a specific intent to aid and abet the infringement). In view of the different standards, the court concluded that willful infringement does not automatically lead to personal liability for a corporate officer:

For example, a corporate officer could negligently believe that a patent was invalid and/or not infringed. This might support a finding of willful infringement by the corporation, but not a finding of personal liability for the officer.

To compare, the court found personal liability in Orthokinetics Inc. v. Safety Travel Chairs Inc. The officers, who were "directly responsible" for the design and production of the infringing chairs and were

the "only ones who stood to benefit from sales" of the infringing chairs, were held liable for both direct and indirect patent infringement.

In summary, to avoid personal liability, corporate officers and directors should:

• Properly maintain the corporation/entity status according to the laws of your state of incorporation. Follow the required formalities. Doing so will make it difficult for a patent owner to successfully assert individual officer liability for direct infringement.

• Seek out qualified legal advice, and follow that advice, when confronted with a potential patent infringement claim. Personal liability for indirect infringement can only be found where there is personal culpability. A company officer should be found to have lacked a specific intent to aid and abet the infringement of the company if that officer acted prudently under the circumstances.

Courts have found indirect infringement where behavior was willful or reckless, and did not find such infringement where behavior was prudent or merely negligent. Acting on advice of counsel has been held to have been prudent by most courts to have considered this question. •

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