

## Corporate Officers Beware: Will Corporate Veils Preclude Personal Liability For Patent Infringement?



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Corporate officers understandably view patent infringement as a risk that they must accept to stay in business, given that over 650,000 U.S. patents issued in the past four years alone.<sup>1</sup> But upon accepting that risk, corporate officers potentially expose themselves (often unknowingly) to personal liability for their corporation's patent infringement. This is especially true in small businesses, where the line of distinction between the separate personalities of the corporation and the individual often fades.

When patent infringement knocks, corporate officers often instinctively grasp corporate veils for personal protection. This seems like a proper reaction given the limited liability nature of corporations of all sizes.<sup>2</sup> Indeed, the Supreme Court has emphasized that "where patents are concerned, the one-person corporation may be an altogether appropriate means to permit

innovation without exposing inventors to possibly ruinous consequences."<sup>3</sup> Although courts normally accord great judicial deference to the separate corporate entity, this entity is still a fiction.<sup>4</sup> Corporate officers should be wary of that fiction—a patentee might establish a corporate officer's personal liability for patent infringement using any of at least four grounds: (1) the officer is a direct infringer; (2) the company is the officer's *alter ego*; (3) equity demands officer accountability; and (4) the officer induced the infringement.

### DIRECT INFRINGER

A patentee, without even piercing the corporate veil, might establish that a corporate officer directly infringed a patent under 35 U.S.C. § 271(a).<sup>5</sup>

Infringement is a tort, and officers of a corporation are personally liable for

tortious conduct of the corporation if they personally took part in the commission of the tort or specifically directed other officers, agents, or employees of the corporation to commit the tortious act. The cases are legion in which courts have recognized and imposed personal liability on corporate officers for participating in, inducing, and approving acts of patent infringement.

*Orthokinetics, Inc. v. Safety Travel Chairs, Inc.*, 806 F.2d 1565, 1579 (Fed. Cir. 1986).<sup>6</sup>

In *Orthokinetics*, defendant Privacek was President, sole stockholder and had elected the Board of Directors of the infringing corporation.<sup>7</sup> In addition, Privacek was one of three people directly responsible for the design and production of the infringing device, and he was found to be in a position to benefit directly from

the patent infringement.<sup>8</sup> The *Orthokinetics* jury, without piercing the corporate veil, found Privacek personally liable for § 271(a) infringement. The Federal Circuit upheld that finding. Since then, the Federal Circuit has stated in later decisions that "to be personally liable for [a company's] infringement under section 271(a), there must be evidence to justify piercing the corporate veil."<sup>9</sup> This makes it unclear now whether or not plaintiff patentees *must* pierce corporate veils to hold corporate officers personally liable for § 271(a) infringement.<sup>10</sup>

### ALTER EGO

A patentee might establish that a corporation is merely a corporate officer's *alter ego*, thereby piercing the corporate veil and making the officer jointly liable for the corporation's patent infringement.<sup>11</sup> Indeed, the "most common reason for disregarding the corporate structure is that the corporation was merely the *alter ego* of its officers."<sup>12</sup>

*Alter ego* liability requires two findings: (1) such unity of interest, ownership, or control that the separate personalities of the corporation and the individual no longer exist; and (2) that the failure to disregard the corporation would result in fraud or injustice.<sup>13</sup> Many factors are relevant to the first finding: (a) nature of the corporate ownership and control;<sup>14</sup> (b) failure to maintain corporate minutes or adequate corporate records; (c) commingling of funds and other assets of the corporation; (d) diversion of the corporation's funds or assets to non-corporate uses such as the personal uses of the corporation's shareholders; (e) use of the same office or business location by the corporation and its individual shareholders; (f) whether the corporation is operated as a separate entity; (g) absence of corporate assets and undercapitalization; (h) use of the corporation as a mere shell, instrumentality or conduit of an individual or another corporation; and (i) general disregard of legal formalities and the failure to maintain an arms-length relationship among related entities.<sup>15</sup> The second finding looks to the basic issue of fairness under the facts. Thus, officers of "sham" corporations generally fall prey to *alter ego* liability.

## EQUITY

Where the facts may not establish *alter ego* liability, a patentee might still establish that 'equity' demands piercing a corporation's veil and holding a corporate officer accountable for the corporation's patent infringement.

[T]he corporate form may be disregarded in the interests of justice where it is used to defeat an overriding public policy. In such cases, courts of equity, piercing all fictions and disguises, will deal with the substance of the action and not blindly adhere to the corporate form.<sup>16</sup>

If the patentee can show that piercing the veil will prevent "fraud, illegality, injustice, a contravention of public policy, or prevent the corporation from shielding someone from criminal liability,"<sup>17</sup> then personal liability for patent infringement may fall into the hands of the corporation's officers.

## INDUCEMENT

A patentee might establish that a corporate officer induced infringement of a patent under 35 U.S.C. § 271(b),<sup>18</sup> regardless of whether the corporation is the *alter ego* of the officer.<sup>19</sup> To do so, the patentee must show both direct infringement (§ 271(a)) by the company and "a certain level of *intent* on the part of the officer" (i.e., alleged inducer) that the patent be infringed.<sup>20</sup> Once again, however, there is "a lack of clarity concerning whether the required intent must be merely to induce the specific acts or additionally to cause an infringement."<sup>21</sup> Thus, corporate officers who "knowingly aid and abet" their corporation's infringement,<sup>22</sup> or who are the "moving, active, conscious force" behind that infringement,<sup>23</sup> or who possess "specific intent" to encourage that infringement,<sup>24</sup> could find themselves writing a personal check for patent infringement damages.

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## SUGGESTIONS

Corporate officers could better protect themselves against personal liability for patent infringement by employing at least the following good business practices. The single most important of which is to obtain and reasonably rely upon one or more independent and competent legal opinions of counsel *before* making corporate decisions about patent issues.<sup>25</sup> Others include:

- Comply with State corporation filing requirements (e.g., Statements of Information).
- Maintain corporate minutes and adequate corporate records.
- Maintain corporate formalities necessary for issuance or subscription to stock, such as formal approval of the stock issue by an independent board of directors.
- Maintain at least an arms-length relationship among related entities.
- Do not undercapitalize the corporation.
- Do not commingle funds and other assets of the corporation with personal ones.
- Do not divert corporate funds or assets to non-corporate uses, such as the personal uses of the corporation's shareholders.
- Do not execute corporate contracts, licenses, agreements, and the like, in a personal capacity (i.e., be sure to sign them in the name of the company).

- Do not use the corporate form for fraudulent purposes.
- Avoid use of the same office or business location by the corporation and its individual shareholders (if possible).

Corporate officers who do not heed these good business practices, do so at their personal peril. Indeed, where such practices are not followed, courts have even demonstrated a willingness to bind corporate officers to judgments already entered against their corporations.<sup>26</sup>

**IPT**

## ENDNOTES

1. Based on USPTO online patent database search. See <http://www.uspto.gov/index.html> (search criteria: (ISD/20010601->20050531 AND APT/1)).
2. See *FMC Finance Corp. v. Murphree*, 632 F.2d 413, 421 (5th Cir. 1980) ("A corporation is a legal entity existing separate and distinct from its shareholders, officers, and directors, who as a general rule are not liable for the corporation's debts and obligations."); see also *Manville Sales Corp. v. Paramount Systems, Inc.*, 917 F.2d 544, 552 (Fed. Cir. 1990) (Courts must "start from the general rule that the corporate entity should be recognized and upheld, unless specific, unusual circumstances call for an exception.").
3. *Nelson v. Adams USA, Inc.*, 529 U.S. 460, 471 (2000) ("One-person corporations are authorized by law and should not lightly be labeled sham.").
4. *Labadie Coal Co. v. Black*, 672 F.2d 92, 96 (D.C. Cir. 1982) ("[W]hen particular circumstances merit—e.g., when the incentive value of limited liability is outweighed by the competing value of basic fairness to parties dealing with the corporation—courts may look past a corporation's formal existence to hold shareholders or other controlling individuals liable for 'corporate' obligations.").
5. Section 271(a) provides that "whoever without authority makes, uses, offers to sell, or sells any patented invention ... infringes the patent."
6. Citing, *inter alia*, 3A WILLIAM MEADE FLETCHER ET AL., *FLETCHER'S CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS* § 1135 (rev. perm. ed. 1975), which states that holding corporate officers personally liable for their tortious acts "does not depend on the same grounds as 'piercing the corporate veil' ...." The *Symbol* court likewise cited § 1135 (see fn. 10 *infra*).
7. *Orthokinetics*, 806 F.2d at 1579.
8. *Id.* (The two other individuals were also found to have personally infringed along with Privacek.).
9. See *Manville*, 917 F.2d at 552.
10. In *Symbol Technologies, Inc. v. Metrologic Instruments, Inc.*, 771 F. Supp. 1390, 1402-1404 (D.N.J. 1991), the district court analyzed *Orthokinetics* and its progeny to illustrate this point, but remained resolute: "[U]ntil changed by an *en banc* decision, the court finds that the long-established rule that a corporate officer can be liable for direct infringement without piercing the corporate veil remains in effect."
11. See RESTATEMENT (SECOND) OF JUDGMENTS § 59 (1982) ("A judgment against a corporation that is found to be the alter ego of a stockholder or member of the corporation establishes personal liability of the latter only if he is given notice that such liability is sought to be imposed and fair opportunity to defend the action resulting in the judgment.").
12. See *Al-Site Corp. v. VSI Int'l, Inc.*, 174 F.3d 1308, 1331 (Fed. Cir. 1999) (internal quotations omitted).
13. *United States v. Standard Beauty Supply Stores, Inc.*, 561 F.2d 774, 777 (9th Cir. 1977).
14. *Labadie*, 672 F.2d at 97 ("In many instances, the person 'controlling' a close corporation is also the sole, or at least a dominant, shareholder. In other cases the controlling person may seek to avoid personal liability by not formally becoming a shareholder in the corporation. The question is one of control, not merely paper ownership.").
15. See *id.* at 96-99 (explaining factors); *United States v. Van Diviner*, 822 F.2d 960, 965 (10th Cir. 1987) (identifying factors).
16. *Bangor Punta Operations, Inc. v. Bangor & A. R. Co.*, 417 U.S. 703, 713 (1974).
17. *Manville*, 917 F.2d at 552.
18. Section 271(b) provides that "[w]hoever actively induces infringement of a patent shall be liable as an infringer."
19. *Orthokinetics*, 806 F.2d at 1578-79 ("[I]t is well settled that corporate officers who actively aid and abet their corporation's infringement may be personally liable for inducing infringement under § 271(b) regardless of whether the corporation is the alter ego of the corporate officer.").
20. *Insituform Techs., Inc. v. Cat Contr., Inc.*, 385 F.3d 1360, 1377 (Fed. Cir. 2004) (emphasis added).
21. *Id.* at 1378 (cases cited and compared); see *Fuji Photo Film Co. v. Jazz Photo Corp.*, 394 F.3d 1368, 1377-78 (Fed. Cir. 2005).



22. See *Orthokinetics*, 806 F.2d at 1578-79 (fn. 19 *supra*); *Water Technologies Corp. v. Calco, Ltd.*, 850 F.2d 660, 668 (Fed. Cir. 1988) ("actively and knowingly aiding and abetting another's direct infringement"; "control" exerted over manufacture of infringing products is evidence of inducement); *Power Lift, Inc. v. Lang Tools, Inc.*, 774 F.2d 478, 481 (Fed. Cir. 1985) (suggesting "broad reading" of § 271(b); "actively aid and abet their corporation's infringements"); *Symbol*, 771 F. Supp. at 1404-1405.
23. See *Power Lift*, 774 F.2d at 481 (quoting *International Manufacturing Co. v. Landon, Inc.*, 336 F.2d 723, 728-29 (9th Cir. 1964)); *Sensonics, Inc. v. Aerosonic Corp.*, 81 F.3d 1566, 1575-76 (Fed. Cir. 1996) (CEO having "authority to control or discontinue production" of infringing device found liable for inducing infringement).
24. See *Manville*, 917 F.2d at 553 ("It must be established that the defendant possessed specific intent to encourage another's infringement and not merely that the defendant had knowledge of the acts alleged to constitute inducement."); *Hoover Group v. Custom Metalcraft*, 84 F.3d 1408, 1412 (Fed. Cir. 1996) (mere knowledge of acts insufficient).
25. See *Manville*, 917 F.2d at 553 (no personal liability: corporate officers had "good faith belief" of noninfringement based on advice of counsel); *Hoover*, 84 F.3d at 1412 (no personal liability: corporate officer made "straightforward commercial response to the assertions of patent infringement, including prompt consultations with counsel"); *Al-Site*, 174 F.3d at 1331-32 (no personal liability: CEO obtained "advice of counsel" before continuing to produce products at issue, and had "good faith belief" of noninfringement).
26. See *Insituform*, 385 F.3d at 1372-75 (affirming post-trial joinder of corporate officer); *Ohio Cellular Prods. Corp. v. Adams USA Inc.*, 2000 U.S. Dist. LEXIS 19657, \*9-\*20, 62 USPQ2d 1522 (N.D. Ohio) (corporate officer joined post-judgment and collaterally estopped from relitigating issues related to his culpable state of mind and inequitable activities, thereby effectively rendering officer personally liable for attorney fees judgment against corporation), *on remand from Nelson v. Adams USA, Inc.*, 529 U.S. 460 (2000); *Fromson v. Citiplate, Inc.*, 886 F.2d 1300, 1303-1304 (Fed. Cir. 1989) (officers who "plainly participated in and approved of the infringement of plaintiff's patent" and who gave "false assurances" of solvency joined post-judgment and made jointly liable for damages).