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Decision could make it difficult to hold executives liable for inducing infringement

The Federal Circuit ruling misunderstands the corporate law doctrine of piercing the veil, some experts contend

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In early 2009, Roger Hall's prospects were excellent. He had invented a travel towel that could be easily folded and zipped into a compact form. He had applied for a design patent on his invention, and three months before the patent issued, he had a meeting with a nationwide retail chain interested in selling the towel.

But in that meeting, things took a turn for the worse. The retailer—Bed, Bath & Beyond (BB&B)—resisted Hall's asking price. Moreover, according to Hall's court papers, Farley Nachemin, a vice president of BB&B, said his company could have similar towels produced in Pakistan at a lower cost. Hall warned against that because he had a patent pending on the product.

The retail giant apparently didn't care. The company allegedly used the sample towels that Hall provided (which were marked "patent pending") and had copies manufactured in Pakistan. BB&B then sold these copies in its stores.

After his patent issued, Hall sued BB&B for design patent infringement and Nachemin for inducing the infringement. The district court threw out Hall's suit. In January, the Federal Circuit partially overturned the ruling, restoring the infringement claims against BB&B.

The court upheld the dismissal of the suit against Nachemin, but under a novel legal rationale. The Federal Circuit panel held that a corporate officer can be liable for inducing infringement only when the corporation's veil is pierced (see "Power Play"). The facts alleged in the complaint did not allow the veil to be pierced, so the claim against Nachemin was properly thrown out.

The Federal Circuit's decision in *Hall v. Bed, Bath & Beyond, Inc.* creates a "big change" in this area of patent law, says Jeffrey Blake, a partner at Merchant & Gould. "This makes it more difficult to prove executives are liable for inducing infringement."

However, some experts have sharply criticized the ruling in *Hall*, asserting that it misunderstands the corporate law doctrine of piercing the veil and wrongly injects this doctrine into the area of patent law. The ruling, these experts say, increases the confusion about when executives are liable for patent infringement.

Limited Liability

The confusion began soon after Congress created the Federal Circuit. The court's seminal 1986 decision in *Orthokinetics, Inc. v. Safety Travel Chairs, Inc.* incorrectly interpreted the patent statute and state corporate law, and the court has held fast to those errors in subsequent rulings, according to Prof. Lynda Oswald, who teaches business law at University of Michigan School of Business.

In *Orthokinetics*, the court addressed when corporate executives could be held liable for direct patent infringement under Section 271(a) of the Patent Act and inducing infringement under Section 271(b) of the Patent Act. Section 271(a) of the Patent Act states that an entity is guilty of direct infringement when it "without authority makes, uses, offers to sell, or sells any patented invention." No bad intent is required. Direct infringement is a strict liability offense.

Section 271(b) of the Patent Act states that "[w]hoever actively induces infringement of a patent shall be liable as an infringer." A defendant is liable for inducing another to infringe only when the defendant has acted with the intent to create patent infringement.

The court in *Orthokinetics* ruled that a company's executives can be liable for direct infringement when their company infringes. That was wrong, Oswald asserts, because except in rather unusual situations, an executive will not personally make, use or sell an infringed invention; the executive's company will perform those acts. Thus the company, not its executives, will be the direct infringer. The executives should at most face liability for inducing the corporation to infringe.

The court's incorrect interpretation of direct infringement liability created a major problem: Company executives could face strict liability whenever their companies infringed.

The Federal Circuit tried to solve this problem by grafting a corporate law doctrine onto the patent statute. The court held that a company's executives could be liable for direct infringement only if the corporation's veil was pierced.

This was another error, according to Oswald, because nothing in the Patent Act suggested that liability for direct infringement could be qualified in this way. Moreover, the court misapplied the corporate veil doctrine; piercing the veil enables a plaintiff to impose liability on a corporation's shareholders, not its executives. "Veil piercing just does not reach executives. That is very clear," Oswald says.

Decision Contradiction

Despite the dubious reasoning in *Orthokinetics*, the Federal Circuit has repeatedly reaffirmed the ruling's interpretation of direct infringement liability. In *Hall*, the Federal Circuit extended the veil-piercing standard to cover executives' liability for inducement.

The decision in *Hall* contradicts prior Federal Circuit decisions, which found corporate executives could be liable for inducing infringement without any need to pierce the corporate veil. However, the court in *Hall* didn't recognize it was doing anything new.

“It’s hard to see how they could reach the conclusion they did without explicitly overruling prior cases, which they didn’t do,” says Robert Gerstein, a partner at Marshall, Gerstein & Borun. “The opinion even cites *Orthokinetics* in support of applying the veil-piercing standard to liability for inducement, but that decision says the opposite.”

The ruling thus adds more confusion to this area of the law. Experts are uncertain if the Federal Circuit intended to change the law or if the court will follow *Hall* in future cases. “It would be hard to bet which direction the court will go,” says Gerstein.

Power Play

State laws generally allow a corporation’s veil to be pierced (i.e., the corporation’s separate identity from its shareholders will be disregarded and the actions of the corporation imputed to the shareholders) only if a shareholder has such power and ownership in a corporation that the corporation does not truly have a separate identity, and there would be an inequitable result if the shareholder was not held responsible for the corporation’s acts.

The courts view piercing as an extraordinary form of relief, and they are usually reluctant to order this relief unless there’s a clear need to do so, according to Prof. Lynda Oswald of University of Michigan Business School.

Thus, if piercing is required to hold company executives liable for inducing infringement, the executives will rarely be liable. This would be particularly true for executives at large companies because the executives usually own just a small percentage of stock and do not dominate the entire enterprise. Such executives would not be liable for inducement, even if they ordered their companies to commit infringement, knowing it to be infringement.