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Patent Litigation and Licensing

Federal Circuit Rules on the Duty to Preserve Evidence

SUMMARY

On May 13, 2011, the Federal Circuit issued two opinions addressing the duty to preserve evidence in anticipation of commencing patent litigation. The rulings do not establish a bright-line rule for when the duty to preserve documents is triggered, but adopt a foreseeability standard and provide guidance on factors relevant to that determination. In *Micron Technology, Inc.* v. *Rambus Inc.*, No. 2009-1263, the Federal Circuit affirmed that a patentee, Rambus, had improperly destroyed documents prior to initiating an infringement action, and remanded to the district court for further consideration of the appropriate sanction for that conduct. In a related case, *Hynix Semiconductor Inc.* v. *Rambus Inc.*, 2009-1299, the Federal Circuit vacated a lower court infringement judgment in Rambus' favor, and ordered the lower court to reconsider its ruling finding that Rambus had not spoliated evidence in accord with *Micron*. Taken together, the *Rambus* opinions reaffirm that the proper standard for determining when the duty to preserve documents attaches is a flexible one based upon the existence of reasonably foreseeable litigation, but emphasize that reasonable foreseeability does not mean that litigation must be immediately imminent or certain.

BACKGROUND

Spoliation of evidence is the negligent or intentional withholding, hiding, altering, or destroying of evidence relevant to a legal proceeding, including prior to the commencement of an action when litigation is reasonably foreseeable. The courts have inherent authority to impose sanctions for spoliation, which, in extreme circumstances, can include dismissal of the action or judgment against the spoliator.

The relevant facts surrounding Rambus' alleged spoliation, as set forth in the Federal Circuit's opinions, are substantially identical in the two cases. In the 1990s, Rambus obtained patents for certain semiconductor technology relating to dynamic random access memory ("DRAM"). Thereafter, Rambus

began to implement a licensing and litigation strategy for the assertion of its patents. Eventually, Rambus focused its efforts on manufacturers of a type of DRAM known as synchronous DRAM ("SDRAM"). Prior to commencing litigation, and apparently with the advice of counsel, Rambus implemented a document retention/destruction policy. Among other things, in September 1998 and August 1999, Rambus held two "Shred Days" and destroyed 700 boxes of documents. Also, in May 1998 Rambus implemented a policy of retaining email backup tapes for only three months, and in July 1998 erased all but one of the 1,269 tapes storing its email backups from the previous years. The only exception was a tape that contained a document Rambus apparently wished to use to establish a priority date in the potential litigation. Rambus kept no record of what was destroyed, but admitted that some of the destroyed documents related to contract and license negotiations, patent prosecution, standard setting activities, Rambus board meetings, and Rambus finances.

In October 1999, Rambus approached Hitachi about licensing its patents with respect to SDRAM. Those discussions broke down, and in December 1999 Rambus instituted a litigation hold. One month later, in January 2000, Rambus initiated an action against Hitachi, its first infringement action against an SDRAM manufacturer. Thereafter, although Rambus successfully negotiated licenses with certain manufacturers, its efforts to license Micron and Hynix were unsuccessful, and resulted in declaratory judgment actions being filed by those companies in the District of Delaware and the Northern District of California. Both companies sought sanctions against Rambus for spoliation, with different results.

In the *Hynix* case, the California district court held a bench trial on spoliation and concluded that "Rambus did not actively contemplate litigation or believe litigation against any particular DRAM manufacturer to be necessary or wise before its negotiations with Hitachi failed" in November 1999.[1] Therefore, Rambus' adoption of its document retention policy in mid-1998 and destruction of documents through August 1999 was a permissible business decision and did not constitute spoliation. The court reasoned that because there were a number of contingencies that needed to be overcome in 1998 and 1999 before contemplated litigation could commence, the litigation was not reasonably foreseeable. The litigation then proceeded and Rambus ultimately obtained a $349 million infringement judgment against Hynix.

In *Micron*, the Delaware district court concluded that litigation was reasonably foreseeable to Rambus no later than December 1998, when Rambus' outside counsel had articulated a "time frame and a motive for implementation" of a litigation strategy to enforce Rambus' intellectual property. The court held that the documents destroyed after December 1998 were intentionally destroyed in bad faith and that the only reasonable sanction for the intentional destruction of documents was to hold Rambus' patents unenforceable against Micron, putting an end to Rambus' infringement claim.

Both decisions were appealed.

[1] *Micron*, at 10 (quoting *Hynix* district court opinion).

THE FEDERAL CIRCUIT'S OPINIONS

The Federal Circuit's opinions addressed primarily whether Rambus' pre-December 1999 document destruction amounted to spoliation and, if so, what the appropriate sanctions should be.

A Company Has an Obligation to Retain Documents When Litigation is "Reasonably Foreseeable."

The Federal Circuit affirmed the general rule that "a party can only be sanctioned for destroying evidence if it had a duty to preserve it." *Zubulake* v. *UBS Warburg LLC*, 220 F.R.D. 212, 216 (S.D.N.Y. 2003). The duty to preserve evidence begins when litigation is "pending or reasonably foreseeable." *Silvestri* v. *General Motors Corp.*, 271 F.3d 583, 590 (4th Cir. 2001). The reasonably foreseeable standard is an objective standard, which asks not whether the party in fact reasonably foresaw litigation but whether a reasonable party in the same factual circumstances would have reasonably foreseen litigation.[2]

In *Micron*, the Federal Circuit discussed five reasons why it concluded that the district court had not erred in determining that the litigation was reasonably foreseeable when Rambus destroyed documents:

- **Document Retention Policy** – The court reasoned that "where a party has a long-standing policy of destruction of documents on a regular schedule and the policy is motivated by general business needs, which can include concern for the possibility of litigation, destruction in line with that policy is relatively unlikely to be seen as spoliation." However, in Rambus' case, the district court found, and the Federal Circuit affirmed, that the raison d'etre of the document retention policy was to further Rambus' litigation strategy based on evidence that the policy was part of getting "battle ready." The court appeared particularly concerned by the fact that Rambus had instructed employees to keep and preserve documents that would be helpful to Rambus in the litigation while destroying other documents. The Federal Circuit found that "[t]aken together, the implementation of a document retention policy as an important component of a litigation strategy makes it more likely that litigation was reasonably foreseeable."[3]
- **Party Is on Notice of Potentially Infringing Activity** – The court stated that where a party is on notice of potentially infringing activity by particular parties, litigation is objectively more likely to occur because the patentee is then more likely to bring suit. In these cases, Rambus had numerous internal documents that laid out its plan to bring patent infringement or breach of contract suits against SDRAM manufacturers prior to the document destruction. These documents included internal claim charts that detailed infringement of Rambus' patents by other companies including Micron. Rambus also actively amended its patent claims during prosecution to cover SDRAM standard-compliant products, in anticipation of asserting its patents against SDRAM manufacturers. Collectively, these documents and plans made it clear that Rambus was on notice of potentially infringing activity.
- **Party Takes Steps in Furtherance of Litigation** – The court found that where a party takes steps in furtherance of litigation, such as prioritizing defendants and forums, creating claim charts, and creating an expected timeline for litigation as a component of its business model, it is much more likely that litigation is reasonably foreseeable. For example, Rambus used definitive language of its future intention to sue, obtained product samples, and proposed high licensing rates that would, in the opinion of outside counsel, result in a lawsuit. Rambus' outside counsel created timelines for litigation, and established goals for "Licensing/Litigation Readiness" in June 1999. These goals

[2] *Micron*, at 12.

[3] *Id.* at 17-18.

included preparing litigation strategy against manufacturers, being ready for litigation with 30 days' notice, and organizing the "shredding party at Rambus."[4]

- **Party Is the Patentee** – The court reasoned that the patentee is in a position to decide whether to pursue patent infringement litigation. As a result, it is easier for a patentee to foresee litigation than for an infringement defendant.
- **Parties Have a Relationship That Either Is Not Mutually Beneficial or Is Naturally Adversarial** – The court stated that where the parties have a relationship that either is not mutually beneficial or is naturally adversarial, litigation is more foreseeable than a situation where parties have a business relationship that is mutually beneficial and ultimately turns sour. Document destruction occurring during a long-standing and untroubled licensing relationship relating to patents and accused products that ultimately become the subject of litigation is less likely to constitute spoliation than destruction of evidence following repeated failures of a licensee to properly mark products or remit royalties, which is more likely to constitute spoliation.[5]

In *Hynix*, the Federal Circuit applied the *Micron* factors to vacate the district court's finding of no spoliation, holding that the district court erred in applying "too narrow a standard of reasonable foreseeability as requiring that litigation be immediate or certain."[6] The court reasoned that the district court's approach placed undue importance on various contingencies where the resolution of those contingencies was reasonably foreseeable. Additionally, the Federal Circuit noted that, although the record showed that Rambus had not received board approval or budgeted for the litigation when the destruction occurred, those facts at most showed that the litigation was not imminent.

Ramifications for Failure to Hold Documents. In *Micron*, the Federal Circuit also addressed the proper sanction for failing to retain documents. While recognizing that the particular sanction imposed is within the discretion of the district court, the Federal Circuit's opinion discusses various factors that a court may consider:

- **Bad Faith/Prejudice** – The Federal Circuit stated that the fundamental element of bad-faith spoliation is advantage-seeking behavior by "the party with superior access to information necessary for the proper administration of justice." Thus, the proper standard for determining bad faith is whether the party intended to impair the ability of the potential defendant to defend itself. If the court finds that the party who destroyed evidence acted in bad faith, the burden falls upon the spoliator to show that the opposing party did not suffer prejudice. If there is no finding of bad faith, the opposing party has the burden of showing prejudice.[7] In the *Micron* appeal, the court concluded that the district court had not sufficiently explained the basis for its bad faith determination, and applied an incorrect "knew or should have known standard," when the proper standard was whether Rambus "'intended to impair the ability of the potential defendant to defend itself' . . . without regard to whether Rambus 'should have known.'"[8] Thus, the court remanded for further assessment of whether there was bad faith and prejudice.
- **Dispositive Sanctions** – In examining the dispositive sanctions imposed in *Micron*, the court noted that dismissal is a "harsh sanction" that "should not be imposed unless there is clear and convincing

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4 *Id.* at 19.

5 *Id.* at 23.

6 *Hynix*, at 16.

7 *Id.* at 29.

8 *Id.* at 27 (citation omitted).

evidence of both bad-faith spoliation and prejudice to the opposing party.[9] The Federal Circuit cautioned that "the presence of bad faith and prejudice, without more, do not justify the imposition of dispositive sanctions." Thus, the district court must "select the least onerous sanction corresponding to the willfulness of the destructive act and the prejudice suffered by the victim."[10] The court must take into account "(1) the degree of fault of the party who altered or destroyed the evidence; (2) the degree of prejudice suffered by the opposing party; and (3) whether there is a lesser sanction that will avoid substantial unfairness to the opposing party and, where the offending party is seriously at fault, will serve to deter such conduct by others in the future."[11]

IMPLICATIONS

The Federal Circuit's *Rambus* decisions provide explicit guidance on when the duty to preserve documents attaches and when litigation may be deemed reasonably foreseeable. The court's decisions clarify that litigation can be reasonably foreseeable even where a number of hurdles or other contingencies need to be cleared before litigation actually commences, noting that immediacy or certainty of litigation is not the proper test. Factors weighing in favor of a finding of reasonably foreseeable litigation that triggers a duty to preserve documents include whether the party is the patentee, whether the parties have an adversarial or non-mutually beneficial relationship, whether a party is on notice of potentially infringing behavior, and whether the party takes affirmative steps towards litigation.

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[9] *Id.* at 29.

[10] *Id*. at 29.

[11] *Id.* at 30.

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