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## Directors and IP: Personal liability maybe at stake

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The Delaware Supreme Court handed down a decision last year that could have a profound impact on the board members of many U.S. companies. It suggests that failure to oversee corporate assets may lead to personal liability for breach of the director's duty of oversight.

Because intellectual assets often comprise a significant portion of a corporation's value and given the increasing magnitude of patent infringement judgments, directors who fail to properly oversee intellectual assets risk substantial liability. Over the last decade, Delaware courts and the federal government (largely through Sarbanes-Oxley legislation) have increasingly stressed directors owe their corporations a duty to oversee corporate property and processes, which includes the corporation's intellectual assets. Directors must also ensure that the corporation is taking necessary measures not to infringe on the IP of others. This oversight duty remains with the board and cannot simply be delegated to management.



Unlike most fiduciary breaches, breach of duty of oversight results from a director's inaction by failing to monitor or take proper action. Breach of this oversight, until now, was viewed as a breach of the director's fiduciary duty or care, not the fiduciary duties of loyalty or good faith. Although directors can be protected in the corporate charter and indemnified against a breach of the duty of care, directors cannot be shielded from a breach of the duties of loyalty and good faith. The Delaware Supreme Court has now made clear that breach of the duty of oversight is a breach of the duty of loyalty that cannot be shielded by the corporation. The Delaware Supreme Court's

ruling in *Stone v. Ritter* found directors may be liable for oversight liability when (a) failing to implement any reporting or information systems or controls that would avoid corporate liability and protect corporate assets; or (b) having implemented such a system or controls, consciously failing to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention.

Additionally, the court found that such an oversight failure breached the director's duty of loyalty, not the duty of care, meaning that directors cannot be shielded from oversight liability in the corporate charter and their fees and damages cannot be indemnified or paid by the corporation. In short, directors are more likely now than ever before to be held personally liable for money damages for breaching their duty of oversight of IP assets and risks at a time when the value of IP assets and the magnitude of liability in IP litigation have never been greater, particularly for companies that specialize in technological innovation.

**Significant of a Delaware decision** Although Delaware is the span of a continent away from San Diego, that state is the corporate home to the majority of public companies in the United States, as well as a significant number of private companies and alternative business entities, such as LPs and LLCs. For the better part of the last century, Delaware state law has taken a leading role in shaping American corporate governance standards. Courts in other jurisdictions throughout the United States frequently look at decisions of Delaware courts as persuasive authority in defining the scope of corporate fiduciary duties and in resolving corporate governance disputes. Developments in Delaware corporate law are viewed as highly relevant, even to corporations not incorporated in that state.

**Practical tactics for boards to implement** What can directors do to avoid personal financial liability? The first recommendation is not to panic -- oversight liability is difficult to establish. Nonetheless, even the remote possibility of personal liability, potentially for millions of dollars in damages, calls for an abundance of caution. The solution is spelled out in the *Stone v. Ritter* opinion itself: Corporate boards should implement systems for collecting timely and accurate information concerning corporate performance and should monitor the information obtained.



What is less clear is which types of information a board must monitor. The types of information that could potentially be monitored are endless. Which types of information are directors duty-bound to monitor? Which types of problems are directors duty-bound to identify and redress?

The types of information that should be monitored may vary by industry. For companies that specialize in technological innovation, one such area of focus is overseeing their IP assets and risk, including the avoidance of patent infringement. Before companies launch new product or processes, or when they learn of patents relevant to their own technology, they have an affirmative duty to ensure that they do not infringe on others' patents. Liability for patent infringement, which could include injunctive relief that effectively puts the company out of business, can be catastrophic. If the infringement is found to be willful, the company could be subject to treble the damages. Given the current prevalence of patent litigation, directors in relevant industries should consider implementing systems for monitoring institutional awareness of competing patents and routine procedures for investigating and ensuring patents are not infringed, particularly when new products or processes are launched.

For companies that derive significant value from intellectual assets that are maintained as trade secrets, oversight should focus on the monitoring and handling, accessibility and disclosure of secret information. Trade-secret protection and attendant economic benefit can be irreparably lost if reasonable efforts to maintain the secrecy of the relevant information are not taken. Complicating matters somewhat is the nature of trade secrecy law itself, which is derived primarily from judicial opinions rather than a uniform body of federal law. Different standards may apply in different jurisdictions and monitoring should be informed by the applicable standards.

Boards of directors should consider creating a committee of the board charged with IP oversight to ensure compliance. With the possibility of being held personally liable

potentially for millions of dollars in corporate losses for failing to institute and monitor systems to protect corporate assets, directors, now more than ever, have a lot at risk and cannot be too careful in exercising their duties to the corporation.

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