

**RECENT CASE LAW CLARIFYING THE  
STANDARD FOR RECOVERY OF  
ATTORNEY'S FEES INCURRED IN PURSUIT  
OF AFFIRMATIVE RELIEF FOR  
INFRINGEMENT OF YOUR COMPANY'S  
INTELLECTUAL PROPERTY RELIEF FROM  
A COMMERCIAL LIABILITY**

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**I. CLAIMANT HP WAS RECENTLY AWARDED \$51.6 MILLION FOR FEES INCURRED IN ITS PURSUIT OF INTELLECTUAL PROPERTY RELIEF WHERE SUCH FEES WERE ALSO “CONDUCTED AGAINST LIABILITY”**

- A. In *HP v. ACE*, U.S.D.C., N.D. Cal., San Jose Div., Case No. C-99-20207 JW The U.S. District Court for the Northern District of California entered an amended judgment May 14, 2008 for Hewlett-Packard Company, and against ACE Property & Casualty Insurance Company (*HP v. ACE*, U.S.D.C., N.D. Cal., San Jose Div., Case No. C-99-20207 JW).**

The judgment is for the principal amount of \$28,347,598.26 for principal damages, \$10,927,416.64 in prejudgment interest calculated at 10% per annum for date of invoice and \$41,557.53 in costs and followed District Judge Ware’s approval of Special Master Stone’s finding that ACE had breached its duty to pay defense expenses in that amount. The court approved all of the post-tender fees sought after credit for a \$11.7 million partial payment during the suit. Litigation expenses included fees for prosecuting affirmative relief because they were shown to be necessary for the defense of the antitrust claims. HP also recovered the expenses of its in-house counsel, time based on reasonable market rates. The **total judgment** is more than **\$51.6 million<sup>1</sup>**.

The insurance coverage action by HP sought expenses incurred in defending a counterclaim for antitrust violations and patent invalidity (*HP v. Nu-kote Int’l, Inc.*, U.S.D.C., N.D. Cal., Civil Case No. 94-20647 JW). In 1999 the federal court found that ACE had a duty to defend HP in the Nu-kote Action (*HP v. Cigna*, 1999 U.S. Dist. LEXIS 20655, 53 U.S.P.Q.2d 1846 (1999)) but ACE refused to do so. HP successfully defended the Nu-kote claims after a sixteen-week jury trial. But ACE continued its refusal to reimburse the defense expenses, challenging whether the substantial defense expenses were objectively reasonable and necessary in defending the Nu-kote counterclaim.

The Nu-kote Action had been initiated by HP against Nu-kote for patent infringement, federal and state trademark infringement, trade dress infringement, and related causes of action

arising out of Nu-kote's sale of printer cartridges, use of deceptive packaging mimicking HP's trade dress, and falsely advertising that its inkjet cartridge refill products were approved by HP. The action took a dramatic turn when Nu-kote launched a massive counterattack alleging antitrust claims against HP and seeking to invalidate all of HP's patents which represented over a decade of HP's development of inkjet printers. Nu-kote continued to pursue its claims seeking potentially billions of dollars in damages, even after filing bankruptcy and obtaining permission from the bankruptcy court to press the suit against HP.

HP successfully argued that the costs incurred in **prosecuting** the patent infringement and related claims were "reasonable and necessary" as "**defense costs**," even though HP sought affirmative relief. HP's defense strategy and proof of its affirmative claims of patent and trademark infringement were found by the Special Master and the District Court to be objectively reasonable and necessary to defend against Nu-kote's counterclaims for antitrust violations and patent invalidity. HP's strategy was vindicated when the jury found that Nu-kote infringed HP patents and trademarks and also found that HP had not violated antitrust laws.

HP successfully showed that the expenses for prosecuting affirmative claims could not and should not be separated out from defense expenditures. The bad faith claim against ACE is still pending.

## **II. LEGAL WORK THAT SERVES DUAL PURPOSES, ADVANCING THE DEFENSE AS WELL AS CLAIMS FOR AFFIRMATIVE RELIEF IS RECOVERABLE**

In evaluating whether to investigate expenses in a claim for recovery of fees incurred in an environmental clean up dispute, the California Supreme Court emphasized that to be recoverable, the site investigation must amount to a reasonable and necessary effort to avoid or at least minimize liability.<sup>ii</sup> This required application of an objective standard because "motive, however, is 'hard ... to discern.'" "That is true ... [as to] an individual: a person's mind

and heart typically reveal themselves and conceal themselves at one and the same time. It is truer still ... [as to] a group of individuals: many minds and hearts are then involved, and they cannot simply be added up. And, of course, it is truest ... [as to] a corporation or \*63 similar entity”-like the typical commercial or governmental insured: “the 'mind' and 'heart' of such a one is purely fictive.” *Id.* at \*62-63. The court concluded “[w]hat matters here is whether the site investigation expenses would be incurred against liability by a reasonable insured under the same circumstances”. *Id.* at \*63.

The burden of proof was on the insured to show the reasonableness and necessity of defense costs by a preponderance of evidence. Where an insurer breached its duty to defend the expenses incurred by the insured, after being shown to be of a particular amount, would be “presumed to be reasonable and necessary as a defense cost with the insurer required “to carry the burden of proof that they are in fact unreasonable or unnecessary”. *Id.* at \*64

In *Barratt American, Inc. v. Transcontinental Ins. Co.* 102 Cal.App.4th 848, 860 (2002) a court of appeal disallowed recovery of repair costs to portions of a construction development project where a roofing subcontractors sought to minimize its exposure by conducting destructive testing of the remaining home owners who had not yet joined the class action suit against it for alleged construction defects. The court found that expenses incurred in connection with these houses, not the subject of the pending lawsuit, were defense costs but the appellate court reversed.

The appellate court found that although Barratt’s evidence may have supported a general conclusion that it can be a reasonable trial strategy in construction defect litigation to use repair information from other homes in a residential development to bolster defense theories, this general conclusion “does not support a reasonable inference that in this case it was reasonable

and necessary to engage in this strategy by repairing every claimed defect in every Cortina nonplaintiff home and to spend \$580,714.50 in doing so.” *Id.* at \*861.

Nevertheless, the court recognized that “under *Aerojet-General* and *Foster-Gardner*, the critical issue is whether the costs were reasonably and necessarily incurred in defense of an existing lawsuit. If the investigation costs satisfy this test, they are recoverable even if the payments of these costs benefited a third party who did not file suit against the insured”. *Id.* at \*860.

Transferring these observations to an intellectual property dispute setting in *Kla-Tencor Corp. v. Travelers Indem. Co. of Illinois* 2004 WL 1737297( N.D.Cal.,2004) the court ruled that Travelers had a duty to defend disparagement allegations made by Therma-Wave and Therma-Wave II. KLA at \*3. KLA moved for consolidation of Therma-Wave I and Therma Wave II arguing “that if KLA prevailed against Therma-Wave in Therma-Wave I, then statements that Therma-Wave was enjoined from shipping its Opti-Probe products would be true. Thus, resolution of the '055 patent may provide KLA-Tencor with a further defense to the” disparagement counterclaim in Therma-Wave II.

The court noted “KLA asserts, essentially, that the best defense to the disparagement counterclaims was showing that the '055 patent was valid, and further that Therma-Wave's Opti-Probe products infringed that patent. Considering KLA's potential for liability based on its internal investigation, this was not an unreasonable strategy.” KLA at \*4. The court stated that the general rule that “reasonable and necessary costs of defending a lawsuit are recoverable if the insurer breaches its duty to defend”, and summarized the relevant burdens of proof for recovery of such costs when an insurer breaches its duty defend set forth in *State v. Pacific Indem. Co.* 63 Cal.App.4th 1535, 1548 (1198); *Aerojet-General Corp. v. Transport Indem. Co., & Barratt* at \*4.

In affirming the special masters report in HP on December 4th, 2006, Judge Ware agreed that all fees incurred in prosecution of claims for pursuit of patent, trademark and false advertising claims against the counterclaimant whose defense was compelled given the character of the fact allegations included therewith, were defenses to that counterclaim. One of the first allegations of which included declaratory relief action that there were no valid patents nor infringement by the defendant counterclaimant.

In reaching this decision, the court considered and rejected a number of arguments advanced by ACE. The court noted that there was no basis for making the standard for recovery of fees that the expense be incurred for the purpose of disproving liability nor was the mere fact that the activity was of strategic benefit insufficient. The strategy may be considered in determining whether expenses were conducted against liability. The question is whether there is “evidence that a reasonable insured would have engaged in a similar defense strategy, which necessarily involves a consideration of whether the benefits of the strategy are worth the cost”. Barratt at \*861-862.

Where a patent infringement claim is a compulsory counterclaim to an alleged infringed declaratory judgment of noninfringement in prior litigation, *Polymer Industrial Products Co v. Bridgestone/Firestone, Inc.* 347 F.3d 935 C.A.Fed (2003). There can be no question that pursuit of a counterclaim is compulsory and that its assertion “conducted against liability”. Addressing a similar scenario and applying California’s, as well as New York’s law, the court in *Ultra Coachbuilders, Inc. v. General Sec. Ins. Co.* 229 F.Supp.2d 824, \*289 S.D.N.Y., 2002:

[i]n fact the counterclaims, alleging unfair competition and interference with competitive advantage, were used to argue (albeit unsuccessfully) that the injunction application was barred by the doctrine of unclean hands, see *Ford Motor Co. v. Ultra Coachbuilders, Inc.*, 57 U.S.P.Q.2d 1356, 2000 WL 33256536, at \*10 (C.D.Cal.2000), and were thus ‘inextricably intertwined with the defense of [defendant’s] claims and necessary to the defense of the litigation as a strategic matter.’ *Safeguard Scientifics, Inc. v. Liberty Mut. Ins. Co.*, 766 F.Supp. 324 (E.D.Pa.1991).

### **III. CONCLUSION**

A defense is required of the whole lawsuit under the applicable law in California as well as generally throughout the country. Thus claimants may secure funding for affirmative relief that is conducted against the liability asserted in complaints or counterclaims against the insured in a number of intellectual property scenarios. All that is necessary is that the legal fees to seek affirmative relief also support a defense of the underlying action against the insured which is potentially covered, and be conducted against liability. This test can be readily met where the claimant seeks among its claims for relief, as did the counterclaimant in HP, declaring relief for noninfringement and/or invalidity of patents which were asserted against the counterclaims in HP's initial complaint.

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<sup>i</sup>David Gauntlett and Jim Lowe of Gauntlett & Associates were counsel for the plaintiffs in the HP action.

<sup>ii</sup> *Aerojet-General Corp. v. Transport Indem. Co.*, 17 Cal. 4th 38, 70 Cal. Rptr. 2d 118, 948 P.2d 909 (1997)