Cases on standing hold lessons for patent privateers and defendants

A recent decision in the US may encourage patent owners who assign or license their rights to others for enforcement. **Max Grant** and **Kieran Dickinson** examine the implications for those structuring privateering deals and those challenging them

Patent privateering – whereby a patent owner (sponsor) assigns or licenses one or more patents to a third party, often a non-practising entity (NPE), which is given the right to enforce the patents against suspected infringers in return for a share of recoveries – was highlighted in the US Government Accountability Office's August report on Intellectual Property: Assessing Factors That Affect Patent Infringement Litigation Could Help Improve Patent Quality. Operating companies, GAO noted, are increasingly recognising that, if asserted, their patents are valuable from the perspective of corporate strategy and revenue, and they are sometimes asserting them indirectly through NPEs. If properly structured, such privateering arrangements allow sponsors to profit from the advantages of patent litigation without some of its disadvantages.

A threshold challenge for would-be privateers, however, is that, when NPEs that have acquired patents by privateering arrangements sue suspected infringers, they often face a challenge to their standing, or, in other words, to their right to sue independent of the sponsor. In most cases where the issue was argued at the US Court of Appeals for the Federal Circuit in the past 15 years, the Court held that the NPE lacked standing because the sponsor retained one or more substantial rights in the patent.

The Eastern District of Virginia's recent decision in *Suffolk Technologies, LLC v AOL Inc and Google Inc*, 910 F Supp 2d 850 (ED Va 2012), provides hope for privateers who structure their privateering arrangements in a sophisticated way, with due regard for the Federal Circuit's precedents. Lessons from this case, as well as contrasting lines of cases it discusses, can assist (1) sponsors and NPEs in successfully structuring future patent privateering arrangements and, by extension, (2) companies defending themselves from infringement suits arising from such arrangements.

One-minute read

Many patent owners choose to assign or licence patents to a third party, who enforces them in return for a share of the profits. The practice was addressed in the recent GAO report on patent litigation and improving patent quality and is sometimes known as patent privateering. However, problems can arise when the enforcer faces a challenge to its standing; indeed, the Federal Circuit has generally held that the enforcer lacked standing when the sponsor retained rights the court deemed substantial. A recent decision in the Eastern District of Virginia though gives new hope to patent privateers. Upholding standing in a case where AOL and Google were being sued, the District Court described in depth numerous terms of an agreement that it held conferred standing on the enforcer. The case provides important lessons for both patent owners and defendants, but it is unclear whether the Federal Circuit would reach the same conclusion. Those involved in privateering deals also need to consider other concerns, such as antitrust law, as well as changes from the legislative and executive branches.

Background to the case

In order to have standing, one suing to enforce a US patent must be the holder of "all substantial rights" in the patent (see,for example, *Alfred E Mann Foun For Sci v Cochlear Corp*, 604 F 3d 1354, 1358 (Fed Cir 2010) holding that a patent licensor had standing to sue notwithstanding the fact that it had granted an exclusive licensee the first right to bring infringement suits under the licensed patents). Ordinarily, the holder of all substantial rights in a patent is also the holder of legal title to the patent, although courts have recognised an exclusive licensee as having all substantial rights when the associated licence is tantamount to an assignment.

The *Suffolk* court, citing Federal Circuit and US Supreme Court precedents, outlined three justifications for limiting standing to those parties with all substantial rights:

> First, the holder of a mere 'nonexclusive license suffers no legal injury from infringement' and thus lacks constitutional standing to bring suit. Second, these requirements 'enable the alleged infringer to respond in one action to all claims of infringement for his act.' Third, the requirement of standing ensures that a fully litigated finding of invalidity of a patent is binding on the party with standing to bring an infringement action based on that patent and thus bars future infringement suits based on that patent.

Accordingly, if a licensee or assignee of a patent lacks all substantial rights, it can only bring suit to enforce the patent if the patent owner is joined to the litigation. Sponsors, however, enter into privateering deals precisely because they prefer to avoid litigation over their patents. Such litigation subjects them to discovery, potential countersuit, and negative publicity; and it diverts management's time and attention and may harm industry relationships. Properly structured, privateering allows them to achieve similar objectives as they could achieve by a direct suit without these disadvantages. The success or failure of a privateering arrangement hangs, though, on whether a court will agree that the NPE has acquired all substantial rights in the patent at issue. If not, the court will dismiss the case.

Of course, the standing problem could be easily solved if the sponsor simply assigned all rights in the patent to the NPE and did not retain any rights. In many cases, however, such an approach would not enable the sponsor to attain other critical objectives. These typically include the sponsor immunizing itself from suit by the NPE for practising the patents and avoiding public recognition of involvement in assertion of the patents. Sponsors also seek to earn a revenue stream on the basis of the NPE's recoveries from assertion of the patents, and the cases show several additional commonly reserved rights. The question for sponsors and NPEs, then, is how far a sponsor can go in retaining rights over the patents necessary to accomplish important business objectives while at the same time satisfying the judicial requirement that "all substantial rights" must be transferred to confer standing on the NPE. For defendants, the question is how successfully to challenge the NPE's standing on the basis of some rights in the patents being retained by the sponsor.

The *Suffolk* term sheet

In the *Suffolk* case, the District Court held that a privateering arrangement with these terms conferred standing on the NPE:

- Assigns to the NPE "all right, title, and interest in the patent";
- The assignment is "absolute and irrevocable";
- Assigns to the NPE "unfettered power to decide whom to license to practice the patent and the royalty rate to charge";
- NPE "grants-back the assignor a non-exclusive license to practice the patent";
- Assigns to the NPE "unfettered power to decide whether to sell the patent and to whom to sell the patent";
- Assigns to the NPE "the responsibility to maintain the patent";
- "Compensates the assignor for the assignment by requiring payment to the assignor [of] a portion of the stream of revenue from licensing, enforcement or selling the patent";
- "Does not explicitly address the right to practice the patent";
- Sponsor retains an exclusive option to buy back the patent if NPE fails to meet revenue goals; ceases exploiting and maintaining the patent; or fails to pay renewal or maintenance fees on the patent;
- Prohibits the NPE from retaining outside counsel for infringement suits where such counsel would be entitled to collect contingent fees of more than 20% of damages or other revenues; and
- Requires the NPE to provide quarterly progress updates.

District court upholds standing

In *Suffolk*, defendants America Online and Google challenged the standing of Suffolk Technologies, an NPE that had obtained patents indirectly from British Telecom through a privateering deal. The US District Court for the Eastern District of Virginia ruled in Suffolk Technologies' favour, affirming that Suffolk Technologies had acquired all substantial rights in the patents it received indirectly from BT and therefore had standing to sue.

Although issued by a district court, and thus only binding on the parties to the case, the Court's opinion nonetheless helpfully provides observers with a framework to confer standing on an NPE while still reserving numerous important rights for the sponsor. This framework is relatively easy for a practitioner to apply because portions of the Court's opinion were, in fact, organised like a term sheet (see box); the court held that a privateering arrangement with these terms conferred standing on the NPE.

In fact, the Court discussed several of these terms in detail. First, the NPE was obligated to pay the sponsor as compensation for the assignment half of the adjusted gross proceeds derived from exploitation of the patent, less certain costs incurred by the NPE to generate this income. Despite this, the court noted that this obligation represents "compensation for assigning the … patent … and is 'not inconsistent with an assignment'." Second, the sponsor retained an exclusive option to buy back the patent if the NPE failed to meet certain revenue goals or to maintain the patent. The Court again clarified that an assignor "does not retain a substantial right in a patent merely by reserving a reversion in the patent contingent upon the [assignee's] financial distress or the [assignee's] cessation of production". Third, the assignment required the NPE to provide quarterly progress reports, but the Court stated that an "inspection provision constitutes a policing mechanism, not a substantial property right."

Fourth, the NPE was prohibited from retaining "outside counsel for infringement suits where such counsel would be entitled to collect contingent fees of more than 20% of damages or other revenues". The Court reasoned that "this provision simply protects [the sponsor's] compensation for the assignment of the patent by ensuring that the revenue stream derived from the patent is not depleted by extravagant legal fees, which are not uncommon". Finally, the sponsor retained use of the patent through the NPE's grant-back to the sponsor of an "irrevocable, world-wide, royalty-free, non-exclusive, non-sublicenseable except to the [sponsor's affiliates]…" licence. Based on this, the agreement further protected the sponsor's future downstream customers by prohibiting the NPE from bringing suit against them. In each case, the Court nonetheless affirmed that these limitations did not affect the conclusion that all substantial rights were assigned to the NPE and that the NPE, thus, had standing to sue on its own.

The court in *Suffolk* bolstered its reasoning by referencing a line of US Federal Circuit cases, discussed below, each holding that all substantial rights had been transferred to an exclusive licensee despite the existence of limits to the grant of rights and distinguished, or, deemed inapplicable, another line of cases in which the Federal Circuit held the opposite.

We will examine the additional lessons that patent owners and NPEs considering privateering deals, and defendants challenging the plaintiffs' standing, can glean from each of these lines of cases.

Cases granting standing to an NPE

In *Vaupel Textilmaschinen KG v Meccancia Euro Italia SPA*, 944 F 2d 870, 875 (Fed Cir 1991), the Court held that an exclusive licensee held all substantial rights in a patent where a sponsor only retained (1) a veto right on sublicensing…; (2) the right to obtain patents on the invention in other countries; (3) a reversionary right to the patent in the event of bankruptcy or termination of production … ; and (4) a right to receive infringement damages. The Court reasoned that "none of these reserved rights was so substantial as to reduce the transfer to a mere license or indicate an intent not to transfer all substantial rights".

Similarly, in *Speedplay, Inc v Bebop, Inc*, 211 F 3d 1245 (Fed Cir 2000) the court held that the exclusive licence granted by the inventor and CEO of Speedplay, Richard Byrne, to Speedplay constituted a transfer of all substantial rights sufficient to give Speedplay standing despite the existence of several limitations on Speedplay's rights. Such limitations included that: (1) the inventors retained a right to sue infringers if Speedplay failed to stop infringement; (2) Speedplay required the inventors' consent, not to be unreasonably withheld, to assign its interest in the licence; (3) Speedplay was required to assign to the inventors any improvements (such improvements were then subject to the exclusive licence to Speedplay);(4) Speedplay's foreign sales were limited in that such products had to be marked according to instructions from the sponsors; and (5) the inventors had the right to audit Speedplay's financial records.

Although both *Vaupel* and *Speedplay* support the conclusion reached in *Suffolk*, it is important to note that, unlike in *Suffolk*, in neither of these cases did the licensor retain rights to practise the patents. For many sponsors, this is an important right. In *Vaupel* and *Speedplay*, the privateering arrangements were structured as exclusive licences, whereas in *Suffolk* the arrangement was structured as an assignment with a licence back to the sponsor.

Cases not granting standing to an NPE

By contrast, in most other cases, the Federal Circuit has held that an exclusive licensee did not acquire all substantial rights in the patents sufficient for standing. In *Prima Tek II, LLC v A-Roo Co*, 222 F 3d 1372 (Fed Cir 2000), the patent owner granted an NPE the right to license the patents to others, but not the right to practise the patent itself. The licensee in turn purported to grant an affiliated sublicensee the exclusive right to practise the patents. The court held that an NPE with only a "license to license" did not have all substantial rights in the patents and, lacking such rights itself, could not confer standing upon a sublicensee.

If bare licences to license are thus inadequate to confer standing on an NPE, so are licences with limited durations. In a case where the sponsor granted the licensee (1) the exclusive right to make, use, and sell products covered by the patent, (2) the right to sue for infringement of the patent, and (3) a virtually unrestricted authority to sublicense its rights under the agreement, the fact that the term was limited to five years was held sufficient to support the conclusion that the licence did not confer all substantial rights in the licensee (see *Aspex Eyewear, Inc v Miracle Optics, Inc*, 434 F 3d 1336, 1342-1343 (Fed Cir 2006)). If conferring standing in the licensee is a prime concern, the term of the licence should be co-extensive with the terms of the licensed patents.

Though not mentioned in *Suffolk*, another recent Federal Circuit case is particularly instructive for companies considering entering into privateering arrangements or defending themselves from suits arising from such arrangements. In *Alfred E Mann Foun for Sci v Cochlear Corp*, 604 F 3d 1354, 1362 (Fed Cir 2010), the court held that an exclusive licence did not confer all substantial rights in the NPE where the sponsor retained a right to sue infringers if the licensee failed to do so. Among many factors taken into account in determining whether all substantial rights had been granted, the court singled out two as particularly important: (1) the licensee's right to practise the patent and (2) the licensee's right to sue infringers. In *Alfred E Mann*, these two factors clashed because the sponsor retained a right to sue infringers if the exclusive licensee declined to do so, but the same sponsor gave up all rights to practise the patents. Interestingly enough, the Court ruled that the patent owner, who lacked any right whatsoever to practise the patent, did have standing. Accordingly, we can deduce that this court found, for standing purposes, that the lack of an exclusive right to sue infringers trumps an exclusive right to practise the patent.

Just as in Alfred E Mann, deficiencies in licensee's right to sue infringers largely determined the outcome in *Sicom Systems Ltd v Agilent Techs, Inc*, 427 F 3d 971 (Fed Cir 2005). In *Sicom Systems*, the agreement granted the licensee the exclusive right to sue for "commercial infringement", while reserving for the licensor the right to sue for non-commercial infringement. The Court held that this division of rights with respect to suits against infringers, coupled with a requirement that the licensor must consent to any litigation, did not confer substantially all rights in the patent necessary for standing. An implication of *Sicom Systems* is that patent licences limited by field of use, such as are common in M&A carve-out transactions, do not confer standing upon the licensee.

Will the Federal Circuit follow Suffolk?

Parties considering privateering deals now have an abundance of guidance from the Federal Circuit on many pitfalls they must avoid if they want to structure a privateering transaction that confers substantially all rights in the patent and standing to the NPE. *Suffolk* offers very helpful guidance to would-be privateers because it upholds standing in the context of a sophisticated privateering arrangement in which the sponsor retained several important rights. Nevertheless, the decision is only binding upon the parties to the case, and it is not clear whether the Federal Circuit would reach the same conclusion. In its discussion of the line of Federal Circuit cases holding that the NPE lacked standing, Suffolk also provides tools for defendants to challenge the NPE's standing if all substantial rights are not conveyed.

Although *Suffolk* and these other cases provide helpful guidance, it is important to remember that each case had a unique set of overarching facts that factored into each decision. It is also worth mentioning that even if a challenge to standing can be overcome, a privateering arrangement may fail for other reasons, such as violation of antitrust law. In addition, while the focus of this article and *Suffolk* is privateering by contract, parties may find that the tension between the sponsor's desire to retain important rights in the patent and its need to transfer all substantial rights to confer standing upon the NPE may be overcome if they structure their transaction as a joint venture instead. Finally, parties involved in structuring or litigating privateering deals should be on the look-out for changes emanating from the legislative and executive branches that will likely restrict, but not eliminate, privateering.

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