

Recent Decision Highlights Importance of Performing a Complete IP Due Diligence Investigation Prior to Acquiring Patents for Licensing and Enforcement Purposes

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The doctrine of patent exhaustion provides that the first authorized sale of a patented item exhausts the patent owner's right to preclude others from making, using, or selling that item, thereby extinguishing the patent owner's right to sue for patent infringement. Companies interested in acquiring patents for the purposes of licensing or enforcement need to carefully examine the licensing history of those patents to ensure that prior licenses have not resulted in exhaustion of those patent rights against intended licensing targets. The consequences of acquiring and enforcing patents without a full investigation is illustrated by a recent court decision, *Rembrandt Data Technologies, LP v. AOL, LLC*,¹ No. 2010-1002 (Fed. Cir. April 18, 2011). There, the Federal Circuit decided a case involving the issue of patent exhaustion for patents having a complicated ownership and licensing history and found that rights in those patents had been exhausted and could not be enforced.

Background

Rembrandt Data Technologies owns two patents relating to modem technology. According to Rembrandt, the patents are incorporated into the V.34 protocol, a modem standard promulgated by the International Telecommunications Union. Rembrandt accused Canon and HP of infringing those patents because Canon and HP market office products containing modem chips capable of implementing the V.34 protocol. All of these modem chipsets, however, were manufactured by a third party, Conexant Systems, who claimed to have a license under the patents. Under the doctrine of patent exhaustion, if Conexant had properly licensed the patents, then Rembrandt would be unable to enforce the patents against Conexant's modem-chip customers, including Canon and HP.

The analysis of whether Conexant was properly licensed was not straight-forward, however, because of the complicated ownership and licensing history of the patents.

1. Ownership

Ownership of the two patents had passed through multiple hands before being acquired by Rembrandt. The patents were initially acquired by subsidiaries of AT&T Corp. In 1996, AT&T Corp. split into AT&T, NCR Corp., and Lucent Technologies, and the patents were transferred to Lucent. The same year, Lucent spun off Paradyne Corp., which became the assignee of the patents. Paradyne was later acquired by Zhone Technologies in 2005. The following year, in 2006, Zhone assigned the patents to Rembrandt Communications, which in turn assigned them to Rembrandt in 2008.

2. Licensing history

The licensing history of the two patents was equally complicated.

In 1988, AT&T Corp. entered into a patent license agreement with the old Rockwell International Corporation ("Old Rockwell"), which included a license for the patents-at-issue.

Old Rockwell and AT&T Corp. amended the 1988 license agreement in 1995 through a side letter agreement that granted Old Rockwell additional rights, including sublicensing rights.

In 1996, Old Rockwell sold its aerospace and defense businesses to a third party and reorganized its corporate structure ("New Rockwell"). Old Rockwell conveyed substantially all of its businesses and assets to New Rockwell in a distribution agreement.

In a letter dated October 17, 1996, Lucent acknowledged Rockwell's reorganization and the assignment of Old Rockwell's rights and obligations under the 1988 License Agreement to New Rockwell, and subsequent to receiving the letter, New Rockwell made its royalty payments to Lucent.

Later, in 1998, New Rockwell spun off its semiconductor systems unit, including its modem business, to Conexant. It was further alleged that New Rockwell had sublicensed the patents to Conexant as part of the spin-off.

By virtue of these transactions, Canon claimed that Conexant was properly sublicensed and thus Rembrandt's right to enforce the patents was extinguished by the doctrine of patent exhaustion. The district court agreed and granted Canon's motion for summary judgment of exhaustion.

The *Rembrandt* Decision and Conclusions on the License Issues Raised

On appeal, Rembrandt argued that Conexant was not sublicensed for two reasons: (1) New Rockwell could not sublicense its rights to Conexant; and (2) even if it could, the sublicense did not apply to the Conexant's modem chipsets at issue.

1. The agreement permitted sublicensing and therefore consent was not necessary

Rembrandt first argued that New Rockwell could not sublicense its rights to Conexant because New Rockwell was not properly assigned licensing rights from Old Rockwell. In particular, Rembrandt argued that the transfer of rights required AT&T Corp.'s written consent. The Federal Circuit rejected that argument, explaining that the 1995 Side Letter Agreement recognized that Old Rockwell "may at some time in the future wish to divest all or part of its business" and provided that "the licenses and rights granted in the Agreement may be sublicensed to any future divested present business of Rockwell." Thus, further consent by AT&T Corp. was unnecessary under the language of the 1995 Side Letter Agreement.

2. The agreement properly limited the extension of rights to include the sublicensee

In 1996, Old Rockwell reorganized but retained its modem manufacturing unit and divested most of its businesses and assets, including its agreements and licenses, to New Rockwell. The divestiture included Old Rockwell's right to sublicense under the 1995

Side Letter Agreement. Rembrandt expressed a concern that, under the interpretation adopted by the Federal Circuit, the license and sublicensing rights could flow infinitely to subsequent licensees, but the Federal Circuit explained that the 1995 Side Letter Agreement limited the extension of rights to divested present businesses, which includes New Rockwell.

3. The agreement allowed the license to be transferred under the present facts

Rembrandt next argued that the license was not transferable from New Rockwell to Conexant. In 1998, New Rockwell divested its modem business to Conexant and granted it a "royalty-free, world-wide, irrevocable, non-exclusive license under all intellectual property rights," including patents "under which the Rockwell Group had a right to license" and "which are used in the conduct of the business of [Conexant]" at the time of divestiture. Generally, the law does not recognize any right of a nonexclusive licensee to assign the license or to further sublicense. The Federal Circuit, however, recognized an exception to that general rule here where the contract provides otherwise. The 1995 Side Letter Agreement provided the right to sublicense so long as the sublicensed "future divested business" continues to "operate[] as a separately identifiable business" selling "products and services sold by the future divested business prior to its divestiture." The Federal Circuit found that New Rockwell and Conexant satisfy the agreement because New Rockwell sold the modem chips at issue prior to spinning off Conexant, and Conexant continues to manufacture those modem chips.

4. The sublicense applies to the products at issue

Finally, Rembrandt argued that even if Conexant was properly sublicensed, the sublicense does not apply to the modem chipsets at issue because they are not the "products and services sold by the future divested business prior to its divestiture," as required by the 1995 Side Letter Agreement. In other words, the modem chipsets at issue are not the same products sold by Old Rockwell in December 1996 when it divested its semiconductor business to New Rockwell. The Federal Circuit dismissed Rembrandt's argument, noting that neither the 1988 License Agreement nor the 1995 Side Letter Agreement refers to specific models of modems. Instead, the agreements use general, functional terms, such as "data communication station systems" and "digital transmission systems." Thus, the Federal Circuit agreed with the district court that the term "products," as used in the 1995 Side Letter Agreement, covers "modems generally, not specifically the exact types of modems in production at the time of the sublicense and/or divestiture."

5. The sublicense exhausts the patent rights and precludes recovery for infringement

Old Rockwell's telecommunications business unit sold modems, New Rockwell's modem business sold modem chipsets, including V.34 protocol-compliant chipsets, and Conexant continues to sell V.34 protocol-compliant modem chipsets. Thus, the Federal Circuit concluded that the conditions in the 1995 Side Letter Agreement are satisfied, and Conexant's sublicense precludes Rembrandt's recovery against Canon and HP for infringement of the two patents-at-issue under the doctrine of patent exhaustion.

Strategy and Conclusion

1. Research the ownership and licensing history

The *Rembrandt* decision emphasizes the importance of researching the ownership and licensing history prior to acquiring patents. Sometimes this will include reviewing not only licenses specific to the patents but also broader arrangements governing relationships between related companies. Failure to do a proper due diligence investigation can result in severely overestimating the value of patents, if the potential licensees from which royalties were expected are already covered by existing license arrangements.

2. Anticipate and plan for future events

This case also highlights the importance of anticipating future events when drafting a license and using specific language to address those particular problems. The court in *Rembrandt* relied on the contract language not only to determine whether Conexant was a proper licensee but also to determine whether the accused products were covered by the license. That the court was interpreting a

16-year-old agreement and was applying it to companies distantly related to the original parties to the agreement shows the potentially broad effects of the language in the agreement.

3. Consider what rights flow to divested businesses and their products

Before executing any agreement, it may be useful for the patent owner to consider what licensing rights it will allow to flow to divested businesses and what products those rights will cover. For example, the patent owner may wish to tailor the language narrowly to require renegotiation of the agreement in the event the licensee, or a future divested business of the licensee, broadens its product line. Similarly, it may be useful for the licensee to consider whether the language of the agreement is broad enough to cover potential future products and to protect its customers, particularly customers of any future divested businesses.

Endnotes

¹ The *Rembrandt* decision: <http://www.cafc.uscourts.gov/images/stories/opinions-orders/10-1002.pdf>.

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