LightSwitch
INTELLECTUAL PROPERTY LAW BULLETIN

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Stanford v. Roche:
A Cautionary Tale for Employers with Intellectual Property

By John Perkins

The United States Supreme Court reminded us again on June 6, 2011 how important employment contracts can be to companies with intellectual property. In a 7-2 decision, the Court held that the Bayh-Dole Act did not change the long-standing law that patents are initially awarded to inventors rather than to their employers. (*Board of Trustees for Leland Stanford Junior University v. Roche Molecular Systems, Inc.,* U.S. No. 09-1959) (*"Stanford v. Roche"*).

While that holding addressed the major question presented to the Court, it also illustrates a more fundamental issue that arises for employers and contractors who deal with intellectual property, especially with respect to patentable inventions. As it turned out the Court based its patent infringement holding on long-standing principles of patent ownership. The Court reminded us that the default rules for patents are different; ownership of patent rights belongs to the inventor unless very specific steps are taken to properly assign those rights to an employer or contractor.

In *Stanford v. Roche*, a Stanford researcher (Mark Holodniy) did some work for Stanford under a government funded contract while he was one of the employees of a contractor (Cetus) who was under a prior contractual duty to assign invention rights to Stanford. Unfortunately, Holodniy left Stanford without ever assigning rights to the invention in question to Stanford and instead assigned rights to Cetus. When Stanford sued Roche (Cetus's successor in interest) for patent infringement, Roche's defense was that a co-owner could not be held liable for patent infringement. The Court of Appeals for the Federal Circuit agreed with Roche, holding that Holodniy's duty to assign rights to Stanford did not block him from actually assigning rights to Cetus so that Roche properly held title to the invention.

This surprising outcome should provide a note of caution to all employers. In common practice most employers attempt to handle this issue with employment agreements and independent contractor agreements that require employees and contractors to assign title to inventions to the employer or the company that hired the contractor. The problem with that practice—as seen in this case—is that the employer must actually perfect its patent rights in a second step by having the inventor later assign title through a written assignment agreement with the employer. Stanford argued unsuccessfully that the provisions of the Bayh Dole Act superseded this requirement because the Act states that an "invention of the contractor" at 35 U.S.C. 201(e) includes all inventions made by the contractor's employees with the aid of federal funding. The Supreme Court held that nothing in Bayh Dole changed the default rules of patent ownership.

While many employers might think this outcome outrageous, the Supreme Court also reminded us of the solution by pointing to Federal Circuit precedent in the 1991 *FilmTec* case. The Federal Circuit established a particular federal-patent-law interpretation of employment agreements in *FilmTec* that allows contracting parties to choose language that optionally includes either a promise to cooperate and assign rights or else an automatic assignment that occurs constructively at the moment of invention. If Stanford had chosen the more stringent automatic assignment language for its employment contract, then it would have automatically taken rights to the invention. Unfortunately, we estimate that 90% or more of employment contracts in the U.S. contain the same language used by Stanford. Perhaps it is time to dust off those employment contracts and make a few updates.

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Intellectual Property is 80% of the Value of a Business

By Michael Mann

Many years ago, a man I met at a party asked me what kind of law I practiced. I told him I was an “intellectual property attorney,” adding, after a brief hesitation, “you know: patents, trademarks, copyrights, trade secrets and know-how.” He gave his cocktail a few swirls in his glass while swirling my response in his head. Then he said, “Do you get much call for that type of practice around here?”

The connection between the needs of a businesses and “intellectual property law” is tenuous for many. And, unfortunately, I made it worse by referring to my little list of intellectual property law areas of practice: patents, trademarks, copyrights, trade secrets and know-how. These terms are familiar, even if not well understood, but their connection with everyday business is remote, yet, studies show that 80% of the value of a typical business is intellectual property. For many business people, this fact seems to be at the very least an exaggeration.

If I use a different list, however, understanding of – and appreciation for – the connection between intellectual property and business success soars. My old list is simply wrong; the elements of that list are not type of intellectual property but, for the most part, references to bodies of law for those types, and they are in the wrong order. For example, “patents” is not a name for a type of intellectual property; it is the name of for the documents the government gives you for a certain type of ideas. This is also true of word “trademarks,” “copyrights” and “trade secrets,” but not true of the word “know-how.” Know-how is a form of intellectual property.

If I focus on types of intellectual property, I can combine patents and trademarks by pointing out that they are two different ways of protecting innovation. Copyrights protect a type of intellectual property technically called works of authorship but I will use the term “message.” Trademarks are for protecting the integrity of the reputation of products and services. So my new list, reordered, is know-how, message, innovation, and reputation.

What company can succeed without know-how, message, innovation and reputation? Indeed, CEOs would do well to think about their job as one of increasing the quality and quantity of each of these in order to increase the value of the company for their shareholders and employees.

I have moved know-how from last to first because it is essential. Furthermore, it is easily the type of intellectual property that is in greatest abundance. Most importantly, in the context of a business, the collective know-how of an assembled and trained work force is huge. In the movie “Miracle on Ice,” about the 1980 US Olympic hockey team’s upset win over the Soviet team, the coach of the US team pushes back against those who want to help him select the best hockey players by saying, “I don’t want the best players, I want the best team.” He understood that there was a difference between a skilled team and a group of skilled players. That difference in his case was victory. A similar notion is found the title of the movie, “Band of Brothers,” about the experiences of Easy Company in World War II. A classic example of knowhow and teamwork is Apple Computer. Note that Apple Computer’s fortunes began an upward juggernaut from iMac (1998), iPod (2004), iPhone (2007), to iPad (2010) beginning when Steve Jobs returned to lead Apple in 1996. That did not falter even when Jobs took a medical leave of absence in 2009: he had built a team that could carry on without him.

Message is the second type of intellectual property. How something is communicated is as important as what is communicated. Music and entertainment is found everywhere but the US entertainment industry is second only to the US aerospace industry in the value of its exports to the rest of the world, and could very well be the leading export industry if it weren’t so easy to pirate CDs and DVDs. J K Rowling, author of the Harry Potter series, is the first person to become a billionaire from writing books and went from being on welfare in the mid 1990’s to a woman of incredible wealth within ten years based on widely-appealing story of Harry Potter.

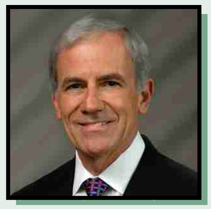
Message does not have to be entertaining to be important. And across the internet, content is king and information is the currency of the Information Age. Content builds traffic and traffic generates sales of products, services and advertising. Google not only increased its market capitalization to $177 billion dollars since it started in 1998 but look what it has done for productivity of all businesses that need information. Moreover, it naturally exerts the pressure of competition on online sources of information for better quality information. Businesses must communicate with their customers and employees; the message in that communication must not only deliver information but shape these relationships.

Innovation is the third type of intellectual property. A company with ideas stands apart from its competitors, and creates value for itself and its shareholders. Innovation drives progress and makes products and services better, safer, more reliable, more fun, more interesting, more convenient, and more affordable. In short, innovation improves the quality of our lives. Innovation can be found everywhere but particularly by a business that has significant know-how and a clear message.

Finally, reputation is what a company ultimately strives to build, that widespread belief by the public at large that its products and services are what people really want, that those products and services have the combination of quality, price, features, and terms that best meet customers' needs. Reputation reduces consumer search costs and consumers will in turn pay a premium price for that savings in their search time. The products of a company with a great reputation can become a status symbol, like BMW, and help it overcome tough times, like TYLENOL. Importantly, reputation is the most scalable of any business asset when the business is ready to expand to new markets.

Know-how, message, innovation and reputation: these are the intellectual properties. They comprise the bulk of the value of a business rather than buildings, desks, file cabinets and machinery – that is clear. The fact that reputation may be embodied in trademarks, which can be registered, or that the message may be protected with copyrights, or innovations can be patented or kept as trade secrets only heightens the value assigned to the underlying intellectual property. Know-how can also be protected and grown by careful hiring, sound employee management practices, training and cross-training, mentoring, succession planning and documenting procedures.

Think about your business, be it for-profit or not, large or small; think about just yourself as a business. Is there more know-how your business needs? Does your message get to your customers? Are you innovating? What is your reputation? How valuable is your business?



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Avoiding Confrontations with Licensing Firms

By Daniel C. Leonardi

In the last installment of Lightswitch, I wrote about patent trolls and specifically about Intellectual Ventures, one of the largest patent trolls in the world. For those that missed that article, a patent troll or "licensing firm" is a company that enforces patents with no intention of manufacturing, marketing, or using the patented technology. They threaten litigation; you pay them in the form of a licensing fee or royalty to avoid litigation.

The prevalence of licensing firms and the threat they present has given rise to a business entity with an even newer business model - defensive patent holding companies. In general, defensive patent holding companies seek to minimize patent litigation by acquiring patents that might be asserted against their clients or members. These holding companies take aim squarely at licensing firms and openly criticize licensing firms' litigiousness. For example, RPX Corporation, one of the largest defensive patent holding companies, declares on its home page: "Patent litigation used to be a form of legal redress. Now it is a business model."

Defensive patent holding companies generally fall into one of two categories: independent patent holding companies, like RPX, and defensive patent pools, like Allied Security Trust. These two types of entities differ primarily in who decides which patents the firm acquires.

RPX provides a service designed to mitigate members' litigation risks by purchasing patent rights on the open market. RPX members pay an annual membership fee ranging from $40,000 to $5.2 million depending on the size of the company. RPX decides which patents to acquire and targets patents representing a threat to a broad base of companies preferably across multiple industries.

As you would expect, RPX provides its member organizations a license to practice the technology covered by the patents it acquires and promises never to sue or assert the patents in its portfolio. More interestingly, RPX does not increase the size of its membership fees based on the size of its aggregated portfolio of patents.

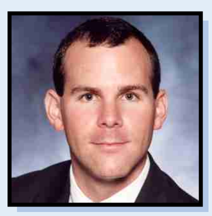
In the last three years, RPX has invested more than $200 million in over 1,300 patents and patent rights, primarily in the mobile, internet search, and radio-frequency identification markets. Its members include some of the largest players in the high-tech field, including Barnes & Noble, Cisco Systems, Dell, eBay, Google, Microsoft, Motorola, and Research in Motion.

Defensive patent pools on the other hand, like AST, are member-based patent trusts in which the members, not the company, decide on a case-by-case basis whether to contribute money and purchase patent rights. Members of the trust contribute funds and AST holds the funds in escrow for the purchase of patents. AST uses a particular member's funds only to acquire patents that particular member is interested in acquiring. AST simply aggregates the funds and formulates the bid. The members involved in that particular purchase obtain a license to the patent. After a certain period time, the acquired patents are sold or donated. Although AST has far fewer members than RPX, AST members include some of the biggest names in high-tech including Sun Microsystems, Motorola, Hewlett-Packard, Cisco, and Google. As you would expect, like RPX, AST does not assert its patents against others.

These two entities both purport to have certain advantages over the other. For example, RPX claims that its strategy of deciding which patents to acquire, targeting patents relevant to more than one industry, and licensing all of its patents to all of its members is highly cost-effective. Moreover, RPX claims that, because its client pricing is separate from the actual value of the patents it acquires, its fees are significantly lower than the typical patent acquisition (and defense) costs a client would otherwise face.

AST, on the other hand, claims that its structure – allowing the members to use their own expertise to decide among themselves which patents to acquire – taps into the intellectual wherewithal of the members collectively in a way that an entity like RPX is not capable. Critics of the patent pool model, however, question whether the individual members devote sufficient resources to evaluating patents in a timely fashion.

As corporations continue to seek ways to mitigate patent litigation expenses, it will be interesting to see how companies like RPX and AST evolve and if newer business models arise.



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