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IP rights at auction

Auction of a covenant not to sue could change IP litigation landscape, according to **Timothy J Maier**, partner at Maier & Maier, PLLC

Recently, an IP brokerage firm called ICAP Ocean Tomo conducted an auction that caught the attention of IP professionals around the world. At the Spring 2011 Live IP auction, an anonymous purchaser spent $38.5 million acquiring a Covenant Not to Sue on a portfolio of approximately 4,200 patents owned by Round Rock Research, LLP. This is the first successful auction of its kind, and has the potential to fundamentally alter the IP litigation landscape.

Transfers of IP rights

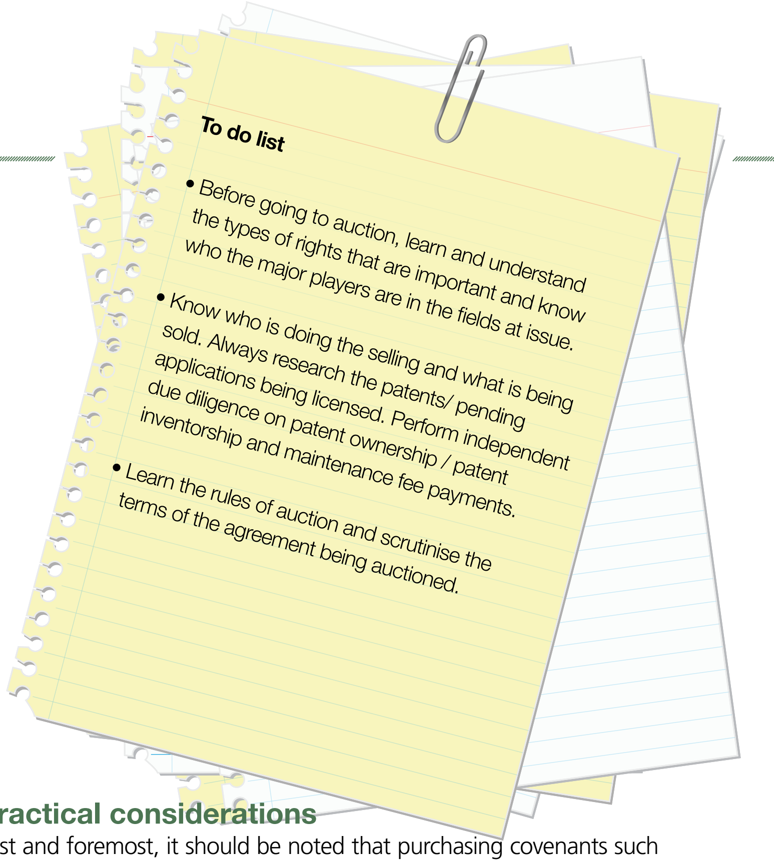
On the spectrum of intellectual property rights transfers, covenants not to sue are relatively narrow. The broadest transfer of patent rights available is, of course, the sale or assignment of a patent. An assignment is a transfer of all of the rights associated with a patent, including the power to exclude others from making, selling, or using the patented invention. The owner can assign all or a portion of his or her interest in a patent, and any joint owner, no matter how small the interest owned, has the right to grant a licence to the patent.

A licence is an agreement that grants a bundle of rights that is smaller than that given in a full assignment of ownership interest. Patent licences can take a variety of forms, and can range from very simple to extremely complex. In its most basic form, a licence is an agreement that the patent owner will not sue the licensee for infringement. Licences can include restrictions on geographic area, time, field of use, and any number of other limitations. Licences can also be exclusive, in which case the patent owner agrees not to compete with the licensee or grant any other licences or limited in exclusivity which may permit the owner or other existing licensees to continue to operate in a particular field. Importantly, licences commonly run with the patent, so any future assignee must comply with the terms of the licence.

A covenant not to sue is much like a licence, but is even narrower. Essentially, a covenant not to sue is exactly what it sounds like: an agreement that the patent owner will not sue the recipient of the covenant for infringement. Until recently, covenants not to sue were considered only valid between the parties directly involved in the agreement. In other words, any downstream purchasers of the patented product were liable for infringement to the original patent owner, and had to negotiate their own separate licences or covenants not to sue. However, a recent decision by the Court of Appeals for the Federal Circuit erased this distinction between covenants not to sue and licences. As a result, the main difference remaining between the two is the fact that, unlike licences, covenants not to sue do not run with the patent. In other words, if the patent is ever sold, any existing covenant is no longer valid, and new covenants must be purchased from the new owner.

Monetisation strategies

A number of different strategies have sprung up in an attempt to monetise these transfers of IP rights. One of the more cooperative strategies is a patent pool, which is a consortium of companies that come together to cross licence patents related to a particular technology or aspect of a technology. A patent pool grants its members freedom to operate in a wide technological space, and at the same time provides a convenient method for standardisation by lowering the cost of coordination between large numbers of entities. A patent pool can also provide revenue for its members by distributing licensing fees and royalties, as well as proceeds from suits asserting the pooled patents. Patent pools have been created in a wide variety of technological areas, from typewriters in the 1850s to video compression in the last decade.



Patent aggregation is a more competitive approach to the monetisation of IP rights. Patent aggregators and in some cases non-practicing entities ("NPE"), of which Round Rock Research is one, are companies that may either acquire portfolios of patents with the main objective of bringing infringement lawsuits on existing companies rather than seeking out new uses for the patented technology, or alternatively provide a type of pool which technology users can participate for a fee. Patent aggregators often purchase patents from individual inventors and bankrupt companies, as well as companies seeking to off load underutilised assets, or other entities that are unable, for various reasons, to bring their own infringement suits or set up a viable licensing framework. They then monitor the market and bring suits against individual operating companies or entire industries. The high cost of patent litigation means that infringement suits of even questionable merit are very often settled, often resulting in the payment of relatively high licence fees to the aggregator or NPE.

A recent wrinkle on this strategy is referred to as defensive patent aggregation. Like more traditional patent aggregators, defensive aggregators also seek out and attempt to acquire large portfolios of patents. Unlike other aggregators, however, they make these acquisitions with the goal of removing them from the hands of others who are more likely to assert the patents in court. RPX Corporation, one of the first defensive aggregators, has pledged never to bring a suit or assert any patents in its portfolio. RPX offers licences to its portfolios based on a yearly membership fee, but unlike a patent pool, it does not distribute these fees to its members. Instead, RPX uses them to seek out and purchase more patents to add to its portfolio, continually broadening the protection it is able to offer. As this is a relatively new strategy, it remains to be seen whether RPX and other defensive aggregators will be able to sustain themselves purely on licences and covenants not to sue, or whether they will at some point need to assume a more offensive, enforcement-based approach.

There is an obvious benefit to dealing with entities such as aggregators. They offer the promise of freedom to operate: negotiate one fee and obtain access to an entire technological space. Despite this, many are hesitant to participate in a pool or pay the fee or royalty to an aggregator, as there is always the possibility that another aggregator will show up and demand payments for something that is very similar to what has already been licensed.

Because of this, aggregators and other NPEs are often regarded with derision, considered at best a nuisance and at worst, a real hindrance to innovation. However, these entities can serve a valuable function by acting as middlemen between inventors and operating companies. They can provide much-needed capital to start-ups, and open up an avenue for solo inventors without business or manufacturing expertise to receive compensation for their ideas. One source of an aggregator's profit, and some would say its ability to hinder innovation, comes from its exploitation of an information asymmetry: no inventor knows just how valuable a particular invention is, and no operating company can tell precisely just how valuable an aggregator's portfolio is.

Impact of Ocean Tomo auction

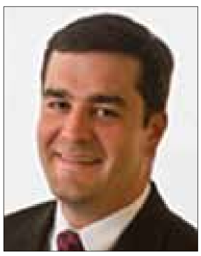
This is why ICAP Ocean Tomo's recent auction could be so significant. Auctions such as this one have the potential to radically alter the way that aggregators interact with operating companies by providing a robust and, more importantly, a transparent market in IP rights. Ultimately, this arrangement could be beneficial to all involved or alternatively, sales such as this may simply empower NPEs to bring infringement suits having recently received an influx of capital. Instead of hiring costly IP litigators to track down potential infringers and initiate unwieldy and expensive court proceedings, aggregators can now simply bring their portfolios to auction and invite bids. Inventors can use auction prices to determine the monetary value of their inventions when considering whether to sell their rights to an aggregator. And every time one of these auctions is completed, operating companies get a new data point which they can use to calculate potential IP liabilities and determine whether to pursue covenants of their own.

Practical considerations

First and foremost, it should be noted that purchasing covenants such as these merely reduces, but does not eliminate, the risk of infringement suits. Aggregators are not the only entities that bring these suits, and profits from licensing agreements are not always the goal. People bring infringement suits for all manner of reasons, for instance to tie up a competitor, capture market share, or simply out of spite.

Keeping that in mind, there are a few practical considerations that should be taken into account when deciding whether to bid on covenants not to sue at auction. First, know the industry, and have an understanding of the types of rights that are important and who the major players are in the technological field at issue. Second, know who is doing the selling. Remember that, for instance, covenants not to sue do not run with a patent. If the seller of one of these covenants seems likely to sell the patent itself soon, then a covenant is next to worthless. Third, know what is being sold. Research the patent being licensed, and make sure there are no related or pending applications that cover the same subject matter. Also be sure to scrutinise the terms of the agreement being auctioned. For instance, one of the properties for sale by Round Rock, a five-year covenant not to sue, was particularly puzzling, as any purchaser would likely turn into a ripe target for litigation at the expiration of the five-year term. Finally, know the rules of the auction. For this particular auction, ICAP required all bidders to register beforehand. An unwary bidder in an auction such as this could inadvertently find itself at the top of an aggregator's target list.

Author



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