Preserving Patent Licensor's SSO Commitments

Steven Wright, Georgia State University
AIRA Submission: Preserving Patent Licensor's SSO Commitments

Preserving Patent Licensor's SSO Commitments

by

Steven Wright*, MBA, PhD

* JD Candidate at Georgia State University College of Law, graduation expected May 2012
AIRA Submission: Preserving Patent Licensor's SSO Commitments

Introduction

Imagine you are the CEO of an innovative startup just starting to break through to commercial success. Along the way, your company had developed patented innovations (at least partially for defensive purposes in an industry prone to cross-licensing agreements) and helped to develop a market by working with others to create interoperable industry standards. Now, some of your former competitors (and the same companies were also former collaborators from the standards organization) are failing. The standardization effort was supposed to assure reasonable and non-discriminatory terms to the participants. Now, you've heard that the “patent trolls” are circling the carcass of your coopetition! How worried should you be?

In some cases, patents are relevant to industry agreements on technology standards. Standards Setting Organizations (SSOs) usually have obligations on participants to disclose patents that they reasonably believe are essential to the implementation of the industry standards and to license those patents on Reasonable And Non Discriminatory (RAND) terms. While the licensing of IP embedded in standards has always been controversial, based on recent reports of commercial transactions, some high profile patent portfolios can have considerable commercial value. High information and


3 See infra note [87] on acquisition by Apple consortium of Nortel patent portfolio through bankruptcy
AIRA Submission: Preserving Patent Licensor's SSO Commitments

transaction costs may make patent enforcement and compliance imperfect⁴. The combination of patent rights and industry agreement could give rise to significant market power, and the realignment of such power through bankruptcies could therefore be disruptive to the industry – especially if acquired by a nonpracticing entity with no need to cross-license.

The Bankruptcy Code permitting a Debtor-In-Possession (DIP) to reject patent licenses may have inequitable effects where potential licensees have inadequate notice to leverage the rights available under §365(n). Parties eligible to negotiate licenses under the RAND policies of Standards Setting Organizations (SSOs) may have inadequate notice in the event of Chapter 11 reorganization of a patent licensor obligated under these policies. This article reviews the relevant non-bankruptcy law and applicable bankruptcy law. Recent Bankruptcy Court cases and Federal Agency actions are also reviewed to develop an understanding of the challenges with the current approach before considering alternate approaches.

**Applicable Non-Bankruptcy Law**

Patents are a form of intellectual property that is granted by government for progress in the technical arts in the form of new and useful processes, machines, manufactures and compositions of matter⁵. A form of personal property, patents are assignable in writing. The USPTO provides a recordation system for the assignments and conveyances of patents⁶. Someone who makes, uses, offers to sell, or sells a patented invention in the United States, without permission of the patent holder, 

---


⁵ 35 U.S.C. §101 (identifying eligible subject matter for patents)

⁶ 35 U.S.C. §261 (ownership, assignment and recordation of patents)

Page 3 of 20
AIRA Submission: Preserving Patent Licensor's SSO Commitments

infringes the patent. Actively inducing another party to infringe a patent also results in liability. Patent infringement claims may be raised in civil suit seeking remedies including injunctions, damages (in some cases trebled damages), attorney fees and customs enforcement of importation bans. Patents grant rights within national law, but broadly similar patent rights are created and enforced in other countries under their national laws. Several international treaties and institutions have facilitated an ongoing harmonization of patent law, internationally. Recent changes to the Patent Act can be seen as part of that harmonization process.

A defense to claims of infringement is absence of liability due to the existence of a license, however the patent statutes are basically silent on the other issues related to patent licenses. Patent

7 35 U.S.C. §271(a) (defining patent infringement)
8 35 U.S.C. §271(b) (identifying liability from inducement of others to infringe)
9 35 U.S.C. §281 (civil remedy for patent infringement)
10 35 U.S.C. §283 (injunctive relief for patent infringement)
11 35 U.S.C. §284 (damages in patent infringement)
12 35 U.S.C. §285 (attorney fees in patent infringement)
13 19 U.S.C. §1337(d) (Tariff Act of 1930 provides for International Trade Commission to exclude infringing articles from entry)
15 See e.g., World Intellectual Property Organization http://www.wipo.int/portal/index.html.en
16 Leahy-Smith America Invents Act, P.L. 112-29, 125 Stat. 284-341 (Sept. 16th, 2011) (amending the US patent system to a “first to file” system to align with the majority of other national patent systems)
17 35 U.S.C. §282 (patent infringement defenses)
18 35 U.S.C. §§101-376
licenses may be express or implied\(^{19}\). Since patents provide a legal temporary monopoly over particular technicals arts, guidelines\(^{20}\) have been developed that restrict patent licensing practices to avoid antitrust issues. A patent license may grant rights to practice the invention on an exclusive or non-exclusive basis\(^{21}\). An exclusive license may be tantamount to an assignment and recordable at the Patent Office. A non-exclusive license is often regarded as merely a covenant not to sue, which does not affect title to the patent, and thus would not be recordable\(^{22}\).

Patents and patent licenses may be used as securities in financing arrangements. Patents and patent licenses are treated as general intangibles under Article 9 of the Uniform Commercial Code. Perfection of security interests in patents and patent licenses is generally achieved by filing the financing statement with the Office of the Secretary of State where the patent owner is deemed located, rather than the Patent Office\(^{23}\). The Patent Act provides for a recordation system at the Patent Office only for documents affecting title to a patent\(^{24}\). A security interest in a patent that does not involve a transfer of the rights of ownership is a “mere license”\(^{25}\). The Patent Act does not preempt every state

\(^{19}\) De Forest Radio Tel. Co. v. United States, 273 U.S. 236, 241(1927)(identifying that no formal granting of a license is necessary to give it effect)


\(^{23}\) In re Cybernetic Services, Inc., 252 F.3d 1039,1058 (9th Cir. 2001) (holding that a 35 U.S.C. §261 does not require the holder of a security interest in a patent to record that interest with the USPTO)

\(^{24}\) 37 C.F.R. §3.11 (providing for recordation of documents affecting title to patents)

\(^{25}\) Id. at 1052 (construing security interests as licenses, not assignments)
commercial law that touches on intellectual property. Patent licenses are commercial agreements and the Supreme Court has observed that commercial agreements are traditionally the domain of state law. Patent licenses are usually construed as a matter of State contract law. In some unusual cases, there may be some grounds for disputing whether a particular commercial agreement actually constitutes a non-exclusive license.

**Applicable Bankruptcy Law**

A license is a contract and contracts are property of the estate. While patents are considered personal property, the commercial exploitation of patents and patent licenses is largely a matter of non-individual entities, e.g., Limited Liability Companies (LLCs) or Corporations. USPTO statistics indicate individuals own less than 6% of all patents, with more than 90% owned by domestic or foreign corporations. Such entities would normally be classified as “corporations” by the Bankruptcy Code. Corporations as Debtors generally qualify to file for bankruptcy under Chapter 7 (liquidation).

---

26 Aronson v. Quick Point Pencil Co., 440 U.S. 257, 262 (1979) (observing that state law is not displaced merely because the contract relates to intellectual property that may or may not be patentable)

27 Lear, Inc. v. Adkins, 395 U.S. 653, 661-62 (1969) (holding construction of a patent license was solely a matter of state law unless inconsistent with aims of federal patent policy)

28 See e.g., Microsoft Corp. v. DAK Indus., Inc ( in re DAK Indus. Inc.), 66 F.3d 1091 (9th Cir. 1995) (holding that an agreement purporting to be a non-exclusive license was in fact a conveyance)

29 11 U.S.C. §541(a) (defining property of the estate as all legal or equitable interests of the Debtor in property as of the commencement of the case, subject to identified exceptions)


32 11 U.S.C. §109 (defining which classes of Debtors may file under which chapters)
AIRA Submission: Preserving Patent Licensor's SSO Commitments

or Chapter 11 (reorganization). The identification and administration of the property of the estate under Chapter 5 as well as the treatment of executory contracts under Chapter 3 apply regardless of whether the bankruptcy is a Chapter 7 or Chapter 11 filing33.

Under Chapter 11, the DIP may act as the trustee34; and continue to operate “in the ordinary course” of business35. The DIP “receives” these patent license contracts into the estate, but initially the DIP and the estate are not considered parties to such contracts and are not obligated to perform under those contracts though the automatic stay enjoins the other parties from taking certain actions against the Debtor36. The DIP and the estate becomes a party to the executory contract only if the DIP makes the decision to assume the responsibility for the contract37. While the code provides several time constraints on the actions of the DIP, the decision on whether to assume or reject executory contracts must be finalized by the date on which the reorganization plan is confirmed by the bankruptcy court38.

The Bankruptcy Code provides that executory contracts in existence at the commencement of the case may be rejected or assumed39. The term “executory contract” is not defined in the Bankruptcy

33 11 U.S.C. §103 (defining applicability of chapters)
34 11 U.S.C. §1107 (defining rights powers and duties of the Debtor in possession)
35 11.U.S.C. §363(c), §1108 (indicating that the trustee may use the property of the estate and enter into transactions in the ordinary course of business)
37 11 U.S.C. 365(a) (indicating trustee may assume or reject any executory contract)
38 11 U.S.C. 365(d)(2) (trustee may assume or reject an executory contract any time before confirmation of the plan); 11 U.S.C. 1123(b)(2) (plan may provide for assumption or rejection of executory contract)
39 11 U.S.C. 365(a) (trustee may assume or reject executory contracts)
AIRA Submission: Preserving Patent Licensor's SSO Commitments

Code, but generally refers to contracts in which performance remains due to some extent on both sides\(^{40}\). The underperformance may need to be substantial for some courts to consider a contract executory\(^{41}\). A non-exclusive patent license is a mere waiver of the right to sue\(^{42}\). As such, the licensor owes a continuing duty to the licensee to refrain from suing it for infringement. License agreements are typically held by the courts to be executory contracts\(^{43}\), though others have criticized this result as tautological\(^{44}\).

Intellectual property laws seek to foster investment in research and development; and freedom of contract plays a significant role in the commercial exploitation of those results. Bankruptcy law affords Debtors considerable leeway to rescind contracts in reordering the affairs of a failed entity\(^{45}\). Bankruptcy law seeks to maximize the economic stake of creditors in the ongoing value of failing enterprises by reorganizing and a “fresh start”\(^{46}\).

____________________________

40 M. Primoff, E. Weinberger, E-commerce and dot-com bankruptcies: assumption, assignment and rejection of executory contracts, including intellectual property agreements, and related issues under sections 365(c), 365(e) and 365(n) of the bankruptcy code, 8 Am, Bankr. Inst. L. Rev. 307, 310 (2000) (citing definition of “executory contract” from V. Countryman, Executory Contracts in Bankruptcy: Part I, 57 Minn. L. Rev. 439, 446 (1973))

41 In re CFLC, Inc., (formerly known as Everex Systems, Inc.) v. Cadtrak Corp., 89 F.3d 673, 677 (9th Cir. 1996) (“the obligations of both parties are so far unperformed that the failure of either party to complete performance would constitute a material breach and thus excuse the performance of the other” citing Griffel v. Murphy (In re Wegner), 839 F.2d 533, 536 (9th Cir.1988))

42 De Forest Radio Tel. Co. v. United States, 273 U.S. 236, 242 (1927) ( holding patent license is covenant not to sue)

43 Primoff, note [40] supra at 315 (citing cases as uniformly interpreting licenses as executory contracts)

44 Menell, note [22] supra at 762 (criticizing that the duty from a covenant not to sue is insufficient to make a license executory, when the existence of the license is itself a complete defense to the claim)

45 Id. at 735  (contrasting policy objectives of intellectual property and bankruptcy laws)

46 Id. at 751 (discussing bankruptcy system objectives)
AIRA Submission: Preserving Patent Licensor's SSO Commitments

The §365 assumption or rejection of executory contracts permits the DIP to go through its inventory of executory contracts and decide which ones would be burdensome or beneficial. A beneficial executory contract may be assumed, provided any default has been cured and adequate assurance of performance is provided. The DIP's decision to assume or reject an executory contract is generally approved by the court under a deferential reasonable business judgment standard.

If the executory contract has been assumed by the DIP, then the executory contract may be assigned to another. The assignment of an executory contract to another relieves the DIP and estate from any liability for breaches occurring after the assignment. If the assignee of the patent (the new licensor) is unable or unwilling to perform obligations under the license, the results could be disastrous for a licensee. Non bankruptcy law may preclude the transfer of a license in some circumstances (e.g., Federal law holds a nonexclusive patent license to be personal and nonassignable by the licensee), but this does not restrict the patent owner (licensor) as the Debtor. In assigning the executory contract, the DIP must provide adequate assurance of future performance by the assignee.

A burdensome executory contract may be rejected by the DIP. The rejection of an executory

47 11 U.S.C. §365(b) (providing for assumption of defaulted executory contracts)
48 Menell, note [22] supra at 767 (discussing review standard of bankruptcy court)
49 11 U.S.C. §365(f) (providing for assignment of executory contracts by first assuming them)
50 11 U.S.C. §365(k) (providing for relief from liability for trustee and estate after assignment of contracts)
51 Primoff, note [40] supra at 320 (discussing consequences of license assignment)
52 11 U.S.C. §365(c) (limiting assignment of executory contracts under non bankruptcy law)
53 In re CFLC, Inc., 89 F.3d 673, 677 (9th Cir. 1996) (holding that patent licenses are personal and nonassignable)
54 Primoff, note [40] supra at 324 (discussing transferability of patent licenses)
contract constitutes a breach of that contract\textsuperscript{57}. The time of the breach is immediately prior to the confirmation of the petition for a Chapter 11 bankruptcy\textsuperscript{58}. A pre-petition breach of an executory contract may then result in a general unsecured claim\textsuperscript{59}.

In \textit{Lubrizol}, the Debtor licensor was permitted to reject a technology licensing agreement resulting in a termination of the licensee's right to use the technology, leaving the licensee with only an unsecured rejection damages claim\textsuperscript{60}. In response, Congress added §365(n) (with the 1988 Intellectual Property Bankruptcy Protection Act\textsuperscript{61}) in order to enable the option for the licensee to continue its operation under the license. If the DIP rejects an executory contract where the Debtor is the licensor of intellectual property, the licensee now has the right to either treat this as a rejection, or to retain its rights under the license\textsuperscript{62}. The licensee may have made substantial specific investments relying on the continued existence of the patent license\textsuperscript{63}.

If the patent license is rejected by the DIP, the licensee may retain its rights for the duration of the contract, as such rights existed immediately before the case commenced\textsuperscript{64}. If the licensee elects to

\begin{itemize}
  \item 11 U.S.C. §365(a) (providing for rejection of executory contracts)
  \item 11 U.S.C. §365(g) (providing for rejection of executory contracts constituting breach)
  \item 11 U.S.C. §365(g)(1) (providing for time of breach prior to filing petition)
  \item 11 U.S.C. §502(g) (providing for claims arising from rejection of executory contract under §365)
  \item \textit{Lubrizol Enterprises Inc v Richmond Metal Finishers Inc. (in re Richmond Metal Finishers, Inc.)}, 756 F.2d 1043,1048 (4th Cir 1985) (holding that licensee has only an unsecured pre-petition breach of contract claim for damages)
  \item PL 100-506 (S 1626), Oct 18, 1988, 102 Stat 2538 (inserting new section §365 (n))
  \item 11 U.S.C. §365(n)(1) (providing for licensee decision when licensor rejects a patent license executory contract)
  \item Menell, note [22] \textit{supra} at 768 (discussing consequences of rescinded license)
  \item 11 U.S.C. §365(n)(1)(B) (providing for licensee to retain rights for the duration of the contract when licensor rejects a patent license executory contract)
\end{itemize}
**AIRA Submission: Preserving Patent Licensor's SSO Commitments**

retain its rights, the licensor is required to not interfere with the licensee's rights\(^{65}\). The licensee must continue any royalty payments\(^{66}\). The DIP must provide access to the intellectual property, if presented with a written demand by the licensee\(^{67}\). The DIP is still bound by several passive obligations (e.g. adhering to confidentiality agreements)\(^{68}\). Performance of licenses requiring no action by the Debtor impose no burden on the estate and result in certainty to the economy and equity to the non-breaching party\(^{69}\). The rights retained by the licensee include the right to enforce any exclusivity portion of the contract but other rights under applicable non bankruptcy law are limited\(^{70}\).

**Recent Bankruptcy Court Cases**

Nortel Networks Inc., was a multinational corporation operating as a major supplier of telecommunications equipment – an industry where equipment suppliers traditionally developed large patent portfolios. Nortel had also been an active participant in several industry standards organizations developing agreements to support the interoperability of their equipment with that of other manufacturers. In January 2009, Nortel filed a voluntary Chapter 11 petition for bankruptcy\(^{71}\). Nortel


\(^{66}\) 11 U.S.C. §365(n)(2)(B) (providing for licensee to continue royalty payments)

\(^{67}\) 11 U.S.C. §365(n)(3)(A) ; 11 U.S.C. §365(n)(4)(A) (providing that trustee is to provide access to the intellectual property on written demand by licensee)

\(^{68}\) Menell, note [22] *supra* at 772-73(discussing consequences of rejection of IP executory contracts and citing to In re Szombathy, 1996 WL 417121 at *30 (Bankr. N.D. Ill. 1996))


\(^{70}\) 11 U.S.C. §365(n)(1)(B) (qualifying the rights retained by the licensee)

\(^{71}\) In re Nortel Networks Inc., 2009 WL 7292466 (No1:09BK10138, Bkrtcy.D.Del)(Trial Filing) at 2
AIRA Submission: Preserving Patent Licensor's SSO Commitments

was a large multinational corporation, and this bankruptcy reorganization involved coordination with
bankruptcy proceedings for nineteen European subsidiaries in England as well as proceedings in
Canada and Israel\(^2\). In October 2009, Nortel, as DIP, filed an application for an order authorizing
employment of an independent intellectual property consultant\(^3\). This consultant was to evaluate both
the marketability of the portfolio of 3,500 patent families and the best manner in which to maximize the
value realized from this patent portfolio\(^4\). In phase 1 of the work, this consultant was to identify assets;
perform ownership due diligence; and create an independent patent claims database; in order to
perform a preliminary market analysis permitting the identification of the key markets segments
covered by the patent portfolio and their relative strengths\(^5\). A second phase was foreseen to develop a
business case for each key market segment and a third phase to develop strategic alternatives and
recommend a strategy for exploiting the patent portfolio\(^6\). In April 2011, Nortel, as DIP, moved for an
asset sale of the patents free and clear of all claims and interests\(^7\). The motion contemplated the sale of
approximately 6,000 US and foreign patents and patent applications spanning wireless, data
networking, optical, voice, internet, service provider, semiconductors and other patent portfolios\(^8\).
Over 100 parties had been contacted about the patents, with 40 companies entering confidentiality

\(^{2}\) Id.

\(^{3}\) In re Nortel Networks Inc., 2009 WL 7292466 (No1:09BK10138, Bkrtcy.D.Del)(Trial Filing)

\(^{4}\) Id. at 4

\(^{5}\) Id. at 5

\(^{6}\) Id. at 5

\(^{7}\) In re Nortel Networks Inc., et al., Debtors, 2011 WL 1227182 (Bkrtcy.D.Del)(Trial Motion, Memorandum and Affidavit)
No.09-10138(KG) April 4, 2011

\(^{8}\) Id. at 3
AIRA Submission: Preserving Patent Licensor's SSO Commitments

agreements to examine diligence materials. The motion contemplated a sale (for $900 Million cash subject to higher and better bids) which envisaged transfer of the patents free and clear of all claims and interests other than those expressly assumed under the confidential Stalking Horse Agreement. Unknown or unassigned licenses would be rejected under §365(a) and §365(n), and authorization for this was requested as a sound business judgment. In addition to notifications to the known licensees, publication of the proposed sale was also requested as reasonable notice under the circumstances. Information regarding the counter-parties under licensing arrangement was considered commercial confidential and filed under seal. The license assignment and rejection procedures from the motion were adopted in the court order. An objection was made by another standards participant (Microsoft Corp.) that the patents should be sold subject to all existing licensing obligations from SSOs. An SSO (The Institute of Electrical and Electronics Engineers, Inc.) also filed an objection, and the successful bidder agreed to certain revisions in the patent transfer agreement. The patent portfolio sale was completed for $4.5 Billion in cash to a consortium of Apple, EMC, Ericsson, Microsoft, Research in

79 Id. at 3
80 Id. at 4
81 Id. at 24
82 Id. at 24
83 Id. at 26
84 In re Nortel Networks Inc., et al., Debtors, 2011 WL 1661524 (Bkrtcy.D.Del) No.09-10138(KG) May 2, 2011 at 4
AIRA Submission: Preserving Patent Licensor's SSO Commitments

Motion, and Sony.87

Qimonda North America Corp., a Delaware corporation, was a wholly owned subsidiary marketing and selling memory chips in the United States on behalf of its parent corporation – Qimonda AG of Germany.88 Qimonda AG filed for Bankruptcy in Germany in January 2009, and the U.S. subsidiaries filed89 for Chapter 11 reorganization in February 2009. Qimonda's assets included approximately 10,000 patents, of which approximately 4,000 were US patents90 of which some number are believed to read on JEDEC standards for memory chips. The foreign representative of Qimonda AG filed with the US bankruptcy court for recognition of the foreign proceedings under Chapter 15 as In re Qimonda AG.91 The Bankruptcy Court issued an order92 to that effect in July 2009, however the order was subsequently modified because of a dispute over whether 11 U.S.C. §365 applied93. The German insolvency code §103 conflicts with the US bankruptcy code in that the administrator may elect nonperformance ie rejecting executory contracts (in this case patent licenses) without the rights available under 11 U.S.C. §365(n) to the licensee94. US licensees of these patents objected, but the

88 Qimonda NA, Complaint for turnover of company property, declaratory judgment, injunctive relief and damages, In re Qimonda Richmond LLC., et.al., Debtors, 2009 WL 6364959 (Bkrtcy.D.Del)(Trial Pleading) No 109BK10589, Sept 21, 2009 at 2 (Facts #11)
89 Id. at 2 (Facts #15,16)
91 Qimonda, Note[88], at 2 (Facts #17); In re Qimonda AG, case No. 09-14766 (Bankr, E.D. Va.)
92 Id. at 3 (Facts #18);
94 Id. at 1
AIRA Submission: Preserving Patent Licensor's SSO Commitments

Bankruptcy Court ruled that the policy objectives of Chapter 15 required the proceedings to be governed by the laws where the main case was pending – in this case Germany. Joint venturers and holders of patent cross-licenses appealed. The District Court agreed that §365(n) was discretionary relief in the context of a chapter 15 proceeding, but remanded for further proceedings on other aspects. On remand, the Bankruptcy Court held that public policy, as well as economic harm required the §365(n) protections apply to Qimonda's U.S. Patents.

Recent Federal Agency Actions

The FTC has recently held hearings on inequitable behavior by patent holders in standards setting organizations. This situation where the licensor of intellectual property goes bankrupt and the DIP seeks to rescind a license agreement has been identified as a point of tension between bankruptcy law and intellectual property law. One of the concerns identified by some participants was the potential for a bad actor to “cleanse” a patent portfolio through the use of a strategic bankruptcy. In this scenario, the Debtor (patent licensor) would reject any patent license under 11 U.S.C. §365. If

95 Id. at 1,2
96 In re Qimonda AG Bankruptcy Litigation, 433 B.R. 547, 552 (July 2, 2010)
97 Id. at 571
98 In Re Qimonda AG Chapter 15, Debtor, Note [90], at 1-2
99 FTC Workshop on standards and IP.
100 Menell, note [22] supra at 736 (identifying principal tensions between bankruptcy law and intellectual property law)
101 Transcript of FTC Workshop on IP Rights in Standard Setting held June 21, 2011 available online at http://www.ftc.gov/opp/workshops/standards/transcript.pdf at 226-27 (identifying as a potential problem area the transfer of patent rights during bankruptcy where those rights had licensing commitments developed through standards organization); see also Comments of International Business Machine Corporation (Marc Sandy Block) 8/4/2011 available online at http://www.ftc.gov/os/comments/patentstandardsworkshop/00037-80151.pdf at 17-18
AIRA Submission: Preserving Patent Licensor's SSO Commitments

successful, the Debtor organization could then use or assign the patents free of encumbrances such as these RAND license commitments to other parties via the SSO. This would enable the discharged Debtor to use the patents to sue other industry members that had made investments in reliance on the availability of RAND licenses for infringement, a potentially inequitable result. 11 U.S.C. §365(n) appears to address the issue, but may not be sufficiently comprehensive in the SSO context.

Challenges with the Current Approach

The licensee rights of §365 were designed with the situation of Lubrizol in mind. A licensee having made investments to exploit a license could be effectively put out of business if the license is revoked by a new patent holder after transfer through bankruptcy. In Lubrizol, the license was express and royalty bearing\(^{102}\) rather than cross-licensed, and inchoate as with the startup example supra. While unlicensed patent use may be pervasive even in commercial settings\(^{103}\), the reassurance of the availability of a RAND license, especially in a cross-licensing industry makes unlicensed practice more rational.

Patents are property which would normally be considered to have well defined boundaries, but some classes of patents (particularly software and business method patents) have been criticized as providing inadequate clarity regarding their scope\(^{104}\). The CEO of our example startup may not know

\(^{102}\) Lubrizol Enterprises Inc v Richmond Metal Finishers Inc. (in re Richmond Metal Finishers, Inc.), 756 F.2d 1043,1046 (4\(^{th}\) Cir 1985) (“Lubrizol owed RMF the unperformed and continuing duty of accounting for and paying royalties for the life of the agreement.”)

\(^{103}\) Eisenberg, note [4] supra at 54 (“unlicensed use is likely pervasive in other settings as well, including commercial production”)

AIRA Submission: Preserving Patent Licensor's SSO Commitments

whether the startup's software patents have claims reading on the industry standards agreements without the expense of seeking a declaratory judgment or opinion of counsel. Knowledge of the existence and scope of whatever patents or patent applications his coopetition from the SSO may have is even less likely105. For a large corporation with thousands of patents, the expense of identifying patents that may read on particular standards agreements may render such an approach even more impractical106. Hence, SSO membership agreements typically only require voluntary disclosure of patents where the individual participants have knowledge, and the disclosures often come after the industry standard has been published107.

The SSO patent policies vary, but may require licensing not just to other members of the SSO, but to anyone who requests such a license from the patent owner108. The pool of potential licensees may thus be very large, and those potential licensees may not even be aware that such licensing opportunities are available (even if they correctly identified that one of the thousands of patents issued each year applies to their activities) even though publication of disclosed patents on an SSO website may provide a form of constructive notice. The Nortel bankruptcy is perhaps unusual in that it was a large corporation with other market participants expecting patent related transfers through its bankruptcy. There may not be the awareness (notice) by other market participants in the event of bankruptcy of smaller companies that hold essential patents.

105 Eisenberg, note [4] supra at 67 (“It is costly to identify unknown rights and to monitor the behavior of strangers.”)

106 See e.g., In Re Qimonda AG Chapter 15, Debtor, Note [90], at 15


108 See e.g., Letter of Assurance request by IEEE available online at https://development.standards.ieee.org/myproject/Public//mytools/mob/loa.pdf
AIRA Submission: Preserving Patent Licensor's SSO Commitments

Not all SSOs have the resources to file objections – many operate as non profit organizations with no income streams beyond membership dues and meeting fees to cover operating expenses. Corporations granted rights to seek licenses under an SSO RAND patent licensing policy may not have standing to intervene in the bankruptcy. While the Debtor presumably has some contractual relationship with the SSO, potential licensees that have not consummated a licensing agreement with the Debtor may not have a claim with the scope of §101(5). While the SSO patent licensing policy may obligate the Licensor (now Debtor), the inchoate rights it creates for the licensee do not form a license contract with the Licensor until the specific terms of the license are negotiated. The license agreement is likely to be narrowly construed under §365(n)(1)(B) to the specific patents identified at the time of the bankruptcy. Even a RAND policy requiring a license price of zero (a “RANDZ” or “FRAND” license) may still require negotiation on other terms. These factors lead to a likelihood of the RAND patent policy being a factor in ex post licensing negotiations or litigation. When the parties are in patent litigation, they have significant incentives to identify any RAND licensing obligations.

The patent lifecycle, the SSO RAND licensing obligation and the bankruptcy of a competitor happen on independent timescales. The startup's CEO's fear is that after the standard has developed, and many competitors have made investments assuming licensing was possible under RAND terms; there is then a market shakeout leading to the bankruptcy of a the holder of an essential patent; and by cleansing the RAND licensing obligations through a bankruptcy, the new patent owner could disrupt not just one or two creditors, but affect an entire industry. In the increasingly global markets for goods and services, our startup's CEO needs to also consider not only the domestic patents acquired by foreign entities, but also foreign patents in the markets in which the startup needs to compete and the interactions of the bankruptcy laws in those jurisdictions.
AIRA Submission: Preserving Patent Licensor's SSO Commitments

Alternative Approaches

It might be possible to modify §365(n) to make a special case for SSO commitments, but this may be a legislative challenge to identify the specific exemption language given the range of potential licensees created under some SSO patent policies. Since §365(n) was added in 1988, there have been very few reported cases of patent owning Debtors rejecting license obligations\textsuperscript{109}. Adding complexity to the bankruptcy code may be overkill if that situation does not occur very often. An essential patent, however, could disrupt an entire industry's cross-licensing assumption (as the Nortel and Qimonda bankruptcy cases demonstrated) and force them to pass on licensing costs to downstream consumers.

Notice is typically provided to specifically identified licensees, but this currently would not necessarily include the SSOs. While the Debtor may recognize a current or former SSO membership as entailing potential contractual obligations to negotiate future agreements, it may not be recognized as a current patent license agreement if specific patents and other parties are not identified. Requiring specific notice to SSOs of which the Debtor was a member may be more practical. Perhaps this could be reduced to just those SSOs where the Debtor has declared the existence of essential patents if there was a need to trade off completeness versus the expense of the notice arrangements. An alternative approach through patent law could also improve notice by requiring license commitments (including SSO commitments) to be registered along with the registration of the patent title at the PTO.

SSO practices and patent policies could be changed to require more effective disclosure and infringement analysis by patent holders, or to require actual licenses or cross licenses be established

\textsuperscript{109} See e.g., \textit{In re Qimonda}, 433 B.R. 547, 559-64(2010)(providing statutory analysis of whether §365(n) applies automatically in Chapter 15 proceedings because this is an issue of first impression); Menell, note [22] Supra at 781 (identifying only one reported case on a licensor's rejection).
AIRA Submission: Preserving Patent Licensor's SSO Commitments within a specific timeframe rather than the current inchoate licensing obligation. ANSI recently held a legal issues forum considering aspects of patents in standards\(^{110}\). The National Academy of Science has also initiated a project in this area\(^{111}\). Changes to the patent declaration procedures required for participation adds costs to the standardization process and may reduce the number of standards developed, possibly reducing innovations and impeding markets. Available econometric evidence appears to be rather limited on this point. Regulatory initiatives (e.g. the FTC) could impose similar constraints by fiat, but have similar risks of creating greater impediments than they resolve.

While notice could be improved by changes to Bankruptcy Law through specific notifications to SSOs, the larger challenge here seems to lie within Patent Law and the industry practices of the various SSOs. Indefinite patents create uncertainty that is untenable in the bankruptcy context. Ill-defined patents in the hands of competitors may give our startup's CEO pause during normal times; but once the bankruptcy clock starts ticking it is too late to go back and negotiate a RAND license from the competitor. Instead, our CEO must deal with the new patent entrepreneur; who may have a very different set of licensing objectives. Rather than relying on others' unilateral promises through the SSO for future license negotiations on RAND terms, our CEO should insist on obtaining concrete licensing arrangements as soon as practical. Mechanisms that reduced the time and costs of patent compliance checks could significantly reduce the uncertainty for our startup's CEO. Without them, the “fresh start” provided by a bankruptcy reorganization to a competitor not only reorganizes and re-energizes that competitor, but also creates opportunities for new patent entrepreneurs (also known as “patent trolls”) to disrupt the industry, resulting in increased litigation and licensing costs passed on to consumers.
