Jeffer Mangels Butler & Marmaro LLP

June 17, 2009

Intellectual Property Group

THE INHERENCY OF THE PATENT RIGHT TO HAVE MADE

By Bernard R. Gans and Rod S. Berman

This article was originally published in the June 17, 2009 edition of the Los Angeles Daily Journal.

The Federal Circuit has clarified the law of patent licensing by holding that a license to make, use and sell "inherently" includes the right to have made, i.e., the right to hire a third party to make the product for it. The court's reasoning, however, is suspect in that it ruled without considering the exclusive rights provided under 35 U.S.C. Section 271(a), namely, the right to exclude others from making, using, offering to sell, selling or importing into the United States, the patented invention. Rather, the court relied solely on a contractual analysis while paying lip service to the intent of the parties.

In *CoreBrace LLC v. Star Seismic LLC*, 2009 WL 1424439 (May 22, 2009), the court examined a license of the '452 patent between CoreBrace, as licensor, and Star Seismic, as licensee. The license included the following provisions:

It granted Star a non-exclusive right to make, use and sell licensed products; CoreBrace explicitly reserved all rights not expressly granted to Star; and the license explicitly prohibited Star from assigning, sublicensing or otherwise transferring its rights except to an affiliated, parent or subsidiary company.

The license was otherwise silent as to Star's right to have third parties make licensed products for it.

When CoreBrace learned that third-party contractors were making licensed products for Star, it sued for breach of the license and for patent infringement based on Star's use of the third-party products. The trial court granted Star's 12(b)(6) motion to dismiss, concluding that "have made" rights are granted in patent licenses unless they are expressly prohibited. Thus, the trial court held that Star had the right to have third parties manufacture the licensed products.

On appeal, CoreBrace contended that it had reserved all rights not expressly granted, which included a reservation of the "have made" right, and also that "have made" rights are not inherent in the right to make.

The Federal Circuit held that Star had the right to make, use and sell the licensed products and also had the right to license third parties to make licensed products for the licensee (legally a "sublicense of the right to make"), even though the licensor reserved unto itself all rights not granted to the licensee, and even though the licensee was expressly prohibited from sublicensing the patent rights. Thus, under the *CoreBrace* decision, at least under Utah law, unless a patent license explicitly excludes the right to have made, the right will exist even though the license does not mention such right.

The Federal Circuit found that the right to have made is inherent in the right to make based on its interpretation of Utah contractual law, the law of the state where the case was brought, after considering a Court of Claims case, *Carey v. United States*, 326 F.2d 975 (Ct. Cl. 1964) and a California Supreme Court case, Advanced Micro Devices Inc. v. Intel Corp., 885 P.2d 994 (Cal. 1994) and distinguishing a Federal Circuit decision, *Intel Corp. v. U.S. International Trade Commission*, 946 F. 2d 821 (Fed. Cir. 1991). Although the Federal Circuit treated the case as one requiring contractual interpretation stating "[u]nder Utah law, 'we first look to the plain language within the four corners of the agreement to determine the intentions of the parties,'" the court never did consider any evidence of the intent of the parties beyond the license agreement.

Considering this case involved an appeal from a 12(b)(6) motion and not an appeal from a summary judgment or trial decision, evidently the court concluded it was the intent of the parties to include the "have made" right even though it was not mentioned in the license and even though the license specifically excluded sublicenses.

Curiously, the court did not examine federal law governing infringement or undertake any examination of the very statute forming the basis of patent licenses, namely, 35 U.S.C. Section 271(a), which provides that a patent gives the patent owner the right to exclude others from making, using, offering to sell or selling in, or importing into the United States the patented invention. Apparently the court concluded that federal patent law did not apply. *See Akira Akazawa v. Link New Technology International Inc.*, 520 F.3d 1354 (Fed. Cir. 2008); *DDB Technologies L.L.C. v. MLB Advanced Media L.P.*, 517 F.3d 1284 (Fed. Cir. 2008).

The facial impact of this ruling is on existing licenses, where the licensor has exacted a royalty from sub-licensees who have made infringing product for the licensee. Licensees should review such licenses, as the licensor may no longer be entitled to royalties from the sub-licensee. The impact is also on drafters of licenses, as they now know that if they do not explicitly exclude the right to have made, it may be deemed to inherently exist.

This decision raises many substantive questions beyond its academic ruling. For example, why did the court not look to federal law to interpret the license terms? Is this decision only applicable to licenses under Utah law? What if another court applies the law of another state and comes to the opposite conclusion? Shouldn't the Federal Circuit have considered this possibility and rendered a decision based on federal patent law, as it has in many other cases where it felt that federal patent law uniformity was critical?

This decision now gives licensees the right to sub-license third parties, who are unknown to the licensor, to make and sell products, and who are not in contractual privity with the patent owner. As a result, a number of significant issues are created:

Does the implicit sub-licensee become a party to the license agreement and become subject to all the terms of the license? If not, then it would appear that the licensor has lost the benefit of the license, e.g. audit rights, possible rights to improvements, etc.
If the licensor has no contractual control over the sub-licensee, does the sub-licensee have any obligations to the licensor?

Can the sub-licensee assign its manufacturing contract to a third party?

What happens when the sub-licensee goes bankrupt?

If the patent license also includes a trade secrets license, can the trade secrets be disclosed to the sub-licensee?

Does the licensee have an obligation to inform the licensor of its sub-licensing to a third party?

What prevents a clever licensee and implicit sub-licensee from entering into a contract that provides that the sub-licensee will make and sell a product to the licensee who immediately transfers title to the product back to the manufacturer who then sells the product as its own, thus circumventing the restriction against sub-licensing?

Although attorneys familiar with this decision will now carefully draft future patent license agreements to explicitly include or exclude the "right to have made," this decision will create foreseeable and unforeseeable problems for existing patent licenses and become a trap for patent owners and their attorneys who are unfamiliar with this decision. The U.S. patent laws were written to grant to the patent owner control over who makes the patented product, and who sells and uses it. Providing an inherent right to have made destroys this control and the contractual relationship between the patent owner and its intended licensee.♦

Bernard R. Gans is senior partner of the firm's Intellectual Property Department. For more information, please contact him at 310. 201.3574 or BGans@JMBM.com.

Rod S. Berman is chair-person of the firm's Intellectual Property Department and relating licensing and litigation. For more information, please contact him at 310.201.3517 or RBerman@JMBM.com.

This article was originally published in the June 17, 2009 edition of the *Los Angeles Daily Journal*.