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Preserving The Chain Of Title

Law360, New York (October 26, 2009) -- Since the beginning of the tech boom of the mid 1990s and the ensuing ramp-up of patent application filings, companies have increasingly used their patent portfolios as the primary collateral to secure desired financing.

Indeed, for many of these companies, the patents may have been their only assets of potential value, especially in those cases where the company's future was riding on a small team of employees, rented office space, a foosball table, a speculative business plan and the secured financing.

It has long been established that security interests in patents — and the attendant foreclosure proceedings in the event of default — are governed by state law under the Uniform Commercial Code.

Upon a sale following foreclosure, title to the purchased patents was routinely considered to have been transferred to the purchaser, even though the purchaser did not execute an assignment at the sale.

The transfer of title without a written assignment seems to be inconsistent with Section 261 of the Patent Act, which requires that any assignment of a patent be in writing.

Section 261 also provides that "[a]n assignment, grant or conveyance shall be void as against any subsequent purchaser or mortgagee for a valuable consideration, without notice, unless it is recorded in the Patent and Trademark Office within three months from its date or prior to the date of such subsequent purchase or mortgage."

Prior to 1988, the United States Patent and Trademark Office Assignment Branch would not record a patent foreclosure without a court order, because there was no executed assignment from the debtor.

The policy changed in 1988, after the USPTO published a notice in the Official Gazette stating that a foreclosure would be recordable in the Assignment Branch without a written assignment from the debtor, if the secured party submitted certain specified documents for recordation that were within its control.[1]

Despite this recognition by the USPTO that secured creditors may properly record their foreclosures on patents, uncertainty remained regarding the transfer of title to a patent in a foreclosure sale that was not accompanied by a written assignment.

This question — whether a sale following foreclosure would effectively transfer title without meeting the writing requirement of 261 — was recently (but, perhaps, tentatively) resolved by a three-judge panel of the Federal Circuit in its Aug. 20, 2009, opinion in Sky Technologies v. SAP AG and SAP America Inc.[2]

In Sky Technologies, the court affirmed the District Court's finding that title to a patent can be transferred at a foreclosure sale by operation of state law, even though the debtor does not execute an assignment.[3]

Sky Technologies LLC v. SAP AG: The Missing Written Link in the Chain of Title

In Sky Technologies, the patents at issue were originally obtained by Jeffrey Conklin and his co-inventors. They assigned the patents to Conklin's company, TradeAccess Inc., which later changed its name to Ozro Inc.

In April 2001, Ozro borrowed money from Silicon Valley Bank (SVB) and Cross Atlantic Capital Partners Inc. (XACP) and executed a security agreement with each of the lenders granting a lien in the patents as collateral for the loans.

Under each of the respective security agreements SVB and XACP had "the right to exercise all the remedies of a secured party upon such default under the Massachusetts UCC," which included the right to take possession and sell the collateral.

In December 2002, SVB assigned its security interest in the patents to XACP, thereby making XACP the sole secured party.

Ozro ultimately defaulted on its loan obligations and XACP foreclosed on its security interest. The patents were sold at a public auction. XACP was the sole bidder and purchased the patent rights. Ozro did not execute a written assignment of its rights in the patent to XACP in connection with the sale.

Shortly after the foreclosure sale, XACP assigned the patents to Sky Technologies Inc., another company founded by Conklin.

In 2008, Sky filed suit against SAP in the Eastern District of Texas alleging infringement of the patents. SAP moved to dismiss the complaint for lack of standing, arguing that the absence of a written assignment from Ozro to XACP left a gap in the chain of title

such that Sky did not own the patents and, consequently, had no standing to file the suit.

The District Court's Reliance on Akazawa

The District Court, relying on the Federal Circuit's decision in Akazawa v. Link New Technology Int'l Inc.,[4] held that title to the patents was transferred from Ozro to XACP by operation of state law through the foreclosure proceedings and that a written assignment was not necessary to effect the transfer.

In Akazawa, the defendant challenged the plaintiff's standing to sue for infringement based on an alleged defect in the assignor's claim of ownership in the patent.[5]

The inventor in that case had died intestate. His wife and daughters inherited the patents under Japanese law, and they later transferred the patents to the plaintiff.[6]

The district court held that the plaintiff lacked standing to enforce the patent because no writing had been issued from the inventor to his wife granting her all of his rights to the patent.[7]

The Federal Circuit reversed, holding that passage of title through intestacy is not an assignment and, therefore, did not require writing.

The court reasoned that, if the controlling state or foreign intestacy law passed title of the patent to the wife and daughters upon the inventor's death, then all subsequent transfers were valid.[8]

Turning to Sky Technologies, the district court relied on Akazawa for the proposition that patent ownership may be transferred by operation of law.

The court held that the chain of title had not been broken because ownership of the patents did not change by assignment, but rather as a result of XACP's foreclosure and sale of the patent collateral in accordance with Massachusetts law.

The Appeals Court Weighs In

The Federal Circuit began its analysis by noting that, while the validity and terms of a patent assignment are usually determined under federal law, state law controls any transfer of patent ownership by operation of law not deemed an assignment.[9]

Section 261 of the Patent Act requires that all assignments of patent interest be in writing. And indeed, the Federal Circuit affirmed that, if assignment is the method of transfer of patent ownership, it must be done in writing.[10]

The court, citing as precedent its ruling in Akazawa, held that title may be transferred by operation of law, and that such transfers are not subject to the Section 261 writing requirement.

The court found Akazawa controlling and affirmed the district court's decision finding that Sky owned the patents and had standing to file suit.

The Request for Rehearing and the Open Question of Best Practices

On Sept. 3, 2009, SAP filed a combined petition for rehearing and rehearing en banc with the Court of Appeals.

SAP, citing the language of the Patent Act and Supreme Court precedent, argues in its petition that the panel's decision was flawed in its conclusion that assignments are merely one way to transfer legal title to a patent and further asserts that the Patent Act preempts any individual state's ability to provide for the transfer of legal title to a patent without a writing.[11]

Ultimately, however, a ruling in SAP's favor would result in a break with conventional wisdom.

As the panel decision warned, patents presently subject to security interests may be without value as collateral were the court to adopt a rule stating that foreclosure on security interests secured by patent collateral could not transfer ownership to the secured creditor without a written assignment.[12]

Such a ruling would be likely to change significantly best practices for attorneys representing lenders in secured transactions involving patents.

It might be expected in most instances for lenders' counsel to insist on securing a power of attorney from the debtor authorizing the secured party's nominee to complete and execute an assignment upon default.

The Tenth Circuit has implicitly endorsed such an approach, recognizing that a lender, after a notice of default, could immediately execute assignments of the debtor's patent rights under a power of attorney in the original loan agreement.[13]

It might also become common practice to have the debtor grant a current interest in the patent coupled with a license back to the debtor, or grant conditional assignment of the patent that would become effective upon a future default.

The tactic of using such collateral assignments or conditional assignments, however, could carry additional burdens for the lender that would militate against their use.

Collateral assignments and conditional collateral assignments are both considered to be present interests held by the lender. It would, therefore, be the lender who would be

responsible for maintaining the patents, and it might be only the lender who would have standing to enforce the patents.

In the event the Federal Circuit rehears the case, its ruling could have significant implications for secured transactions involving patents. Lenders' counsel would be well-served to watch this case closely.

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[1] Theresa A. Brelsford, Recordability of Foreclosures for Assignment Purposes, Official Gazette Notice, March 14, 1988, available at www.uspto.gov/go/og/con/files/cons053.htm.

[2] -- F.3d ----, 2009 WL 2526472 (Fed. Cir. August 20, 2009).

[3] Id. at *1.

[4] 520 F.3d 1354 (Fed. Cir. 2008).

[5] Id. at 1355.

[6] Id. at 1355.

[7] Id.

[8] Id.

[9] Sky Technologies, 2009 WL 2526472, at *4.

[10] Id.

[11] See Defendants-Appellants' Combined Petition for Rehearing and Rehearing En Banc, Sky Technologies LLC v. SAP AG and SAP America Inc. at *3, No. 2008-1606 (Fed. Cir. Sept. 3, 2009).

[12] Sky Technologies, 2009 WL 2526472, at *6.

[13] See In re Tower Tech Inc., 67 F.App'x 521 (10th Cir. 2003); see also Thomas J. Ward, Intellectual Property in Commerce § 3:70.