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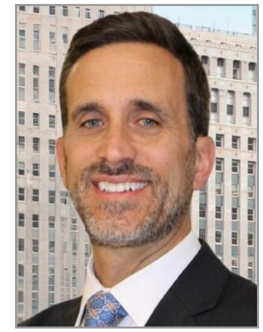
When Patents As Loan Collateral Can Cost You Standing

By **Joseph Marinelli and Suet L. Lee** (July 2, 2024, 3:46 PM EDT)



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In a May **decision**, the U.S. Court of Appeals for the Federal Circuit in Intellectual Tech LLC v. Zebra Technologies Corp. provided additional guidance on the complex issue of constitutional standing in patent cases.[1]

The Federal Circuit tackled the question of whether a patent owner had standing to assert a patent that it pledged as loan collateral, and then defaulted on the loan. The decision hinged on the precise language of the loan security agreement and whether the patent owner's default divested it of its standing to sue.

Default provisions of loan security agreements can have many unintended consequences for patent owners and creditors alike.

Federal courts have exclusive jurisdiction over patent disputes, but standing to sue is a separate threshold requirement that is not always a given for plaintiffs asserting patents. Article III, Section 2 of the U.S. Constitution vests judicial power in the federal courts to resolve cases or controversies. To invoke a federal court's power, a party must show that its case or controversy is amenable to resolution by demonstrating that the party has suffered an injury that can be fairly traced to the defendant and likely redressed by a favorable judgment.[2]

This doctrine, known as constitutional standing, often presents as a gateway defense in which the accused infringer seeks to dismiss the case on the basis that the plaintiff does not have constitutional standing to invoke the court's power. Importantly, constitutional standing must exist at the time the suit is filed and cannot be cured after the fact.[3]

Over the past five years, the Federal Circuit has issued several important decisions probing the boundaries of constitutional standing in patent cases. For example, in the 2019 case of Lone Star Silicon Innovations LLC v. Nanya Technology Corp., the Federal Circuit **held** that even though a patent owner had less than all substantial rights in the patent, it still had constitutional standing to sue but had to join the previous owner who retained rights.[4]

In Schwendimann v. Arkwright Advanced Coating Inc., the court in 2020 **ruled** that the assignee of a patent application had constitutional standing even though there was a defect in the assignment that incorrectly named the plaintiff's employer as the assignee because there was a real intention to assign the patent to the plaintiff.[5]

And in University of South Florida Research Foundation Inc. v. Fujifilm Medical Systems USA Inc., the Federal Circuit in 2021 explained that even if a party does not meet the statutory standing requirements of Title 35 of the U.S. Code, Section 281, the party may still sue on the basis of constitutional standing as long as the plaintiff shows injury in fact through having at least one exclusionary right to suffer legal injury.[6]

Constitutional Standing Meets Creditor Rights: Intellectual Tech v. Zebra Technologies

Most recently, in Intellectual Tech LLC v. Zebra Technologies,[7] the Federal Circuit grappled with the constitutional standing of a patent owner who had defaulted on a loan security agreement that used the asserted patent and other intellectual property assets as loan collateral.

Patent owners frequently pledge their patents and other intellectual property assets as loan security, entering loan agreements that give the crediting bank rights to the intellectual property assets if the patent owner defaults. These loan agreements, however, may have varying provisions that are triggered if the borrower defaults, such as automatic assignments to the lender, optional rights that the lender may exercise, or payment acceleration, to name a few.

In this case, Intellectual Tech granted lender Main Street Capital Corp. a security interest in its patents and other intellectual property assets in exchange for credit as part of a loan security agreement. The loan security agreement gave IT the rights to "exclude others from making, using or selling items covered by the Patents and Trademarks and any licenses thereunder, in the same manner and with the same effect as if this Agreement had not been entered into, so long as no Default exists."[8]

If IT defaulted, the loan security agreement provided that Main Street, "at its option may sell, assign, transfer, pledge, encumber, enforce, and/or grant or issue any exclusive or nonexclusive license of the patents to any third party."[9]

IT sued Zebra in the U.S. District Court for the Western District of Texas for patent infringement, but at the time IT filed suit, IT was in default of the loan agreement with Main Street.[10] Zebra moved to dismiss IT's complaint in the district court, arguing that IT's default divested IT of constitutional standing to assert the patent.[11]

The district court granted Zebra's motion to dismiss because in its view, the fact that Zebra could have obtained a license to the patent from Main Street after IT defaulted deprived IT of all exclusionary rights and constitutional standing.[12]

IT appealed, and the Federal Circuit reversed the dismissal.[13]

The court first narrowed the analysis to the "injury in fact" requirement of constitutional standing, recognizing that the parties did not have a meaningful dispute over the other requirements. Zebra argued that IT could not satisfy the "injury in fact" requirement for constitutional standing because Main Street's ability to "sell, assign, transfer, pledge, encumber or otherwise dispose" of the patent, with a primary focus on licensing the asserted patent, deprived IT of all exclusionary rights.[14]

The court explained that a plaintiff must have at least one exclusionary right against the defendant to establish an injury in fact. It then focused on whether IT had an exclusionary right in patents at issue.[15] The court explained that the district court incorrectly concluded that the bank's option to assign or license the patents divested IT of its legal interest in the patents.

Even if Main Street had a nonexclusive ability to license the patents upon default, IT retained its exclusionary rights because it shared the ability to license the patents. As the Federal Circuit explained, "a patent owner has exclusionary rights sufficient to meet the injury-in-fact requirement even where, without more, it grants another party the ability to license."[16]

And, as the court mentioned, IT's exclusionary rights were not all presently divested, because Main Street did not exercise any of its optional rights, including the right to assign.[17]

Patent Owners and Licensees Do Not Have Identical Patent Rights

In the appeal, Zebra relied heavily on the Federal Circuit's 2010 **opinion** in WiAV Solutions LLC v. Motorola Inc.[18]

In WiAV, the court considered whether a licensee had constitutional standing to sue where it had the sole ability to practice and sublicense the patent in a subfield. The court concluded that while an exclusive licensee has the right to exclude others from enforcing the patent, the exclusive licensee may lack standing to sue if a third party has the right to grant licenses to the accused infringer.[19]

Zebra argued that as in WiAV, Main Street had the option to license Zebra upon IT's default, and therefore IT was divested of standing.[20]

The Federal Circuit, however, distinguished WiAV because whereas the plaintiff in WiAV was a licensee, IT was the patent owner. According to the Federal Circuit, patent owners maintain the baseline right to exclude others even if the infringer could receive a license from a third party.[21] This potential for the accused infringer to obtain a license does not automatically remove the patent owner's right to sue: "Main Street and IT's shared ability to license while a default existed did not divest IT, the patent owner, of all exclusionary rights," the opinion stated.[22]

Viewed differently, if there had been an automatic assignment, IT would have lost its status as a patent owner and would have become a mere licensee, potentially without any exclusionary rights, and the outcome of this case would likely have been different.

Further, the Federal Circuit observed nothing in the loan security agreement that stated that the mere triggering of Main Street's conditional rights would automatically transfer all exclusive rights from IT to Main Street.[23] The court held that "whatever role another entity's ability to license has in the Article III [constitutional standing] inquiry for a patent owner, it is clear that assignment must be evaluated based on the actual transfer of rights, not mere ability."[24]

Despite Main Street's ability to license or assign the patents, Main Street did not exercise any of its options under the loan security agreement, which meant that IT still retained the exclusionary right to sue unlicensed infringers.[25] Thus, IT satisfied the "injury in fact" requirement for constitutional standing despite its default.

It is important to note that issues of joinder were not on appeal, but the Federal Circuit mentioned that joinder could be addressed on remand.[26]

Takeaways

When using patents as loan security, patent owners should be aware of provisions that trigger an automatic assignment of the patents to the lender in the event of default. Such language may jeopardize the patent owner's standing to enforce the patents. Default provisions that require the bank to proactively exercise an option to possess the patent are more beneficial to the patent owner.

Patent owners may also consider granting lenders rights to litigation or licensing proceeds generated by the patents as loan security, instead of outright ownership rights to the patents, to avoid the potential constitutional standing issue.

However, patent owners should bear in mind that even optional provisions leave open the possibility that an accused infringer can go behind the patent owner's back and approach the lender for a license or outright assignment if the patent owner defaults. Because lenders are likely to insist on some recourse in the event of a default, patent owners need to understand that using patents to secure credit may put the assets at risk if the patent owner defaults.

At the same time, creditors should understand the implications of default provisions in loan security agreements. Default provisions that automatically trigger an assignment to the lender may be a deterrent against default, but they may also result in the lender unintentionally owning the patents and stripping its patent owner of the ability to enforce the patents, or at the very least, being involuntarily joined as a co-plaintiff in the litigation.

The IT v. Zebra case involved a presuit default and its effect on constitutional standing. It is worth noting, however, that a patent owner may default on a loan security agreement after filing suit. Such a post-suit default that changes the rights or ownership in the patents is a different issue that would involve other considerations, such as continuing the suit in the name of the defaulting patent owner as a nominal plaintiff, substituting the lender as the new plaintiff, or joining the lender as a co-plaintiff.

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Disclosure: While at another firm, author Joseph Marinelli was counsel for Lone Star in the case of Lone Star Silicon Innovations v. Nanya Technology, discussed in this article.

[1] Intellectual Tech LLC v. Zebra Technologies. Corp. , 101 F.4th 807, 807 (Fed. Cir. May 1, 2024).

[2] Lujan v. Defenders of Wildlife , 504 U.S. 555, 560 (1992).

[3] Intellectual Tech LLC v. Zebra Technologies Corp. , No. 6:19-CV-00628-ADA, 2022 WL 1608014 (W.D. Tex. May 20, 2022), reconsideration denied, No. 6:19-CV-00628-ADA, 2022 WL 3088572 (W.D. Tex. Aug. 3, 2022), and rev'd and remanded, 101 F.4th 807 (Fed. Cir. 2024).

[4] Lone Star Silicon Innovations LLC v. Nanya Tech. Corp. , 925 F.3d 1225, 1235 (Fed. Cir. 2019).

[5] Schwendimann v. Arkwright Advanced Coating Inc. , 959 F.3d 1065, 1073 (Fed. Cir. 2020).

[6] Univ. of S. Fla. Tsch. Found. Inc. v. Fujifilm Med. Sys. USA Inc. , 19 F.4th 1315, 1324 (Fed. Cir. 2021).

[7] Intell. Tech LLC, 101 F.4th at 809.

[8] Id. at 811.

[9] Id.

[10] Id.

[11] Id. at 812.

[12] Id.

[13] Id. at 813, 817.

[14] Id. at 812.

[15] Id. at 812, 813.

[16] Id. at 815 (citing Uniloc USA Inc. v. Motorola Mobility LLC, 52 F.4th 1340, 1345 (Fed. Cir. 2022)).

[17] Id. at 817.

[18] WiAV Solutions LLC v. Motorola Inc., 631 F.3d 1257, 1266 (Fed. Cir. 2010).

[19] Id. at 1263.

[20] Intell. Tech LLC, 101 F.4th at 817.

[21] Id. at 816.

[22] Id.

[23] Id. at 815.

[24] Id. at 817.

[25] Id.

[26] Id. at 815 (citing Uniloc USA Inc. v. Motorola Mobility LLC, 52 F.4th 1340, 1345 (Fed. Cir. 2022)).