IP Alert | Federal Circuit to License Drafters: Specifically Address Survival of Sublicense Rights

By Sarah A. Kagan, Ph.D.

Earlier this fall, a German research organization convinced the U.S. Court of Appeals for the Federal Circuit that the U.S. District Court of Delaware had mistakenly dismissed its infringement suit against Sirius XM Radio Inc. (SXM) based on the broadcasting company's defense that it had a sublicense to use the patents.

In its recent ruling, the Federal Circuit vacated and remanded the suit to the district court so that Fraunhofer-Gesellschaft zur Förderung der angewandten Forschung E.V. (FH) and SXM could establish an appropriate record and the district court could make factual findings. [1]

Background

FH — a government sponsored, nonprofit research organization — developed and patented multicarrier modulation technology for transmitting multiple data streams. In 1998, it exclusively licensed the technology to WorldSpace International Network Inc. (WS), giving WS the right to sublicense. WS soon after exclusively sublicensed the technology to SXM for use in the United States only. SXM used the technology to develop its digital audio radio system. FH also served as technical consultant to SXM in its development of the system.

Ten years later, WS filed for bankruptcy, during which it rejected the master license agreement from FH. As part of the bankruptcy process, WS and SXM entered a settlement agreement in which SXM agreed to pay WS for all its obligations under the sublicense and the parties agreed that the sublicense would remain in effect. Several years later, FH sent WS a letter purporting to terminate the master license agreement to WS. FH then sued SXM for patent infringement based on the

theory that the master license agreement had been terminated, extinguishing the rights of sublicensee SXM. SXM maintained that its sublicense was still operative.

The district court focused its analysis on the sublicense and its durability, seemingly independent of the master license agreement. The Federal Circuit found error in the failure of the district court to construe the master license agreement.

Choice of Law

Although neither party raised the choice-of-law issue, it seemed to be what most animated the panel of judges of the Federal Circuit.[2] Prior to oral hearing, the court advised the parties to prepare to address (1) whether the choice of law provision in the master license ("the Agreement shall be subject to, governed by, and construed in accordance with German law") should govern interpretation of the master license and SXM's rights, (2) whether SXM's rights would survive termination of the master license under German law, and (3) whether the case should be remanded for proceedings to address German law.

At the oral hearing, FH urged that both parties had waived the application of German law by not raising it. Upon questioning, FH seemed to indicate that the sublicense would survive under German law but not under U.S. law. In its Oct. 17 opinion, the Federal Circuit agreed that the parties had waived the issue and that the law of the forum should be applied.

Hearing

During oral arguments, the judges raised questions relating to interpretation of the master licensing agreement. U.S. Circuit Judge Timothy Dyk asked FH when the license had been terminated. Stating that WS' rejection of the license during bankruptcy was not itself termination, but a breach that permitted FH to terminate, Judge Dyk pressed FH as to when it elected to terminate the master license agreement after the breach.

In response to SXM's assertion that New York law should be applied to the sublicense, Circuit Judge Richard Taranto said that he thought the court needed to resolve the status of the master license agreement, because the sublicense was fully paid up at the time of the bankruptcy.

Judge Dyk also asked about the nature of the fees that FH asserted WS had not paid: Were they for U.S. prosecution? Were they for maintenance fees? Did they relate to the asserted patents? These issues will likely play into the district court's interpretation on remand of the termination conditions in the master license agreement.

The Opinion of the Panel

The Federal Circuit opinion corrects a misapprehension of its precedent on which the district court's dismissal rested: Federal Circuit law does not provide for automatic survival of a sublicense when the master license has been terminated. Rather, the court must interpret the particular master license to determine if a sublicense survives.

The Federal Circuit found the master license agreement equivocal on the issue of sublicense survival. Its opinion notes that the master license agreement was designated as irrevocable, but also contained provisions referencing termination. The court instructs the district court on remand to investigate extrinsic evidence of the circumstances surrounding the agreement to determine the intent of the parties. The Federal Circuit's opinion lists six facts (some known and some not yet known) that should be considered by the district court in resolving the ambiguity:

1. the fact that SXM had performed all its obligations under the sublicense agreement at the time of the alleged termination of the master agreement;
2. FH's knowledge of and agreement to the terms of the sublicense agreement and the amendments made to the sublicense agreement;
3. whether the parties discussed SXM's long-term reliance on the license's validity;
4. FH's own role in constructing the allegedly infringing devices and the parties' assumptions that a license would be required for SXM's continued use of the devices;
5. other discussions among FH, WS, and SXM before and after the execution of the relevant agreements that may shed light on the effect of a termination of the master agreement on the sublicense; and
6. commercial practices and custom, particularly as it relates to the default rule that should apply if the agreement remains ambiguous after considering extrinsic evidence as to the parties' conduct.

The Federal Circuit opinion sets up a logic flow chart for the district court that gives SXM two ways to win and FH just one. The court should ask first whether the master license agreement was properly terminated. If not, then SXM still has a valid sublicense. If the master license was properly terminated, then the court must determine if the sublicense nevertheless survives, based on the interpretation of the master license agreement. If the sublicense survives, SXM retains a valid sublicense. If the sublicense does not survive, SXM is subject to FH's charges of infringement.

Although FH in its briefs repeatedly characterized SXM's license defense as "not exactly your plain vanilla license defense," one wonders: why not? The license/sublicense combination seems anything but exotic. Ditto an allegedly defaulting party. Nonetheless, the master license agreement left the fate of sublicenses unclear, at least according to the three-judge panel of the Federal Circuit. License drafters are on notice to clarify this crucial aspect in their future licenses.

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[1] Fraunhofer-Gesellschaft zur Förderung der angewandten Forschung E.V. v. Sirius XM Radio Inc., 2018-2400 (Fed. Cir.) (October 17, 2019)

[2] The panel consisted of U.S. Circuit Judges Timothy Dyk, Richard Taranto, and Richard Linn.

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