A False Sense of Security?: Nonpracticing Entities and Potential Liability for Inducing Others to Infringe

By Paul J. Meyer Jr.

Entities that do not commercially practice the intellectual property that they own (“nonpracticing entities”) have long been part of the IP landscape. These entities not only include IP-holding companies that may be established by a parent company for tax reasons, but also include research institutions that only commercialize their proprietary technology by licensing it to other companies. Moreover, during the past few years, new business models have emerged that strictly involve the buying, selling, and licensing of IP solely to monetize the IP. The success of these new companies (e.g., those known as “patent trolls”) has forced many industries to consider how best to engage nonpracticing entities and their business models.

It is conventional wisdom that nonpracticing entities are insulated from infringement risks, at least with respect to counterclaims as part of patent litigation originally initiated by such entities. However, nonpracticing entities should not consider themselves completely immune from claims of patent infringement.

Under the U.S. Patent Act, even if an entity itself does not directly practice a claimed invention, or make or sell a component that is used in an infringing product, the entity might still be liable for inducing patent infringement. Specifically, under 35 U.S.C. § 271(b), “[w]hoever actively induces infringement of a patent shall be liable as an infringer.” The general rationale for imposing liability for indirect infringement is to provide patentees with effective protection against infringing activities when the direct infringer is not truly culpable or would be difficult or impractical to sue. For instance, a patentee’s ability to sue an indirect infringer under § 271(b) “can avoid injustice by holding liable those who contract infringing work out to someone who cannot pay a damages judgment.”

Most commonly, claims under 35 U.S.C. § 271(b) are made against defendants that are part of a supply chain for an infringing product or sell products or services that allow others to make or use the infringing product. Often in these cases the patentees find that the direct infringers are unsuitable targets for infringement claims for various reasons. For instance, the direct infringers might be judgment proof and thus likely to lose, courts have thus far been unwilling to find that entering into these types of agreements cannot, by themselves, serve as a basis for finding that the defendant induced the recipient to directly infringe patents.

This article considers how an entity that solely intends to sell or license intellectual property (e.g., an IP-holding company) might become the subject of an infringement claim by a patentee under 35 U.S.C. § 271(b), and how the entity might proactively address such risks. Imagine, for example, the following hypothetical scenario: Bio. Patent Holding Company, Inc. (HoldCo) owns a number of portfolio patents that it has purchased from various distressed biotechnology and pharmaceutical companies. HoldCo is financially backed by a large investment fund and has sufficient resources to protect its investment. HoldCo is familiar with the drug industry and it often becomes aware that certain companies infringe its patents. However, HoldCo is only in the business of buying and licensing patented inventions, and it does not employ a technical staff or make any products that are covered by its patents.

HoldCo has recently purchased a small patent portfolio, and related documentary know-how, that covers LEX-8 inhibitors. Rather unexpectedly, a small U.S. biotechnology company (SmallCo) approaches HoldCo to ask if HoldCo would be willing to sell or license one of these patents. During negotiations, SmallCo indicates that it has learned of a patent regarding LEX-8 inhibitors that has just issued—U.S. Patent No. 9,999,999 to Smith et al. (the ’999 patent), assigned to Drug Corporation (Drug Corp.). The ’999 patent claims, in part, a method of making one of the LEX-8 inhibitors covered by the HoldCo patent. SmallCo now suggests that it may need to use the method claimed by the ’999 patent and it does not have the resources to fight off a potential suit against Drug Corp. As a result, SmallCo demands that if it is going to buy or license HoldCo’s patent, HoldCo must indemnify SmallCo against a patent infringement claim by Drug Corp. Under these circumstances, what steps (if any) should HoldCo take in order to limit its potential exposure?

The Standard for Proving Inducing Infringement

The liability for inducement to infringe is imposed by 35 U.S.C. § 271(b): “Whoever actively induces infringement of a patent shall be liable as an infringer.” A claim for inducement requires proof that (1) there was direct infringement by a third party, (2) the defendant was aware of the subject patent, and (3) the defendant knowingly induced the infringement.
**Direct Infringement**

A plaintiff’s first hurdle in proving inducement is to show direct infringement by a third party. Inducing infringement cannot be found in the absence of direct infringement. Direct infringement is defined by 35 U.S.C. § 271(a): “whoever without authority makes, uses, offers to sell, or sells any patented invention, within the United States or imports into the United States any patented invention during the term of the patent therefor, infringes the patent.” The plaintiff bears the burden of showing a third party’s direct infringement by a preponderance of the evidence. Direct evidence of infringement is not required, however; rather, circumstantial evidence will suffice.

**Inducement**

*Knowledge of the Patent.* For the defendant to be liable for inducing infringement, a plaintiff must also show that the defendant knew of the infringed patent. Indeed, a “crucial element of induced infringement is that the inducer must have actual or constructive knowledge of the patent.”

*Intent to Induce Infringement; Standard for Intent.* The plaintiff also bears the burden of proving that the defendant intended to induce the direct infringer to infringe the patent. Section 271(b) does not specifically mention intent. Decisions interpreting this section and the relevant legislative history, however, “uniformly assert such a requirement.”

In order to prove intent, the plaintiff must show “that the alleged infringer’s actions induced infringing acts and that he knew or should have known his actions would induce actual infringements.” Establishing that the defendant merely knew that a third party was infringing the patent is not enough to establish “intent.” Instead, in order to fulfill the intent prong, a plaintiff must establish that the defendant engaged in some type of affirmative action in furtherance of the infringing acts.

As in the case of the direct infringement element, the plaintiff has to prove intent by a preponderance of the evidence. Likewise, however, direct evidence of intent is not necessary—circumstantial evidence may be used and may be sufficient. Consequently, “the requisite intent to induce infringement may be inferred from all of the circumstances.”

*The Level of Plaintiff’s Burden: “Actual Intent” versus “Specific Intent.”* From the 1990s until 2006, there was an apparent “split” in the Federal Circuit regarding the level of a plaintiff’s burden for proving intent. The split was epitomized in two 1990 Federal Circuit decisions. One decision seemed to require “actual intent” to induce infringement and the other seemed to require “specific intent” to induce infringement. The two standards conflict—while “actual intent” requires the plaintiff to show that the defendant intended to cause the acts that constitute infringement, “specific intent” requires the plaintiff to show that the defendant specifically intended to cause the infringement itself. Thus, the specific intent standard requires the plaintiff to satisfy a higher burden of proof. The conflicting standards of intent created confusion in the district courts over the proper intent standard.

The Federal Circuit appeared to clear up the confusion in *DSU Medical Corp. v. JMS Co., Ltd.* by holding that a plaintiff is required to show specific intent, rather than actual intent, in order to succeed on its claim for inducing infringement. This Federal Circuit decision confirms that the higher standard of specific intent is the proper measure for determining whether a defendant can be liable for inducing infringement—namely that the defendant specifically intends to encourage third parties to infringe the patent.

**Acts Constituting Inducement**

As courts have recognized, the “spectrum of acts potentially demonstrating the requisite intent for inducing infringement is broad.” Courts, for instance, have held that certain acts, including advertising or marketing an infringing product, can give rise to inducing liability when the defendant commits these acts with intent.

**Most Relevant to Nonpracticing Entities.** While any number of factual scenarios and actions by a defendant could lead to a court finding inducement, the cases that are most relevant to the potential liability of nonpracticing entities are those in which the courts have considered claims of inducement related to the grant of license rights or agreements to indemnify for patent infringement. With respect to licensing activities, some commentators have suggested that a licensor may be subject to liability if, in addition to providing rights to technology, it also provides instructions, plans, know-how, or other similar information that enables the licensee to practice the patented product or process. For indemnification agreements, the courts have held that “an indemnification agreement will generally not establish an intent to induce infringement, but such an intent can be inferred when the primary purpose [of the agreement] is to overcome the deterrent effect that the patent laws have on would-be infringers.”

The following discussion provides some guidance regarding how a court may consider these types of acts while considering relevant claims of inducement.

In *Hewlett-Packard Co. v. Bausch & Lomb Inc.*, the plaintiff (Hewlett-Packard Co. (HP)) manufactured a patented X-Y plotter. The patent covering the plaintiff’s product was known as the “LaBarre patent.” The defendant (Bausch & Lomb, Inc. (B&L)) sold a similar product covered by a different patent (known as the “Yeiser patent”) through its Houston Instruments division. About two years after it began commercializing its X-Y plotter, B&L entered into a “Purchase Agreement” with Ametek, Inc. (Ametek) pursuant to which B&L sold the entire Houston Instruments division (including all its “assets, properties, rights and business”) to Ametek. In conjunction with execution of the Purchase Agreement, B&L and Ametek also entered into an ancillary patent agreement under which B&L would grant Ametek a license under the Yeiser patent and B&L agreed to indemnify Ametek against liability for infringing the LaBarre patent up to a cap of $4.6

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million. HP sued B&L, in part, for active inducement of infringement under § 271(b) for the period subsequent to the sale of the Houston Instruments division. The district court found that B&L did not actively induce infringement of the LaBarre patent by Ametek under § 271(b).

On appeal, the Federal Circuit affirmed. The court held that, “by looking at the totality of the events surrounding the sale of Houston Instruments,” there was insufficient proof of intent in order to find active inducement. The court specifically found that “it is clear that B&L was merely interested in divesting itself of Houston Instruments at the highest possible price.” With respect to the patent agreement, the court observed that “the grant of a license from B&L to Ametek under the Yeiser patent is not probative of any intent to induce infringement.” The court based this conclusion on the rationale that the “license agreement between B&L and Ametek did not purport to give Ametek the right to make, use and sell X-Y plotters; it merely freed Ametek from whatever bar the Yeiser patent would have been to such activity.”

The court also found that while “the most troubling aspect of the agreement between B&L and Ametek is the indemnification clause,” it was not sufficient evidence to demonstrate the necessary level of intent. In coming to this conclusion, the Federal Circuit noted that courts have found that “an indemnification agreement will generally not establish an intent to induce infringement, but that such intent can be inferred when the primary purpose [of the agreement] is to overcome the deterrent effect that the patent laws have on would-be infringers.” Applying this line of reasoning to the B&L deal, the court found that “[w]hile overcoming the deterrent of the patent laws might have been the ultimate effect of the indemnification agreement in the present case, we cannot say that that was its purpose.” According to the court, “[a]ll B&L really wanted out of this agreement was the sale of Houston Instruments at the greatest possible price. Therefore B&L agreed that, if Ametek should wish to continue the manufacture and sale of [the infringing products], B&L would bear the risk of those [products] ultimately being found to infringe the LaBarre patent.” The court finally concluded that “[t]he indemnification agreement certainly facilitated the sale of Houston Instruments at the particular price at which it was sold, but we cannot agree that B&L used it to induce infringement by Ametek.

Since Hewlett-Packard, some defendants have argued that a grant of a license to a direct infringer cannot, by itself, support a claim of inducement to infringe. For example, in Proteotech, Inc. v. Unicity International, Inc., as part of a motion to dismiss filed by the defendant, the district court considered an argument that, as a matter of law, the mere act of licensing cannot constitute inducement of infringement under § 271(b).

For support of its motion, the defendant cited the findings of the Federal Circuit in Hewlett-Packard. The district court denied the defendant’s motion by finding, in part, that Hewlett-Packard was not on point. The court specifically noted that the Federal Circuit’s opinion “does not suggest that licensing alone could never be adequate evidence of the requisite intent; rather, the Federal Circuit examined all of the evidence in that case and concluded that B&L’s intent was not to infringe HP’s patent, but rather to get rid of Houston Instruments ‘lock, stock, and barrel.”

In addition to Hewlett-Packard, other courts have considered indemnification agreements as evidence for showing inducement to infringe. In H.B. Fuller Co. v. National Starch and Chemical Corp., for instance, the court relied heavily on the evidence of an indemnification letter to find that there was inducement to infringe the subject patent. In H.B. Fuller Co., National Starch and Chemical Corp. (National) filed a counterclaim that H.B. Fuller Co. (Fuller) was liable for patent infringement. National claimed that Fuller should be liable because Fuller promoted an adhesive covered by one of National’s patents for use in diapers made by certain manufacturers and indemnified the manufacturers against damages resulting from any lawsuit brought for infringement of the National patent. The court held that Fuller was liable for inducing infringement because it encouraged a manufacturer, Weyerhaeuser, to directly infringe the National patent. The court found that an indemnification letter provided to Weyerhaeuser from Fuller to be persuasive evidence of inducement. The court noted that the letter stated that the indemnification was granted at Weyerhaeuser’s request, thus inferring that it was a requirement for Weyerhaeuser’s continued use of the Fuller product.

Other courts have rejected claims of inducement based upon the use of agreements to indemnify. For example, in MEMC Electronic Materials, Inc. v. Mitsubishi Materials Silicon Corp., the Federal Circuit concluded that an indemnification provision included in a purchase order did not establish intent to induce infringement because there was no evidence “that the primary purpose of the agreement was to induce the [direct infringer] to infringe” the relevant patent. In order to support its finding, the court noted that it was more reasonable to conclude that the indemnification agreement was only meant to cover claims of infringement under Japanese law since the sale of the relevant products occurred in Japan.

### Practical Suggestions on How to Minimize Potential Risks for Nonpracticing Entities

Under the hypothetical situation summarized above in the Introduction section, if HoldCo ultimately agrees to license the technology to SmallCo and to indemnify SmallCo against claims by Drug Corp., HoldCo should be concerned about possible liability under § 271(b). However, by taking certain steps, HoldCo might be able to minimize its risks. The following discussions provide some suggestions on ways that nonpracticing entities can minimize their potential risks, some of which may apply to HoldCo’s specific situation.

Generally speaking, if there are third-party patents that are possibly relevant to the commercialization of a nonpracticing entity’s technology, there are various approaches to minimize the risks of inducement liability for the nonpracticing entity. Some of these approaches can be implemented in preparation of a potential transaction or during the deal stage (i.e., executed in the deal documents).

Although one might be tempted to use general approaches to minimize risk, the most effective approaches are likely to
be dictated by the specific circumstances. As an example, a nonpracticing entity might include a general disclaimer in the definitive documents that indicates that the nonpracticing company is only providing the technology for lawful purposes that do not infringe third-party rights. However, a court reviewing this type of disclaimer may not see the general disclaimer as necessarily probative and most likely will not consider it sufficient to negate a showing of intent to induce infringement.46

Instead of relying on general approaches, a nonpracticing entity should consider how the operative language of the IP conveyance/license or the indemnification obligation provided by the nonpracticing entity (if any) will appear to a trier of fact. A license grant provided by a nonpracticing entity, for instance, should be carefully crafted so that it will not likely be construed as providing the licensee with a “blank check” to exploit potentially infringing products. For example, as suggested by the court in Hewlett-Packard,47 the license grant should be limited so that it only provides rights “under” the relevant IP owned or controlled by the nonpracticing entity. With respect to indemnification agreements, an obligation that identifies a specific patent is likely to receive much greater scrutiny than a general obligation.48

In the event that a nonpracticing entity becomes aware of a specific patent that might be implicated by an acquirer’s or licensee’s activities related to the nonpracticing entity’s technology, it should seek legal advice as to whether obtaining an opinion of counsel is warranted. Such opinions of counsel are often used by a defendant during litigation to show that it exercised due care by obtaining an opinion that its activities do not infringe any valid claims of the relevant patent. The Federal Circuit, in Broadcom Corp. v. Qualcomm Inc.,49 has in fact not only recently reaffirmed that opinion-of-counsel evidence can be an important component of a defense against a claim of inducement,50 but it has found that a patentee may use a failure to procure an opinion of counsel as circumstantial evidence of intent to infringe.51 Therefore, if a nonpracticing entity fails to obtain an opinion of counsel in certain circumstances, it may run a higher risk of becoming liable for the infringing activities of its customers/licensees.

Conclusion
As a general matter, a plaintiff’s biggest challenge in asserting a claim of inducement is to prove that the defendant intended to induce infringement. This challenge has become even more pronounced since the DSU Medical decision, as the Federal Circuit has now clearly indicated that a showing of “specific intent” is necessary. Under the “specific intent” standard, a plaintiff must show that a defendant’s actions induce infringing acts and that the defendant specifically intends that its actions induce infringement. As a result, a claim against a nonpracticing entity, whose only “activity” is entering into a contract with the direct infringer, is especially challenging.

Nevertheless, even if the above is true, one should still acknowledge that the courts have not yet clearly indicated that evidence of certain relevant activities of nonpracticing entities (i.e., selling/licensing technology or agreeing to indemnify others for IP infringement) is, by itself, insufficient to support a claim of inducement. Therefore, as part of their standard operating practices, nonpracticing entities should carefully consider how their particular situation, vis-à-vis a possible third-party claimant, could lead to potential exposure. For example, if a nonpracticing entity becomes aware of a patent that is potentially relevant to the exploitation of its technology by a third party, the entity should weigh the risks of inducement liability with the costs of procuring an opinion of counsel.

Acknowledging the risks can help prevent a nonpracticing entity from being blindsided by a third-party infringement claim. And taking certain steps (e.g., obtaining an opinion of counsel) can help dispose of such claims before they become a drain on financial and operational resources.52

Endnotes


2. See Minn. Mining & Mfg. Co. v. Chemque, Inc., 303 F.3d 1294, 1304–05 (Fed. Cir. 2002); Robert L. Harmon, Patents and the Federal Circuit § 7.3(c) (6th ed. 2003). While § 271(b) does not use the word “knowing,” case law interpreting this section and the applicable legislative history support such a requirement. Water Tech. Corp. v. Calco, Ltd., 850 F.2d 660, 668 (Fed. Cir. 1988).

3. See, e.g., Water Tech., 850 F.2d at 668 (“Direct infringement is a prerequisite to finding induced infringement”); Epon Gas Sys., Inc. v. Bauer Compressors, Inc., 279 F.3d 1022, 1033 (Fed. Cir. 2002) (“It is well settled that there can be no inducement of infringement without direct infringement by some party . . . [u]pon a failure of direct infringement, any claim of inducement of infringement also fails.”) (citations omitted).


7. Harmon, supra note 3, at § 7.3(c).

8. Water Tech., 850 F.2d at 668. See also Rader, supra note 6, at 311 (observing that “courts interpreting and applying § 271(b) have imported [an intent] requirement from § 271(c), the legislative history of the statute, and the common law development that led to its enactment”).

9. Manville Sales Corp. v. Paramount Sys., Inc., 917 F.2d 544, 553 (Fed. Cir. 1990) (emphasis in original). See also Organon Inc. v. Teva Pharm., Inc., 244 F. Supp. 2d 370, 380 (D.N.J. 2002) (“[T]he knowledge must be of the resulting infringements themselves; in the instant case, it would be the knowledge of the existence of the use-patent, coupled with knowledge that some doctors will prescribe generic mirtazapine with an SSRI, plus an act (other than the mere existence of the generic on the market) to induce doctors to commit the infringing act. Sale of a lawful [sic] by lawful means, with the knowledge that an unaffiliated, third party may infringe, cannot, in and of itself, constitute inducement of infringement.”).

10. See Warner-Lambert Co. v. Apotex Corp., 316 F.3d 1348, 1364 (Fed. Cir. 2003) (“If a physician, without inducement by Apotex, prescribes a use of gabapentin in an infringing manner, Apotex’s knowledge is legally irrelevant. In the absence of any evidence that Apotex has or will promote or encourage doctors to infringe the neurodegenerative method patent, there has been raised no genuine issue of material fact.”). See also Catapano v. Wyeth Ayerst Pharm., Inc., 88 F. Supp. 2d 27, 30 (E.D.N.Y. 2000) (“Even if the
Defendants are aware that doctors and hospitals are using the vaccine to stimulate patients’ immune systems in violation of Catapano’s patent, such knowledge alone does not suffice to hold the Defendants liable for inducement.”


12. See Rader, supra note 6, at 312 (“The plaintiff bears the burden of proof on intent, just as on the existence of direct infringement, by a preponderance of the evidence.”) (citing Allergan Sales, Inc. v. Staur Surgical Co., 41 U.S.P.Q.2d 1287 (S.D. Cal. 1996)).


14. Water Tech., 850 F.2d at 669.

15. In Hewlett-Packard Co. v. Bausch & Lomb Inc., 909 F.2d 1464, 1469 (Fed. Cir. 1990), the Federal Circuit held that a plaintiff must show “actual intent to cause the acts which constitute the infringement.” See also Rader, supra note 6, at 314 (interpreting Hewlett-Packard: “According to [the actual intent] standard, a defendant may be found liable for infringement by encouraging others to undertake infringing acts, even if the defendant honestly believes that these acts do not constitute patent infringement, and the defendant, therefore, does not literally intend for patent infringement to occur.”).

16. After the Hewlett-Packard decision, in Manville Sales Corp. v. Paramount Systems, Inc., 917 F.2d 544 (Fed. Cir. 1990), the Federal Circuit held that a plaintiff must demonstrate “that the defendant possessed specific intent to encourage another’s infringement and not merely that the defendant had knowledge of the acts alleged to constitute infringement.” Id. at 553 (emphasis added). Further, “[t]he plaintiff has the burden of showing that the alleged infringer’s actions constituted infringing acts and that he knew or should have known his actions would induce infringing activity.” Id.

17. See Rader, supra note 6, at 320 (observing that “the Federal Circuit’s conflicting holding in Manville Sales has led to a great deal of confusion in the district courts.”).

18. 471 F.3d 1293 (Fed. Cir. 2006).

19. Id. at 1306 (“[I]nducement requires evidence of culpable conduct, directed to encouraging another’s infringement, not merely that the inducer had knowledge of the direct infringer’s activities.”).

See also Kyocera Wireless Corp. v. U.S. Int’l Trade Comm’n, 545 F.3d 1340, 1354 (Fed. Cir. 2008).


21. For example, it has been found that instructions or literature accompanying the defendant’s product can act as sufficient evidence of intent. See, e.g., Bio-Tech. Gen. Corp. v. Duramed Pharm., Inc., 325 F.3d 1356, 1361 (Fed. Cir. 2003) (finding evidence that defendant’s package insert was identical to plaintiff’s package insert was sufficient to satisfy burden at the summary judgment stage); Allergan Sales, Inc. v. Staur Surgical Co., No. CV 96-1430 (H(JFS), 1996 U.S. Dist. LEXIS 21051, at *23 (S.D. Cal. Oct. 22, 1996) (enjoining defendant from including any language in its package inserts that gives instructions for the process disclosed in the plaintiff’s patent).

22. See Donald C. Shebus, CHESUM ON PATENTS § 17.04[4][a], 17–93–17–94, See also, e.g., Water Tech. Corp. v. Calco, Ltd., 850 F.2d 660, 668 (Fed. Cir. 1988) (finding that the district court did not err in finding that defendant liable for inducement to infringe, based, in part, on evidence that the defendant exerted control over the manufacture of the infringing products as owner of the applicable trademark and through the terms of license agreements where the licensee was required to obtain approval by the defendant of the construction of the product); In re Dahlgren Int’l Inc., 819 F. Supp. 568, 576 (N.D. Tex. 1992) (“Although Dahlgren itself no longer directly makes, uses or sells the infringing devices, Dahlgren has provided technology, drawings, and know-how to Dahlgren U.S.A. through licensing agreements which have enabled Dahlgren U.S.A. to directly infringe the [patent]. Therefore, on the basis of Dahlgren’s inducement of direct infringement, Dahlgren is liable as an infringer for any infringement by Dahlgren U.S.A. of the [patent].”).


24. See id. at 1467.