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## Licensing

# Unregistered Patent Transaction? Even in Win, That'll Cost You



By Jonathan Radcliffe

The U.K. patents system penalizes a failure to record a patent transaction at the Patent Office by depriving a successful plaintiff of its entitlement to recover its full legal costs in any subsequent infringement litigation on that patent.

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The extent of the litigation sanctions that can be imposed in such circumstances has now been clarified. The U.K. Patents Court's recent judgment in *L'Oréal v. RN Ventures* [2018] EWHC 391, gives guidance both to litigants and to parties to a corporate transaction on the consequences of failing to register a transaction.

The decision has potentially significant strategic implications for both patent litigation and for commercial transactions that require recordal of patent transactions and the consequences of failing to do so.

- As a matter of public policy, the U.K. patents system is deliberately structured to coerce the timely and proper registration of transactions affecting legal interests in patent ownership. Any "recordal gap" will be penalized in subsequent successful infringement litigation by disallowing full recovery of legal costs and expenses. The successful patent licensee (in this instance) will be prevented from recovering its legal costs attributable to the period before the license was actually registered.

- Nonregistration of a transaction, instrument, or event affecting rights in or under patents at the Patent Office will not prevent the patent owner or the exclusive licensee from suing for infringement or from obtaining an interim injunction, but it will adversely affect their entitlement to make the defendant pay their full legal fees and expenses if they win.
- This decision gives thorough guidance to both patent litigants and to those involved commercial transactions that require recordal of patent transactions about the consequences of failing to do so.
- This decision will also have an impact on due diligence exercises in corporate and commercial transactions. Buyers of patents or exclusive licenses under them will need to ensure there is no “recordal gap” in their title. If one is identified, specific contractual comfort should be obtained from the seller.

## Background

L'Oréal SA and its U.K. affiliate L'Oréal (UK) Limited brought claims of patent and community registered designs (CRD) infringement against certain products in RN Ventures' range of Magnitone electronic facial skin care devices. These deep-cleanse facial pores by using oscillating circular heads with bristles arranged in rings of concentric circles. L'Oréal's Clarisonic products are primarily mechanical devices that treat acne through the removal of sebum plugs from skin pores.

RN Ventures did not challenge the validity of the patent, its primary defense being non-infringement. This failed. The judge rejected RN Ventures' attempted squeezes between infringement and validity, and also held that its Magnitone products infringed one of L'Oréal's CRDs because they created the same overall impression as that CRD.

The history of the ownership of the patent in suit was fairly typical of the sorts of arrangements between parent companies in international corporate groups and their national affiliates. L'Oréal SA granted L'Oréal UK an exclusive license July 1, 2008, and by an addendum dated Dec. 9, 2012, the Clarisonic product (the subject of this litigation) was added as a licensed product. However, the exclusive license was not formally registered until Dec. 9, 2016, some six weeks after it issued proceedings.

As L'Oréal's patent infringement claim was successful, under the normal English cost-shifting rules L'Oréal became entitled to recover its legal expenses and costs from RN Ventures, the losing party. However, RN Ventures argued at a subsequent hearing that L'Oréal should nonetheless not be entitled to do so on the basis that it had failed to register its relevant legal interests in the patent.

Section 33 of the Patents Act 1977 provides that “*transactions, instruments or events affecting rights in or under patents*” should be registered on the Register of Patents.

Section 68 of the Patents Act 1977 provides that:

“Where by virtue of a transaction, instrument or event to which section 33 . . . applies a person becomes the proprietor or one of the proprietors or an exclusive licensee of a patent and the patent is subsequently infringed before the transaction, instrument or event is registered, in proceedings for such an infringement, the court . . . shall not award him costs or expenses unless -

- (a) the transaction, instrument or event is registered within the period of six months beginning with its date; or
- (b) the court . . . is satisfied that it was not practicable to register the transaction, instrument or event before the end of that period and that it was registered as soon as practicable thereafter.”

## The Consequences of Failing to Register

Assignments and exclusive licenses are both transactions to which Section 33 applies. In this instance, there could therefore be no argument but that the L'Oréal UK licenses should have been registered at the Patent Office. L'Oréal should have registered the exclusive Claritone license by Feb. 1, 2013, but had failed to do so until Dec. 9, 2016, after it had sued.

L'Oréal could not therefore argue that Section 68 was not applicable. Instead, this litigation directly raised the issue of the detailed application of the sanctions imposed by this section and whether there was any proper basis on which its binary impact could — or should — be mitigated.

The Supreme Court had previously emphasized (*obiter*) in *Schütz (UK) Limited v. Werit (UK) Limited* [2013] UKSC 16, that the overarching public policy rationale behind Section 68 was not penal, and directed at punishing the tardy proprietor and/or exclusive licensee for their delay in registering the transaction, but was directed at ensuring the public good in informing interested parties about who is the owner or exclusive licensee of the monopoly conferred by the relevant patent. The Section 68 (and Section 33) regime is therefore deliberately structured to coerce the timely registration of the relevant interests in a patent. This public policy rationale is achieved by protecting the losing infringer from having to pay the legal costs and expenses of parties whose legal interests in the patent that infringer could not have identified from the public register.

The Supreme Court's *obiter* view in *Schütz v. Werit* was that the correct interpretation of Section 68 is that where a licensee wins on the issue of infringement of a patent in circumstances where its license has not been registered, then:

- the licensee cannot recover its costs insofar as they are attributable to the claim for damages or an account of profits in respect of infringements pre-dating the registration of the license;
- but it can recover costs attributable to such relief in respect of infringements post-dating the registration; and
- where — temporally — the infringement straddled both sides of the date of registration, an appropriate

apportionment would have to be made.

(Strictly, this aspect of the Supreme Court's judgment is *obiter dicta* given that it had ruled against *Schütz* on the question of infringement, with the result that the question of disentitlement to legal costs did not formally arise.)

### Applicable Costs Sanctions

The judge was mindful that in *Schütz v. Werit*, the Supreme Court had specifically rejected an interpretation of the Section 68 costs sanction that left the section "with little real bite." In his view:

*"The policy underlying section 68 is not concerned with prejudice to defendants against whom proceedings for infringement have been brought. It is concerned with the consequence to the public of a failure to register and provides an incentive to ensure that registration is performed by an appropriate date. When the section applies, it may always be characterised as a windfall in favour of the defendants, but that is because it is directed to the public interest, rather than the private interests of the parties to the litigation."*

Although they had succeeded in the litigation and would ordinarily have been entitled to payment of their legal costs under the English legal costs-shifting regime, the judge held that both the patent owner (L'Oréal SA) and the exclusive licensee (L'Oréal UK) should be deprived of a proportion of their legal costs by having failed to record the license in time.

In reaching this decision, the judge comprehensively examined the scope of the Section 68 regime, including formally endorsing and expanding on the Supreme Court's previously *obiter* comments on this regime. As a result, this case gives thorough guidance to both patent litigants and to those involved commercial transactions that require recordal of patent transactions about the consequences of failing to do so.

#### ■ Who should be deprived of their legal costs and expenses?

The court accepted as a matter of statutory interpretation that the identity of the party being penalized for its registration deficiencies is clear. Section 68 provides that where a person becomes either the proprietor or exclusive licensee and fails to record that transaction, "*the court . . . shall not award him costs or expenses*" (emphasis added).

The clear wording of the section means that this sanction applies only to the party acquiring such legal interest in a patent who fails to record that particular transaction. In this case, the sanction clearly applied to the exclusive licensee L'Oréal UK but not to the patent owner, L'Oréal SA. Section 68 prevented recovery of L'Oréal UK's legal costs and expenses as proprietor of the exclusive license because it had indeed failed to register that license.

The position was different for L'Oréal SA as the patent owner, as it had always been the proprietor, and there was no recordable transaction that had not been properly registered.

But the wording of the section meant that the court nonetheless had to consider the practical effect on legal costs where *both* the patent proprietor and the exclusive licensee were the claimants. In principle, and as a matter of judicial discretion, both L'Oréal parties could be deprived of their entitlement to legal costs and expenses.

#### ■ Can litigants structure their inter-company relationships and their legal representation to avoid the statutory consequences?

The claimants L'Oréal SA and L'Oréal (UK) Limited are parent and affiliate companies in the L'Oréal Group.

L'Oréal argued that the effect of Section 68 was moot. As a matter of law, both L'Oréal parties were jointly and severally liable for the costs of the litigation. L'Oréal had structured its engagement with its lawyers so that L'Oréal SA was liable to pay their lawyers' fees, not the deficient affiliate. L'Oréal, therefore, argued that although under Section 68 L'Oréal UK could not recover its legal costs, as the winner of the litigation L'Oréal SA was entitled under the ordinary English costs-shifting rules to recover all of its costs in any event.

The judge had no truck with this argument. He noted that the claimants were parent and affiliate L'Oréal Group companies, and held that Section 68 would "have no bite" if the co-plaintiff patent owner could recover all the legal costs of the infringement action in circumstances where the section required the exclusive licensee to be deprived of its legal costs. It would defeat the statutory purpose if the L'Oréal plaintiffs could avoid the consequences of failing to register the exclusive license because of the particular contractual arrangements they had made in respect of their legal costs, by seeking to characterize all of those legal costs as being recoverable by the patent owner in any event.

The danger perceived by the judge — an experienced specialist patents judge — is that it is common for patent owners to grant exclusive licenses to other companies in the same group, and then for both to bring claims for infringement as claimants. If L'Oréal's argument was correct, it would be possible to deprive Section 68 of any bite in all such cases.

The judge specifically approved the Supreme Court's *obiter* rejection in *Schütz v. Werit* of an interpretation of Section 68 that would allow an unregistered licensee to avoid its consequences simply by registering and then starting the proceedings. He held that the same consequence would follow if the courts allowed the parent to recover costs that could not be recovered by the affiliate company as a result of failure to register the license. In his judgment, the court's discretionary power to award legal costs should be informed by, and should reflect, this statutory policy.

#### ■ Structuring the transaction to avoid the "recordal gap"

It is common practice to structure transactions so that the patent seller sells both the patent and the right to sue for prior infringements. Or, for exclusive licenses, the exclusive license will be granted coupled with the exclusive right to sue for prior infringements.

A variation of this tactic was tried in *L'Oréal v. RN Ventures*. It was argued that the exclusive license to L'Oréal UK was intended to operate as a grant of the right to bring proceedings for infringement that operated solely in favor of L'Oréal UK to the exclusion of L'Oréal SA.

The judge rejected this as a matter of contract interpretation. He held that the grant of an exclusive right to sue infringers merely confirmed the existing statutory position under Section 68 that grants exclusive licensees “the same right as the proprietor of a patent” to bring infringement proceedings.

It should also be noted that it is settled law that where a patent is assigned together with the assignor's right to sue for prior infringements, the assignee takes the assignor's title subject to any defects in that title. *LG Electronic Inc. v. NCR Financial Solutions Group Ltd* [2003] FSR 24.

The *L'Oréal v. RN Ventures* judgment makes it clear that if there is a recordal gap in that title, then that recordal gap is acquired by the assignee and can operate to prevent the assignee from recovering its full legal costs and expenses.

### ■ Calculating the percentage deduction

The general presumption in English litigation is that the loser pays the winner's legal costs to the extent that reflects the degree to which the winner has been successful. In patent cases, the court applies an issue-by-issue approach so that while it identifies the overall winner, it will offset issues where that winner lost.

The judge held that the correct approach where there is a recordal gap is that the winning plaintiff cannot recover its costs attributable to infringements pre-dating registration of the transaction document (be it an assignment or a license), but can recover its post-registration costs. He approved the dicta of Lord Neuberger in the Supreme Court in *Schütz v. Werit* that “Obviously in a case where there was a claim for pre- and post-registration relief, there would have to be an apportionment, and the apportionment would normally involve an element of rough justice. But that is a familiar state of affairs when it comes to costs.”

In this instance, the court analyzed the contours of the litigation as follows. The proportions of the infringements that took place before and after registration worked out at approximately 70 percent pre-registration and 30 percent post-registration. There was also the successful RCD claim that accounted for 20 percent of the legal costs, leaving 80 percent of costs attributable to the patent claim. Because RN Ventures had claimed that the patent was invalid and attempted to revoke it, some 30 percent of the costs of the patent claim were on the issue of validity. The judge held that that meant that 50

percent of the costs of the proceedings were attributable to patent infringement costs.

This led to the following result. As there were two claimants, the judge held that a 50/50 split in terms of costs between the two was appropriate, meaning that 25 percent of the overall costs were attributable to the costs of each. Because factually there was a 70/30 split between pre- and post-infringement costs, the appropriate Section 68 deduction was 17.5 percent.

This might be perceived as rough justice in the sense articulated by Lord Neuberger, but it is consistent with the standard approach of the English courts in costs assessments, as well as giving litigants certainty in approach for the future.

### Lessons to Be Learned

This section now has judicial teeth. The lesson for potential litigants is a simple one. They should always register their interests, and be alert to whether amendments to licenses (for example) amount to the grant of a fresh license that needs to be registered separately. This latter point was raised before the Supreme Court in *Schütz v. Werit*, but expressly not ruled upon because it had not been fully argued by the parties. The Patents Court in *L'Oréal v. RN Ventures* closes the use of supplemental agreements or other creative arrangements of any kind. Prudence dictates that the additional registration of such a license would be the correct course of action, not least because the Register is a register of transactions in patents, not of parties.

*L'Oréal v. RN Ventures* will also have an impact on due diligence exercises in corporate and commercial transactions. Care will need to be taken to identify any recordal gap. Attention should be paid not just to whether all relevant transactions, instruments, or events affecting patent rights have been properly registered, but also to whether or not there is any relevant infringement of the patent, given that this will trigger the adverse legal costs sanctions under Section 68.

Patent enforcement can be expensive, so if any recordal gap is identified, it should be dealt with appropriately by getting suitable representations and warranties that provide a proper indemnity for any loss in the reasonable costs that are lost because of the failure to register.

Patent owners and licensees should not be deterred from registering because of concerns that the world at large would know the terms of their commercial arrangements. The register only records the date of the license and the name of the licensee. Although the public has a right to inspect the register, those who do so have no right to see, or to be told of the terms of, any license.