No. 429PA13 TENTH JUDICIAL DISTRICT

SUPREME COURT OF NORTH CAROLINA

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ROBERT PAUL MORRIS,	)	
Plaintiff-Appellee,	)	
v.	)	From Wake County
	)	
SCENERA RESEARCH LLC and	)	
RYAN C. FRY,	)	
Defendants-Appellants	)	

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BRIEF OF AMICI QUALCOMM INCORPORATED, QUALCOMM TECHNOLOGIES, INCORPORATED, CISCO SYSTEMS, INC., MICROSOFT CORP., AND CREE, INC. IN SUPPORT OF DEFENDANTS-APPELLANTS SCENERA RESEARCH LLC AND RYAN C. FRY

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TO THE HONORABLE SUPREME COURT OF NORTH CAROLINA:

Pursuant to this Court's order dated 19 December 2014, amici Qualcomm Incorporated, Qualcomm Technologies, Incorporated (together "Qualcomm"), Cisco Systems, Inc. ("Cisco"), Microsoft Corp. ("Microsoft"), and Cree, Inc. ("Cree") (collectively "Amici") hereby submit this joint amicus curiae brief in support of Defendants-Appellants Scenera Research LLC and Ryan C. Fry (together, "Scenera") regarding the "hired-to-invent" doctrine and the availability of rescission of patent assignments as a remedy for breach of an employment agreement.

I. Amici's Interest

Amici are technology companies whose success depends in large part upon their research and development ("R&D") efforts and their ability to protect their R&D investment with clearly defined intellectual property ("IP") rights.

Qualcomm is a global wireless communications technology company that has developed patented technology essential to the wireless communications standards implemented by cell phones, tablets, and other mobile devices. Qualcomm licenses its patents to well over 260 manufacturers of such devices, and it also develops and sells wireless integrated circuits (known as "chips") for use in mobile wireless communications. In fiscal year 2014, the company invested nearly $5.5 billion in R&D.[1] It currently employs approximately 680 people in North Carolina.

Cisco designs, manufactures, and sells Internet-Protocol-based networking and other products related to the communications and information technology

[1] Qualcomm Incorporated, Annual Report (Form 10-K) at 10 (Nov. 5, 2014).

industry and provides services associated with these products and their use. Cisco owns over 12,000 patents, spends over $6 billion dollars per year on R&D,[2] and employs roughly 5,000 employees in North Carolina.

Microsoft develops, licenses, and markets a wide array of cloud-based services, software products, and hardware devices, including Microsoft Windows and Office Suites, the XBox 360 gaming console, the Surface tablet, and the Bing search engine. In fiscal year 2014, the company invested $11.4 billion[3] and employed over 39,000 people in product R&D. It employs roughly 1,200 people in North Carolina.

Cree, which began in North Carolina 28 years ago and still maintains its global headquarters in Durham, is a market-leading innovator of lighting-class light-emitting diodes ("LEDs"), LED lighting, and semiconductor products for power and radio frequency ("RF") applications. Cree's product families include LED fixtures and bulbs, blue and green LED chips, high-brightness LEDs, lighting-class power LEDs, power-switching devices, and RF devices. For its fiscal year ended 29 June 2014, Cree invested $181 million in research and development. It reported revenues of approximately $1.65 billion from its global

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[2] Cisco Systems, Inc., Annual Report (Form 10-K) at 12 (Sept. 9, 2014).

[3] Microsoft Corp., Annual Report (Form 10-K) at 10 (July 31, 2014).

operations, derived from the licensing of, and sale of products based on, its proprietary technology.[4] Cree employs over 2,500 workers in North Carolina, including the vast majority of the company's research scientists and engineers.

Although they take no position on the underlying facts of this case, Amici's experience with developing patented technology, pursuing patent licensing arrangements, and selling products that incorporate patented technology renders them well situated to highlight the disturbing legal ramifications of the decision below for innovation-based industries and North Carolina's economy.

II. Issues Presented

i. Whether the Court of Appeals misapplied this Court's holding in *Speck v. N.C. Dairy Found., Inc.*, 311 N.C. 679, 686-87, 319 S.E.2d 139, 143-44 (1984), when it granted a hired-to-invent employee an ownership right in his employer's patents as a remedy for a purported breach of an employment agreement.

ii. Whether the Court of Appeals erred when it approved the rescission of patent assignments as a remedy for a purported breach of an employment agreement notwithstanding the adequacy of damages at law, the impossibility of

[4] Cree, Inc., Annual Report (Form 10-K) at 6, 29 (Aug. 26, 2014).

returning the parties to the status quo *ex ante*, and the extensive reliance interests that would be upset by such a remedy.

III. Argument

A. The Court of Appeals' Decision Undermines Established Legal Principles That Are Critical to North Carolina's Innovation-Based Industries.

The Court of Appeals erred in two respects. *First*, it significantly undermined the well-established "hired-to-invent" rule that is critical to businesses in innovative industries. The rule provides that when an employee is hired for purposes that include inventing, his or her inventions and associated patent rights are, without further action, the property of the employer, absent an express agreement to the contrary. *See Speck*, 311 N.C. at 686-87, 319 S.E.2d at 143-144. The Court of Appeals wrongly added a new requirement for the "hired-to-invent" rule to apply. It made the employer's ownership of patents depend not only on the terms of the inventor's employment arrangement, but also on the parties' subsequent performance of those terms. More precisely, it held that the rule should not apply if the employer materially breaches its obligations, such as by failing to pay amounts owed to the employee. And it made this new requirement a continuing one, such that a breach by the employer long after the invention was developed or patented could have the effect of changing patent ownership. This was legal error. An employer's ownership of patents developed by its employees depends upon the parties' relationship at the time of the invention; it does not change based on the outcome of subsequent employment disputes. Such a rule would substantially undermine the certainty necessary in innovation-based industries.

Second, the Court of Appeals granted the employee an unprecedented rescission remedy. Ordinarily, when an employer fails to pay an employee, the employee's remedy is a monetary award. The decision below, however, authorized the employee to rescind patent assignments he made in favor of his employer and take ownership of patents on inventions he had explicitly assigned to his employer. This too was legal error. Amici have found no other case where, absent an express contractual provision, a court has allowed an employee-inventor to reclaim an assigned patent from his or her employer as a remedy for breach of an employment agreement.

Together, the two errors in the Court of Appeals' decision have the potential to transform every routine employment dispute with an inventor into a dispute over patent ownership. The decision below could subject employers, as well as their customers, to patent infringement claims brought by disaffected employees. Such a rule also would undermine countless licensing arrangements and the clarity around patent ownership upon which businesses in innovation-based industries depend.

B. The Decision Below Destabilizes Patent Licensing Arrangements and Discourages Innovation in North Carolina.

The decision below injects uncertainty into a legal and business environment that depends upon clarity. Amici, and other innovation-led businesses, invest in R&D in reliance on their ability to obtain clear legal ownership of any patentable inventions developed by their engineers, programmers, and scientists. In reliance on such patents, these businesses then invest substantial resources in negotiating patent licensing agreements and in commercializing products that incorporate patented technology. For example, employers invest in the work necessary to bring an invention from the idea stage to a functional product, they invest in developing demand through advertising and marketing, they invest in obtaining any needed government approvals, and they often combine one patent with many other patents to create a final product with a prospect for commercial success. By granting an inventor-employee a rescission right, the decision below undermines these significant reliance interests. It could allow an employee to bring a patent infringement action *after* the employer has already invested significant resources—perhaps amounting to tens or hundreds of millions of dollars—to develop and market a product incorporating a patent that the employee later claws back through rescission.

It is not only the employer who relies upon owning the patents obtained through the efforts of employees hired and compensated to invent. Firms that transact with the employer also rely on the fact that the company's ownership of patents will not later be unwound. For example, Amici grant licensees the right to use a portfolio of patent rights. Those licensees rely on Amici's actually having the legal authority to grant the rights they license.

There is also industry-wide reliance. Qualcomm, for example, and others in its industry frequently participate in standards-setting organizations (or "SSOs"), such as the European Telecommunications Standards Institute or the Institute of Electrical and Electronics Engineers. These SSOs, which are common in many high-tech industries, establish technical standards that firms in the industry follow to ensure compatibility among products.[5] In setting these technical standards, SSO members consider whether any necessary patents will be available to firms that wish to implement the standard. Under these SSOs' rules, firms like Qualcomm

[5] For example, such standards permit someone using an Apple phone on the AT&T network to communicate with someone using a Samsung phone on the Verizon network. Likewise, such standards enable the user of a laptop to access a WiFi network at home, at the office or at a café, regardless of which company manufactured the wireless router being used at that location.

may be obligated to disclose their patents that may be essential to proposed standards. Participating firms also generally commit that, if a standard using their patents is adopted, they will license those patents on fair, reasonable, and nondiscriminatory terms. SSOs take these representations into account in determining whether to include a particular technology in a standard, and firms implementing the standard then invest tremendous resources in developing and marketing products that comply with the standards. Allowing rescission of the assignment of standards-essential patents risks undermining these representations, subjecting the SSO and any entity that practices the standard to considerable risks.

Vast sums are expended in reliance on well-established rules as to the ownership of patents. The clear default rule created by the "hired-to-invent" doctrine is a critical component of the landscape on which companies license patents and develop products. The decision below changes this landscape by making patent ownership depend upon unpredictable developments in innumerable individual employment relationships. The rescission remedy allowed by the Court of Appeals exponentially compounds the problem. Otherwise routine employment disputes might be transformed into "bet-the-company" litigation over tremendously valuable patent rights with substantial implications for third-party customers, licensees, and, potentially, for every company practicing a technical standard that includes the patents at issue.

Even the *potential* for rescission claims and the possibility that significant patents could be lost would make it virtually impossible for patent holders such as Amici to offer their licensees the legal certainty fundamental to patent license agreements. This would erode the value of otherwise significant patent assets. Moreover, purchasers of manufactured products, such as Qualcomm's chips, would not be willing to pay fair value for a product that might be subject to future patent infringement claims from the employees who designed the products.

It is no answer to say that companies can avoid this problem simply by entering into clear written agreements regarding patent ownership. The fluid reality of innovation and the dynamics of start-up businesses may often entail employment arrangements that are not governed by written contracts or that have some ambiguity and imprecision. And even larger companies with written employment agreements may become exposed to these security-of-title issues when they acquire a smaller company, license a smaller company's patents, or purchase a smaller company's products.

A default rule is necessary, and the "hired-to-invent" doctrine articulated in *Speck* properly makes employer ownership the default when it is an employee's job to invent for the company, so that (absent agreement to the contrary) employers may safely invest in bringing to market the innovations they have hired the employee to develop.

In sum, the decision of the Court of Appeals creates uncertainty in a marketplace that requires clarity of title. Ultimately, the decision would deter companies that develop IP assets from establishing a presence in North Carolina.

C. The Decision Below Contravenes this Court's Precedent Defining the "Hired-to-Invent" Rule.

When an employer hires employees to create a product or products for the employer, the resulting creations belong by default to the employer. The "hired-to-invent" doctrine does nothing more than apply this commonsense principle to the area of patent rights. The rule in North Carolina—and the other states that have considered the issue—is well established:

> It matters not in what capacity the employee may originally have been hired, if he be set to experimenting with the view of making an invention, and accepts pay for such work, it is his duty to disclose to his employer what he discovers in making the experiments, and what he accomplishes by the experiments belongs to the employer.

Speck, 311 N.C. at 687, 319 S.E.2d at 144 (quoting *Houghton v. United States*, 23 F.2d 386, 390 (4th Cir. 1928)). "The fruit of the labor of one who is hired to invent, accomplish a prescribed result, or aid in the development of products belongs to the employer absent a written contract to assign." *Speck*, 311 N.C. at 686, 319 S.E.2d at 143.

Nothing in this categorical rule makes an employer's patent ownership in any way contingent. Rather, the rule operates as a simple inquiry into whether an employee's duties include invention. If so, the "fruit of [his] labor . . . belongs to the employer absent a written contract to assign," and the employee, who invents as an agent of his employer, "never possesse[s] any interest cognizable in equity or at law" to the resulting invention. 311 N.C. at 686-87, 319 S.E.2d at 143-44. This principle operates both as a default rule of contract, and as a "fiduciary duty owed" by hired-to-invent employees to "the employer who had employed them to develop the process." *Id*.

The Court of Appeals decision wrongly engrafts upon this simple test an additional inquiry into the parties' *subsequent* performance. In the Court of Appeals' view, the application of the "hired-to-invent" rule—and thus ownership of the inventions themselves—depends on whether the employee receives the full extent of his promised compensation. Such a rule would run directly contrary to *Speck*'s clear holding that a new invention "belong[s] to the [employer] immediately upon its discovery" by the employee. 311 N.C. at 687, 319 S.E.2d at

144. It would have the effect of holding the question of ownership in suspense until judicial remedies for contract or employment disputes have expired.

The Court of Appeals attempted to ground its holding on language in *Speck* that states that the "hired-to-invent" rule applies when an employee "be set to experimenting with the view of making an invention, *and accepts pay* for such work." 311 N.C. at 687, 319 S.E.2d at 144 (emphasis added). The Court of Appeals interpreted that language to require an assessment of whether the employee actually *received* the pay that he had agreed to accept for doing his job. On its face, however, the quoted language refers to whether the employee "accept[ed] pay" as a term of employment, not whether the promised compensation was paid. That is why *Speck* states that "[t]he respective rights of employer and employee in an invention or discovery by the latter arise from the *contract* of employment." 311 N.C. at 686, 319 S.E.2d at 143 (emphasis added). So long as the *terms* of the employment relationship include "accept[ance of] pay for such work," then any resulting invention belongs to the employer.

The rationale for this rule is compelling, particularly in the context of an innovation-based global marketplace. Research and development in the field of information technology is capital- and risk-intensive. Businesses assume the risk that many avenues of inquiry will not bear fruit, in exchange for clear ownership of those discoveries that do. As this Court has said, the hired-to-invent rule fairly allocates risk between employer and employee: "If the employee fails to reach his goal the loss falls upon the employer, but if he succeeds in accomplishing the prescribed result then the invention belongs to the employer . . . ." 311 N.C. at 686, 319 S.E.2d at 143 (quoting *Nat'l Dev. Co. v. Gray*, 316 Mass. 240, 247, 55 N.E.2d 783, 787 (1944)).

The holding below upsets that balance. It forces the employer to continue to bear the loss for failed efforts but subjects its ownership of successful inventions to the risk of being claimed by dissatisfied employees. Moreover, the inventor-employee stands to enjoy a windfall for which he had not, at the outset, negotiated—and could never, even if sought, have obtained. No employer would agree to give an employee the right to take back a patent after the employer had invested in building a business based on its ownership of the patent. The ruling below effectively puts employers to an impractical choice: either (a) invest in patents that an employee could later claw back through the rescission remedy permitted by the Court of Appeals, or (b) suspend exploitation of that technology until they can be assured no employment disputes will arise.

The possibility that employees might come forward after patents have been granted, seeking ownership on the basis of alleged promises, dramatically disrupts an IP economy for which clarity of ownership rights is vital. This Court should correct the decision below and reaffirm its holding in *Speck* that employers' patent ownership vests with the employer *ab initio* and that it is not contingent upon the employer's performance.[6] We have found no other jurisdiction that has held, under these circumstances, that an employer's title to patents is subject to repossession by hired-to-invent employees on the basis of a subsequent failure of performance.[7]

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[6] *See also Oliver v. Lockport Mills, Inc.*, 6 Misc. 2d 356, 363-64, 163 N.Y.S.2d 317, 324-25 (N.Y. Sup. Ct. 1956) (where plaintiff sued for rescission of patent assignments due to purported failure to pay "additional or extra compensation," the court found "no possible basis for a rescission of the assignments of the patents; the assignments merely formalized the existing situation and vested the legal ownership of the patents in the company which was already entitled to the equitable ownership").

[7] Indeed, numerous decisions stand for the proposition that the application of the "hired-to-invent" rule hinges on the existence and terms of an employer-employee relationship, without reference to the employer's subsequent performance of individual contract terms. *See, e.g.*, *Gray*, 316 Mass. at 247, 55 N.E.2d at 787 ("If the employer contemplates the discovery of an invention and enters into a contract with another to endeavor to make the invention for the benefit of the employer and the contract, . . . then the employee is under an implied obligation to assign any patents acquired by him for said inventions to his employer."); *Yeshiva Univ. v. Greenberg*, 255 A.D.2d 576, 578, 681 N.Y.S.2d 71, 72 (N.Y. App. Div. 1998) (the "prima facie case" for application of the rule requires a showing that the employee-inventor's work responsibilities "were sufficiently directed as to area, method, and intended result," without making reference to the adequacy of employer's subsequent performance); *White's Elecs., Inc. v. Teknetics, Inc.*, 67 Or. App. 63, 67, 677 P.2d 68, 70-71 (Or. Ct. App. 1984) (where employee's "duties were to invent and develop improvements in [employer's] product line," the employee "had a duty to assign all inventions arising during his employment"); *Teets v. Chromalloy Gas Turbine Corp.*, 83 F.3d 403, 407 (Fed. Cir. 1996) (to apply the rule, "a court must examine the

D. The Holding Below Conflicts with Black Letter Contract Law on Rescission.

The rescission remedy advocated by the Appellee and authorized by the Court of Appeals departs from settled precedent and is especially inappropriate where assignments of employee patent rights are concerned.

First, as the Court of Appeals acknowledged, rescission is traditionally available only "if the remedy at law will not be full and adequate." *Morris v. Scenera Research LLC*, 747 S.E.2d 362, 381 (N.C. App. 2013). Accordingly, "[r]escission as a remedy for breach of contract is not available against a defendant whose defaulted obligation is exclusively an obligation to pay money." Restatement (Third) of Restitution and Unjust Enrichment § 37 (2011); Corbin on Contracts § 61.1 (2012) ("It is generally agreed that once a performance has created a debt, restitution is unavailable."). An award of monetary damages will virtually always be adequate to compensate an employee in disputes over employment compensation.

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employment relationship"); 19 Williston on Contracts § 54:20 (4th ed.) ("If an employee's job duties include the responsibility for inventing or for solving a particular problem that requires invention, any invention created by that employee during the performance of those responsibilities belongs to the employer, since, under these circumstances, the employee has produced only what he or she was employed to produce . . . ."); 5 Pat. L. Fundamentals § 17:23 (2d ed.) ("[A]n employer that hires or engages someone for consideration to devote his or her time to developing a product or process becomes the owner of that property which is developed and of any invention incident to it.").

Second, rescission as a remedy is generally not available where it may be used by a plaintiff to improve upon the terms of the original bargain. *See generally* Restatement (Third) of Restitution and Unjust Enrichment § 54 (2011); *id*. § 37 cmt. a(2) (rescission not appropriate where it would "alter the terms of the underlying transaction in the plaintiff's favor, giving the seller (in effect) the benefit of security arrangements that are ordinarily the subject of negotiation and separately paid for").

Innovative companies make substantial investments to commercialize new patented technologies. In addition to the large investment required to create and perfect new technology, they engage in marketing and advertising for the new technology, they develop and sell products using the patented technology, they develop and sell complementary products, or they license the patent either individually or as part of a broader portfolio. Permitting an employee to rescind a patent assignment after the employer has made such investments would grant the employee a windfall in the form of an option right: either for the monetary value of the allegedly breached obligation or for title to the relevant patent after the *employer* made the investments to "bring it to market." That would materially alter the transaction in the employee's favor, granting the employee a security arrangement for which the employee never negotiated and which the employee could not have obtained.

Finally, and of special relevance in the patent context, rescission is inappropriate where it would upset substantial reliance interests by the defendant or third parties. "The remedy of rescission is not available to plaintiffs[where] the parties cannot be placed in statu quo." *Tarlton v. Keith*, 250 N.C. 298, 306, 108 S.E.2d 621, 626 (1959); *see also* Restatement (Third) of Restitution and Unjust Enrichment § 54(3) (2011). Moreover, "the remedy will . . . be denied" in instances where it would "prejudice intervening rights of innocent third parties." *Id*. § 54(4)(c).

As described in Part III.B, innovation-based companies invest significant resources in R&D, and they enter into extensive contractual arrangements in reliance upon patent ownership rights. The decision of the Court of Appeals would upset the ecosystem of extensive reliance interests at stake in the innovation marketplace and materially prejudice the "intervening rights of innocent third parties," such as licensees, customers and standards-setting organizations. Licensees and business customers cannot *ex ante* engage in due diligence to determine whether a patent holder will be subjected to future breach-of-contract claims by an employee. They must take their licenses and make their investments on the basis of the patent holder's representations as to title. It would be entirely inequitable to expose these innocent third parties to potential claims for patent infringement as a result of a counterparty's private employment dispute.

Appellee maintains that a rescission remedy should be available even where substantial reliance interests prohibit a return to the status quo *ex ante* and in spite of the fact that a wholly adequate damages remedy exists.[8] He argues, based on *Wilson v. Wilson*, 261 N.C. 40, 134 S.E.2d 240 (1964), that the courts must afford an aggrieved employee the right to reject a legally adequate damages remedy in favor of a flawed rescissory one. This Court should not extend *Wilson*, a 1964 case concerning an action for alimony pendente lite (a dispute inherently limited in scope to the parties directly involved), to control the complex ecosystem of patent rights undergirding North Carolina's innovation economy in the year 2015.

In *Wilson*, this Court addressed the straightforward question of whether a spouse who had waived her right to alimony through a separation agreement could nonetheless seek alimony in the wake of her husband's material breach of that agreement. The Court cited a line of cases standing for the proposition that "[t]he existence of a separation agreement is not a bar to an award of alimony pendente

[8] *See* Plaintiff's Response and Motion to Strike Motion by Qualcomm Incorporated, Qualcomm Technologies, Incorporated, Cisco Systems, Inc., Microsoft Corp., and Cree, Inc. Denominated 'Motion for Leave to File Amicus Brief' dated November 11, 2013, at 10, 11-12.

lite," and it permitted the wife to choose between a suit for contractual damages and an action for alimony. 261 N.C. at 45-47, 134 S.E.2d at 244-45. In so doing, it clarified that the wife "is *only entitled* to such an award as would be proper *if no contract had been signed*." 261 N.C. at 47, 134 S.E.2d at 245 (emphases added). As such, the case concerned the straightforward distribution of tangible assets and property between two married individuals, and the authorized remedy was explicitly contingent upon a return to the status quo *ex ante*. The decision did *not* contemplate an application of the remedy to the complex ecosystem of reliance interests and billions of dollars of investments at stake in today's innovation economy. To borrow such a precedent from the domestic relations context and apply it mechanically to the entirely distinct areas of employment and patent law would not be reasonable.

IV. Conclusion

North Carolina is currently a leading state for R&D-based enterprises. Continued success requires a legal environment in which businesses of all sizes can rely on clear rules regarding ownership of the patent rights from innovations developed by their employees.

The undersigned Amici respectfully pray that this Court reverse the Court of Appeals' decision that misapplied the "hired-to-invent" doctrine and permitted the Appellee to elect a rescission remedy in place of legal damages.

Respectfully submitted this 19th day of February, 2015.

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