

Patent Licensing After *MedImmune*

Jonathan M. Rotter, Esquire, & Paul M. Gelb, Esquire
Kaye Scholer LLP
Los Angeles, California

I. Introduction

The U.S. Supreme Court's first patent decision of this term, *MedImmune, Inc. v. Genentech, Inc.*, 127 S. Ct. 764 (2007), places patent licensors in a predicament: licensees may prosecute a declaratory judgment action to challenge the licensed patent and simultaneously maintain good standing under the patent license agreement, thereby preventing a countersuit for infringement by the licensor.

MedImmune v. Genentech involved a patent license agreement whereby MedImmune licensed an existing patent and a pending patent from Genentech. The license agreement provided that MedImmune's royalty payments would be due on the pending patent once the patent was granted. After the pending patent was granted, Genentech sent MedImmune a letter requesting the license payments. MedImmune asserted the patent was invalid but paid royalties under protest and brought a declaratory judgment action to invalidate the patent. The Federal Circuit, following its then-governing precedent, held that the license prevented MedImmune from establishing an Article III case or controversy to challenge the patent validity. Thus, no declaratory judgment action could lie.

The Supreme Court reversed and held that a patent licensee may seek to invalidate a patent while simultaneously maintaining its good standing under the license agreement. This creates a problem for patent licensors; it allows the licensee to attack the patent, but prevents the licensor from counterclaiming for infringement. Such a counterclaim is powerful because the patent holder can obtain an injunction and treble damages. By allowing a challenge to a patent without the usual threat of an infringement suit, *MedImmune* encourages licensees to establish themselves in the market by licensing a patent and then challenging the validity of the very patent they have licensed. Two licensing terms, however, might be used to better protect patent licensors after *MedImmune*.

II. Contractual Promise Not to Seek a Finding of Invalidity

The first licensing term that potentially will protect patent holders is a contract term prohibiting the licensee from seeking to invalidate the patent during the period of the license. The majority in *MedImmune* specifically noted the absence of such a term from the license at issue: "Promising to pay royalties on patents that have not been held invalid does not amount to a promise *not to seek* a holding of their invalidity." The Court's formulation suggests that prohibiting the licensee from seeking to invalidate the patent may be a viable strategy for protecting patent licensors.

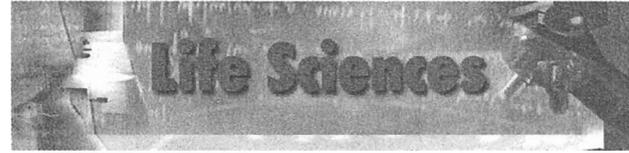
Yet, the answer may not be so simple because *Lear, Inc. v. Adkins*, 395 U.S. 653, 670 (1969), potentially invalidates such contract terms.

Lear licensed one of Adkins' patent-pending inventions but, before the patent issued, decided that the invention was not novel and ceased payment of royalties. When the patent issued, Adkins sued for breach of the license and *Lear* raised the patent invalidity defense. The California state courts held that the license estopped *Lear* from arguing invalidity. The U.S. Supreme Court reversed.

In doing so, *Lear* criticized prior Supreme Court opinions that prevented patent challenges "without citing or considering *Pope's* powerful argument," referring to *Pope Mfg. Co. v. Gormully*, 144 U.S. 224, 235 (1892). *Pope Mfg.* involved a broad patent license that prohibited any challenge to the validity of the patents. In *Pope Mfg.*, the Court disapproved of such restrictions on the licensee's capacity to challenge the patents and held, "It is as important to the public that competition should not be repressed by worthless patents, as that the patentee of a really valuable invention should be protected in his monopoly and it is a serious question whether public policy permits a man to barter away beforehand his right to defend against unjust actions or classes of actions, though, in an individual case, he may doubtless assent that a judgment be rendered against him . . ." This *Lear/Pope* liberalizing of patent challenges was also noted in *United States v. Glaxo Group Ltd.*, 410 U.S. 52, 57 (1973), in which the Court noted that cases allowing attacks on patent validity in the antitrust context were "much in the tradition of *Pope Mfg.*," which had been recently echoed by *Lear*.

However, the Federal Circuit in *Flex-Foot, Inc., v. CRP, Inc.*, 238 F.3d 1362, 1368 (Fed. Cir. 2001), specifically considered the possibility that *Lear* may prevent settlement agreements that preclude further contest of patent validity, and found that *Lear* did not prohibit a "waiver of future challenges" clause in a settlement agreement. The Federal Circuit in *Flex-Foot* specifically distinguished *Lear* by noting that no contractual provision prohibiting a validity challenge existed in *Lear*; the only question there was one of licensee estoppel.

Furthermore, the hostility to restrictions on patent challenges expressed in *Lear* may not extend to a reasonable contractual provision. The precedent relied upon by *Lear-Pope Mfg.*—is distinguishable because the contract was particularly egregious covering numerous patented and unpatented inventions, both during and after the patent term. This practice categorically was deemed patent misuse in *Brulotte v. Thys Co.*, 379 U.S. 29 (1964). And, more significantly, the Court in *MedImmune* impliedly endorsed a contract term that will prohibit licensees from seeking to invalidate the patent during the license term. While *Lear* does articulate some hostility to restrictions on the ability to challenge a patent, later statements by the Federal Circuit in *Flex-Foot* and the Supreme



Court itself in *MedImmune* point to the possible viability of a reasonable provision.

III. Contractual Provision Granting the Licensor the Power to Terminate

A second way for a patent licensor to overcome the licensee advantage allowed by *MedImmune* is a provision stating that the licensee's seeking to invalidate the patent constitutes grounds for the licensor to terminate the license agreement. While this will not prevent a licensee from seeking to invalidate a patent, it imposes a much higher price: the licensor then may countersue for infringement and either obtain an immediate injunction or ultimately collect treble damages. The advantage to the licensee is that such a provision circumvents the problem confronted by Genentech when *MedImmune* sued for declaratory relief but continued paying royalties. A terminating provision would put the licensee in the same position as a *Lear* protected patent challenger; while the licensee does not have to continue to pay royalties, it can be liable for infringement if it continues to sell products covered by the patent.

Even this arrangement, in theory, could run afoul of *Lear*'s rejection of licensee estoppel. Yet, as *MedImmune* held: "A licensee cannot invoke the protection of the *Lear* doctrine until it (i) actually ceases payment of royalties, and (ii) provides notice to the licensor that the reason for ceasing payment of royalties is because it has deemed the relevant claims to be invalid" (citing *Studiengesellschaft Kohle, M. B. H. v. Shell Oil Co.*, 112 F. 3d 1561, 1568 (Fed. Cir. 1997)). Moreover, *MedImmune* "express[ed] no opinion on whether a nonrepudiating licensee is similarly relieved of its contract obligation during a successful challenge to a patent's validity—that is, on the applicability of licensee estoppel under [the *MedImmune*] circumstances."

It is possible that when presented with the appropriate case, the Court will decide to extend *Lear* to cases in which the licensee does not repudiate the license. But even if the Court extended *Lear* to cover nonrepudiating licensees (*i.e.*, to hold that license payments during the successful challenge must be refunded), that would not necessarily mean that the patent holder could not countersue for infringement and collect infringement damages if the patent were upheld. Thus, neither *Lear* nor its possible extension as discussed in *MedImmune* would prevent a terminating provision. It is possible, however, that future enlargement of *Lear*'s prohibition on certain obstacles to patent challenges could eventually prevent a terminating provision.

There are several other possible contractual responses to *MedImmune*. A licensor could charge more of the license fee as an up-front lump-sum payment so that there will be less incentive to invalidate the patent. Many licensing businesses, however, do not have the resources to make an up-front payment that would cover the license for the term of the patent. Additionally, courts may find that an amortized portion of the lump-sum is recoverable should the patent be invalidated.

Another option would be a liquidated damages provision effective upon the licensee's seeking a finding of invalidity. But if provisions prohibiting licensees from challenging licensed patents is disapproved by the courts, a penalty for seeking to invalidate may be rejected as well. Finally, licensors could stop licensing, but unless they can exploit the patent in-house to a degree equal to license payments, this will not be economically advantageous.

Among the various options, the terminating provision comes close to returning licensors to the position they held prior to the *MedImmune* decision. Licensees will be less likely to attack the patent if it will trigger an infringement countersuit, which would jeopardize their ongoing sales through the possibility of an injunction, and their accrued profits through the possibility of treble damages. Licensors may prefer the no-challenge provision, but if it is unavailable, a terminating provision may be the next best alternative.

Thanks to the
Life Sciences Practice
Group's
Board Liaison

Kristen Rosati
Coppersmith Gordon
Schermer &
Brockelman PLC
Phoenix, Arizona