

Recent court decisions have created uncertainty for patent licensors. **Marc Morley** and **Brenden Gingrich** of **Knobbe Martens Olson & Bear** explain how patent owners could improve their weakened position

Sue first, negotiate later

Three recent court cases have shifted the balance of power between patent owners and licensees. These cases impact all stages of that relationship: during negotiations, during the term of a licence agreement, and after successfully litigating against an infringer.

First, the Federal Circuit's holding in *SanDisk v STMicroelectronics* (— F3d — (2007)) raises the alarming prospect that patentees open themselves up to suit under the Declaratory Judgment Act for little more than offering a licence under their patents. (This Act permits a potentially infringing party that has not been sued by the patentee to preemptively file a declaratory judgment suit in a favourable venue to determine if the patent is valid and/or infringed.) Next, in *MedImmune v Genentech* (127 SCt 764 (2007)) the Supreme Court held that a patent licensee could sue to have the licensed patent invalidated while remaining a licensee in good standing. As a result, the licensee no longer has to choose between keeping the licence and challenging the licensed patent. Lastly, in *eBay v MercExchange* (126 SCt 1837 (2006)) the Supreme Court undermined the longstanding rule that if you win your suit against an infringer, you can make them stop infringing. This removes a powerful tool that was previously available to patentees – the threat of a permanent injunction against any infringing activity.

So what can patent owners do in this new legal environment? One possible solution is to sue first, and negotiate later. Under current law, filing suit first provides opportunities for avoiding undesirable venues, more flexibility in negotiating licensing terms in the context of a settlement, and the possibility of obtaining the right to permanently enjoin future infringing behaviour. Although this is obviously not a suitable strategy in every case, it does permit patent owners to shift the balance of power back in their favour.

Uncertainty during negotiations – the *SanDisk* decision

Before the Court's *SanDisk* decision, a potential infringer could challenge a patent through declaratory judgment (DJ) only by satisfying a two-part test: (1) did the patentee's conduct create a "reasonable apprehension" that the infringer faced an infringement suit; and (2) did the infringer's conduct show that steps had been taken towards infringing activity. Under this standard, a patentee's mere offer to licence would not expose the patentee to a potential lawsuit. This

was true when licence negotiations were ongoing, even if a potential licensee's allegedly infringing products had been identified. The Court in *SanDisk* refers to this as a "safe haven...for patentees to offer licences without opening themselves up to expensive litigation".

This safe haven has now been lost. In the *MedImmune* case, the Supreme Court tossed out the Federal Circuit's reasonable apprehension test. As a result, the Federal Circuit has now announced a new standard:

"[W]here a patentee asserts rights under a patent based on certain identified ongoing or planned activity of another party, and where that party contends that it has a right to engage in the accused activity without license, ... the party need not risk suit for infringement by engaging in the identified activity before seeking a declaration of its legal rights."

So what does this new standard mean for a patent owner who wishes to approach a potential licensee? In a concurring opinion, Judge Bryson gave a rather alarming assessment of the practical effect of this new test:

"[I]t would appear that under the court's [new] standard virtually any invitation to take a paid license relating to the prospective licensee's activities would give rise to [grounds for a DJ lawsuit] if the prospective licensee elects to assert that its conduct does not fall within the scope of the patent."

Marc Morley



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Judge Bryson concludes by stating that this new rule “will effect a sweeping change in our law regarding declaratory judgment jurisdiction”.

In light of this standard, a patentee must now carefully consider how it approaches a prospective licensee. In appropriate situations, suing first, and negotiating later, might be a solution.

Uncertainty during the licence term - the *MedImmune* decision

Even after a licence is in place, a patentee is not safe from a challenge to the validity of a patent by its licensee. Under the

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Supreme Court’s *Lear v Adkins* decision, a licensee that repudiates the licence cannot be prevented from suing to invalidate the patent, even if the licence purports to expressly prohibit such a challenge. Before the *MedImmune* decision, a licensee in good standing could not unilaterally challenge the validity of the patent because there was no reasonable apprehension of suit – the licensor could not sue the licensee for infringement with the licence still in force. A licensee had to decide if challenging the patent was worth giving up the licence. If the licensee lost the challenge, and the patent was found valid and infringed, the former licensee faced damages for wilful infringement and a nearly automatic permanent injunction if a new licence could not be negotiated.

In *MedImmune*, the licensee filed a DJ lawsuit asserting that its products were not covered by the licensed patent, that the patent was invalid or unenforceable, and that therefore no royalties were due, while continuing to pay royalties “under protest and with reservation of all of [its] rights”. Following precedent, the lower courts dismissed the lawsuit because the pre-*SanDisk* test for a permissible DJ suit had not been met – there was no reasonable apprehension of suit because of the licence.

The Supreme Court scrapped the reasonable apprehension test relied on by the lower courts, and held that a licensee does not need to stop making payments before filing suit. The Court reasoned that there was a real and immediate dispute as to whether the licensee’s products were covered by the licensed patent, and whether the patent was valid. The fact that the licensee did not want to risk an infringement lawsuit and damages for wilful infringement did not change the fact that there was a dispute. There was no reason to deny the licensee the ability to seek a declaratory judgment.

This decision alters the balance of power between licensor and licensee. A licensee no longer needs to choose between remaining a licensee protected from an infringement suit, and challenging the licensed patent – it can do both simultaneously. If the licensee wins the challenge, and the patent is found invalid or not infringed, it is likely that no future royalties will be due. If the licensee loses the challenge, it can proceed under the existing licence agreement as if the lawsuit never happened. Because a licence clause prohibiting a licensee in good standing from challenging the validity of a licensed patent is probably unenforceable, a licensor has few options to prevent

a licensee from challenging the licensed patent. One option, which we discuss below, is to sue first and then negotiate a licence in the context of a settlement agreement.

Uncertainty after a finding of infringement - the *eBay* decision

Before the *eBay* decision, patentees had a powerful bargaining tool: the threat of a permanent injunction against conduct adjudged to be infringing. Permanent injunctions were almost always issued after a patent was found valid and infringed. This meant that a potential licensee or alleged infringer faced the choice of taking a licence or being shut down if the patent were found valid and infringed. The rationale for this rule was that the patent right is a right to exclude, and such a right generally cannot be adequately protected by monetary damages.

In the *eBay* decision, the Supreme Court removed the certainty of an automatic injunction for patent infringement, stating that such a general rule was impermissible. Instead, the courts must

exercise their “equitable discretion” and apply a four-factor test. The plaintiff must demonstrate: (1) that it has suffered an irreparable injury; (2) that remedies available at law, such as monetary damages, are inadequate to compensate for that injury; (3) that, considering the balance of hardships between the plaintiff and defendant, an injunction is warranted; and (4) that the public interest would not be disserved by a permanent injunction. In two concurring opinions, the Justices appear divided over whether the historical practice of granting injunctions should continue, or if a new environment in which patents are merely used to generate licensing revenue requires a different outcome. Regardless, the days of the almost automatic permanent injunction appear to be over.

A new approach

In response to the changing landscape faced by patentees looking to licence their patents, a different approach deserves consideration. In the right circumstances, a promising strategy is to file an infringement lawsuit against a potential licensee before approaching that licensee. Under federal procedural rules, the lawsuit does not have to be served on the defendant for 120 days. If an agreement is reached, the licence can be part of a settlement agreement that results in dismissal of the lawsuit. Or the suit can be dismissed without prejudice at the end of the 120 days. This strategy has advantages that address the problems presented by each of the cases discussed above.

First, there is the problem raised by the *SanDisk* decision – the possibility that merely offering a licence will expose the patentee to a DJ lawsuit. By filing first, the patentee can preemptively choose a venue that is favourable to the patentee. Also, the ticking of the 120-day clock can bring a sense of urgency to the negotiations that might motivate a recalcitrant prospective licensee. Obviously, filing a lawsuit is not the best way to start what is meant to be a collegial relationship, so this solution will not be appropriate for every situation. But where the risk of a DJ action by the potential licensee is high, it might be a prudent approach.

Next, there is the problem presented by *MedImmune* – that a licensee need not repudiate a licence to challenge a patent, combined with the likelihood that a licence agreement not to challenge the validity of the patent is unenforceable. By suing first, and negotiating later, the licence agreement can be couched as a settlement agreement. This presents more flexi-

bility in creating terms favourable to the licensor that will be enforceable. For example, under current law, a settlement agreement that prohibits the licensee from any future challenge to the validity or infringement of the licensed patent is enforceable. Similarly, a settlement agreement that requires royalty payments even if the patent is later found to be invalid or unenforceable is also enforceable. These decisions are based on the Court's rationale that there is a strong public policy favouring the settlement of lawsuits, and that settlements must be enforceable to be an effective alternative to full litigation. It remains uncertain whether or not the settlement of a lawsuit that never moved beyond filing or service of the complaint enjoys the benefit of this strong public policy, but such an agreement will certainly be in a stronger position than a mere licence agreement.

Lastly, there is the problem raised by the *eBay* decision – permanent injunctions are no longer automatic following a finding of validity and infringement. The concurring opinion of Justice Kennedy raises the possibility that, if the licensor has licensed the patent to others and does not practice the patent itself, monetary damages – effectively a compulsory licence – are remedy enough. This argument would be particularly strong where a licence is already in place and the dispute centres on whether the licensee's new

product is covered by the patent. The licensor would have difficulty arguing irreparable harm or the insufficiency of monetary damages if the licensee previously licensed the same patent for similar goods.

By suing first, and licensing in the context of a settlement agreement, a patentee might be able to get the licensee to agree to a permanent injunction if any activity of the licensee is found to infringe a valid, licensed patent. This agreement could be drafted to survive termination of the licence. The strong public policy favouring the enforceability of settlement agreements improves the chances that the agreement would be upheld.

A licensee no longer needs to choose between remaining a licensee protected from an infringement suit, and challenging the licensed patent – it can do both

While obviously risky, in the right circumstances the sue-first-negotiate-later strategy offers potential advantages for patent owners. In light of recent decisions that have weakened the position of patent licensors, it is a strategy that deserves consideration.

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