

**LICENSORS BEWARE: YOUR PATENTS LICENSED IN THE UNITED STATES MAY BE AT RISK!!**

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A recent landmark U.S. Supreme Court case, *MedImmune v. Genentech* (Jan. 9, 2007) held that MedImmune could contest the validity and infringement of a patent (Cabilly II) under which it was licensed by bringing a Declaratory Judgment (D/J) action even though it was not at risk of being sued because it was continuing to pay royalties due under the license and was, therefore, not in breach. This decision changes established U.S. law.

Prior to this decision, IP lawyers in the U.S. had understood that a D/J action could only be brought by a party who was in imminent threat of being sued, which MedImmune was not. The law was that U.S. courts, state or federal, did not give “advisory opinions,” courts only accepted jurisdiction to decide “cases or controversies.”

The case had been appealed from the Court of Appeals for the Federal Circuit (CAFC) which had, under established law, rejected MedImmune’s action for lack of jurisdiction; i.e., there was no “case or controversy” to support a D/J action since MedImmune wasn’t at risk of being sued.

The Supreme Court reversed the CAFC stating: “Contrary to Respondent’s (Genentech) assertion that only a freestanding patent invalidity claim is at issue the record establishes that petitioner (MedImmune) has raised and preserved the contract claim that, because of patent invalidity, unenforceability, and non-infringement no royalties are owing under the license agreement.” (Emphasis added)

The details of the background and history of this particular patent, license and ensuing dispute may have motivated the court to reach its decision. The licensed product was 80% of MedImmune’s business and the Supreme Court stated that MedImmune should not have “to bet the farm” by breaching and being subject to a potential injunction before being entitled to bring a D/J action. But, the implications of this case on all existing and future patent licenses and license negotiations subject to jurisdiction in the United States are proving to be dramatic.

A proposed final draft of this article on March 25, 2007 stated optimism that future trial and appellate decisions would restrict the scope of the MedImmune case to factual situations which were closely parallel, i.e., coercion upon or real vulnerability of a D/J petitioner. However, such hope evaporated on March 26 when the CAFC left no doubt that the law prior to MedImmune which controlled D/J actions no longer existed!

In *Sandisk Corp. v ST Electronics* the CAFC reversed a dismissal of a D/J action by the Northern District Federal Court of California. Judge Bryson, of the CAFC, in a concurring opinion stated: "Under our law, as things stood before... MedImmune, the District Court's order... was correct. ST, the patentee, had offered a license to Sandisk, but had not threatened suit...." Further, Judge Bryson noted: "Footnote 11 of the MedImmune opinion... criticized this court's 'reasonable apprehension of suit' test for declaratory judgment jurisdiction." Judge Bryson also warns that this CAFC decision in *Sandisk* will permit D/J actions beyond the bounds of the facts of *Sandisk* or *MedImmune*.

The following comments relating to licensing situations are not necessarily aimed at intellectual property lawyers, but are primarily for business people, licensing executives and technologists, especially those associated with small businesses and universities who have daily activities pertaining to patent licenses and who must recognize that new or altered approaches may be necessary in view of the recent changes in U.S. law.

## OBSERVATIONS FOR LICENSEES

### A. Existing Licenses

1. For licensees under an existing license, if you have a genuine concern that a patent which is the subject of the license is invalid, unenforceable or your product, method, etc. do not infringe, then follow MedImmune's path and cast your D/J action as a contract dispute. Of course, if the projected cost of such litigation greatly exceeds the total royalties projected to be paid under the license, then a D/J action would be imprudent unless: 1) the circumstances surrounding the patent's defects, e.g., fraud before the USPTO, may entitle you to an award of attorney's fees and/or potential recovery of past paid royalties, or 2) your licensor is litigation averse and would, if faced with a D/J action, be amenable to "renegotiation," granting better license terms, such as a lower royalty or a reasonable paid-up license.

2. Licenses, however, which have resulted from settlement of litigation may be outside the ambit of the MedImmune decision's affect upon the "reasonable

apprehension” test for D/J actions, since the Supreme Court noted that such a situation was not before it. But, the Sandisk decision may cast doubt even on that.

## B. Future Licenses

1. For licenses currently under negotiation, a prospective licensee would be prudent (perhaps?) to negotiate the best deal available, execute the license, then protest while paying royalties per MedImmune, giving due consideration to the factors stated above regarding currently existing licenses, plus one additional consideration as emphasized by the “perhaps” caveat, and, that is: In many states in the U.S. there is an implied warranty of good faith negotiation which attaches to every agreement executed in that state or which may have impact within that state, even as to agreements executed elsewhere. Thus, if a licensee immediately protests a license agreement upon which the ink is barely dry, there is a risk that an alert licensor could potentially assert a cause of action for breach of the implied warranty of good faith negotiation, demand cancellation of the agreement and assert a cause of action for infringement. Alternatively, the licensor could enforce the agreement, i.e., demand royalties be paid and assert the breach of warranty as a cause of action to recover attorney’s fees and costs defending a licensee’s D/J action, if one had been brought.

2. Other tactics may be available to licensees especially if circumstances can be shown that even for a recently executed license that licensee was in a vulnerable position or felt coerced to execute the license, which were factors noted in the MedImmune case. In such circumstances a licensee could protest, file a D/J action and possibly defeat a charge of bad faith negotiation or bad faith litigation, especially if the evidence supporting the D/J action was discovered after the license negotiation and execution.

## OBSERVATIONS FOR LICENSORS

The MedImmune decision and subsequent Sandisk decision have the potential to be disruptive to many existing license agreements, especially those which were negotiated and executed in a strictly commercial setting, i.e., not as part of a litigation settlement. These decisions may affect any agreement involving U.S. Patents where the agreement may be adjudicated in the United States.

## ADVICE TO LICENSORS

### A. Existing Licenses

1. Licensors possessing existing licenses should avoid any communication to a licensee which could in any way be interpreted as a “threat.”

2. Licensors should review all existing licenses, especially those where the licensee’s fidelity may be suspect, to determine if there is an express warranty of good faith negotiation or if such a warranty is implied. Such warranty, express or implied, however, may be averted by a Licensee if its protest and D/J action are based upon evidence allegedly discovered after execution of the license.

3. Look for any other clauses which would provide licensor with a right to terminate if any part of the agreement is disputed by licensee. (Neither MedImmune nor Sandisk addressed issues such as “licensee estoppel,” which had been addressed in an earlier opinion of that court in *Lear v Adkins*).

4. Look for pertinent clauses and for conduct by licensee which could be characterized as an “anticipatory breach” of the agreement which could justify a pre-emptive lawsuit against licensee in a jurisdiction favorable or convenient to patentee (licensor). (Again, in *MedImmune*, the Supreme Court commented on such an action, but did not render an opinion on it and such was not involved in *Sandisk* since a license wasn’t involved.)

### B. Future Licenses

1. Include an express warranty of good faith negotiation.

2. Have licensee indicate it has fully evaluated the patent or patent applications being licensed, and accepts the validity of same and that the licensed product, method, etc. fall within the scope of one or more claims of same.

3. Put in a “license estoppel” clause even though it may not be enforceable under current law, with alternative remedies that if licensee protests and/or brings a D/J action that licensor can 1) recover all attorney fees and costs if licensee’s legal actions are in any way unsuccessful, and/or 2) if license is exclusive, licensor may convert it to a non-exclusive license and license others and/or 3) have the right to transfer any legal action by licensee to a jurisdiction and venue of licensor’s choosing.

4. Negotiate licenses on an “evergreen” basis, i.e., the term of the license is one year, at the end of which, the license is automatically extended for another year, provided that during the preceding year the licensee has not protested or disputed any aspect of the agreement. The “annual” term can thus be “rolled over” for subsequent years under the same conditions for the full term of the patent or patent applications being licensed so long as the licensee does not “protest,” etc. If the licensee “protested” etc., licensor could then sue for patent infringement at the end of the one-year term.

5. Provide a two-tier royalty rate. A normal rate and a lower, discounted rate for such licensees who have not protested nor disputed the agreement.

6. Create a litigation environment, even one resolved by a Consent Judgment, then license as part of a Settlement. This may cause divisiveness, negating the possibility of successful negotiation, but it may avoid the scope of the MedImmune case, and given the facts in Sandisk, such a tactic may become more commonplace.

7. Other strategies and tactics may be admissible with regard to future licenses, such as accelerated royalties, and/or a large initial license fee secured by an installment note, payable even if the license is protested. Further, require the licensee to exhaust all Administrative Remedies, such as re-examination in the U.S., which is usually more favorable to patentees, before a protest or D/J can be taken. Other inclusions such as Arbitration clauses, Choice of Law and Venue clauses heretofore often used, take on new importance.

Licensors must recognize that protests and D/J actions by licensees who continue to pay royalties may become commonplace. Even assuming that such conduct by a licensee is in good faith, nevertheless, licensors who contemplate a secure royalty stream for numerous years without any cost associated therewith, except perhaps an occasional, casual audit, may find that assumption shattered.

## SUMMARY

The MedImmune decision appears to be the opening of a “Pandora’s Box.” The world of patent licensing has been significantly changed by this decision and per Sandisk, may extend to what had been, in the past, innocuous “notice” letters carefully drafted to avoid threatening language, but meant merely to notify another entity (a possible future licensee or adverse party) of the existence of one’s issued patent.

The MedImmune and Sandisk decisions coupled with the Supreme Court’s recent decision in eBay indicating that injunctive relief is no longer a right of a patentee, but a privilege requiring the same type of proof required of any other party seeking an injunction places current patent law in the U.S. in an entirely new environment.

Although it has no bearing upon the U.S. Supreme Court’s ruling in MedImmune, the USPTO on February 16, 2007 announced a final ruling in its re-examination of the Cabilly II patent holding that many of its 36 claims were unpatentable. Genentech has stated that it will respond to the ruling and appeal, if necessary, through the USPTO and the courts, which could take several years. Thus, their dispute has the potential to make Dickens’ “The Pickwick Papers” look like a brief legal interlude.

While the ultimate outcome between Genentech and MedImmune may be uncertain, what is certain is that the U.S. Supreme Court has put its stamp on patent law in the U.S., reversing recent CAFC decisions so that future cases before the CAFC may have the judges there looking over their shoulders and being uncertain of their own precedent, regardless of the legal issue being presented or of the duration of settled law or even of good rationale supporting such precedent.

Certainly, in the Sandisk case the CAFC judges’ opinions gave the impression that they felt the whole weight of the Supreme Court upon them. That weight then shifts to anyone trying to predict the law as it may be applied in any situation regarding patents, especially the licensing thereof, until further Supreme Court cases or legislation returns some certainty to this area of U.S. law.